THE ECONOMIC DEVELOPMENT OF UNITED ARAB EMIRATES, WITH SPECIAL REFERENCE TO THE OIL/FINANCIAL SECTORS FROM 1979 to 1984

A Research Topic

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CHAPTER 1

INTRODUCTION

The discovery of Petroleum in the U.A.E. has led to a profound change in the economic and social structure of the country resulting in the transformation of its simple and primitive community into a growing and developing society. Prior to the discovery of petroleum, the U.A.E. had a simple, primitive and localized economy whose only link with the world economy was provided by the pearl industry which at the time dominated the national economy.

Soon after joining the petroleum exporters' Club, the U.A.E. concentrated its efforts on catching up with more advanced countries. It embarked on a cash program of economic and social development powered by its petroleum and financial resources. Oil opened up the floodgates of economic and social change and laid the foundations of a modern state and the establishment of a free economy linked with the economies of the advanced countries. And despite its predominance in the country's economy and high level technology. The petroleum industry haspromoted the development of subsidiary and service industries alongside the traditional and primitive industries. Oil is thus also helping to bring about a diversification of the economy so as to avoid permanent reliance on a single source of income.

Statement of the Problem:

The substantial and progressive weakening of the international oil market since 1981 has profoundly affected the Emirates. With the decline of oil revenues due to reduced world demand and fall in oil prices, transition in the Emirates to less-oriented economies has suddenly become more immediate and more difficult than might have been expected, the pressure to speed up diversification of their economies into non-oil sectors has increased.

Statement of the Purpose:

This study examines the effects of oil revenues on development of the United Arab Emirates (U.A.E.). It analyzes the effects of changing oil production policies on different sectors of economy including agriculture, industries and banking. Overall the study provides an assessment of the fact as to the extent and magnitude the Emirates has to depend on oil revenue for their economic prosperity.

Problem Questions:

The study will help to provied some answers to the following questions:

1- How was the U.A.E. economy affected by fluctuations in oil revenues?

2- What was the policy of U.A.E. in diversifying its economic bases?

3- How were oil revenues allocated among competing needs of the country?

4- What has been the pattern of economic development of U.A.E. since 1977, with respect to the pattern of oil allocation utilized?

5- What have been the major economicaldevelopments?

6- What are the alternatives open to ensure continuous growth?

Performance objectives:

Upon completion of the research, the writer would be able to accomplish the following objectives:

1- To analyze the pattern and structure of oil revenues and their allocation to different sectors of the economy.

2- To assess the efficiency with which oil revenues were utilized to promote the future economic developments of the Emirate.

3- To examine the question of future utilization of petroleum resources of Emirates; and

4- to scrutinize the past oil policy of the countries comprising the Emirates in relation to their effects of economic development.

Organization of the Study:

In presenting and analyzing the research, the subject is analyzed systematically in the following segments of Chapter Two (2).

Part A. examines the composition of the economic structure. It summarizes the Emirate's geographical and natural features, population growth, decline of the pearl fishing industry, and the sequence of the developmental change in agriculture, construction and manufacturing industries, manpower, education, telecommunications and foreign trade.

Part B. includes a brief discussion of economic activities undertaken by different Emirates with a view to promote economic development in the area. This part examines the problems associated with industrial development.

Chapter Three (3) describes the development of the oil industry, particularly crude oil production, prices, consumption and exports. It discusses the actual oil revenues received by the Emirates, identifies the factors determining their volume. Also, it examines the allocational pattern of oil revenues, assesses the state public revenue, public expenditure and public reserve. There is an attempt to relate oil revenues to economic development through an analysis of the impact of oil revenues on the financial sector of the economy. It sheds light on the institutional and monetary developments achieved during the period between 1978-1984. It depicts the weaknesses and prospects of the financial system.

A few technical points need to be mentioned in this introduction. This study necessitated the choice of a model to act as a basis for investigating the channelling of oil revenues to different items of allocation. The model gives the basis for deducing the contribution of oil revenues to different items of allocation, through assessing and presenting the State public revenue by source, public expenditure by economic category and function as far as available information allows, and finally the net allocation to the reserve fund.

