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Financial Aspects of Middle East Oil Production 12 pages

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Financial Aspects of Middle East Oil Production

Summary

The income from oil is the largest category of revenue for all of the oil producing countries in the Middle East. Following the closing of the Suez Canal in early November 1956, there was a general curtailment in oil production in the area of about 38 per cent. This enforced cutback was not evenly distributed among producing countries. The largest decline was found in Iraq where daily output fell by 72 per cent in November and December; Kuwait experienced a 41 per cent and Saudi Arabia a 32 per cent fall.

With these cutbacks in output, the producing countries had to adjust to reduced oil receipts. Most of the governments assign substantial portions of their oil revenue to long-term development programs. In most cases, current outlays tend to lag behind planned expenditures; this lag in spending provides an additional period of time during which these countries can adjust to short-run reduction in revenue. The rapidly rising trend in revenues over the past few years helped to cushion the cutbacks in current output. In addition, the oil industry is not a large employer of local labor; hence, the brunt of output losses fell chiefly on the government finances of the producing countries, and not on the private sector of the economy.

For the oil producing countries as a whole, the balance-of-payments position has not been critical. For example, Iraq, the country most affected, had large monetary reserves. Iran, which had only begun to recover from reduced oil receipts following oil nationalization (1951-54) happened to be the country least affected by the Suez crisis. With the Israeli withdrawal from the Sinai Peninsula, the worst difficulties of the Suez crisis began to disappear. On March 6, 1957 the Syrian authorities authorized the Iraq Petroleum Company to resume pumping at about 40 per cent of normal with existing facilities and to commence permanent reconstruction of damaged pumping stations. At about the same time, the first tiny boats came through the Suez Canal, and there is a general expectation that the unblocking of the Canal will permit progressive increases in the size of ships which can go through.

The effect of Suez blockage

After the Suez Canal was blocked and pipeline deliveries to the Mediterranean were drastically reduced, daily average output of Middle East oil declined by about 38 per cent during November and December of 1956. In the first ten months of the year, the average daily output of the area was 3,678,000 barrels -- in the last two months 2,286,000 barrels; i.e., 2,143,000 in November and 2,429,000 in December. Even with this substantial year-end decline, the total for 1956 was 6 per cent greater than in 1955 because of the high rate of production in the first ten months of the year when the average daily production exceeded 1955 by 14 per cent.

Table 1

Middle East Oil Production
(Daily average -- thousands of barrels)

	1956	Per cent change from 1955	Jan.-Oct. 1956	Per cent change from Jan.-Oct. 1955	Nov.-Dec. 1956	Per cent change from Jan.-Oct. 1956
Kuwait	1,093	--	1,174	6.3	689	-41.3
Saudi Arabia	986	2.2	1,042	9.6	705	-32.3
Iran	538	63.5	540	69.8	528	- 2.2
Iraq	638	- 7.3	725	5.6	205	-71.7
Israel	1	--	1/	--	1	129.2
Qatar	122	6.1	126	10.5	104	-17.5
Bahrain	30	--	30	--	30	--
Neutral Zone	36	33.3	38	58.3	25	-34.2
Total	3,444	6.2	3,676	14.0	2,286	-37.8

Source: Oil and Gas Journal, monthly figures.

1/ Less than 500.

Iraq production was the most seriously affected by the Egyptian crisis. The pipelines of the Iraq Petroleum Company which traverse Syria and carry over 500,000 barrels daily to the Mediterranean ports of Tripoli (Lebanon) and Banias (Syria) were put out of commission at the beginning of November when pumping stations were expertly demolished shortly after the Canal was closed. Output was limited to domestic requirements (30,000 barrels daily) and output in the southern fields normally exported by way of the Persian Gulf (approximately 178,000 barrels daily). In the last two months of the year, the overall production of Iraq was only 29 per cent of the daily average of 725,000 barrels in the first ten months of the year.

