ENERGY, INVESTMENT AND TRADE: THE U.S. AND THE GULF

ODEH ABURDENE

At the end of 1973, when oil prices were raised by OPEC, there was considerable speculation in the press about how the oil producing countries would use the receipts they obtained from the sale of oil at higher prices. At the time, there were dire forecasts that the OPEC countries, particularly the Arab members, were slowly but systematically buying major American companies. The list of possible investments included IBM, General Motors, Dupont, Exxon, the New York Times, CBS and others. In fact, certain "experts" actually calculated that it would take 210 days to purchase IBM and 374 days to purchase every acre of farmland in the state of Iowa.

Moreover, renowned experts asserted that the accumulation of external assets by the oil exporting nations would have a critical impact on the existing monetary system. They stated that "there will be monetary disorders when large holders speculate against a particular currency. Unlike the oil market, where the producing countries must act in concert or accomplish nothing, even a single nation with big enough foreign balances can do substantial damage to the world monetary system, or try to bring down a government it dislikes."

While these anxieties were being expressed, Mr. Abdul Latif Al Hamad, then General Director of the Kuwait Fund for Arab Economic Development, cautioned: "One issue has been increasingly on our minds . . . this concerns continuous erosion in the value of Arab Investment Portfolio, an erosion that has unfortunately reached alarming proportions if account is taken of the successive devaluations of the world's once most prestigious reserve currencies, as well as of the worldwide spiral of inflation and the rapid decline in the purchasing power of money."

In reality, the Gulf oil states, through a mixture of accident and design, have been helping to stabilize rather than disrupt the international monetary system. According to the *Financial Times* of London, "the main movers of speculative funds on today's markets are the big international corporations, now free of currency controls in most countries." With world oil supplies abundant and falling prices, the so-called "prophets of doom" are rejoicing now. They are in a state of rampant euphoria because they perceive that

---

Dr. Odeh Aburdene, F'68, is Vice President of Occidental Petroleum Corporation.

the era of dependence on Arab oil is over. One potential consequence of this is continued lower oil prices. A participant in the formulation of U.S.-Mid East Policy declared that "the Arabs had their decade, and it's not going to come again." *Barron's*, the business and financial weekly stated:

> "About the only things we can conceive of as more beneficial to mankind than the crack in crude prices would be the invention of noncaloric pure chocolate or a non-carcinogenic cigarette."

Are lower oil prices good for the world economy? The answer is yes for some and no for others. In the short-term, the benefits would accrue to the consumer in the industrial countries in the form of lower prices. The economies of these countries would also grow far more rapidly than currently projected. On the other hand, there are negative consequences that would be both somber and real. To be sure, some of the warnings about would-be losers make for scary reading. The financial problems of Mexico, Venezuela, Nigera and Indonesia would probably worsen and they might default on their foreign borrowings if prices slide steeply.

Furthermore, if the Arab oil producers countenance a major decline in oil prices, it will lead to a slide in prices to levels which would bankrupt the new higher cost oil producers and some of the banks that extended loans to them. It must be pointed out that the cost of bringing in new production in the Middle East is probably $1.50 a barrel. However, by comparison, in the smaller fields of the North Sea or the Arctic it is closer to $23 or $25 a barrel.

Having said this, it must be remembered that OPEC is not dead; the energy crisis has not been resolved and dependence on Middle East oil remains necessary to lubricate the world economy. The world economy floats on oil more perilously than ever, and despite the new oil discoveries, alternative energy and conservation, the world's oil reserves are dwindling. For example, the domestic reserves of the nine largest U.S. oil companies are only 17.3 billion barrels, while the Gawar oil field in Saudi Arabia contains 61 billion barrels.

If the U.S. oil companies are to continue prospering they will have to find or buy additional oil reserves. In 1983, the United States consumed twice as much oil as it produced. Meanwhile, ominously for the oil consuming nations and in spite of all the exploratory efforts of the last decade, OPEC's share of total world reserves has scarcely changed.

Finding oil in the United States is tough. No other area has been so thoroughly explored or developed as the United States. Of 702,000 producing oil wells in the non-communist world in 1982, 609,000 were in the United States. Despite increased activity, proven U.S. oil reserves fell from 39 billion barrels in 1971 to roughly 28 billion in early 1983.