Chapter Four (4) provides the conclusion, recommendations and summary of the study. It discusses the need for an alternative approach and some considerations relevant to a development-oriented strategy which are brought forward. It is not only important to achieve growth but to sustain it. This Chapter will prove the need for a comprehensive strategy for economic development whereby the Emirates can harmonize their policies and direct their society's scarce resources in proper direction.

Sources Used:

The problem of obtaining a series of statistics suitable for comparative purposes almost defeated me. The lack of clarity and the unreliability of some official statistics, such as those concerned with oil revenue, public revenue, public expenditure and public reserves is considerable. Thus, after visiting and interviewing important personnel in the Ministry of Finance and Ministry of Petroleum, Dubai Petroleum Company, and the National library of Abu Dhabi, and after consulting a wide range of documents, the study decided to depend heavily on the "Annual Statistical Abstract" published by the Ministry of Planning, Central Statistical Department. It includes a summary of industrial, financial and social statistics pertaining to U.A.E.

CHAPTER 2

PRESENTATION AND ANALYSIS OF RESULTS

A. AN OVERVIEW OF THE ECONOMIC STRUCTURE OF U.A.E:

a. Natural features: The U.A.E. is located in the South-eastern part of the Arabian Peninsula with a 600 km coastline along the Arabian Gulf. The country possesses more than two hundred islands, having an area of approximately 77, 000 sq km, nearly 65% of which consists of desert.

The climate of the U.A.E. is hot and dry during the summer and warm at times rainy in the winter. Humidity is very high especially along the coast.

The U.A.E. is also rich in other minerals such as uranium, iron, zinc, lead, chromium, sulphur, and raw materials for the manufacture of cement and bricks.[1]

b. Population: The U.A.E. has a population of 1,186,000 according to the latest 1982 estimates.[2] It consists of town dwellers, the Bedouin, and oases-based dwellers. The latter constitutes the majority of the inhabitants of the principal towns. The Bedouin are nomadic.

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[1] Mana Saeed Al-Otaiba, "Petroleum and the Economy of the U.A.E.", 1977, pp.4.

[2] SOURCE: "Demographic Yearbook", 1982.

The principal occupations of the oases dwellers who mainly inhabit the fertile oases at Al-Ain, Ras Al-Khaimah and at Al-Dhaidh and who are a more settled element than the bedouin, are farming and the raising of cattle. It should be noted that the country's workforce, among the native population, is made up mainly of men.

However, with the speed of women's education, we find that women are taking a greater and active part in society.

c. <u>Agriculture</u>: The Agricultural sector makes a modest contribution to GDP (1.1%).[3] It is regarded as important by planners because of its major role in the economies of the non-oil producing emirates, and because of the high priority attached to increasing domestic food production. The Sector is plagued by extreme water scarcity, poor quality soil, an adverse climate, and limited storage facilities along with labor shortage and marketing problems.

Nevertheless, the government assigns high priority to agriculture. Government aid consists of the following:

- The authorities provide loans and grants for the purchase of equipment and subsidies for different aspects of production, distribution and land improvement programs. Grants of up to 50% of the purchase price of agricultural equipment are

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[3] Computed on the basis of data presented in Table 4.

made available.

- Agricultural trade shows are being organized by the authorities on yearly basis.
- The establishment of the Public Corporation in agricultural produce in 1983. It will be responsible for packaging and storing local produce and marketing and distributing agricultural surplus among the Emirates.

As a result of these programs and the growing demand for food products, the value added contributed by the agricultural sector greatly increased. From 1977 to 1981, the value of crops at current prices increased more than fourfold. Furthermore, the number of cultivated areas increased from 30,000 in 1971 to more than 60,000 in 1984.[4] Over and above this, the Ministry of Agriculture has announced plans to invest Dh 1, 172 billion ($319 million) in agriculture development over the next ten years. Plans are being formulated to insure better distribution, a better product mix and better storage facilities. The Ministry has indicated that it is confident that, with proper planning and adequate investment, the U.A.E. should be able to meet 57% of domestic food needs through local farming. Most experts are optimistic about the growth

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[4] Ministry of Planning, "Annual Statistical Abstract", 1984. pp. 139.

prospects of the agricultural sector, at least relative to the needs of the local population. Even if agriculture grows faster than industry, it will not constitute more than a minute proportion of GDP.

d. <u>Industrial Sector</u>:

(i) <u>The Pearl fishing industry</u>: Before the discovery of oil the Pearl fishing industry constituted the mainstay of the country's economy as well as the principal source of its national wealth. The Abu Dhabi and Dubai emirates were closely involved in this industry, and the contribution of the other emirates was somewhat less. Pearl prices were important not only for theindustry but for the economy of the Arab emirates as pearl prices determined incomes in an industry in which 80% of the country's workforce was involved.[5] The main factors determining prices were as follows: Quality and type, weight, colour, shape, and size. Pearls were exported to foreign countries, principally to India, which at that time was the world's largest market for natural pearls. And finally from India pearls moved to all parts of the world.

