UTILIZING MIDDLE EASTERN PETRO-MONEY: ALTERNATIVES AND PROSPECTS

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INTRODUCTION

The last two years or so have brought the oil-producing countries of the Middle East (all of which are Arab, with the exception of Iran) many fold increases in wealth, following the quadripling of crude oil prices. The increase in oil prices came about because of the relative scarcity of oil as a basic input factor in almost every economy in the world. This relative scarcity was accentualted by several other factors:

I. Excess demand for oil during and shortly after the period of oil embargo.

II. The socio-economic and political factors in the Middle East in particular, and in the world in general in the early seventies which gave rise to an increased Arab bargaining power (i.e. the war of 1973 made them discover the "mighty oil" as a political and economic weapon; and the occurance of the embargo in the cold season made the oil-consuming countries more vulnerable to fluctuations in the oil supply.)

III. For more than four decades; Middle Eastern oil was underpriced, which caused a constant deterioration in the terms of trade of crude oil vis-a-vis industrial products (e.g. from 1958 = 100 to 81 in 1968). (1) Thus, the increased oil prices came to adjust the oil market structure by charging the fair price (i.e. which clears the market).

IV. The galloping inflation in the developed world which pushes up Arab oil producing countries' import bills (2) (the latter soared (75%) in 1975 from 1973).

The suddeness of the increase in wealth has confronted the oil producing countries with a new problem, namely: the management and utilization of the influx of petro-money. Before the recent hikes in crude oil

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(1) Mikdashi, Z. "The Community of Oil Exporting Countries, a study in Government Cooperation," George Allen and Unwin Ltd., 1972 P. 166.

(2) The Economist, London, January 11, 1957.

(3) Wall Street Journal, May 23, 1975 P. 4.

prices, this problem didn't arise since oil revenues were more or less just sufficient to finance the oil countries' development efforts with modest surplus left over. However, at present, even the most ambitious development plans of the oil producing countries substantially fall short of absorbing the newly acquired increase in wealth. Consequently, many of these countries began to search for investment alternatives beyond their national boundaries in order to fully utilize their financial capital. This article will attempt to generalize the response of the oil countries' economic policy to this newly emerging situation at the domestic, national and international levels.

I. Domestic Economic Policies:

At the domestic level, the governments of the oil producing countries responded to the increased oil revenue by greatly accelerating the pace of economic development. The development plans of most of these countries foresee huge expenditures on developing almost all sectors of their economies. Table 1 shows the planned development expenditures by a selected group of Arab oil-producing countries:

Table 1 *

Country	**Population (millions)**	**Plan Period**	**Planned Expenditures**
Algeria	14.20	1974-1977	$26 Billion
Iraq	10.40	1975-1980	$25 Billion
Kuwait	.850		$3.5 Billion
Libya	2.00	1972-1975	$ 4 Billion
Saudi Arabia	5.00	1975-1980	$50 Billion

The main drivnig force behind these ambitious development plans is the countries' desire to diversify their economies to insure their viability when the oil wells run dry. This is their long-run objective. In the short-run the governments of these countries are paying increasing attention to the immediate welfare of their people. In many of these countries, the ordinary citizen enjoys free medical care and free education through the university level. The leader in this respect has been Kuwait whom the Wall Street Journal describes as the Utopia of a welfare state. The Kuwaiti citizen, writes a staff reporter of the Wall Street Journal, can expect his government to keep him "free of such western worries as income taxes, hospital bills or employment. (The Kuwaiti citizen) can take for granted such good things as a full free education up through a Ph.D., free medical care, modern housing. . . ". (1) The continuity of such prosperity in these countries is conditional upon meeting one main condition: diversify the

* U.S. Department of Commerce Overseas Business Report, October 1974.

(1) Wall Street Journal, April 8, 1974.

industrial origin of these countries' output. For between 80 and 85 per cent of Gross Domestic Product in the Arab oil-producing countries originates in mining and quarrying (i.e. oil extraction). Thus, the main challenge that faces the policy-makers in these countries is to transform the industrial origin of their economies from mining and quarrying into a more "industrially-oriented origins".

This is a necessary condition for these economies to reach the self-sustained growth according to Rostow's terminology. (1) This conclusion is based on the fact that less than five percent of the total labor force in the oil producing countries is engaged in oil-related industries, and that "the major function of the crude oil industry — doesn't relate to the domestic factors employed in the industry, for these cost the industry very little, or less than five percent of the posted price. Neither is it related to the production process in the non-oil sectors of the economy, for the amounts of oil products used up as inputs are very small (in 1970 the amount of oil products consumed in Kuwait was 4.9 million U.S. barrels, while total exports of both crude and refined oil products were over one billion barrels). Being a (non-drinkable!!), non-renewable asset, the main fact about oil and gas production is the production decline curve," (2) (i.e. with the passage of time total output of oil extracted from Middle Eastern wells will decline). Huge doses of internal investment are required to achieve a more balanced economic growth. Table 1 puts the costs of such policy-objectives at billions of dollars; nevertheless, such costs are substantially less than the revenues that oil-producing countries get from exporting oil. The rest of oil revenues must therefore be placed back in the outside world. In what follows, the external outlets for investing petro-money are discussed.