Table 1A

Production and Disposition of Middle East Oil

(Thousands of barrels daily)

	Production		Shipped Via Canal		Shipped via Mediterranean pipelines		East of Suez and domestic use including bunkering	
	1955	Jan.-Oct. 1956	1955	Jan.-Oct. 1956 estimate	1955	Jan.-Oct. 1956 estimate	1955	Jan.-Oct. 1956 estimate
	(1)	(2)	(3)	(4)	(5)	(6)	7=(1-3-5)	8=(2-4-6)
Kuwait	1,093	1,174	845 1/	908	--	--	248	266
Saudi Arabia	965	1,042	192	208	300	325	473	509
Iran	329	540	100	164	--	--	229	376
Iraq	688	725	81	86	475	500+	132	139
Israel	--	2/	--	--	--	--	--	--
Qatar	115	126	81	89	--	--	34	37
Bahrain	30	30	41 3/	41 4/	--	--	--	--
Neutral Zone	24	38	1/	--	--	--	--	--
Total	3,244	3,676	1,340	1,496	775	825+	1,116	1,327

Columns 1, 2, 3, 6 from Oil and Gas Journal, various issues.
Column (4) estimate based on ratio of column (3) to column (1) applied to column (2)
Column (5) estimate based on ratio of column(6) to column (2).

1/ Includes 10,200 barrels daily from Neutral Zone.
2/ Less than 500.
3/ Includes some products.
4/ Figure carried forward from 1955.

The Syrian Government made repairs to the damaged pipeline contingent on the withdrawal of Israel from the Gaza strip and the Gulf of Aqaba and IPC officials indicate that rerouting the flow around damaged pumping stations and the use of booster pumps will rapidly permit the passage of 220,000 barrels per day (2/5 of normal). Restoration to full service may take as long as a year.

The effect of the closing of the Suez Canal on Kuwait production was initially severe. This country, which vies with Saudi Arabia as the foremost producer in the Middle East, normally sends more than 75 per cent of output to Europe. It was therefore very vulnerable to the Suez blockade and the shortage of tanker space caused by delays in sending shipments around the Cape. Such rerouting is estimated to have raised Kuwait's tanker tonnage requirements 30 to 40 per cent. The average production for November was down to 558,000 barrels a day as compared with 1,204,000 in October and 1,174,000 in the first ten months of the year. A rise in the December average to 820,000 barrels a day probably reflected a relatively high priority on the redistribution of tanker tonnage because of the importance of Kuwait crude to Europe.

Saudi Arabia, suffered a one-third reduction in daily average output in the last two months of the year. Production which averaged 1,055,000 barrels in October declined to 720,000 in November and 690,000 in December. There was no interference with the operation of the pipeline to the Mediterranean, which normally carries one-third of output, but deliveries to Britain and France were embargoed. On the Persian Gulf side, where the bulk of output is handled, pipeline shipments to the Behrain refinery were cut off, and British and French tanker liftings at Ras Tanura embargoed.

Production data show Iran to be the least affected by the Egyptian crisis. Production which averaged 538,000 barrels daily in the first ten months of the year and 638,000 in October, still averaged 531,000 in November and 524,000 in December. The revival of operations under the international Consortium was two years old at the time of the Suez blockade and production had almost regained the prenationalization (1951) figure. This, however, appears to have been achieved on a changed marketing pattern over that which prevailed before the nationalization dispute arose. Markets east of Suez have become more important to Iran, a fact which accounts for the lesser sensitivity of production to the Suez difficulty.

There has been no dearth of indications that these various cutbacks, if long continued, would have held serious implications for the world economy. The importance of the Middle East in world oil production has risen spectacularly in the post-war years. In 1950, its share was 18 per cent of the free world total; in 1955, 24 per cent; in the first ten months of 1956, 25 per cent. The advancing ratio means more in absolute than in relative terms. Between 1950 and 1955, Middle East production doubled even though, for a part of the period, Iran's large output was totally cut off. Perhaps the most significant indication of the importance of the region's oil resources is the fact that, while production has doubled, the revenue of the producing countries from oil has quintupled because they have been able to renegotiate producers' concessions in more favorable terms.