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[5] Mana Saeed Al Otaiba, "Petroleum and the Economy of U.A.E." 1977, pp.8.

During its long history, the pearl industry has been greatly affected by fluctuations in supply and demand in prices. It was at its height in the period preceding the outbreak of the First World War. In consequence of the world economic depression that lasted from 1929 to 1933. The demand for pearls fell sharply, but the market regained its buoyancy thereafter and continued to flourish until the outbreak of the Second World War. After the end of the war, various developments led to the decline of the industry as oil replaced pearls as the country's principal source of income. The principal factors were:

- Discovery of oil: The major, international oil companies had obtained oil exploration rights before the Second World War but operations had to be postponed until the war ended. The arrival of the oil companies in Abu Dhabi created a big demand for labor. The country found itself with a new source of income and therefore of purchasing power as a result of the annual cash payments received under the terms of the oil concession agreements. And as working for the oil companies was steadier and more profitable than diving for pearls, large numbers of men abandoned their traditional vocations of the pearl diving and found work in the oil industry.

- Competition from the cultured Pearl industries in Japan.

- Abolition of the Maharaja Rule in India.

The secondary factors were:

- Perils of diving.
- Price fluctuations which rarely assumed steady income for pearl divers.
- Income fluctuations depending on the changing world demand for pearls.
- Restrictions imposed by the Indian Government in order to conserve its foreign exchange.
- Employment in government officies.

In view of the abundant financial and material means at the disposal of the government now, we feel that it should consider reviving the pearl diving industry. Accordingly we suggest that the following steps should be taken:

1. Establishment of a government agency to study the possibility of reviving the industry.

2. Employment of modern diving techniques and equipment.

3. Establishment of a research center which would not only undertake studies relating to the industry now but would also compile a history of pearl diving in the country.

4. Cooperation with other countries of the Gulf on matters relating to pearls and the holding of a regional conference.

5. Investment of some of the country's surplus funds, if any, in the purchase of pearls existing in foreign markets with a view to causing a rise in demand once again.

(ii) Manufacturing industry: Because of the limited agricultural potential, the industrial sector is regarded as a prime sector on which the UAE expects to depend once it exhausts its oil revenues. The relative contribution of industry to GDP declined prior to 1975 but grew significantly in absolute terms after that. The manufacturing sector, including petrochemicals, accounted for 9.6% of GDP[6], and while the percentage of gross capital formation directed to manufacturing has fallen since 1979, it remains high at 40.4% in 1982.[7]

The large investments in the industrial sector changed the composition of the industrial output. In the early seventies, furniture and paper products accounted for a third of manufacturing output. In 1978, they accounted for only 9% of manufacturing output. The contribution of chemical

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[6]Computed on the basis of data presented in Table 4.

[7]Ministry of Planning, "Annual Statistical Abstract", 1984. pp. 428.

and food products greatly increased.

Private investment in the manufacturing sector has been concentrated on light industries such as prefabricated steel and Soft drinks. The Government of the U.A.E. have also been very active in this sector and most of the sector's fixed capital formation has been government sponsored.

Most industrial ventures, especially heavy industries, are undertaken by the emirate governments. A number of large scale, capital intensive, generally oil-based industries have been developed as public sector enterprises. On the other hand, the private sector has developed several small-scale light industries and processing plants in every emirate in the federation. These include small plants for the processing of imports such as flour. A 1979 federal law was enacted for the licensing of private sector industries, requiring at least 51% local ownership.[8] The major industries (interms of contribution to industrial output) are either petrochemical or linked to construction. While impressive success has been recorded in the development of such industries, it should be noted that these do not contribute significantly to adequate diversification.

