Kingdom of Saudi Arabia
Ministry of Higher Education
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RESEARCH CENTER

INVESTMENT ALTERNATIVES THAT FACED SAUDI ARABIA IN THE SEVENTIES

By

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INVESTMENT ALTERNATIVES THAT FACED SAUDI ARABIA IN THE SEVENTIES

Dr. Asem T. Arab.*

INTRODUCTION

The idea of petro-dollar appeared after 1973, when the price of oil started going up very past than anybody expected. The price increase causes the oil revenue for, Organization of Petroleum Exporting Countries (OPEC) to rose substantially.

Since most of these oil revenues cannot be absorbed domestically, these countries (in particular Saudi Arabia) faced the problem of choice whether to continue to produce at the current level and invest the surplus between the total revenue and total expenditure or lessen the current production to the same level wherein total revenue and total expenditure correspond equally.

In this paper, I deal with specific case which involves Saudi Arabia Investment Program during the period from 1970-1980.

The main source of income in Saudi Arabia in that period was almost derived from oil revenue, which ranges between 88-90 percent of the total revenue. These revenues are affected by two factors:

1. The price of oil is constantly changing.
2. The production is going up causing the oil revenue to increase rapidly.

However, the government was partly concerned for growth development. With the limited program established, the revenue still increasingly

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having a huge surplus, causing the revenue to be excessively greater than the expenditure.

I looked at the various programs that the government of Saudi Arabia used these surplus and I found out that these are:

1- Domestic Investment, which concentrates more in development program.
2- Investment abroad in developing countries and industrial countries as well.
3- Portfolio
4- Euro-dollar market.

This paper is divided into three sections. The first one deals with economic development in Saudi Arabia during the study period. The second part is a survey about the income and expenditure. While the third part deals with the government investment programs.

I

ECONOMIC DEVELOPMENT

The economy of Saudi Arabia is dominated by the oil industry which provides about 88 percent of the government's revenues and 90 percent of the country's foreign exchange. Oil income has made it possible to keep down the tax burden on the population and has also made possible a sharp increase in imports.

Oil revenues are paid directly to the government and through control of disbursement and expenditures from the immense funds it receives, the government has influenced major aspects of economic life. For example, the government of Saudi Arabia owns and operates the communication system. Airline, also create new enterprises companies with the Saudi citizens.

The main characteristization of the Saudi economy is that it is neither capitalist nor socialist. It is an Islamic system, which is based on Islam. That is the substantial part of the production of goods and services is left to individuals and groups enjoying freedom in their dealings and transactions under the constraint that he has to work within the religious and moral values of Islam. And the government upholds the market system and encourages the private sector to play a fundamental role in accelerating growth and development of the country. The government also takes all necessary measures to make the market system conforms to the wide range of country's social interests.

Since the beginning of 1970's, the government of Saudi Arabia engaged in the first Five Year Plan for Development (1970-1975). This program was aimed to develop the communications, agriculture, education and health. This plan was prepared under financial constraints faced in the wake of 1967 Middle East War.

The projections plan for Financial resources were therefore cautious. It was expected to be between 33.8 to 37.4 billion Riyals against equally conservative outlays of 41.3 billion Riyals. Which has occured a substantial deficit. The plan had also forecasted an annual growth of 9.8 percent in GNP, so that the prospects for the government revenue changed significantly during the plan period because of unforeseen international developments. At the end of the plan period the actual revenue was 180 billion Riyals which is substantially larger than the plan projections. Also the actual expenditures, including that substantial amount of foreign aid were about 86.5 billion Riyals or more than double the projections. Therefore , the surplus were planned to be used in the investment program either domestically, or abroad internationally, particularly concerning the development of the non-oil sectors which has a great dependability for the future hopes of the country. As a result of this unexpected growth in revenue, the GNP was risen to 13 percent per annum which was far above the projected rate.

However, the growth in some crucial sectors such as agriculture and manufacturing had fallen below the plan expectations. Inspite of efforts in the positive direction, there was a slow absorbing capacity domestically resulting from non-financial constraint.

The standard of living has been risen due to the rise of imports in this plan. Also, as a result, the annual per capital income has risen in the average of $12,000 to $ 15,000 accordingly.

The main target of the Second Five Year Plan, was to accelerate the growth of the economy and social welfare. At the same time, to reduce the dependence on oil.

The Second Five Year Plan was aimed for accelerating the growth of non-oil sectors such as industrialization, education, health, communication and agriculture.

Also during this period the GDP has grown in average by 15.7 percent per annum which is higher than the plan projection of 10.2 percent.[1] The reason is that the oil sector has registered a growth of 15.8 percent against the plan projection of 9.7 percent.

If we look at the table (1) we will find that the construction has risen to 26.6% at non oil GDP followed secondly by transport, communication and storage which is 22.2% and lastly, agriculture which has share of 8.6%. These three sectors has a total percentage of 57.4 of the non-oil GDP and the other sectors consist the remaining percentage of the estimated share.