II. National Economic Policies:

Not all Arab Countries are oil producers or exporters. However, all of these countries can be said to be economically less developed. This statement implicitly rejects the traditional measures of economic development, namely per capita income. Measuring economic development by per capita income implies that most of the oil-producing countries are highly developed. For in terms of per capita income, many of these countries rank right along or even ahead of such countries as the Unitted States, Sweden and Switzerland. "In addition to a high level of per capita income" writes one scholar, "the concept of development means — the development of a set of institutions and organizational patterns that render the economy self-sustaining at a high and advancing level of performance. Development also means that social conditions have improved enough to sustain that level

(1) To be able to "fuel the process of development", these countries have to spend part of their incomes on buying Western machinery and know-how.

(2) El-Sheikh, R. "Kuwait, Economic growth of the oil state, problems & policies" A publication of the Kuwait University 1972/1973 P. 54.

of performance." (1) It is according to this more comprehensive measure of the concept of development that the Arab oil as well as non-oil countries are to be considered less developed. However, all Arab countries are engaged in serious efforts to bring their countries economies across the threshold of economic development. Various bottlenecks and obstacles challenge most of these countries development efforts. For the oil-producing countries these bottlenecks manifest themselves in the form of shortages of skilled labor, land, enterpreneurial and/or organizational ability. The only resource that is not binding is capital. The non-oil Arab countries, on the other hand, face severe shortages of capital (as well as other limiting factors of production like land in some and skilled labor in others). Elementary economics tells us that this implies a higher marginal productivity of capital in the non-oil Arab countries than in the oil countries. Consequently there is much to be gained, from the point of view of the Arab world as a whole, by transforming investment funds from the capital-rich (oil countries) to the capital-poor (non-oil countries). This fact, combined with other political and nationalistic considerations should underlie the oil-producing countries' policies concerning the investment of their surplus funds abroad.

The main issue of the political economy of the Arab Middle East today is: to what extent can oil revenues contribute to the overall economic development of the region? The potential for inter-Arab economic cooperation is large and the achievements should measure up to the potential. The following two tables reflect the extent to which the oil-producing Arab Countries can contribute to financing development projects throughout the non-oil producing part of the Arab World. Table II shows the estimated magnitudes of surplus oil funds in some oil-producing Arab Countries during the decade of the seventies. The term "Surplus Oil Funds" refers to the excess of oil revenues over the investment expenditure requirements of the oil-producing countries.

Table II * : Projected Surplus Oil Funds in some producing Arab Countries (U.S. Dollars, Billions)

Country	**1975**	**1977**	**1978**	**1980**
Saudi Arabia	11.425	12.595	13.225	14.580
Libya	5.025	5.540	5.817	6.412
Kuwait	4.350	4.795	5.035	5.552
Abu Dhabi	3.275	3.610	3.790	4.182
Qatar	.825	.910	.955	1.050
Total	25.000	27.000	28.800	21.800

(۱) Tuma, E. "Economic Devedopment in the Middle East", delivered at the Middle East Symposium, California State University at Sacramento, April 27, 1973.

* Al-Hamad, A. "Surplus oil Funds, and the Arab Capital Markets", Eurpomoney, Feb. 1975, P. 17.

The significance of the above figures is made clearer when they are compared with Table III. This table shows the total investment requirements of the Arab Countries during the same period — excluding the oil countries listed in Table II.

Table III * :Arab investment requirements and inter-Arab finance 1975-1980 (U.S. Dollars, Billions)

	1975	1976	1977	1978	1979	1980
Total investment Requirements	10.5	12.1	13.9	16.0	18.4	21.2
Inter-Arab finance (25% of requirements)	2.6	3.0	3.5	4.5	4.6	5.3

Even if the above estimates of investment requirements and inter-Arab finance (the portion of investment financed by oil money) were doubled, the new estimates would use up only about (50%) of surplus oil funds. The fact that Arab oil revenues greatly exceed Arab investment requirements points to the limited absorptive capacities of the Arab economies. This leads us to the assertion that investment policies in the Arab Countries should give priorities to the types of investment that would expand the Arab economies absorptive capacity. The factors limiting absorptive capacity — especially in the short-run are the bottlenecks mentioned above. The function of productive investment would be to eliminate these bottlenecks by providing for expansion of cultivable land, skilled labor, organizational and enterprenurial ability, efficient financial markets and institutions. This should be the long-run objective of Arab investment if the economies of the Arab countries are to be able to nearly fully absorb the surplus oil funds.

