Hamad Al-Sayari: Economic and structural policy reforms in Saudi Arabia

Speech by His Excellency Hamad Al-Sayari, Governor of the Saudi Arabian Monetary Agency, at the Institute of International Finance, INC MENA Regional Economic Forum, Riyadh, 7 November 2007.

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It is a great pleasure for me to welcome you at this important gathering organized by the Institute of International Finance and hosted by the National Commercial Bank.

I would like to thank the organizers for inviting me to speak to this distinguished audience. I understand that for the next two days, the participants will be deliberating on the state of the global economy in general and the opportunities and challenges facing the Middle East and North Africa (MENA) economies in particular.

The Gulf Cooperation Council Countries (GCC) are an important constituent of the MENA region, a marketplace that is undergoing significant transformation where the member countries are opening up their markets and significant structural policy reforms are taking place.

Let me begin by providing you with an overview of the ongoing economic liberalization and structural policy reforms currently underway in the Kingdom. Since the discovery of oil in the early 1930s, the oil sector has remained the linchpin of Saudi Arabian economy. Nevertheless over the past three decades, a strategic decision was made to diversify and expand the base of our economy. Towards this goal, a series of wide ranging reforms and policies were implemented in order to improve the investment climate and to attract greater private sector participation in the economy as well as facilitating inflow of foreign direct investment into the country.

In the last decade, significant progress has been made and the Kingdom has enacted and implemented forty-two new trade-related laws and regulations; nineteen of them were required for our WTO accession in 2005. The last and most important of these initiatives was the reform of the Judicial System. In addition, to stimulate economic activities and attract foreign investment, the rate of corporate taxation has been reduced from 45 percent to a flat 20 percent, and the requirements for minimum start-up capital were abolished. The negative list of investment was also revised and now allows foreign investment in vital sectors like insurance services, wholesale and retail trade, air and train transport, and communication services. The Government has set itself an objective to place Saudi Arabia amongst the world's top ten most investor friendly economies by 2010 and, therefore, the opening up of new economic sectors to FDI is in line with the ongoing economic reforms with the aim of improving the Kingdom's investment climate.

The Kingdom's efforts towards economic reforms in order to attract foreign investment have come to fruition. According to a recent report of the United Nations Conference on Trade and Development (UNCTAD), Saudi Arabia emerged as the largest recipient of foreign direct investment (FDI) in the Arab world in 2006, attracting $18 billion in FDI, an increase of 51 percent over 2005. The global rating agencies Standards & Poors and Fitch have also raised the sovereign credit ratings of the Kingdom to A+. Also, Saudi Arabia has been upgraded according to the World Bank's Ease of Doing Business Index from 38th place to 23rd place in 2007.

The Government has encouraged the establishment and growth of value-added industries in areas where the Kingdom has competitive advantages, namely, cheaper energy, strategic locations and availability of raw materials. King Abdullah has recently launched four mega-economic cities in Rabigh, Hail, Al-Madinah and Jazan, which are expected to draw almost

SR 300 billion in investment and create more than a million jobs. It is worthy to note that these economic zones are located in the less developed cities and in areas away from the existing economically developed regions and are specifically selected to ensure that development and employment opportunities are spread around the Kingdom.

An important indicator of progress made in diversifying the economy is provided by the trend in our non-oil exports. Such exports were insignificant in early eighties, but they have been rising sharply in recent years. Since 2000, they have risen continuously. The non-oil sector exports were valued at about $21 billion in 2006 and constituted almost 6.0 percent of total GDP and 13.2 percent of non-oil GDP.

During 2006, the national economy continued its remarkable growth for the fourth consecutive year, especially in the non-oil sector which grew by 6.2 percent following its growth rate of 5.2 percent in 2005. The non-oil industrial sector was the fastest growing sector of the economy recording a robust growth of 10.1 percent during the preceding year. The sector has continued its robust growth during the current year.

