EFFECTS OF FISCAL AND MONETARY POLICIES IN SAUDI ARABIA: A Structural Vector Auto-regression (SVAR) Model

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Abstract

There is considerable debate about the efficacy of discretionary fiscal and monetary policies in developing countries. Economists are by no means in agreement with respect to either the effectiveness or the desirability of macroeconomic policies. The literature indicates that fiscal and monetary policies stances exert strong short run effects on the target non-policy macro variables in a small open economy. The economy of Saudi Arabia is, however, a fixed exchange rate regime as the Saudi riyal is pegged to the US dollar; the monetary policy therefore remains relatively ineffective compared to the fiscal policy. This economy is unique in a sense that there is no personal income tax. As a result, an expansionary fiscal policy is implemented by spending oil revenue.

The aim of this paper is to identify some of the issues and policy implications associated with the effectiveness of fiscal and monetary policies to economic development. More specifically, the empirical work aimed to examine the impacts of expansionary fiscal and monetary policy measures in Saudi economy on some chosen real economic variables such as non-oil GDP, consumption, and investment, using annual data on these variables for the period 1968-2013. For our analysis, a Structural Vector Auto Regressive (SVAR) model and the impulse response functions (IRFs) for Saudi economy will be estimated, which may have important policy implications.