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[8] Ministry of Finance and Industry, Mana Saeed Al-Otaiba, "Petroleum and the Economy of the United Arab Emirates, 1979, pp. 158.

Hydrocarbon-based industries are too closely linked with the dominant petroleum sector; their future would be precarious when oil reserves are depleted. Indeed, the recent reduction in oil output, which has limited the availability of natural gas has seriously affected gas liquifaction operations. At the same time, industries such as Aluminum or cement production are closely linked to construction, a heavy cyclical industry that is very dependent on the level of economic activity.

The geographic distribution of industries, current and planned, is uneven and reflects serious regional disparity. The major industrial centers are in Ruwais in Abu Dhabi and Jebel Ali in Dubai - the emirates which have the greatest oil wealth are the ones most successful in industrical production.

The Emirate Industrical Bank (EIB) was created in 1981 to provide concessional funding for the private industries of the U.A.E. Full funding was not completed until April, 1983; at which time the EIB began accepting private sector project proposals. The EIB is intended to provide assistance to local manufacturing industries. Equity, working capital and medium-and-long-term credit are provided by the EIB, which will also aid the private sector to identify business opportunities and gain access to the capital market. The EIB board has indicated that the bank will favor industries employing high technology and capital intensive production processes. Preference will be given to small-and-medium scale-light industries minimizing the use of human resources and using the highest technological methods.

As a conclusion, the U.A.E. should and must coordinate its private and public efforts in favor of industrial development, by passing all problems related to the industrial sector, since it is the U.A.E's only hope of serious diversification. In today's world, where the concept of free trade is rapidly losing its relevance, the emirates should design policies which strengthen their industrial bases and assume access of their products to overseas markets, particularly inthe Industrialized West. The first requires more governmental patronage, which can take several forms: investment incentives, realignments of commercial policy instruments and levying of anti-dumping and countervailing duties in case of those products which are treatened by comparable foreign merchandize. The second requirement is that the projects which may generate exportable surpluses ought to be given special institutional support and assistance, particularly in respect of export finance, insurance, and industry related research and development.

(iii) Construction Industry: Between 1972 and 1975, construction grew at annual rate of 18%. Construction activity accounted for 9.9% of GDP at market prices in 1982 (compared to 13.6% in 1978. In recent years the construction sector's growth rate has subsided; indeed, construction registered negative growth (-6%) in 1981 and while the construction sector grew at an impressing 16.4% in 1982 (at a time when the economy registered overall negative growth), the prospects for the construction sector are far from promising. This, inturn, reflects the following:

- Declining oil revenues necessitates fiscal austerity, which entails relatively modest allocations for development, infrastructural and housing projects. Overall expenditure on projects declined by 15.4% in 1982, and development expenditure on housing, industry and electricity, communications and municipalities fell sharply, in 1983.

- Most of the infrastructural and a large number of individual projects have already been completed.

- The troubled conditions of the financial sector are restricting the availability of funds for construction projects to be undertaken by the private sector.

As a conclusion, construction is currently in a serious slump, brought about by the increasing fiscal conservatism of the government and very tight liquidity. sharp reductions in development allocations in 1983 indicate a depressed market for some time to come.

e. Man-Power: The U.A.E. has been heavily dependent on foreign labor for its development. By 1980, it was estimated that fully 79.3% of the population was foreign and by 1984 estimates were up to 90%. Since most expatriates living in the U.A.E. are workers, the size of the expatriate population relative to the total labor force is even higher. Thus, while the employment ratio has remained relatively stable at around 52% in recent years, the percentage of foreigners in the workforce has increased considerably.

Construction, despite its sluggish growth in recent years, has been the sector accounting for the largest percentage of civilian employment. Trade employs the second largest group of workers followed by government services, transportation, storage and communications. The pattern of employment reflects a number of social and technical realities. The high ratio employed in construction, transportation and communications reflects the emphasis placed on infrastructural development and the boom mentality still prevalent despite the reduction in oil revenue. Government services absorb a large number of nationals, especially educated ones, as evidenced by the high wages in that sector. Trade attacks a large number of workers, partly because it presents many opportunities in an open rapidly growing economy, and partly because of the commercial traditions of the local population., while the oil sector remains the most productive sector and commands the third highest wages, its accounts for only 1.3% of total employment. Agriculture, which used to be a major employer before the discovery of oil, has such low productivity and commands such low pay that only 5.8% of the labor force is employed in this sector. Industry, although it has grown in importance in recent years, employs only 8.3% of the population.