Oil in the general economy

In the oil producing countries themselves, however, the economic effects of the temporary cutback are more difficult to assess. Although oil is the region's most valuable resource and the one on which the hope of economic progress principally rests, it is also characteristic in requiring more capital than labor for exploitation, so that it is little felt among the rank and file of the population. Only about 150,000 out of the 34,000,000 inhabitants of the oil producing countries derive their livelihood directly from oil production. If this figure were doubled to include those who might conceivably be existing for the purpose of supplying the oil industry's consumption requirements, the proportion of the total population affected would still be small, less than 10 per cent. The remainder of the people get the benefit of oil income in the highly distributed form in which it reaches them from disbursements by the governments which receive it.

It may be said, therefore, that the effect of the oil reduction on the income position has been tempered by the existence of a built-in cushion. Governments, as distinct from individuals, have taken the impact of the adjustment, and they have been relatively well able to absorb short-term fluctuation in receipts. They have, in fact, been in a particularly good position because the immediate history of their revenue has been extraordinarily favorable.

Some of the producing countries report annual revenue from oil. Others do not, but the uniformity of the payment terms which has resulted from post-war negotiations and the availability of production data permit fairly reliable estimates. Table 2 shows the over-all direct receipts from production on a partly reported and partly estimated basis at $953 million in 1956, as compared with $897 million in 1955. While the increase is largely in Iran, where the changed marketing pattern puts production largely outside the Suez problem, there was also with the other countries a remarkably good showing. In the case of Iraq, where the production loss was greatest in the last two months of the year, revenue was down from $207 million to $193 million, or about 7 per cent. In the case of all the countries, the magnitude of the figures is of special interest.

Table 2

Middle East Oil Production and Revenue

	Production 1/ b/d (000's)		Revenue (millions of U. S. dollars)		
				1956	
	1955	1956	1955	Prior to Suez	After Suez
Kuwait	1,093	1,093	280 2/	298 3/	280 3/
Saudi Arabia	965	986	280 2/	307 3/	286 3/
Iran	329	538	84 4/	149 4/	146 4/
Iraq	688	638	207 4/	224 4/	193 4/
Qatar	115	122	37 2/	41	39 3/
Bahrain	30	30	9 2/	9 3/	9 3/
Neutral Zone	24	36	5/	5/	5/
Total	3,244	3,444	897	1,028	953

1/ Oil and Gas Journal, annual figures for 1955, monthly figures for 1956.

2/ Estimated. The Banker, November 1956.

3/ Estimated on basis of ratio of revenue to production in 1955.

4/ Officially reported.

5/ Revenue shared by Kuwait and Saudi Arabia.

Oil in the budgetary position

The importance of revenue from oil production in the budgets of some of these countries is shown in Table 3. Adequate data are available for only a few of them and the method of estimating data for the others shown is explained in the footnotes. As a proportion of total revenue, the oil income accounts for about one-half in Iran, three-fifths in Iraq, about nine-tenths in Saudi Arabia, and practically the whole in Kuwait.

Table 3

Draft Budgets of Selected Middle East Countries
(Millions of dollars)

	Fiscal year	Revenue			Expenditure			
		Total	Oil	Oil as per cent of total	Total	Current	Development	Development as per cent oil
Iran	3/22/56 3/21/57	327 1/	157 2/	48%	382	295 3/	87 4/	55%
Iraq	4/1/56 3/31/57	356 1/	213 5/	60%	390	241	149 6/	70%
Kuwait	55/56	195 7/	189 7/	97%	62 8/	63 8/		...
Qatar	1956	...	37 9/	...	...	...	3 10/	8%
Saudi Arabia	9/54 8/55	305	258	85%	361	299	62 11/	24%

1/ Ordinary budget plus oil revenue not included in ordinary budget.

2/ Estimate based on the ratio of reported allocations to Treasury and Plan Organization.

3/ Ordinary budget plus National Iranian Oil Company. Assumes expenditures of latter are equivalent to receipts included in column 2.

4/ Assumes expenditures equivalent to oil revenue allocated to Plan Organization. There is no adjustment in revenue or expenditure for foreign or domestic loans which the Plan Organization is authorized to obtain.

5/ Estimated on the basis that oil revenue in the ordinary budget is equivalent to 30 per cent of total oil revenue.

6/ There is no annual breakdown of Development Board planned revenue and expenditure and no adjustment has been made for amounts which may be drawn from reserves. The figure is the estimated annual oil revenue allocated to development.

7/ Estimate. United Nations Economic Developments in Middle East 1954/55.