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(1) Second Development Plan, Ministry of Planning 1975-1980, p.75.

Table (1) shows the actual and estimated share of non-oil gross domestic product by sector:

Table 1

Actual Estimated Share of Non-Oil GDP

	Actual		Estimated
	1389-90	1392-93	1394-95
- Agriculture	16.1	12.0	8.6
- Minings & Quarrying (excluding oil)	0.8	1.0	1.1
- Manufacturing (excluding refining)	7.0	6.5	5.5
- Electricity, gas, water and sanitary services	4.5	3.4	2.0
- Construction	15.2	19.1	26.6
- Wholesales and retail trade, restaurants & hotels	16.4	16.4	15.7
- Transport, communications, and storage	20.3	22.4	22.2
- Ownership of dwellings	10.8	10.6	10.0
- Finance, Insurance, real estate and other business services	5.8	5.5	5.5
- Community, social and personal services	3.9	3.6	3.2
- Less imputed bank services charges	0.8	0.6	0.4

Source: Second Development Plan 1395-1400, Ministry of Planning, p.31.
Note : Percentages based on current prices.

Table (2) shows the gross domestic product in the different sectors.

Table 2

Gross Domestic Product: 1394-95 & 1399-1400 in Constant 1394 - 95 Price (SR millions)

	Estimated 1395	Average Annual Growth Rate	Projected 1399-1400
PRIVATE			
Agriculture	1,490.0	4.0	1, 714.3
Crude petroleum and natural gas	121,232.0	10.0	195,199.5
Other mining and quarrying	175.3	15.0	352.6
Petroleum refining	7,494.7	5.0	9, 565.5
Other manufacturing	901.8	14.0	1,736.3
Electricity, gas, water and sanitary services	333.3	15.0	670.4
Construction	4,362.0	15.0	8,773.3
Wholesale and retail trade, restaurants, and hotels	2,580.0	15.0	5,189.4
Transport, communication and storage	3,637.8	15.0	7,317.1
Ownership of dwellings	1,636.7	6.0	2,190.2
Finance, insurance, real estate, and other business services	895.2	15.0	1,800.6

Continued....

Community, social, and personal services	522.4	14.0	1,005.8
Less imputed bank service charge	(63.2)	-	(63.0)
Total Private	145,117.2	10.2	235,452.4
GOVERNMENT			
Puolic Administration	1,291.4	10.0	2,079.8
Education	1,026.8	13.8	1,960.0
Health	256.5	15.0	515.9
Sub-Total	2,574.7	12.1	4,555.7
Defense	1,025.4	15.0	2,062.5
Total government	3,600.1	12.9	6,618.2
GROSS DOMESTIC PRODUCT (excluding import duties)	148,717.3	10.2	242,070.6
Import duties	82.7	15.0	166.3
GDP (at market prices)	148,800.0	10.2	242,236.9
SUMMARY			
Private sector			
Oil	128,726.7	9.7	204,765.0
Non-oil	16,390.5	13.4	30,687.4
Govt. sector	3,600.1	12.9	6,618.2
Total Non-oil	19,990.6	13.3	37,305.6

Source: Second Development Plan 1395-1400, Ministry of Planning.

Table (3) shows the increase in gross domestic product in the first plan comparing the second plan.

Table 3

Increase in Gross Domestic Product First Plan vs. Second Plan
(SR Millions in constant 1394-95 prices)

	1389-90	1394-95	1399-1400	Increase I Plan	During II Plan
PRIVATE					
Agriculture	1,181.0	1,409.0	1,714.3	228.0	305.3
Crude petroleum & natural gas	52,197.7	121,232.0	195,199.5	69,034.3	73,967.5
Other mining and quarrying	67.7	175.3	352.6	107.6	177.3
Petroleum refining	6,118.8	7,494.7	9,565.5	1,375.9	2,070.8
Other manufacturing	517.5	901.8	1,736.3	384.3	834.5
Electricity, gas, water and sanitary services	177.5	333.3	670.4	155.8	337.1
Construction	1,867.8	4,362.0	8,773.7	2,494.2	4,411.7
Wholesale and retail trade, restaurants, and hotels	1,460.8	2,580.0	5,189.4	1,119.2	2,609.4
Transport, communications & storage	1,801.5	3,637.8	7,317.1	1,836.3	3,679.3

Continued.....

Ownership of dwelling	1,222.9	1,636.7	2,190.2	413.8	553.5
Finance, insurance, real estate and other business services	603.0	895.2	1,800.6	292.2	905.4
Community, social, and personal services	345.5	522.4	1,005.8	176.9	483.4
Less imputed bank service charge	(69.0)	(63.0)	(63.0)	6.0	-
Total private	67,492.7	145,117.2	235,452.4	77,624.5	90,335.2
GOVERNMENT					
Public Admin.	920.9	1,291.4	2,079.8	370.5	788.4
Education	529.7	1,026.8	1,960.0	497.1	933.2
Health	120.6	256.5	515.9	135.9	259.4
Sub-Total	1,571.2	2,574.7	4,555.7	1,003.5	1,981.0
Defense	769.3	1,025.4	2,062.5	256.1	1,037.1
Total Government	2,340.5	3,600.1	6,618.2	1,259.6	3,018.1

Continued.....

