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# **Saudi Arabia, Kuwait, UAE: Asset Management in Austere Times**



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**An Intelligence Assessment**

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*GI 85-10099  
April 1985*

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# **Saudi Arabia, Kuwait, UAE: Asset Management in Austere Times**

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**An Intelligence Assessment**

This paper was prepared by   
Office of Global Issues, with contributions by   
 Office of Near Eastern and South Asian  
Analysis. Comments and queries are welcome and  
may be directed to the Chief, Economics Division,  
OGI,

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**Saudi Arabia, Kuwait, UAE:  
Asset Management in  
Austere Times**

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**Key Judgments**

*Information available  
as of 31 March 1985  
was used in this report.*

Since 1982 declining oil demand has reduced the revenues of the Gulf producers and forced Saudi Arabia to draw down its huge asset holdings. We calculate that Riyadh has drawn down foreign assets at the rate of \$1 billion a month since yearend 1982, and the Saudi Arabian Monetary Agency (SAMA) is continually shortening the maturity structure of its \$126 billion portfolio in the quest for further liquidity. Kuwait and the United Arab Emirates (UAE) have been able to preserve their financial asset positions but at the expense of sharp budget and import cuts.

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At the current rate of asset liquidation, Riyadh reserves would fall below the psychological barrier of \$100 billion, to about \$94 billion by the end of the year. A further fall in oil prices could push Riyadh's liquid reserve levels below \$90 billion by December. We believe Riyadh may be forced to accelerate its current rate of asset liquidation—from \$1 billion to \$1.5 billion per month—but not in a manner that will disrupt US financial markets. Some US banks could experience a cash squeeze, however, if Saudi Arabia makes sudden large cash withdrawals. Because they sell less, Kuwait and the UAE would fare better than Riyadh if oil prices drop further. Continued high capital flight in both countries, however, could pressure asset levels as domestic investment opportunities shrink.

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To slow depletion of their assets, we believe that Riyadh, and to a lesser extent the UAE and Kuwait, will further reduce budget expenditures and imports. Only priority expenditures, largely defense, will remain untouched. Such retrenchment could have repercussions on two very different fronts:


- The UAE and Kuwait have already drastically reduced aid to other LDCs, and Saudi commitments will be made with more discretion. Both the Saudis and Kuwaitis will continue to provide substantial aid to Iraq, but reductions to countries like Sudan can be expected.
- Further slowdowns in domestic spending and economic activity could create severe problems for banks in the Gulf area. Information on their operations is spotty, but indications are that bad loans are mounting. Although we do not believe a crisis is imminent, the banking system remains vulnerable to intensified regional instability or another shock such as the Kuwaiti stock market crash of 1982.

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To augment revenues and provide alternative outlets for crude production, all these countries have pursued oil refining and petrochemical production plans. However, even these operations will be vulnerable to sluggish prices for oil products and protectionism in developing country petrochemical markets. 

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Should divergent self-interest among OPEC members divide the organization, Riyadh's financial strains may force it to rethink its role as swing producer and to try to reverse the slide in oil revenues by selling more oil. We do not consider an all-out price war a serious threat, but the pressure on the Saudis to take action could build this spring with the seasonal drop in oil demand, and possible temptation by other OPEC members to raise production. We believe that a prolonged price war would damage Riyadh's financial position—unless it were able to substantially raise exports—but could devastate other OPEC economies. 

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### Saudi Arabia, Kuwait, UAE: Asset Management in Austere Times

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#### The Asset Buildup

From 1974 to 1982, the Governments of Saudi Arabia, Kuwait, and the United Arab Emirates (UAE) earned more than \$700 billion in oil revenue and together accumulated an estimated \$220 billion in foreign assets, some four-fifths of the OPEC total (see figure). The foreign assets of the Saudi Arabian Monetary Agency (SAMA) grew by an average of 30 percent a year, and by 1982 SAMA was managing a portfolio of foreign assets estimated at \$153 billion (table 1). Diversified into 11 currencies—with more than 60 percent US dollars—SAMA's portfolio was made up mainly of short- and medium-term securities. Bank deposits, gold, International Monetary Fund placements, and government securities accounted for more than 60 percent of total assets. Although the United States was the main repository for Saudi funds, \$53 billion was also placed in Western Europe, Japan, and Canada.