8/ Estimated on basis of one-third alloted for development and current expenditures, (The Banker, November 1956).

9/ Estimate.

10/ Estimated on basis of $9 million to be expended on development between mid-1953 and the end of 1956 (Economist, February 1954).

11/ Public works in ordinary budget.

On the expenditure side, oil income is apportioned between current and development budgets in the ratio of 45-55 per cent in Iran; 30-70 per cent in Iraq, and 75-25 per cent in Saudi Arabia. It is estimated that one-third of the oil revenue of Kuwait is allotted for development and current expenditure. Much of the remainder goes for the purchase of foreign securities by the Government.

In Iraq, the 70 per cent of oil income which is earmarked for investment goes to the Development Board which is currently embarked on a long-term program contemplating expenditures of $1,400 million for roads, irrigation and other capital works in the 6-year period ending April 1961. The financing of the program is expected to come almost entirely from oil royalties which would be fed by the increase in production and export. Significantly, the Development Board has indicated that its reserves are sufficient to keep the program in operation for more than a year should the Suez problem not be earlier resolved. The Board terminated its first 5-year development plan (1951-56) in April 1955 in the course of which its revenue totalled $300 million and its expenditure $118 million. In the first ten months of the 1955-61 program (April 1955 - January 1956) revenues exceeded expenditures by $93 million. At the end of 1956 reserves of the Development Board were reported at $285 million.

Iran also has an ambitious program for national development which was reactivated with the resumption of oil production in October 1954, after nationalization in May 1951. The development plan here is, on the one hand, in a less easy financial position than in Iraq, and on the other hand, seemingly less vulnerable, at least for the time being, to the effect of the Suez problem. The Plan Organization proposes expenditures of $1,120 million in the seven years September 1956 to September 1963. Until March 1958, it is to receive a 60 per cent share of all funds received from the operation of the Oil Consortium. Thereafter, its share would rise to 80 per cent. Because expenditures are expected to exceed receipts in the first three years, a $75 million loan, guaranteed by the pledge of oil revenue, was extended by the International Bank for Reconstruction and Development in December 1956, to help cover an anticipated deficit of $140 million in this period.

Oil revenue has also enabled Kuwait to engage in long-term development. A 10-year program, commenced in 1950-51 was revised in August 1954 with planned expenditures in the five years ending 1960 estimated at $267 million. Projects included erection of two sea water distillation plants, power plants, replanning of the town of Kuwait and construction of roads, schools, public buildings, and port dredging. While some of these have been completed, prosecution of the over-all plan commenced to lag in 1953 and came to almost a complete stop in 1954. There was some revival in 1955 and the cost of the program in that year was estimated at $85 million. In December 1955, the Development Board approved in principle the drawing up of a master plan to cover development projects for the next five years. Activity in 1956 was centered on roads and housing for lower income groups and the program is reported to be moving forward.

Other Near Eastern countries, not producers of oil, benefit from the oil industry by reason of transit pipeline and terminal facilities. Among these, Syria receives the largest amount. A large part of Iraq production is exported by way of the Syrian port of Banias after traversing a 260-mile pipeline through this country. Receipts from oil transit account for approximately one-fourth of the proposed ordinary and 6-year development budgets. An agreement with the Iraq Petroleum Company in December 1955, substantially increased the level of payment and assured the country of an annual income of $18 million on the then current rate of throughput. An additional sum of $24 million was paid in settlement of all outstanding claims. As a result of the sabotage of the pipeline in November, the 1956 payment was reduced to $13 million. A 20-mile branch of the Iraq pipeline through Syria emerges also at the port of Tripoli in Lebanon and the amount of revenue to be received from this facility has been in dispute from time-to-time because Lebanon has refused to accept the ton-mile formula on which the Syrian payment has been negotiated.

The Trans-Arabian Pipeline Company (Tapline) also pays transit fees on the third of Saudi Arabian production exported to the Mediterranean through Saudi Arabia, Jordan, Syria and Lebanon. Tapline has offered a half share of its profits to be divided among these countries in proportions to be decided by them.