Wages are to some extent sensitive to national origin; no reliable statistics are available, but some indication of purchasing power can be derived from the observation that monthly per capita spending is estimated at $ 636 for U.A.E. nationals, and $ 397 for Arab expatriates, and $ 398 for non-Arabs. Foreigners find it necessary to spend an inordinate amount on rent and food (60% of total wages, compared to 28.6% for UAE nationals), a fact that reflects their inability to own real estate, forcing them to pay inflated rents. The large number of foreigners present a number of problems. First, having such a high percentage of foreigners in the population is socially and perhaps politically destabilizing. Second, the presence of large number of foreigners has been blamed for the growth in such previously unheard of phenomena as juvenile delinquency and social crimes, in particular sex-related offenses.

Third, foreigners account for part of the high demand for imports. The remittances they send home also represent a leakage of foreign currency - an increasingly important problem as the UAE's balance of payments position worsens.

In the light of the social and political implications of nationals being a minority in their own country, the U.A.E. authorities have begun to limit the number of expatriates. Steps wer taken to accomplish this goal as early as 1977. Additional measures have been taken since then including the following:

1- Increase participation by UAE nationals in the work force.

2- Imposition of strict limitations on the mobility of foreign workers.

3- Entry visas were also restricted.

4- Enforcement of a local partner on foreign companies.

5- Inspection campaigns have been initiated to crack down on illegal immigration and employers violating labor regulations.

These steps are believed to have succeeded in at least stemming the growth in the percentage of foreigners. However, while such measures may mitigate some of the undesired phenomena listed above they could as easily provoke hostilities. They are certainly going to lead to higher labor costs, a reduction in the flexibility employers enjoy to expand or modify their range of products, and a rise in social tensions as foreigners become fearful of deportation or termination. Unless the monitoring system proves successful, the limitations on legal immigration could result in an increase in illegal immegration and exploitation of foreigners by employers.

f. Health and Education: While health standards are already quite high, notably in Dubai and Abu Dhabi, the federal government plans to increase the number of public sector hospital beds to 5,500, thus increasing the ratio of hospital beds to residents from 250:1 to 200:1, an ambitious program considering the rapid growth of the population.[9]

As far as education is concerned, the planning authorities are committed to raising literacy levels through expansion of the school and university systems and adult education programs. The 1982/83 total of over 300 schools

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9. As estimated by the Ministry of Health of U.A.E.

is to be raised to a projected 762 schools by 1985. The Al-Ayn University, which currently graduates 500 students a year is to be enlarged to permit a total enrollment of 10,000 student by the end of the Century.[10] There are problems associated with the development of education in the U.A.E., among them the severe shortage of qualified teachers among the native population, the tendency by nationals to view education as a means of enrichment, and a distinct predilection for foreign education at the university and graduate level.

g. Telecommunications: Emirted, a federal authority, handles telecommunications with the mostly state-owned Cable and Wireless and International Aeradio. Telecommunications are crucial for the conduct of business. Attempts are made to integrate the emirate's systems into a national one. Ras Al-Khaimah took steps in this direction by merging its telecommunications authority into Emirted. A Dh. 300 million development plan was enacted for Emirted in 1980.

h. Public Utilities (Power & Water): Both of these are very high priorities in the UAE. The severe scarcity of water is a major inhibiting factor in the development

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10 As projected by the Ministry of Education of A.U.E.

of agriculture and industry, and the demand for electricity has been rising rapidly. The need for electricity for industrial as well as consumer use has to be accommodated. To satisfy water demand desalination is used on a large scale. The Dubai industrial complex provides Dubai city with more than half of its water needs. Desalination is expected to be the main water treatment technology, although the oil slide may have dealt a temporary blow to desalination efforts. A special committee was set up by the cabinet in 1979 to project power needs through the end of the century. A national grid system is the desired objective, the attainment of which has been facilitated by such steps as Dubai's nationalization of the electricity company, and the projected (through scaled down) Taweelah power and water station. Overall power capacity is projected to increase to 2,272 mw by 1985 to accommodate demand. By 1990 a nuclear power station is envisaged.