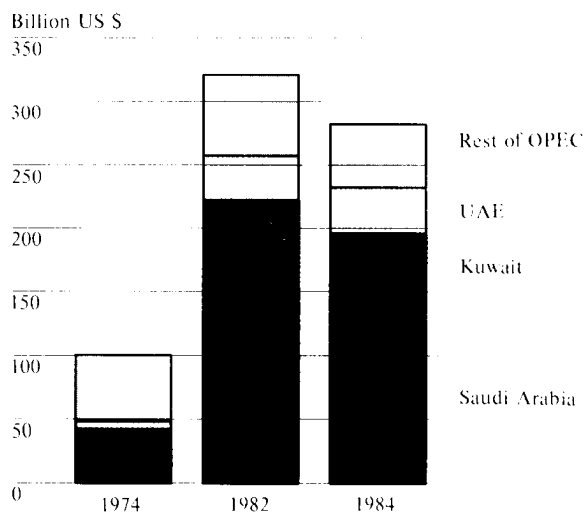
Similar asset accumulation was experienced by Kuwait and the UAE. By yearend 1982, Kuwait had amassed \$69 billion and the UAE \$35 billion (tables 2 and 3). We believe that bank deposits and short-term government securities made up little of either portfolio. the bulk of each country's financial investments in long-term government and corporate securities, with more than two-thirds located in the United States and Western Europe.

This wealth allowed each nation to make foreign and domestic investments designed to cushion their domestic economies against future oil price declines. In the past this cushion, along with Saudi productive capacity, provided Riyadh leverage to force other OPEC members to maintain production quotas. It also gave the Saudis the wherewithal to try to affect the politics of other countries with large doses of foreign aid.

#### Investment Philosophies and Strategies

Since the rapid buildup in assets began in 1974, Saudi Arabia, Kuwait, and the UAE have followed fairly conservative investment philosophies. All are secretive

#### Saudi Arabia, Kuwait, and UAE: Official Foreign Assets



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about their portfolios and prefer to avoid speculation in securities that might destabilize financial markets. Kuwait and the UAE, for example, sought long-term, high-yielding investments in order to free future generations from dependence on crude oil exports. To this end, Kuwait allocated 10 percent of its annual oil revenues to the Reserve Fund for Future Generations (RFFG)—now accounting for about half of Kuwait's \$70 billion portfolio.

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Saudi investment policy has reflected Riyadh's desire to keep assets relatively liquid and to maintain a maturity structure that would provide a steady cash flow to finance the country's development plans and make Riyadh less dependent on the vagaries of the oil

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**Table 1**  
**Saudi Arabia: Distribution of Official Foreign Assets <sup>a</sup>**

*Billion US \$*

	1979	1980	1981	1982	1983	1984 <sup>b</sup>
<b>Location <sup>c</sup></b>	<b>63</b>	<b>95</b>	<b>144</b>	<b>153</b>	<b>135</b>	<b>126</b>
United Kingdom	13	16	18	15	4	3
Other Western Europe	11	11	22	21	26	21
Canada and Japan	3	7	14	17	21	18
IMF and other international institutions	4	5	7	9	17	18
United States, other countries, and unlocated	31	50	83	90	67	66
<b>Currency</b>						
Dollars	46	62	84	92	78	70
Pounds sterling	1	3	3	3	2	3
Marks	4	8	13	13	15	14
Yen	2	5	11	13	14	14
Other currencies	4	7	7	8	12	11
Gold and SDRs	2	6	8	10	14	14
Unknown	4	6	18	14	NEGL	NEGL
<b>Type of account</b>						
Gold and IMF	4	6	7	10	12	13
Bank deposits	17	20	19	19	16	11
Government securities	17	31	56	59	62	54
Corporate securities	18	24	32	32	16	15
Other assets <sup>d</sup>	7	13	18	21	29	33
Unknown	NEGL	1	11	12	NEGL	NEGL

<sup>a</sup> Yearend totals; derived using yearend exchange rates.

<sup>b</sup> Estimated.

<sup>c</sup> 1979-82 numbers based on balance-of-payments data. Numbers may not add because of rounding.

<sup>d</sup> Includes concessionary loans and oil for Iraq.

[Redacted]

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market. During the latter stages of the accumulation, however, SAMA attempted to lengthen the maturity structure, shifting its purchases to medium- and long-term securities. Holdings of corporate securities increased by 75 percent, while shorter term government securities were rolled over into longer maturities to take advantage of higher interest rates and to boost investment income. However, liquidity and safety remained the key to SAMA's investment strategy.