Total Government	2,340.5	3,600.1	6,618.2	1,259.6	3,018.1
Gross domestic product (excluding import duties)	69,833.2	148,717.3	242,070.6	78,884.1	93,353.3
SUMMARY					
Private Sector					
Oil	58,316.5	128,726.7	204,765.0	70,410.2	76,038.3
Non-oil	9,176.2	16,390.5	30,687.4	7,214.3	14,296.9
Govt. sector	2,340.5	3,600.1	6,618.2	1,259.6	3,018.1
Total Non-oil	11,516.7	19,990.6	37,305.6	8,473.9	17,315.0

Source: Second Development Plan 1395-1400 Ministry of Planning

However, the plan was very ambitious which required a huge expenditure approximately SR 188.4 billion. This caused a lot of problems such as inflations which was 38.9 percent, short of manpower. But at the end of 1978 the rate of inflation was under control and reduced to almost 20 percent. This was done by subsidies on the essential consumer goods and price controls which reduced the cost of living from 31.6 percent in 1975 to almost 11.4 percent at the end of 1976.

As a result of the Second Five Year Plan, the real income per capita has risen to US$ 9995 compared to US$ 4200 in the First Five Year Plan.

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(1) SAMA, Annual Report, 1980, p. 42.
(2) Ibid., p. 44.

II

REVENUE AND EXPENDITURE

The main source of income in Saudi Arabia is oil. Therefore, the amount of production and the price of oil are very important factors in determining the revenue of Saudi Arabia, bearing in mind that revenue of oil is almost between 88 percen to 90 percent of the total revenue. Table (4) gives oil production and price.

Table 4

Oil Production: Price

Year	Production Million barrels per day	Price
1970	3.8	$ 1.80
1971	4.8	$ 2.18
1972	6.0	$ 2.48
1973	7.6	$ 5.12
1974	8.5	$ 11.65
1975	7.1	$ 12.38
1976	8.60	$ 13.00
1977	8.50	$ 13.66
1978	8.50	$ 15.00
1979	8.50	$ 18.00

Source: SAMA 1970-1980

(1) Each $1.00 = 3.5 Saudi Riyals in average.

Table 5

Total Revenue and Expenditure

Year	Actual Total Revenue in million SR	Actual Total Expenditure million SR	Surplus in million SR
1970	7,954	6,294	1660
1971	11,116	8,130	2986
1972	15,325	10,159	5166
1973	41,705	18,595	23110
1974	100,103	35,039	65064
1975	103,384	81,783	21601
1976	135,505	106,867	28638
1977	130,505	111,400	19105
1978	131,505	130,000	1505
1979	211,196	160,000	51196

Source: SAMA, Annual Reports, 1970-1980.

It is clear that the price of the oil per barrel had increased very rapidly during 1970-1980. In early 1970, it was $1.80 then rose up to $13.00, by January 1977 and by the first quarter of 1980 it was $27 per barrel. There are many factors behind this rise. One of them is the depreciation of the dollar.[(2)]

The price of crude oil was more or less stagnant at around $1.40 per barrel for almost two decades, from 1950 until 1970. While the prices of most other primary goods enjoyed a steady rise over the same period,

(2) Ibid., p.

that of oil was held constant, if not experienced by actions of multinational oil companies. This market strategy did not reflect the true value of this depletable asset and was considered extremely unfair to the oil producers.

The price started rising steadily since 1971, and until the oil embargo in late 1973. The sharp rise following the embargo was a signal of the oil producers that they cannot any longer sell their only depletable asset at low prices particularly in the face of increasing demand and deteriorating terms of trade.

The sharp rise in late 1973 did not leave much impact on the demand for oil. Actually, that demand continued to rise sharply while supply was increasing at modest rates, due to rationing of production and, in 1978, to the Iraq-Iran war.

This has resulted in a second price shock in 1979. As a consequence, many developed countries throught that the shocks will continue so they piled up huge amounts of reserves by increasing their imports at very high rates in 1980 and 1981. This in turn, resulted in a third rise in oil prices in 1981.

It is clear from table (5) that the total revenue increased by 26.55 times from 1970 to 1979 while total expenditure increased by 25.42 times. But if we take the total revenue and total expenditure in the second development plan, we will find out that total revenue is 712,701 million riyal while total expenditure is 684,439 million riyal and the difference is considered as surplus. However, the rates of growth of both total revenue and total expenditure are as follows:

Table 6

Rate of Growth in Revenue and Expenditure

Year	Annual Rate of Growth in Revenue	Annual Rate of Growth in Expenditure
1970	38.6	25.2
1971	39.6	29.2
1972	37.9	21.9
1973	172.1	81.6
1974	140.0	78.0
1975	3.2	155.3
1976	31.5	56.8
1977	3.9	7.6
1978	.6	7.2
1979	60.6	27.3

Source: SAMA, Annual Reports 1970-1980.