DOMESTIC OIL RESERVES OF MAJOR U.S. OIL COMPANIES

Company	Reserves (Billion Barrels)
Sohio	2.856
Exxon	2.836
Arco	2.561
Shell	2.200
Standard/Indiana	1.660
Getty	1.241
Socal	1.202
Texaco	1.045
Mobil	.906
Gulf	.816
Total	17.323

From 1973 to 1983 OPEC oil production fell from 31 million to 18 million barrels per day. The economic significance of OPEC is reflected in the amount of new production outside OPEC since 1979. From 1973 to 1982 the number of oil producing countries in the world grew from 50 to 74, however non-OPEC producers increased their oil production by only 8.6 percent during 1979-1983.

Falling oil prices will reduce the incentive for consumers to switch to other fuels, drive less or turn down the thermostats. Inevitably, the cycle of consumption and scarcity will start again and dependence on Middle East oil will become significant. It should be pointed out that no new major oil fields have been found and production outside OPEC has peaked.

Finally, declining oil prices will not only slow down oil exploration activities, but will put to death all the grandiose plans for developing alternate energy sources, coal gasification and synthetic fuel. Predictions about the price and quantity of oil production have proved disastrously wrong too often in the past. However, it is safe to bet that the weakness will be temporary and the economic recovery plus continued restraint in OPEC production will stabilize oil prices at $29 a barrel, or even cause them to rise within the next year or two.

Political upheaval in the Gulf during 1984 could easily spark off another oil price increase. It should be remembered that it was just over ten years ago that the Arab oil producers, led by Saudi Arabia, imposed an oil embargo against the United States in support of Egypt and Syria at a critical point in their war with Israel. The graduated cuts had by December 1973 removed 4.5 million barrels a day from the market, or 10 percent of the non-communist world's supplies, sending spot prices soaring and laying the basis for a price increase of 266 percent by OPEC. Now, a decade later, the world is faced with a threat from Iran to close the Strait

of Hormuz to all oil traffic if Iraq attacks Iran's oil installations, or vessels lifting oil from Kharq Island.

What impact would such a dislocation of supplies have on the international oil market and what effect would it have on prices? On the basis of the recent rate of supplies flowing from the Strait, a cutoff of oil from the Gulf would reduce supplies by 8.5 to 9 million barrels daily, or 17 to 20 percent of the non-communist world's supplies. If Iran has the military capacity to maintain a blockade or deter international tanker traffic for a long period of time, the outlook would be somber. Only about half of the volume of petroleum recently passing through the waterway could be supplied from other sources or by other routes.

In reality, however, it would be several months before worldwide stocks were reduced to a dangerously low level. The more immediate danger would be of a strong upward surge in prices on the spot market, which accounts for 20-30 percent of trade. If the shortage is prolonged for more than three weeks, there would be growing temptation for producers to escalate official prices in line with spot rates. It is estimated that a net shortfall of 4.5 million barrels, resulting from a three week closure of the Strait, would drive prices up to between $40 and $45 a barrel. For this reason alone, it is far too early to write off our dependence on Middle East oil.

There are few areas in the world where critical American interests intersect in such a compelling way as in the Gulf. There are many important aspects to U.S.-Arab Gulf relations; energy and finance are key elements, with considerable impact not only on the U.S. economy but on the entire world. Trade in non-energy products is becoming increasingly important, as well.

It is appropriate to discuss and analyze U.S. energy, finance and trade relationships with Saudi Arabia, Kuwait and the United Arab Emirates (U.A.E.). But before doing so, it is useful to analyze Saudi Arabia's oil policy.

In order to discern present and possible future Saudi oil policy trends, we should look at the general determinants of the Kingdom's petroleum policy. It is a serious mistake to view Saudi Arabia as a very large oil company like Exxon rather than as a nation, in terms of its behavior, motives and interests. The constants which govern the development of Saudi oil policy are conservatism and national self-interest. These attributes take the form of flexibility and moderation when it comes to Saudi policy on oil quotas and oil prices. A primary reason for Saudi Arabia's moderate position on oil prices is a recognition that a steep price rise would hinder world economic development and growth. However, Saudi Arabia's moderate policy on oil prices is not entirely altruistic. Saudi Arabia's economy is

closely linked with the economies of the advanced industrial countries. The key decision makers in Saudi Arabia know that large and unexpected oil price hikes tend to sap the political strength of the United States and its allies. Since Saudi leaders assume that the support of the United States is essential to protect the Kingdom from unfriendly radical forces in the Gulf, they are reluctant to embrace the notion of substantially higher oil prices.