[Redacted]

United States. Traditionally, Kuwait and Abu Dhabi have maintained equity holdings under 5 percent in any one company to avoid possible bad publicity resulting from disclosure laws. However, Embassy reporting indicates that Kuwait's newly established Public Investment Authority may change the rule for more profitable investments. The Abu Dhabi Investment Authority (ADIA) has already diverged from this policy by purchasing 10 percent of Reuters.

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Kuwait and UAE investments are believed to consist largely of corporate bonds and equities.

[Redacted] Kuwait owns 3 to 5 percent of some of the top 500 companies in the

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**Table 2**  
**Kuwait: Distribution of Official and**  
**Quasi-Official Foreign Assets<sup>a b</sup>**

*Billion US \$*

	1979	1980	1981	1982	1983	1984 <sup>c</sup>
<b>Location<sup>d</sup></b>	<b>42</b>	<b>54</b>	<b>62</b>	<b>69</b>	<b>67</b>	<b>70</b>
United Kingdom	11	14	17	25	22	21
Other Western Europe	5	6	6	7	6	7
Canada and Japan	1	1	1	1	1	2
IMF and IBRD	1	1	2	2	1	1
United States, other countries, and unlocated	25	31	36	34	37	39
<b>Currency</b>						
Dollars	24	26	28	40	33	36
Pounds sterling	3	3	3	2	2	2
Marks	5	6	6	6	6	6
Yen	1	1	1	1	2	1
Other currencies	3	4	4	5	4	3
Gold and SDRs	1	2	2	1	1	1
Unknown	6	12	18	14	19	21
<b>Type of account</b>						
Gold, SDRs and IMF position	2	2	2	2	2	2
Bank deposits	2	2	1	1	2	1
Government securities	2	3	3	3	3	3
Investment accounts <sup>e</sup>	26	33	37	39	35	32
Other assets <sup>f</sup>	7	10	15	17	10	14
Unknown	2	5	4	7	15	18

<sup>a</sup> Yearend totals; derived using yearend exchange rates.

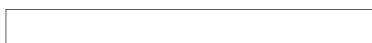
<sup>b</sup> Includes foreign assets of mixed-sector investment companies.

<sup>c</sup> Estimated.

<sup>d</sup> Estimates based on balance-of-payments data. Numbers may not add because of rounding.

<sup>e</sup> These accounts include some deposits but are largely invested in medium-term government securities, corporate bonds, and equities.


<sup>f</sup> Includes concessionary loans and direct placements.



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**Increased Direct Investments**

Diversification away from crude oil exports as their sole source of revenue and into petrochemical and oil product exports has been a prime goal of all three Gulf states. Embassy reporting indicates that Saudi Arabia, along with its foreign partners, has invested \$15 billion in developing its petrochemical sector—substantially more if infrastructure costs for Al Jubayl and Yanbu al Bahr, where the industry is located, are included. Press reports indicate that Riyadh's capacity to produce basic petrochemicals and petrochemical products is expected to reach 7 million metric tons by 1986 and, despite decreasing

world demand, expansion plans continue. In mid-December, the Saudi Arabian Basic Industries Corporation signed the final agreement to construct a \$600 million facility at Al Jubayl that is expected to go on stream in 1988. With at least a 2-to-1 cost advantage over developed country producers, a little more than half of the production will be aimed at the export market. 

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**Table 3**  
**UAE: Distribution of Official Foreign Assets <sup>a</sup>**

Billion US \$

	1979	1980	1981	1982	1983	1984 <sup>b</sup>
<b>Location <sup>c</sup></b>	<b>18</b>	<b>27</b>	<b>33</b>	<b>35</b>	<b>39</b>	<b>36</b>
United Kingdom	1	3	2	2	2	2
Other Western Europe	1	2	1	2	2	2
Canada and Japan	1	2	3	2	2	2
<b>IMF and IBRD</b>	<b>NEGL</b>	<b>NEGL</b>	<b>NEGL</b>	<b>1</b>	<b>NEGL</b>	<b>NEGL</b>
United States, other countries, and unlocated	16	20	27	28	33	30
<b>Currency</b>						
Dollars	10	7	6	7	10	7
Marks	NEGL	1	1	1	1	1
Yen	1	2	2	2	3	3
Other currencies	NEGL	1	1	1	NEGL	NEGL
Unknown	6	14	41	22	24	24
<b>Type of account</b>						
Gold and IMF	NEGL	NEGL	NEGL	1	1	1
Bank deposits	2	3	1	3	4	2
Government securities	1	1	3	3	4	2
Corporate securities <sup>d</sup>	3	3	3	3	7	6
Other assets <sup>e</sup>	3	7	8	8	6	6
Unknown	9	12	19	18	17	16

<sup>a</sup> Yearend totals; derived using yearend exchange rates.