If production and/or price changes, the rate of increase of revenues will change accordingly higher or lower. Also, the revenues are used for a wide range of programs, some of these are development projects and the other to raise consumption standards directly through increased imports and subsidies. This can be shown in the following table (7).

Table 7

Expenditure Distribution

Year	Salaries and allowances	Supplies and services	Transfers subsidies & Foreign Aid	Non-Recurring expenses	Total
1970	1702	592	1696	2304	6294
1971	1952	752	2052	3374	8130
1972	2238	1015	2403	4503	10159
1973	3158	1271	4041	10125	18595
1974	4453	1785	8969	19832	35039
1975	6484	2574	29422	43304	81783
1976	8489	4156	39485	54737	106867
1977	9039	6042	21420	94795	110935
1978	17110	7278	12145	97720	111400
1979	21426	9305	16222	97606	130000
1980	23004	12990	18327	125939	160000

Source: SAMA, Annual Report, 1970-1980.

Table (7) shows how the expenditures are usefully divided into 4 categories. During that ten year period, salaries and allowances had risen to 13.52 times. Supplied and services has an average increase of 21.94 times. The highest percentage rose by the non-recurring expenses while the transfers, subsidies and foreign aid got the lowest percentage increase which is 10.81 times from 1970-1980.

The rise of the income, has essentially helped the planners to be free of financial constraints, either in terms of foreign exchange or in terms of Riyals. In terms of expenditures, with no foreign exchange constraint, the strategy of economic development is concentrated on infrastructure investment projects such as transportation, communications, education, agriculture and industries as well. Also the government is involved in direct import subsidization for medicine, food and meat.

In general, there are two major characteristics of the 1970 to 1979 periods.

First: Revenue increased very rapidly.
Second: Expenditures also increased, but less rapidly than the increase of the revenue.

From above tables, it was clear that the earnings exceeds the capacity of Saudi Arabia to "absorb" income. As a result, Saudi Arabia will continue to save foreign exchange every year, as long as the price of oil is $18.00 and production is about 7 million barrel a day. The savings will be accumulated every year and the greater the level of these savings, Saudi Arabia will emerge as a major force in the international financing markets.

If we look at the composition of Saudi Arabia external assets, we find that these assets could be classified as follows:

1- Foreign currency and cash in hand
2- Foreign exchange
3- Gold.

These assets are shown in the following table:

Table 8

Foreign Assets

Year	Gold	Convertible Foreign Exchange	Million Riyals Foreign Currency
1970	574.2	1,306.0	1,677
1971	574.2	1,508.8	316,833
1972	574.2	1,626.8	3, 481,300
1973	574.2	2,195.8	2, 641,016
1974	546.4	3,006.9	5, 259,714
1975	546.4	5,541.6	6, 693,405
1976	546.4	7,432.7	684,578
1977	546.4	17,139.0	971,029
1978	756.3	21,167.3	1, 421,083
1979	756.3	25,469.4	1, 610,052

Source: SAMA, Annual Reports, 1970-1980.

* includes rls. 67,391,000 part of government subscription in IMF.

Here in table (8) it was clear that the amount of convertible foreign exchange and foreign currency increased very rapidly. While the amount of gold is almost unchanged. The foreign currency for example, increased by 960 times from 1970 to 1979 while the convertible foreign exchange increased by 19.5 times in the same period.(1)

As a result of the rise of the foreign exchange, this will strengthen the external position of the Riyal and made it one of the strongest currencies in the world. Internally as well, the Riyal remained strong and remained a more or less stable value for more than a decade. But in the seventies, inspite of its continuing external strength, the Riyal weakened internally because of the rapidly rising world prices and strong domestically generated inflationary pressures resulting from the unprecedented increase in government domestic spending and in money supply without a commensurate increase in supplies.

(1) SAMA, Annual Reports 1970-1980.

III

INVESTMENT

Since petroleum is an exhaustible resource, and from above tables the amount of saving increased very rapidly even every day. Obviously, the government of Saudi Arabia cannot spend every dollar earned domestically, otherwise if it does, this will create a very high inflation in the country. Also it is not wise to keep that accumulated amount of billions of dollars without investing it, otherwise it will depreciate. Hence, the public authorities have to make a decision regarding two alternatives:

First Reducing the production of oil to a level resulting its balance of payment in a stable position. That level is six million barrels per day at the current price.

Table 9

Balnce of Payment

Year	Balance of Payment million Riyals
1970	+ 283
1971	+ 4005
1972	+ 5852
1973	+ 7898
1974	+ 79055
1975	+ 48671
1976	+ 47600
1977	+ 41971
1978	+ 7528
1979	+ 37231

Source: SAMA, 1970-1980.