Another high Saudi priority is to maintain harmonious relations with all of its Arab and Islamic sister states if possible. Many Saudis agree that their nation can endure and prosper only if their Arab and Islamic neighbors are cajoled and accommodated. For this reason Saudi oil policy will continue to be influenced by the political as well as the economic environment that surrounds them.

Finally, Saudi Arabia's oil policy is a function of the economic and financial needs of Saudi Arabia as well as economic and financial conditions of the other OPEC members. The Saudis recognize that careful and prudent management of the country's oil resources is essential to maintain domestic stability, to provide an economic base for future generations and to guard their oil wealth against covetous neighbors or enemies.

"Money alone," wrote a Roman poet, "sets all the world in motion." For the last decade, that motion has been strong. Billions of dollars have been transferred from oil-consuming nations to the oil-producing nations, and then back again to the oil-consuming nations, particularly the United States. The reverse flows to the U.S., however, have frequently been ignored.

A major feature of U.S. economic transactions with the oil producing countries is the flow of petrodollars into the United States. Funds flow to the U.S. via the following transactions: (1) Repatriation of profits and dividends by American oil companies, (2) Purchase of non-military and military goods and services, and (3) The flow of new money into U.S. capital markets, consisting of bank deposits, holdings of U.S. Treasury obligations and agency bonds, and purchases of U.S. corporate bonds and stocks.

It should be pointed out that the oil reserves of the oil producing countries are immense. The U.A.E. has nearly 40 billion barrels of proven oil reserves, Kuwait has over 60 billion barrels and Saudi Arabia has 165 billion barrels.

American oil companies have played a major role in developing and marketing the oil of these countries. In fact, the bulk of Saudi oil exports are marketed through the Aramco consortium which is comprised of Exxon, Chevron, Texaco and Mobil. In addition, 97 percent of the Saudi reserves are under the management of Aramco. American oil companies

operating in the above-mentioned countries repatriated $1,919 million in 1980, $2,051 million in 1981 and $1,100 million in 1982. The 1982 figures reflected lower oil production as well as lower profit margins.

The oil producers of the Arabian Peninsula provide the United States with a large export market. U.S. exports to these countries rose from $7,653 million in 1980 to $9,380 million in 1981 and reached a new high of $11,066 million in 1982. Conversely, U.S. imports of petroleum from the Gulf were valued at $16,127 million in 1980, $15,470 million in 1981 and $9,475 million in 1982, with Saudi Arabia providing by far the largest share (see the following table). The U.S. trade deficit with these countries dropped from $8,474 million in 1980 to $6,090 million in 1981. In 1982 the United States shifted to a surplus of $1,591 million, explained partly by the rapid growth in U.S. exports of agricultural machinery.

The United States is Saudi Arabia's largest supplier of imports, with 20 percent of the market. At the same time, Saudi Arabia is the largest market for U.S. goods in the Middle East. U.S. exports there amounted to $9,026 million in 1982. The United Arab Emirates remains the third largest market for U.S. products in the Arab world with a value of $1,100 million in 1982. Kuwait is the United States' fourth largest Arab market, having imported $940 million worth of U.S. goods in 1982. A $36 million drop in the level of exports to Kuwait from 1981 to 1982 was more than offset by a steep drop in Kuwaiti exports to the U.S. from $500 million in 1980 to $86.2 million in 1981 and $40 million in 1982.

U.S. EXPORTS
($U.S. Millions)

	1980	1981	1982
Kuwait	886	976	940
Saudi Arabia	5,769	7,327	9,026
U.A.E.	998	1,077	1,100
	$7,653	$9,380	$11,066

U.S. IMPORTS
($U.S. Millions)

	1980	1981	1982
Kuwait	494	86	40
Saudi Arabia	12,648	14,391	7,443
U.A.E.	2,985	1,993	1,992
	$16,127	$15,470	$9,475
TRADE BALANCE	−$8,474	−$6,090	+$1,591

The significance of these countries as export markets for U.S. products can best be seen when compared with other markets. Collectively, the Arab countries constitute the fifth largest export market for the United States, after Canada, Japan, the United Kingdom and Mexico. In Saudi Arabia alone, there are over 1,000 U.S. companies, including joint ventures, branches and subsidiaries of U.S. firms, but not including agents, distributors and licensees of U.S. firms.