<sup>b</sup> Estimated.

<sup>c</sup> Estimates based on balance-of-payments data. Numbers may not add because of rounding.

<sup>d</sup> Includes some placements with international institutions and government securities.

<sup>e</sup> Includes concessionary loans, direct placements, and real estate.

[REDACTED]

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In addition to Riyadh's petrochemical ventures, all three countries have expanded their refining capabilities. Between mid-1984 and 1987, Saudi Arabia, Kuwait, and the UAE will add more than 1 million barrels per day (b/d) of capacity to refine fuel oil, diesel, naphtha, and other petroleum products, according to industry studies.<sup>1</sup> While Riyadh maintains primarily home-based production, Kuwait and Abu Dhabi also seek foreign energy-related direct investments. Last year, for example, the Kuwait Petroleum Company (KPC) purchased Occidental's Geothermal Power Plant in northern California for \$350 million to

add to existing US holdings that include the purchase of Santa Fe International for \$2.5 billion. During 1983-84, the KPC purchased Gulf Oil's European refineries and marketing outlets. [REDACTED]

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The UAE is just beginning to diversify overseas. In mid-1984, the Abu Dhabi National Oil Company together with ADIA set up the International Petroleum Investment Company (ADIPIC). Press reports indicate that ADIPIC is modeled after the KPC, and the company will eventually seek to purchase or

<sup>1</sup> A forthcoming DI research paper will examine OPEC refining and marketing operations in depth. [REDACTED]

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**Prospects for Petroleum Investments**

*The expansion of Persian Gulf petroleum investments has several implications for future oil markets. By purchasing foreign interests or planning to increase crude oil pipeline capacity to the Red Sea, Riyadh will become less dependent on Gulf shipping lanes, thereby ensuring its income stream should Gulf hostilities worsen. In Kuwait's case, foreign oil interests may also serve to soften the blow of depressed crude exports in the wake of the current oil glut. On the other hand, competition to sell products from downstream refining activities by Saudi Arabia, Kuwait, and the UAE could counter their longer term interests as members of OPEC. Since product prices are not regulated by OPEC, countries with export refineries can sell products at attractive prices—keeping oil production up when crude sales weaken. This practice cuts into the market shares of those members exporting primarily crude oil—forcing them to discount prices to retain customers—while further undermining the official price structure.* [redacted]

*At the same time, the existence of substantial unused petrochemical capacity will lessen Saudi ability to reduce its vulnerability to oil price movements. Depressed petrochemical prices will reduce the value of Riyadh's 1985 exports to about \$1.6 billion instead of the \$3-4 billion originally forecast. Furthermore, the EC decision to impose a 13.5-percent duty on Saudi methanol exports probably will be the first of several actions designed to reduce Riyadh's penetration of West European petrochemical markets. Because of their proximity to European and Japanese markets, Saudi petrochemicals can compete more effectively there than in the United States. However, because they produce primary petrochemical products, they probably could provide feedstocks for the US markets as well.* [redacted]

manage foreign refineries and petrochemical operations. ADIPIC activities probably will focus on downstream operations instead of oil exploration since the emirate of Abu Dhabi currently produces about 800,000 b/d of crude—only about a third of its capacity. With the decline in oil revenues, ADIPIC will probably purchase some existing oil refineries and distribution networks for more attractively priced product sales. [redacted]