III International Economic Policies

One conclusion that emerges from the above analysis is that surplus oil funds would still be substantial even after meeting all of the investment requirements of the oil countries and a large portion of the non-oil Arab Countries The Arab countries are thus left with surplus funds that needs to be invested somewhere. The outflow of Arab petro-money is now being directed to two main destinations outside the Arab World: The industrialized west and the developing third world countries. The flow of petro-money from the Arab oil-producin countries to the outside world has been term "recycling" of petro-money. In 1974 the oil-exporting states were estimated to have earned $80 billion in revenues. The following table illustrates the alternative ways in which these funds were used.

* Source Al-Hamad, op. cit., P. 20.

Table IV *: The Expenditure Pattere of Petro-money in 1974 (U.S. Dollars, Billions)

Domestic Expenditure by the oil countries	25
Addition to official international reserves	20
Loans to World Bank & International Monetary Fund ...	3.5
Loans to developing countries	2.5
Aid to "frontier" Arab States	1.5
Loans to industrialized states	5
Foreign investment in shares and property governments ...	3...
Private foreign investment	10
Floating short-term in the European & American money markets	9.55
Total	80 ·

These outflows of Arab petro-money to the outside world served two important purposes:

(1) Provide profitable returns to the investing countries (the oil-producing countries); although sometimes they were badly affected by the now-and-then occuring devaluations of the major currencies in the world (e.g. Pound Sterling, and American Dollar).

(2) The second purpose is of substantial significance. Many of the oil-consuming countries suffer from deficits in the balance of payments. The recycling of petro-money help ease their balance of payments deficits. This fact carries additional importance when account is taken of the high degree of interdependence of the world economy. In today's world, economic fluctuations within one country are not confined to that country alone, but are transmitted through international trade to the rest of the world. Capital flows help stabilize such fluctuations and this contributes to the stability of the world economy as a whole.

IV. Concluding Remarks

In this paper we have discussed the role of Arab Petro-money in the domestic, national and international economies. We have showed that such funds have contributed — and is expected to contribute — to economic activities in these three areas to the mutual benefits of all parties. Petro-money has provided the Arab countries with the capital that is critically needed to develop their economies. Due to the surplus of oil funds; the outside world has also derived benefits from the recycling of such funds. The prospects for the continuation of the recycling trend look promising. However, economic conditions in the industrialized countries are now characterized by a combination of recession and inflation. These conditions

* Source: Middle East Economic Digest — Meed — Feb., 1975.

(1) As a matter of fact, Arab Petro-money has recently become among the most significant factors in stimulating the British economy. The Time Magazine illustrates this by stating that "The (British) government has been borrowing Arab Petro-money to maintain living sandards at home, and thus to keep the workers happy...". Time, May 26, 1975, P. 37.

do not provide encouragement to foreign investment. Therefore, these countries should adopt economic policies aimed at correcting these problems. This will provide a better environment for international economic cooperation.

One final remark: All the above analysis is based on the following assumption; the oil revenues are going to increase in a linear pattern (i.e. straight line estimates). In other words, oil revenues, are treated as a linear function of the quantity supplied of oil; with no alolwance whatsoever being made for exogeneous variables on the national and/or the international level to enter the picture and affect the validity of the estimates It stands to reason that once one of the explanatory variables changes, then one is apt to come up with different results; in our case with different futurc revenue estimates. (1)

(1) This might explain partly, the difference of opinion concerning the size ot petro-money revenues; where the latest estimates (made by a senior U.S. official in the Department of Commerce) puts the oil revenues at the end of the decade at $200 billion instead of the originally estimated $650 billion. See Wall Street Journal, May 23, 1975., P. 4.

STATISTICAL APPENDIX

COUNTRY				
Algeria *	R — $3,384 Billion E — $1,585	$571	14.2	30%
Bahrain *	R — $225 E — $177	n.a.	230,000	n.a.
Egypt	R — $6.2 Billion E — $6.3 Billion	$260	35.0	30%
Iraq *	R — $9.3 Billion E — $9.9 Billion	$798	10.4	25%
Jordan	R — $33.9 Million E — $374 Million	$350	2.5	33%
Kuwait *	R — $7 Billion E — $2 Billion	Over $4,000	850,000	50%
Lebanon	R=E — $602 Million	$935	3 (est.)	85%
Libya *	R = $3.1 Billion	$2,500	2	27%
Qatar *	R = E — $150 Million	$620	130,000	Low
Saudi Arabia *	R = E — $27 Billion	$2,500	55	n.a.
Syria	R = E — $1,705 Billion	$340	6.89	40%
Tunisia	R = E — $483	$455	5.5	55%
U.A.E. *	R = E — $428	n.a	250,000	n.a.

E = Expenditure

R = Revenue

* Oil-Exporting countries

n.a. = Not available

Source of table: Overseas Business Report, U.S. Department of Commerce, March 1975.

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