Second: Continuing production at higher level in 1980 - 9.5 million barrels per day and use the resulting amount of surplus for investment and development of the country.

Table 10

Oil Production

Year	Production	Price
1970	3.8	1.80
1971	4.8	1.80
1972	6.0	1.80
1973	7.6	2.00 - 3.00
1974	8.5	8.32 - 10.46
1975	7.1	10.46 - 11.51
1976	8.6	11.51
1977	9.175	12.09 - 12.70
1978	8.325	12.70
1979	9.56	13.34 - 24.00

Source: SAMA, Annual Reports, 1970-1980.

The first choice was omitted for political and economical reason as well as that Saudi Arabia was concerned with the welfare of the whole world. As a result, it sacrifices its interests for the benefit of the world as a whole which is part of it. This implies that second choice was adopted.[1]

(1) SAMA, Annual Reports, 1970-1980.

The Saudis find it more appropriate for them to invest at least some portion of that saving to protect the next generation. This investment has various kinds and channels: (1) Through banks and credit within the country; (2) Abroad, through institutions such as regional organizations or international organization, e.g. IMF; (3) Portfolio; (4) Euro-dollar market; (5) Direct investment to industrial countries; (6) Grants.

First: Domestic Investment:

The Saudi Arabian Government has invested part of their savings through many institutions established for the purpose of development. These institutions are:

A. Public Investment Fund: The public Investment Fund was established in 1971 with an initial capital of 350 million Riyals. By 1978, the capital increased substantially to 5,886 million Riyals. The purpose of the fund is financing commercially-oriented productive investments of the government, industrial credit institutions and public corporations undertaken independently or in collaboration with the private sector.

The Fund has given Saudi Arabian Airline (Saudia) loans of 854.3 million Riyals financing requirements for aircraft, plant and equipment, which repaid up to SR 494.1 million with interest rate roughly 5 percent. Also, it gave petromin (National Oil Company) a loan of SR 209.0 million.

Also, the Fund has been used as a channel for the Kingdom's participation of \$67.8 million (capital \$500 million) in the Arab Maritime Company for Petroleum Transport and \$60 million in the Suez-Mediterranean Pipeline Company (Sumed) (Capital %400 million)

B. Real Estate Fund: The Fund was established in 1974 to encourage the private sector to build houses and apartments for residential and commercial purposes, by providing medium and long-term loans to Saudi nationals in low and medium-income brackets for housing construction. The capital of the Fund was initially 4,000 million Riyals and it increased to 16,000 million Riyals by 1978. The Fund provides 20 percent of the total loan with free interest and instalment repayment over twenty years.

C. Saudi Industrial Fund: This institution was founded on March, 20, 1974 with an initial capital of SR 500 million and increased to SR 3,000 million by the end of 1978. The fund was established to assist and encourage the private sector in the establishment or expansion of local industry. The fund grants medium and long-term interest-free loans up to 50 percent of total financing requirements of new industrial projects or for renovation.

Also, there is an agricultural fund which gives loans for agricultural purposes and the Saudi Credit Bank.

However, the Saudi Arabia government thoughout its agencies had established on June 23, 1976 an Investment Bank called "AlSharika Al-Masrafiyyah AlSaudiyah Lil Istithmar" in English, "Saudi Banking Company for Investment". The major objective of this institution is to provide the required medium and long-term financing business and individuals particularly for financing new projects. Its actual role is to assist activity in the continuing economic, industrial and agricultural development of Saudi Arabia and to serve as an instrument for the implementation of the Saudi's economic objectives. The capital of the Bank was 30 million Riyals. Thirty-six percent of the capital was earmarked for public subscription and the remaining sixty four percent for the Saudis and foreign sponsors of the institutions. The Saudi sponsors, which have 29 percent were:

(a) The National Commercial Bank.
(b) The Riyadh Bank.
(c) Al-Jazira Bank.
(d) The General Organization for Social Insurance (Govt. agency,

The foreign sponsors, which have 35 percent of the capital comprise:

(a) The Chase Manhattan Overseas Banking Corporation (U.S.A., which hold 20 percent.

(b) The Industrial Bank of Japan (Japan).
(c) J. Henry Schroder Wagg & Co. Ltd. of the United Kingdom (England).
(d) Commerz Bank A.G. of West Germany (West Germany).

The institution which was managed by Chase Manhattan Banking Corporation for five years, has ended in 1981.