Due to higher economic growth and receipt of higher than anticipated revenues, the fiscal position of the government has improved substantially in recent years. The budget surpluses since 2003 have enabled the government to reduce its domestic debt sharply and increase its expenditure on infrastructure and social sectors. The ratio of domestic debt to GDP has declined from 82 percent in 2003 to 27.9 percent in 2006 which was reflected positively on our public finance and macroeconomic stability. These trends are likely to continue against the oil revenue cushion and fiscal discipline along with continuous expansion of the economy.

The foregoing policy initiatives, combined with the recent budgetary surpluses have enabled us to launch a number of key development projects that are designed to develop the county's physical and social infrastructure, especially spending on education and training, diversifying the economy, creating jobs and enhancing growth prospects. A key facet of the economic reforms has been the active participation of the private sector in all aspects of the economy particularly in the manufacturing, construction and services sectors.

Now turning to the Kingdom’s goals and aspirations for the next decades. We have a clear vision that Saudi Arabia will represent an industrial hub among the region's countries, leveraging off on its strategic location, competitive supply of energy, size of the local market, ease of access to global markets, and the growing partnerships between the public and private sectors. This strategy fulfils our State’s goal of diversifying our economic production base away from Oil. For this purpose, we have encouraged and will continue to encourage the private sector by providing attractive incentives, including the setting up of industrial zones in various parts of the country, equipping them with various infrastructural facilities and by increasing the capital base of specialized credit institutions to provide long-term loans to entrepreneurs.

Nevertheless, the Saudi economy is facing a number of challenges the most important of which is the increasing rate of inflation. Although inflation was less than 1 percent on average in the last two decades, it rose to 2.2 percent in 2006 and it continued to increase during the last months, exceeding 4 percent in last August according to the Central Department of Statistics and Information. Our concern is that factors that caused accelerating inflation are still in existence. These include external ones such as higher prices of foodstuffs and commodities, and internal factors such as the remarkable rise in rents in the main cities due to the economic expansion, increasing demand for housing and offices resulting from an increase in spending on investment, and the expansion of services sector especially in the financial and construction sectors.

Although the inflation rate in the Kingdome is less than that in most countries of the region due to the size of domestic production base and due to the availability of directly and indirectly subsidized goods and services such as flour, fuel, water, electricity, and some foodstuffs, the continuing increase in inflation requires SAMA to keep a close watch on it and adopt all possible policies to confront this challenge.

Dear audience,

The banking system's performance has continued to strengthen over the years with proactive monitoring and guidance from SAMA. Saudi banks achieved good profits, such as the average Return on Equity and average Return on assets. They have not been affected by turmoil in global markets. The banks also have average Basel Capital Adequacy Ratios of over 21 percent well above the mandated international standard of 8 percent. To ensure the continuation of this trend, we continue to accord high priority to appropriate prudential regulations and close supervision of banks. During 2005, SAMA rolled out a risk based approach to bank supervision with on site and off site risk assessments undertaken on an ongoing basis. All Saudi Banks are on target to implement all 3 Pillars of the Basle II Capital Adequacy by January 2008, using the standardized approach.

During the past decade, Saudi banks have made tremendous progress in terms of offering innovative products and services, introducing sophisticated technological delivery channels including ATMs, Internet and Phone Banking. In cooperation with SAMA, banks have set up advanced payment and settlement systems, including Automated Clearing Houses and real time gross value electronic funds transfer systems such as SPAN and SARIE. The introduction of technologically advanced systems has resulted in significantly improving the level and quality of customer service, a reduction in transactional costs and increase in efficiencies and strengthening controls.

Regarding the capital market, a number of measures have been taken by the Capital Market Authority to deepen and broaden the market which will enhance its role in the development of the economy. The Capital Market Authority has been issuing licenses for setting up specialized companies devoted exclusively to conducting securities business in the Kingdom. So far, it has issued 70 licenses for the purpose.