**Changed Circumstances and Reactions**

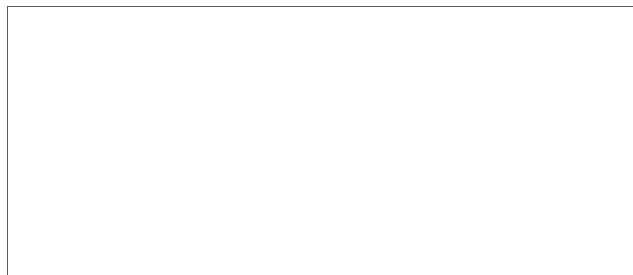
**Saudi Arabia**

The fall in oil production by more than one-half since 1981 has rendered Saudi financial reserves essential to maintaining planned levels of economic activity in the Kingdom. We estimate that SAMA now has \$126 billion in foreign assets, having drawn down more than \$1 billion a month from the 1982 peak. The liquidation is even larger if an estimated \$6 billion of cash and oil given to Iraq during 1982-84—but still counted as assets—are excluded. We estimate that Riyadh currently has \$103 billion in spendable assets consisting of gold and IMF accounts, bank deposits, corporate and government securities, and direct placements. The rest consists of illiquid concessionary loans and aid to Iraq. [redacted]

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SAMA's recent portfolio management policy reflects the government's continuing desire for a high degree of liquidity:

- We estimate that \$17 billion in corporate securities were liquidated during 1982-84 and turned into shorter term assets. 25X1
- Press reports indicate that SAMA is no longer rolling over maturing bonds plus interest but is transferring the interest to cash deposits and rolling over the bonds into shorter maturities. Maturities of Certificates of Deposits (CDs) and other time deposits are also being shortened. Furthermore, US Treasury bills and other assets sold prior to maturity have become increasingly important to satisfying normal liquidity requirements. 25X1



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The shorter maturity structure of SAMA's portfolio makes it more interest sensitive. We estimate the lower level of interest-earning assets and the decline in world interest rates reduced SAMA's investment income in 1984 by almost \$2 billion, to \$13 billion.

In addition to raising the liquidity of their reserves, the Saudis have reduced the proportions of dollar assets and US placements in their portfolio. We estimate that dollar investments now constitute less than 55 percent of their asset holdings, down an estimated 7 percent from 1982. Dollar placements in the United States are down an estimated 20 percent. The heavy sales of dollar assets in favor of European currency-denominated assets have dampened Riyadh's investment income and cost it an estimated \$4 billion in foreign exchange losses during 1984. We believe SAMA's policy reflects the desire to purchase goods with valuable dollars and the hope that other currency-denominated assets recover sometime in the future.

**Kuwait and the UAE**

Although Kuwait and the UAE have made fewer portfolio adjustments than Riyadh, investment income has become more important as a source of revenue. We estimate that Abu Dhabi earned \$4.2 billion from investments during 1984—about a third of oil revenues—which added a sizable cushion for its recession-plagued economy. Kuwait's investment income equaled over half of its \$10 billion oil revenue last year. However, Kuwait continues to reinvest its asset earnings rather than use them for current spending.

**Continued Strains**

Although OPEC has done remarkably well in preventing large oil price declines over the last few years, the continued weak oil market is making it difficult for OPEC to maintain the present price structure. Last year's mild fourth quarter prompted buyers to draw on inventories in anticipation of a further fall in prices. Spot prices rose only slightly in response to the cold weather this year in Europe and the United States, and further pressure on prices is likely in the spring when seasonal declines in demand probably will occur.

**Table 4**  
**OPEC: Oil Revenues and Current**  
**Accounts Under Various Price Scenarios**

*Billion US \$*

	1984 Oil Revenue	1985 Oil Revenue If Prices:		
		Constant	-\$2/b	-\$5/b
<b>Total OPEC</b>	<b>150.2</b>	<b>144.8</b>	<b>137.5</b>	<b>126.7</b>
Saudi Arabia	39.0	38.2	36.2	33.3
Kuwait	10.0	10.0	9.5	8.7
UAE	12.6	11.7	11.1	10.3
Rest of OPEC	88.5	84.9	80.7	74.4

	1984 Current Account Balance	Projected 1985 Current Account Balances If Oil Prices:		
		Constant	-\$2/b	-\$5/b
<b>Total OPEC</b>	<b>-9.3</b>	<b>-23.6</b>	<b>-30.9</b>	<b>-42.1</b>
Saudi Arabia	-13.7	-14.6	-16.6	-19.7
Kuwait	6.1	5.4	4.8	4.0
UAE	7.4	5.6	5.1	4.2
Rest of OPEC	-9.1	-20.0	-24.2	-30.6

As the largest oil exporter, Saudi Arabia stands to lose the most financially from an oil price decline (table 4). A \$2 or \$5 per barrel oil price decline from the 1984 average of \$27.28 per barrel would reduce Saudi liquid asset levels well below \$90 billion if Riyadh maintains current import levels. Even if OPEC manages to forestall a further fall in prices, we believe Riyadh will have to continue its \$1-billion-per-month reserve drawdown and push its spendable assets to about \$94 billion by the end of this year, according to our estimates.