Over the last few years a great effort has been made by the American business community to increase exports to China and the Soviet Union. Much attention has been paid to these markets in the financial press. Yet five to six milion Saudis bought $9,026 million worth of U.S. products in 1982 as compared with $4,871 million for 250 million Russians and one billion Chinese. In 1982 U.S. exports to the Soviet Union and China were valued at $2,587 million and $2,284 million, respectively.

On the other hand, it should be remembered that the outflow of dollars from the United States to pay for U.S. oil imports goes mainly to non-Arab suppliers. Total U.S. oil imports in 1982 cost $60.5 billion. As mentioned previously, U.S. oil imports from Saudi Arabia, Kuwait and the U.A.E. stood at $9,475 million. Thus, U.S. oil imports from these countries amounted to less than one-sixth of the total. Currently the bulk of U.S. oil imports comes from Mexico, Canada, Venezuela and Nigeria, while the oil exports from Saudi Arabia, Kuwait and the U.A.E. are sold mainly in Western Europe and Japan.

Another significant factor affecting U.S.-Arab trade flows is the export of U.S. arms and military services. This category includes the sale of private services such as architectural consulting, engineering and construction services. The export of military and non-military services to Saudi Arabia, Kuwait and the U.A.E. reached $4,161 million in 1980, $4,992 million in 1981 and $4,696 million in 1982. Income from the sale of military equipment and related services was also substantial: $2,003 million in 1980, $2,532 million in 1981 and $2,709 million in 1982. Military services include a large number of construction projects and other technical assistance projects related to military developments in Saudi Arabia. Fundamental to the development of Saudi defense capability has been the engagement of the U.S. Army Corps of Engineers in the supervising of the construction of military facilities.

It should be noted that from 1971 to 1980, agreements on U.S. foreign military sales totalled $34 billion. Other commercial military sales authorized under the Arms Export Control are valued at over $11 billion. Perhaps a quarter of the 45,000 American citizens and their dependents who live in Saudi Arabia are involved in defense schemes.

Several major American firms have substantial military related contracts in Saudi Arabia. Among these are: Northrop, Lockheed, McDonnell-

EXPORT OF MILITARY SERVICES
PLUS EXPORT OF OTHER SERVICES

	1980	1981	1982
Military Sales and Services	2,003	2,532	2,709
Non-military Services	2,158	2,460	1,987
	$4,161	$4,992	$4,696

Douglas, Raytheon, the Vennel Corporation, and the Whittaker Corporation. Although it is not well publicized, Litton Industries is engaged in a nationwide, top secret $1.4 billion microwave system designed for internal security.

Spending on arms has soared in the Middle East since the 1979 Iranian revolution sparked off a renewed rise in oil prices. The overthrow of the Shah Reza Pahlavi increased security fears among the oil states. Consequently, the fall in oil revenues over the last year is not likely to have a drastic impact on this surge in defense spending. In many cases it will be the last item to be cut.

In the non-military services area, the renowned design and engineering companies, Bechtel and Ralph Parsons, are responsible for the multi-billion dollar infrastructure at Jubail and Yanbo. Other American companies dominate the design and project management of the petrochemical plants and refineries. Equally important has been Aramco's construction of the $12 billion plus gas gathering facility. Receipts from contract operations of U.S. construction, engineering and other technical service companies were $650 million in 1980, $667 million in 1981, and $493 milion in 1982. During 1982, 38 U.S. firms received some $18.4 billion worth of new awards, up 20 percent from $15.3 billion in 1981.

Superimposed upon the flow of funds from oil operations and trade, there is one other flow; it is the flow of new money into the U.S. capital market. Due to lack of sufficient data the inflow of money to U.S. real estate will be excluded. This should understate the inflow.

FLOW OF MONEY TO U.S. CAPITAL MARKET

	1979	1980	1981	1982
Bank deposits	7,703	847	−1,295	4,411
U.S. Treasury bonds and notes	−1,015	7,672	11,156	7,125
Corporate bonds	424	3,499	3,465	−635
Corporate stocks	656	1,206	1,140	379
	$7,768	$13,224	$14,466	$11,280

The flow of funds to the United States increased substantially during 1980 and 1981. Dollar assets, mainly from Saudi Arabia, Kuwait and Abu Dhabi increased to $14,466 million in 1981, as compared with $13,224 million in 1980. These increases reflected the surge in revenues from higher oil prices and higher production in Saudi Arabia. The flow of funds in 1982 amounted to $11,280 million, a drop of over $3 billion. This was caused by lower oil revenues resulting from lower oil production.