Second: Investment Abroad:

Before preceeding into more details, it might be wise to answer why the Saudis invest in the other countries. The reasons for this could be found as follows:

(1) Productive investment opportunities within the Kingdom are very limited to the available funds.
(2) Foreign investment is a productive project for funds that can not be utilized for domestic projects.
(3) Complete dependence on petroleum exports for foreign exchange earnings makes the Saudi economy vulnerable so that other sources of foreign exchange would ease the situation. This will safeguards the balance of payment.
(4) Since petroleum is an exhabustible source in the long run, and an alternative source of foreign exchange, earnings would enable the Saudis to think and prepare their own welfare for the sake of the future, when the dependency of oil will come to last.
(5) Income from other foreign investments would be helpful during any short run disruption in the petroleum export.(1)

For this purpose, the Saudi Arabian government established on September 1, 1974 a fund called "Saudi Fund for Development" (SFD) with capital equals to ten thousand million Riyals. The reasons for establishing this fund are:

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(1) Wells Donald A., Saudi Arabia Revenues and Expenditures Resources for the future, Inc. 1974, p. 12.

(1) To invest Saudi Arabia money abroad by giving loans to the governments only.
(2) To help underdeveloped countries for their developing progams.

The loan which was given by SFD should be used in the productive projects in the borrowing countries. Here, by productive projects, we mean one which creates the supply of foreign exchange necessary to service this investment and repay it either directly by increasing exports or indirectly by reducing the need for imports in the borrowing country. In addition to the productivity of the projects and the repayment, the SFD has to take the following factors under consideration for granting a loan such as:

(1) Financial creditability of the borrowing country with reference to size of loan and the adequacy of financial and economic resources that insure its repayment.

(2) Significance of the projects for which a loan will be made in terms of its priority over other projects and its integration with other economic activities of the borrowing country.

(3) Effectiveness of appraisal and analytical studies supporting the project from economic and technical point of view.(1)

The SFD does not give any loan arbitrarily, but it has to meet the above consideration. The fund can only participate in by 50 percent of the total cost at the maximum. The other 50 percent must be financed through the borrowing country by other means of resources.

In addition, the SFD is well aware of the difficult economic situation confronting these developing countries and is very keen to help in minimizing the burden that overloaded these countries, namely the burden due to the

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(1) Article (6) from the charter of SFD.

service of loans, their installments and interest accumulated on them. The fund is also willing to extend soft loans characterized by:

(a) A long period for repayment. The average period for repayment is 20 years.

(b) A reasonable grace period, almost five years.

(c) Very low service charges, which does not exceed the average 2.6% per year, paid only on sums actually disbursed from the loaned, compared with other financial institutions that bear an annual interest rate that fluctuates between 10% and 15%.

If we look at the geographical distribution of the loans by SFD in 1977 to 1978 we find that:

Geographical Distribution of the Loans

	1977–1978	1974–1977
Africa	7 countries	12 countries
Asia	8 countries	9 countries
Latin America	1 country	
Europe	1 country	
Total	17 countries	21 countries

Source: SFD Annual Reports 1977-1978.

But if we look in terms of numbers of loans assigned, we find that:

Numbers of Loans

	1977–1978	1974–1977
Africa	12	19
Asia	12	19
Latin America	1	
Europe	1	
Total	26	38

Source: SFD Annual Reports 1977-1978.

In terms of the committed loans that SFD had given during the financial year 1977-1978:

Committed Loans

	Million Riyals
African countries	1,036.39
Asian countries	1,057.19
Latin America	194.00
Europe	70.60
Total	2,358.18

Source: SFD Annual Reports 1977-1978

The percentage of SFD disbursed loans to the cost of the projects was between 10% to 50% from the total funds.

It is clear from the charter of SFD that the loans must be given to the productive projects. Therefore, it was found from the investigation of the projects financed by SFD that there exists emphasis on the infrastructural projects such transporation, power, agriculture, irrigation projects and welfare programs. It never financed prestigeous projects. To show that, about 43% of the loans were spent on the transportation, 7% on water supply and sewerage, 26% on the agriculture, 16% on health, education and housing and 21% on power.

Here, there is one point I would like to make it clear, that the SFD does not disburse the money to governments directly but instead it pays directly to contractors and suppliers as the work progresses. This is in fact an effort to insure that the funds go where they are supposed to go and pay for work that has actually been carried out. Needless to say, that the loan is not tied to buy oil, or to spend high proportion of it in Saudi Arabia as

Marshall Plan after World War II required.

There are other regional and international organizations through such the Saudi Arabia has invested some of their savings. These are:

(1) The Arab Fund of Economic and Social Development.[1] The Saudi Arabia has almost 15% of its total shares. This fund was established to help the other Arab countries especially non-oil producing in particular, when there is a deterioration of the balance of payments and international reserve position of these countries.

(2) The Arab Bank for Economic Development in Africa. This Bank was established in 1975. The main purpose is to aid economic development of the African countries. Saudi Arabia has almost 26% of the total shares in this institution.

(3) The OPEC Special Fund. This fund was established in 1976 by the OPEC members. This fund was founded to provide additional financial assistance on highly concessional terms to other developing countries. The aim of the fund is to promote the economic development as well as the international solidarity of the third world. The Saudi Arabia holds almost 25% of the total shares and the amount invested in this fund is almost $35 million dollars.