Although Saudi assets are still huge given Riyadh's population, their steady dwindling raises some potential political problems. We believe that a drop in assets below \$100 billion coupled with depressed oil revenues would force Saudi leaders to make some difficult choices. Popular criticism of the perceived mismanagement of the economy by the royal family makes domestic austerity measures, budget cuts, and import reductions unattractive. Faced with a continuing drawdown in assets, the Saudis will probably reduce spending further.

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For the UAE and Kuwait, capital flight is more of a problem than declining oil revenues. According to press reports, the UAE Central Bank logged a \$5.5 billion capital outflow during the first half of 1984, and we estimate an \$8 billion outflow for the year. For several months during 1984, Kuwait was experiencing a \$1-billion-a-month capital flight, [redacted]

[redacted] In both countries, higher returns on dollar deposits versus local currency deposits, shrinking domestic markets, as well as regional Gulf hostilities have prompted individuals to seek safer and more lucrative havens for investments. [redacted]

According to Embassy reports, the UAE Central Bank issuance of local currency-denominated CDs to commercial banks earlier this year to attract liquidity met with only limited success. Recently, the UAE Central Bank manager also issued a warning to private investors regarding restrictions on monetary flows abroad. The Kuwait Central Bank reportedly had more success with the implementation of a two-tier exchange rate and increased regulations of banks and exchange houses. However, Gulf central banks usually have little authority in financial affairs and influence policy largely through moral suasion. Thus, we believe the fundamental problem of capital flight will not be corrected until Gulf economies strengthen, domestic investment opportunities expand, and central banks obtain more power to implement currency controls. [redacted]

Under the circumstances of a \$2 or \$5 price decline, we believe that Kuwait and Abu Dhabi still would show healthy, albeit smaller, current account surpluses and fare better than their OPEC counterparts. Both probably could get by with reduced oil exports, but investment income would begin to play a role in current financing. Because both countries' portfolios are largely made up of corporate securities and equities, a drop in world interest rates and the higher OECD economic growth that probably would result from an oil price decrease could well raise investment income and the value of their holdings but probably not enough to compensate for the drop in oil revenues. Returns from downstream oil operations would weaken, and financial and domestic pressures could mount. Resulting recessionary impacts coupled with continued capital flight would add to UAE pressures to

draw on assets, and both Kuwait and the UAE might have to scramble for more liquid portfolios as future drawdowns appeared imminent. [redacted]

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**Cuts in Spending**

The financial strains that already have reduced economic activity in the three countries will continue. Real gross domestic product (GDP) in Saudi Arabia and the UAE declined 11 percent in 1983 and an average of 3 percent last year. Further declines of 3 to 4 percent are expected in 1985 for Riyadh and Abu Dhabi. After real GDP growth of 7.6 percent in 1983, the Kuwaiti economy only grew an estimated 2 percent in 1984, and slower growth is expected this year. [redacted]

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Because the three have tried to insulate their indigenous populations from budget cuts, expatriate labor and foreign-dominated companies are bearing the brunt of spending decreases. Construction companies continue to be hardest hit as projects are put on hold and payments are delayed. Riyadh refused to bail out two large construction companies—Carlson al Saudia (a Saudi-US joint venture) and the Shobokshi group (Saudi-owned)—along with more than 300 other bankrupt firms last year. Press reports indicate that some of the firms have large loans outstanding, payable to US banks. [redacted]

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Some parts of expenditures will remain unscathed in spite of declining oil revenues. Defense expenditures remain a high priority for all three countries. Abu Dhabi has announced that it will proceed with its option to purchase a second squadron of Mirage 2000 aircraft from France. Defense accounts for more than 50 percent of UAE expenditures, and Abu Dhabi probably will budget another \$2 billion this year despite grumblings that the federation should allocate more for infrastructure and development projects. Embassy reporting indicates that petrochemical and crude refining development expenditure plans will also remain largely intact for Kuwait. In addition, subsidies—such as free health care and cheap electricity—have not yet been targeted for serious cuts as they are considered too politically sensitive. [redacted]

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Riyadh is attempting to reduce its reliance on reserves this year through fiscal belt-tightening. King Fahd recently ordered a balanced budget of \$55 billion—a \$4 billion decrease from last year’s actual expenditures. We estimate this could ease Riyadh’s current account deficit by \$1-\$4 billion, depending on the import component of expenditure cuts. Two refinery projects were abandoned in March, but other targeted cuts were not specified. Embassy reporting indicates that local businessmen favor reduced budget outlays but are concerned about how the cuts will be made.