Oil receipts in the balance of payments

The importance of oil receipts in the foreign-exchange position of the oil-producing countries is shown by the available data on their balance of payments (Table 4). The receipts in this sense include not only the payments to governments but the foreign exchange received from local currency sales for wages and other outlays by oil companies. The latter is estimated to amount to between $100 and $150 million per annum for all these countries combined. The table shows that, in general, current account payments are more than met by oil receipts and that there is a substantial excess which goes into reserves or capital exports. An important exception is Iran, where oil production has not yet reached the pre-nationalization level and foreign grants and loans are supplementing the oil income. As mentioned earlier, however, this country's production is the least affected by the Suez crisis. Iraq's excess receipts are going into the building up of reserves and that is true also of Kuwait. In the case of Saudi Arabia some capital export appears to have taken place. The equivalent of $25 million was made available to Egypt in the form of an advance payment for goods and in the purchase of Egyptian currency following the blocking of Egyptian sterling, franc and dollar assets in July when the Suez Canal was nationalized. Along with Egypt and Syria, Saudi Arabia is reported committed to payments to Jordan as compensation for the $36 million subsidy that country has been receiving annually from Britain. Saudi Arabia's obligation is reported to amount to L.E.5 million ($14 million) annually over the next ten years.

Table 4

Balance of Payments - Selected Middle East Countries

(Millions of dollars)

	Kuwait 1954 1/	Saudi Arabia 1954 1/	Iran 3/22/55 3/21/56 2/	Iraq 1955 3/	Bahrain 1954 1/
A. Receipts					
1. Oil	195	273	139	262	15
2. Goods and services			81	53	33
a. Exports	8	31	70	44	19
b. Other			11	(net) 9	14
3. Other			72 4/	8	...
Total	203	304	292	323	48
B. Payments					
1. Goods and services	114	191	277	254	43
a. Imports	80	115	259	254	38
b. Other	34	76	18	(2b)	5
2. Other	...	...	9	14	...
Total	114	191	286	268	43
C. Residual A - B	89	113	6	55	5
Reported increase in reserves	...	...	6	49	...
Errors and omissions	...	...	...	7	...

1/ Latest available estimates.

2/ Bank Melli Iran Annual Report for year ending March 20, 1956.

3/ International Financial Statistics, International Monetary Fund.

4/ Includes $63 million in foreign loans and grants.

In view of the outdated character of much of the balance-of-payments data, there is greater significance attached to the more current reports of the reserve position of these countries. As shown in Table 5, these latter indicate a measure of ease despite the fact that for some of them large amounts are sterilized as note cover. Of the $237 million shown for Iran at the end of January 1957, $148 million is earmarked in accordance with the Note Reserve Act of 1954 which provides for a 40 per cent reserve in gold and foreign exchange. Iraq currency is backed by a 70 per cent cover in gold and foreign exchange. About $100 million out of the $341 million reserve reported at the end of September is, therefore, unavailable for emergency expenditure. By the end of November, the reported reserves had increased another $40 million, but the amount of the note circulation is not yet available. The data for Saudi Arabia are not comparable to those shown for other countries. They are short-term liabilities to foreigners reported by banks in the New York Federal Reserve District only. They represent official and private balances, including balances of foreign individuals and businesses resident or domiciled in Saudi Arabia. There is no official information on the reserve position of Kuwait. The figures in the table are estimated on the assumption that one-third of the annual oil revenue has been assigned to the Investment Board since its establishment in 1953.

Table 5

Gold and Foreign Exchange Reserves of Selected Middle East Countries

(Millions of dollars)

Year or month	Iran	Iraq	Saudi Arabia 1/	Kuwait 2/
1950	252	117	8	...
1951	196	114	13	...
1952	177	129	16	...
1953	185	181	19	64
1954	186	233	62	137
1955	205	294	80	230
1956 - September	219	341	n.a.	...
October	235	380	"	...
November	220	...	"	...
December	230	...	"	323
1957 - January	237	...	"	...

Source: International Financial Statistics for Iran and Iraq; Federal Reserve Bulletin for Saudi Arabia.

1/ The figures are short-term liabilities reported by banks in the second (New York) Federal Reserve District only.

2/ Estimated on basis of one-third of oil revenue assigned to Investment Board established in 1953.

n.a. Not available.