(4) The Islamic Development Bank. This Bank was established to help the Muslim countries in the financing of productive projects. Saudi Arabia holds 30% of the total shares in this institution.

(5) In addition, Saudi Arabia increased its quota in the International Monetary Fund (IMF) to 1.0401 million Special Drawing Rights (SDR) with a total of SDR 600 million in 1977.

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(1) Members of the fund are 21 countries.

Third: Portfolio Investment:

Saudi Arabian government has invested some of their assets in the portfolio markets through the major world capital markets. Portfolio investment is an acquired income earning assets without any attempt to get involved in the managerial affairs. The following table (11) shows the amount invested abroad in the short and long run:

Table 11

Foreign Investment

Year	Million Riyals Foreign Investment	Million Riyals Deposits with Bank Abroad
1970	691.3	216.8
1971	785.1	167.7
1972	764.2	388.8
1973	982.7	863.7
1974	2,292.9	468.0
1975	31,798.5	735.2
1976	88,392.4	801.7
1977	116,540.2	775.5
1978	110,679.8	638.7
1979	113,376.2	622.2

Source: SAMA Annual Reports 1970-1980.

This portfolio investment can be divided into two categories:

(i) Stocks: These investments are long-run investments, which involves a more investigation in selecting common stocks for investment and by comparing price -earning ratios, growth prospects, yields and market price records in the light of available information on quality and market factors. These investment are concentrated in the U.S.A., Europe and Japan. Some of these companies are : Exxon, Shell, Dow Chemicals, CBS, Xerox, IBM, Bechtel Corporation, Citibank and Chase Manhattan Bank in the U.S.A.; Mitsubishi (Japan); and Korfstahl (West Germany). In fact, it was very dif-cicult for me to get the names of all companies which Saudi Arabia government has invested outside the country and how many shares it has in each company.

(ii) Short-term Investment: Saudi Arabia Government throughout its agencies has performed on August 22, 1975, a bank with British company in the name "Al-Bank AlSaudi AlAlami Limited" or "Saudi International Bank Limited" as its registered business name. The authorized capital was 25 million sterling pounds. The purpose of the bank is to be active in international, commercial banking on the development business relationships with companies and banks trading and investment. The Monetary Agency (government agency) is the principal shareholder of the Bank with 50 percent.

The other participating banks are:

1- National Commercial Bank – 2.5% (Saudi Bank).
2- Riyad Bank Limited -- 2.5% (Saudi Bank)
3- Morgan Guaranty Trust Company of N.Y. -- 20% (U.S.A.)
4- Bank of Tokyo Ltd. – 5% (Japan)
5- Banque Nationale de Paris -- 5% (France)
6- Deutsche Bank A.G. – 5% (Holland)
7- National Westminster Bank Limited -- 5% (England)
8- Union Bank of Switzerland - - 5% (Switzerland)

The bank works on behalf of Saudi Arabia Government and involves in a wide range of investment activities carried out by commercial banks in the London market.

Fourth: Euro-Dollar Investment:

Most of the SAudi Arabia foreign exchange is in US dollars. That is because the payment of Saudi oil is paid by dollars. Therefore, a depreciation of the value of the dollar means a loss for the Saudis.

Since the accumulative levels of savings increased very rapidly, some portion of these funds is more likely to be invested. But because Saudi Arabia is concerned with its international liquidity position to protect itself against short-run disruptions or fluctuations in the oil revenues, considerable amounts are invested in short-term assets.

More precisely, these investments are mainly in the Euro-dollar markets. Saudi Arabian government is motivated by a number of considerations such as:

1. Higher interest rate which is usually above the current rate that prevails in the U.S.A. by almost one percent.
2. The availability of the liquidity in these markets.
3. Since most of the country's income derived from the revenue of oil which is mostly transmitted through dollar currency, it would be more appropriate or advisable to directly invest it in the Euro-dollar.
4. This channel of investments may help in reducing the overall risk of investments abroad more than if they all concentrated in the U.S.A.

It is very difficult for the author to get any reliable statistics about these assets and how much are in each country. However, since half of the Saudi Arabia oil is exported to Western Europe, Japan and the United States, so it seems logically that most of these assets are more likely invested in these countries.

Fifth: The Direct Investment:

It is quite known that the criterion of which governs the capital movements, is that capital moves from country of lower marginal productivity to country of higher marginal productivity.

Saudi Arabia was involved in giving loans to Western European countries and Japan. For instance, in 1975 the Saudi Arabian Government gave a loan to Japan of 5 billion dollars with an interest rate of 8 percent payable in 1980.[1] Also on March 21, 1980 West Germany confirmed that it borrowed $5.4 billion from Saudi Arabia to offset effects of a deficit in the current balance of payment with interest rate of 12 percent.[2]

Furthermore, Saudi Arabia sometimes gives loans for some reasons. These loans should not be necessarily productive. They may be unproductive in the sense that the loan neither earns foreign exchange through increasing exports nor saves it by lowering imports. This type of loans entails a number of problems. Difficulties may arise in repayment. The example of this kind of loan are: loans given to Egypt of almost $7 billion that excluded the grant. The government of Egypt is not willing to repay the installment payment of the loan or portion of it. In this case, Saudi Arabia might be facing the need for more financing the countries with these kind of difficulties. Thus, the original loan may be a drain for a new loan.