Although the amassed fortunes of Saudi Arabia, Kuwait, and the UAE have enabled them to give billions of dollars in project loans, military aid, and balance-of-payments support to other LDCs, aid disbursements are down more than 50 percent since 1981, to an estimated \$6.4 billion in 1984 (table 5). Iraq received two-thirds of last year’s total, with more than 85 percent consisting of oil sold on Iraq’s behalf by Saudi Arabia and Kuwait. Saudi and Neutral Zone exports for Iraq now amount to about 400,000 b/d. We expect oil aid to Iraq to remain at the same levels in 1985. Even after 1987, when Iraq will be in a position to increase oil exports by as much as 1 million b/d, we believe Baghdad will insist on continued oil and cash from Saudi Arabia and Kuwait as payment for protecting the Gulf states from Iran. The UAE made one aid payment to Iraq early last year, but we find no evidence of any payments since. Because of its commercial and cultural ties to Iran, Abu Dhabi is more likely than other Gulf states to reduce aid to Iraq. Furthermore, we believe President Zayed dislikes Iraqi President Husayn and is using the depressed state of the UAE economy as an excuse for the drop in aid.

We expect the three countries to continue to reduce aid to other LDCs, such as North Yemen and Sudan, although Saudi cuts have been and probably will continue to be less severe. Saudi Arabia is current on its \$1 billion annual Baghdad Pact payments to Syria, Jordan, and the PLO, but we have seen no evidence that Riyadh made its usual \$100 million payment to Yemen for balance-of-payments support in 1984. Kuwait promised to continue its Baghdad support last year, committing \$340 million, but we believe only \$98 million was disbursed. Kuwait disbursed another

**Table 5** *Million US \$*  
**Bilateral Military and Economic Aid Disbursements**

	1981	1982	1983	1984 <sup>a</sup>	1985 <sup>b</sup>
<b>From Saudi Arabia</b>	<b>8,385</b>	<b>6,035</b>	<b>4,934</b>	<b>4,733</b>	<b>4,500</b>
Iraq					
Cash	4,000	2,400	622	233	
Oil <sup>c</sup>	0	0	1,025	2,600	
Other Arab states	3,655	2,960	2,005	1,082	
Non Arab Islamic	665	595	985	584	
Other less developed	65	80	297	234	
<b>From Kuwait</b>	<b>2,810</b>	<b>3,280</b>	<b>1,087</b>	<b>1,454</b>	<b>1,500</b>
Iraq					
Cash	2,000	2,000	400	50	
Oil <sup>c</sup>	0	0	292	1,131	
Other Arab states	730	1,100	350	268	
Non Arab Islamic	45	110	10	5	
Other less developed	35	70	35	NEGL	
<b>From UAE</b>	<b>2,170</b>	<b>1,690</b>	<b>580</b>	<b>215</b>	<b>200</b>
Iraq	1,400	1,250	450	200	
Other Arab states	680	275	130	15	
Non-Arab Islamic	70	65	0	0	
Other less developed	20	10	0	0	

<sup>a</sup> Estimated.  
<sup>b</sup> Projected.  
<sup>c</sup> Valued at \$25 per barrel.

\$98 million earlier this year. Moreover, Riyadh is substituting oil for cash in more disbursements. Last year the Saudis provided Somalia with \$20 million of oil,

In addition, Saudi Arabia and Kuwait reportedly have renewed the contract to provide 250,000 b/d of Neutral Zone crude to Iraq.

We expect Riyadh to maintain foreign assistance disbursements in 1985 close to last year’s levels, but oil aid could make up a larger portion.