There also was a shift to investments in longer term securities in the form of U.S. government bonds and notes. Investments in U.S. Government bonds and notes were $7,672 million in 1980, $11,156 million in 1981 and $7,125 million in 1982. U.S. corporate stocks and bonds also increased, and during 1982, these countries increased their investments in bank deposits by nearly $4.4 million.

As of January 1984, the accumulated foreign assets of Saudi Arabia, Kuwait and Abu Dhabi totalled $245 billion.

FOREIGN ASSETS OF SAUDI ARABIA, KUWAIT AND ABU DHABI
($U.S. Billion as of January 1, 1984)

Saudi Arabia	140
Kuwait	75
Abu Dhabi	30
	$245 Billion

Saudi Arabia's foreign assets are now around $140 billion. Kuwait also has a strong foreign exchange position. Foreign reserves reached the $75 billion mark. Abu Dhabi's foreign assets, by no means insignificant, are estimated to be around $30 billion.

Like any big investor, these countries have sought to spread their risk from both political and financial points of view. In terms of interest, capital appreciation and long-term prospects these nations have come to regard the U.S., Germany, Japan, Switzerland and England as the best respositories for the bulk of their funds.

The foreign assets of these countries consist largely of deposits with foreign banks, mostly dollar deposits in the United States and Europe. Their holdings of Deutsche Marks, Japanese Yen, Swiss Francs and Sterling assets are also significant. A large portion of Saudi Arabia's foreign assets are invested in U.S. government bonds. All of these countries have purchased top-rated U.S. stocks and bonds.

Kuwait recently completed formal acquisition of Santa Fe International, the contract drilling and energy company. The takeover, which is the largest single investment by an Arab oil producing country in the U.S., was valued at $2.5 billion.

Other investments consist of subscriptions to the IMF, World Bank and capital contributions to OPEC and Arab-sponsored aid project funds. For example, Saudi Arabia has committed almost $11 billion in loans to the IMF in return for which it will gain a much larger vote.

In their use of oil revenues, these countries have so far been extremely cautious and conservative. They have not engaged in financial maneuvers to upset the economies of those nations where their oil is sold and where their funds are invested. The oil producers have treated their surpluses as a pension fund, and have therefore had to evolve a serious investment policy.

The overseas financial assets of Saudi Arabia, Kuwait and Abu Dhabi are generating considerable income in their own right. Investment income during 1983 should top $25 billion. Kuwait alone earned $6.1 billion on its overseas investment in the year that ended in June of 1983.

CONTRIBUTION OF THE GULF OIL EXPORTING COUNTRIES TO THE U.S. BALANCE OF PAYMENTS
($U.S. Millions)

	1980	1981	1982
Profits from oil operations	1,919	3,051	1,100
Merchandise trade balance	−8,474	−6,090	1,591
Receipts from arms sales & other services	4,161	4,992	4,696
Flow of money to U.S. capital markets	13,224	14,466	11,280
Aggregate net inflow	$10,830	$16,419	$18,667

The aggregate net inflow to the U.S. from these countries amounted to $10,830 million in 1980, $16,419 million in 1981 and $18,667 million in 1982. It is worth noting that the overwhelming share of the total contributions to the U.S. balance of payments comes from Saudi Arabia.

Examination of trade and investment data reveals that the dollar value of U.S. oil imports from these Arab countries is more than covered by the inflow of funds to the United States through the export of goods and services, earnings of American oil companies and the flow of money to the U.S. capital markets. In addition, the placement of funds by the oil producers means that these countries are putting investable resources at the disposal of U.S. business. Arab portfolio investments broaden the market for the U.S. stocks and bonds and thus enhance the opportunities for American firms to acquire needed investment capital. Such a development

tends to reduce interest rates and increase the output and productivity of U.S. industry over the long-term.

In sum, the flow of petrodollars to the U.S. means more jobs, higher sales, more investment capital and a stronger economy.

The United States and the Arab oil producers, particularly Saudi Arabia, Kuwait and Abu Dhabi are caught up in an economic relationship from which neither can escape. The United States and its allies need oil, export markets and cooperation in managing the international monetary system. The oil nations need not only goods, services and military technology, but also investment opportunities. Looking ahead, the economies of these countries should continue to be significant to the United States. However, the tremendous demand for U.S. exports will probably slow down and the flow of investment capital will most likely drop sharply due to lower oil production.