Our financial system is continuing to develop and grow in strength and sophistication. The insurance sector is being reorganized under the Cooperative Insurance Law of 2003, which has entrusted SAMA with the responsibility of supervising insurance business in the country. At the time of the enactment of the Law, there was only one licensed company namely National Cooperative Company for Insurance (NCCI) operating in the country. Other companies were unlicensed. Several companies have applied, and Royal Decrees were issued approving the establishment of 21 insurance companies. Approvals were issued by SAMA for 50 offices to provide insurance related services such as brokerage, loss assessment and insurance consultations. Some offices completed necessary procedures to obtain commercial registrations and others are about to finalize necessary procedures. More licenses are expected to be issued soon.

The banking system is also being expanded by allowing foreign banks to open branches in the Kingdom. So far ten licenses have been issued for that purpose to 5 GCC banks and to 5 banks from other countries. All of them have already established their branches in the Kingdom, or are likely to open their branches in the very near future.

Also, in March 2006 the Council of Ministers approved the foundation of a Saudi joint-stock company under the name "Alinm'a Bank" with a capital of SR 15 billion to carry out normal banking business and investment. This bank is likely to become operational in the near future.

Saudi Arabia has one of the youngest populations in the world. This means that one of the challenges facing the national economy is to continue creating jobs for our young people to enter the labour market. This involves development of education and training to qualify the youth and prepare it to meet the requirements of the labour market. This subject is being given a high priority in the State's plans which envisage expansion in the establishment of more universities, specialized colleges, training centers and encouraging the private sector to contribute to the effort in that direction. Notable progress has been made in providing most government jobs to Saudis. A major achievement of the Saudi Banking system has been in areas of human resources, where banks have continued to increase the use of Saudi citizens. I am therefore pleased to note that in this regard the Banking sector is ahead of all other industrial sectors and currently a level of about 80 percent Saudization has been achieved. The employment of Saudis at senior executive level has reached 70 percent.

However, one of the most important challenges currently facing the financial sector is the great increase in the need for qualified skills due to the expansion by banks in their business and establishment of financial services institutions and insurance companies and insurance related services and free professions. This will result in a great pressure on available technical skills in these fields. This has been noted recently in the high rise in the wages for such specialized skills and competition by financial institutions to attract such skills. I hope that exaggeration in this competition will not increase the rotation of the manpower in this sector in a manner that would affect work in its institutions.

The next stage in the Saudization policy is to increase the proportion of Saudis in the new jobs that are being created by our expanding economy. The government has recently launched a program to support small-and-medium-size enterprises which will also create employment opportunities for Saudis.

The forthcoming stage of the Saudiization policy will focus on increasing the share of Saudis in new posts created by economic growth. The Government has recently launched a programme for supporting small and medium size companies, thereby, new jobs will be available for Saudis.

There are also a number of challenges in deepening and broadening the financial sector with significant implications for the economy. These include the creation of a viable and vibrant mortgage industry, which would have significant impacts on housing, construction, durable goods and other ancillary sectors. Also, there are initiatives in place to establish sound insurance and leasing industries. These initiatives are also aimed at enlarging the institutional investors' base that can channel resources in developing a pool of expertise, professional skills and technical knowledge in the financial sector.

I wish to conclude with the observation that Saudi Arabia's economy is currently undergoing through a stage of accelerated growth in all sectors of the economy at a level and pace unprecedented in the past. The Government is spearheading this dynamic growth with its avowed policy of structural reforms and liberalization in the economy, as evidenced by its success in attracting the private sector and foreign direct investment into primarily the non-oil sectors of the economy.

The Saudi economy is an integral part of the global economy and is thus susceptible to systemic risks, although Saudi Arabia did not feel the financial turmoil and liquidity crisis experienced by the rest of the world as a result of the recent sub-prime crisis, we are, nonetheless, vigilant in our efforts to continually monitor the domestic market and to ensure continuation and stability of policies and regulations.

I wish all success to your forum and a good stay in the Kingdom.

Thank you for your attention.