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[Redacted]

[Redacted] We expect that most Kuwaiti assistance in 1985 will be to Iraq in the form of oil sales; the UAE will again provide only minimal aid. [Redacted]

Saudi banks have also been hit by the regional slowdown. Embassy reports indicate that Riyadh's National Commercial Bank recorded a second year of declining profits, partly because of bad loans. The Embassy expects the other 10 Saudi banks to report similar declines. [Redacted]

**Regional Banking Impacts**

The continuance of depressed economic growth coupled with intensified regional instability could damage Gulf financial sectors. Gulf governments probably could rectify the situation before a collapse, but it may require a substantial liquidation of reserves. Although we do not believe a crisis will occur this year, the regional banking systems remain vulnerable to shocks such as a surge in capital flight. In Kuwait and the UAE, domestic lending has scarcely grown since 1982 because of the economic slowdown and lack of domestic investment opportunities. Furthermore, the dissolution of the Souk al Manakh, Kuwait's unofficial stock market, continues to weigh on bank balance sheets. [Redacted]

**Cartel Pressures**  
As the oil market weakness continues, pressures within OPEC probably will mount. In the past, Saudi Arabia, with its large production capacity, acted as swing producer—filling shortfalls in production or absorbing cuts to stabilize crude prices. Riyadh also could maintain discipline over weaker and less wealthy cartel members as other OPEC states realized that Riyadh, with its large production capacity and financial reserves, could send oil prices tumbling and further weaken some already shaky economies. [Redacted]

[Redacted]

[Redacted] according to press reports, the 45 registered companies on Kuwait's official stock exchange could lose \$1.4 billion in 1985—possibly setting off another stock market crisis. [Redacted]

Lower production has given Riyadh less room to maneuver when market conditions dictate a large cut in production, but it still maintains the production capacity to flood the oil market and cause a large price decline. Although we do not consider an all-out price war a serious threat, we cannot rule out the possibility. Currently, OPEC members are generally adhering to their quotas, however, a further drop in OPEC oil demand could prompt members to produce more oil. The Saudis seek to serve their long-term interests and may reach the point where they believe a sharp price drop is the only way to restore discipline. A prolonged price war could damage Riyadh's financial position, but it would be far more damaging to the rest of OPEC. [Redacted]

In the UAE, the recession has reduced the number of profitable lending opportunities for banks and left some on shaky ground. The takeover of the Dubai-based Emirates National Bank (ENB) by the Union Bank of the Middle East was the result of ENB's carrying \$55 million in doubtful loans. Embassy reporting indicates that the Dubai Bank, the UAE's fifth largest in terms of assets, was in danger of collapsing because of foreign real estate losses. It was later purchased by the government. The Central Bank is encouraging more local bank mergers as the regional slowdown has cut into bank profits, but the Central Bank has no more power to rectify the situation than the individual emirates are prepared to give it. Moreover, some bank-owning families have close connections with the rulers of emirates and probably will lobby against further interference. [Redacted]

**Implications for US Financial Markets**

Over the last two years, we estimate that Saudi Arabia has drawn down \$13 billion of its assets placed in the United States, about 90 percent being US Government securities. We believe, however, that the current rate of asset liquidation is not enough to strain

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the markets for US securities and that, even if oil prices drop by \$5 a barrel, the selloff of US investments by Riyadh probably would not exceed \$1.5 billion a month. SAMA, being an active trader of US securities, could liquidate \$100-200 million of US investments a day indefinitely to dealers without attracting undue attention or affecting interest rates.

[redacted]

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We and other financial observers also believe that a sudden, large selloff of government securities by SAMA would not pose problems for US financial markets. The market for US Government securities is large and efficient and handles an average of more than \$50 billion a day. Many analysts believe that for Saudi Arabia to sell \$20 billion to the Treasury over a week might cause temporary instability but that the market could absorb this amount with no effect on US interest rates or exchange rates. [redacted]

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Given SAMA's penchant for secrecy and its aversion to disturbing financial markets, we feel that sudden changes in investment policy are unlikely. SAMA probably realizes that sharp shifts in its investment holdings in the United States could negatively impact on other portions of its portfolio. For example, a large liquidation of US Government securities might lead to a loss in the value of other dollar-denominated investments. [redacted]

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Some US banks, however, could experience a cash squeeze should SAMA make sudden, large withdrawals. [redacted]

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[redacted] Riyadh is concerned about the amount of loan exposure to debtor nations by US banks holding SAMA deposits. Should SAMA's worries deepen, it could withdraw deposits from some US banks. [redacted]

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Middle Eastern branches of US banks are also recording declining profits because of the regional slowdown. Embassy reporting indicates that US branches are reducing lending and increasing their reliance on service fees to generate revenues until commercial activity resumes. Even though US banks have a competitive edge over Saudi banks in providing services, they may not provide enough revenue for all to survive. [redacted]

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