The effect on Saudi economy will be clear: further outflow of new capital will eventually might lead to a deficit in the current account. As a result, new capital exports will be detered and recipient countries may suffer restrictive policies.

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(1) Arab News, March 22, 1980.

(2) Root Franklin R. and others, International Trade and Finance, Cambridge: The MIT press, p. 458.

Sixth: Grants:

There are very considerable amount of money which Saudi Arabia gives as a grant or gift to Arab countries as well as Muslim countries. For example, from 1978 to 1979, Saudi Arabia has made an annual grants averaging $150 million to the other Arab countries. Also, since Saudi Arabia is considered a leader in the entire Moslem world, it gives annual grants averaging $100 million to some Moslem countries such as Pakistan, Bangladesh and Uganda.[1]

It is clear that Saudi Arabia is becoming one of the major capital exporting countries since it has a net surplus on the current account for almost ten years, and it gains more and more attentions in the international financial markets. In addition to all that, its contribution exists in almost all the world financial institutions.

Now, the question is what the effect of the capital export on the balance of payment of the Saudi Arabia. The answer will be carried as follows: An export of long-term capital creates a deficit in the balance of payments of Saudi Arabia. When the exchange rates are flexible, lack of stability causes a depreciation in Saaudi's currency (Riyal) and adjustment in the exchange rate cease when Saudi Arabia accumulates a surplus on current accounts that exactly offsets its export of long-term capital.

In 1978, the total aid and loans that Saudi Arabia had given was no less than $4 billion which accounts as almost 6 percent of the Kingdom's GNP.

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(1) Source: SFD Annual Reports 1978-1979.

CONCLUSION

With huge surplus in the Saudi Arabia balance of payment, the government of Saudi Arabia has two choices:

1- To cut the production to the same level at which total revenue equals total expenditure, or
2- Continuing producing the current level of production (9.5 million barrel per day at price $27.00 per barrel and investing the resulting surplus.

The first choice was ruled out, even with the fact that oil is an exhaustible resource; for several reasons, such as political and welfare of the world needs. So that the choice the Saudi Arabia adopts is the investment program.

The following conclusion has been drawn from the above mentioned analysis:

1- Domestically: since most of these investments are directly to the Saudi citizens, these loans are given to public and private firms to encourage them to participate in the government plan. These loans are free of interest rate. These loans are free of interest rate. The reason for that, I think, is that the government feels that is has some duties towards its citizens. Here, we can consider these free interest rate as a kind of subsidy program.

2- Loans to developing countries: since the loan to these countries are involved almost 2 percent, which barely covers the services, I think this just like giving money free of interest. The reasons for this kind of loan involves many aspects such as political, as well as religious reason in addition to the good-will relationship between the borrowing country and Saudi Arabia government.

3- Loans to the industrial countries: this kind of investment is given to the U.S.A., Western Europe and Japan. The reason for giving loans to these countries is to offset effects of a deficit in current balance of payment resulting from the rise of the oil price. But with the low interest rate between 5-10 percent this is given for good-will relationship between these countries and Saudi Arabia.

4- Euro-dollar Market: this is purely an economic activity for investment purposes. But regarding the information about how much is invested in the market, and in which country, it is very difficult to analyze it.

5- Portfolio Market: this is also purely an economic activity, but in this case it is very difficult to get information about how many shares they have and in which company and in which country.

I think since oil is an exhaustible resource, with the assumption that government of Saudi Arabia will not reduce its production from the current level, we must choose the best way to invest that huge surplus in the economic activities which will give a good return in the future, such as investment in Euro-dollar or portfolio. This does not mean that the government of Saudi Arabia does not have to give loans to developing countries and industrial countries. No, we have to continue to do so because Islam asks us to do such a thing, but this should be in a very restrictive way.

Therefore, we find that the optimal policy of investing oil surplus lies in the channel of Euro-dollar investment. Saudis are concerned with international liquidity position to protect itself against short-run disruption or fluctuation of oil revenue. In addition, the risk of loosing is very small, all these factors are in favor of Saudis in the long run, but there is a problem of freezing or blocking the assets for some reason or other. To prevent this from happening the Saudi Arabia government must incorporate with many large companies in the U.S.A., Japan, and Western European countries to formulate multinational corporations in Saudi Arabia for the development purpose. In addition, it must formulate a joint commission so that if anything happened to the assets overseas, the Saudi Arabia has something in its hand to bargain with. This is purely from an economic point of view.

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