(i) Foreign Trade

Exports: The UAE exports grew rapidly through the seventies, peaking at Dh 82.3 billion in 1980. This reflected rapidly rising prices for the UAE's main export, crude oil. The price of UAE crude increased an average of 162% from 1978 to 1980. After peaking in 1981, prices declined slightly in 1982 and rather considerably 12.6% in 1983. The volume of crude oil exports decreased as the price rose. Crude oil exports accounted for 79% of total UAE exports in 1982 - October exports included:

- Newly developed products of national gas liquids and liquified natural gas.

- Re-exports, channelled largely through Dubai.

- Refined petroleum products.

- A small volume of nonhydrocarbon exports, mainly dried fish, dates and animal by-products.

The direction of crude oil exports has changed somewhat in the last five years, reflecting different patterns of demand and also shifts due to production cutbacks.

- Imports: The UAE's limited non-oil production capabilities have made the economy heavily dependent on imports for both consumption and investment. In 1981, with the oil glut beginning to assert itself, import growth declined to 12% as a result of decreased government spending. The recession which followed led to a reduction in import demand by both private and public sectors, precipitating an actual decline of 5% in imports.

Figures for the first half of 1983 indicate further decline in imports value.

TABLE 1: Foreign Trade and Payments
Trend of Foreign Trade, UAE Federation
(Dh mn.)

	1978	1979	1980	1981	1982	1983
Exports, fob	35,433	51,807	76,885	74,302	63,365	55,105
of which:						
Crude Oil	33,528	49,078	72,144	68,144	58,344	47,510
Imports	20,765	26,527	32,425	35,417	34,654	30,675
Balance	14,668	25,280	44,46	38,885	28,711	24,430

SOURCE: IMF International Financial Statistics. 1984.

- Current account: During the past five years, the merchandize trade balance has been in surplus, while literally every other part of the balance of payments has been in deficit. The merchandize trade balance grew rapidly from 1978 ($ 5.34 billion) to 1980 ($ 14.76 billion), as exports grew much faster than imports. With the decline in export value, the merchandize trade balance began to shrink in 1981 and 1982 as the slight fall in imports failed to compensate for the considerable reduction in total exports.

The net outflow for services and transfers has traditionally been in deficit. Most transfers began to level off in 1981 and service charges tended to decline with the slowdown in economic activity.

The current account surplus, began to shrink with the fall of merchandize trade surplus, in 1981-82 and 1983.

- <u>Aid Payments</u>: Aid disbursement by the UAE consists of foreign grants and foreign loans. The UAE has traditionally been a generous donor of aid.

Grants by the government used to represent a high percentage of both GDP and oil export revenues. However, in 1981 concessionary loans began to be substituted in grants which fell sharply to Dh 2.4 billion. Loans, also declined to Dh 3.2 billion in 1982, reflecting increasing fiscal conservatism by the government.

- <u>Capital Accounts and overall Balance of Payments</u>: The major items in the capital account are government foreign investments and errors and omissions. U.A.E. is a net exporter of capital. With the reduction in oil prices in 1981 and 1982, the amount of foreign investments undertaken by the government is reported to have diminished to the 1982 level of Dh 10.4 billion. Errors and omission include private capital movements, but official estimates here are unreliable, especially as careful records were not kept for some time, and confusion with private transfers seems inevitable. One fairly reliable observation, however, is that the foreign assets of commercial banks have diminished sharply since 1979.

- Prospects: Preliminary indicators suggest no or slightly negative growth in UAE imports in the near future. Imports by and re-exports from Dubai are likely to increase somewhat as the dry-dock becomes fully operational, and the opening of the Fujairah port is also likely to stimulate trade. However, higher tariffs and declining spending power will discourage import growth.

Exports are known to have fallen considerably (21%) in the first half of 1983, but the proportion of non-crude oil exports is likely to continue its rise. With the fall in service changes and transfer expected as a result of the slowdown of economic activity, aid reduction, and the leveling off remittances with efforts to curb the growth of foreign labor, it is likely that the current account surplus estimated for 1983 will stand, and that the current account will record a comfortable surplus in 1984 and beyond.[11]

- Direct Foreign Investment: The UAE does not permit foreigners to own property. Some emirates, however, lease property to foreigners with the condition that all additions

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11 As shown in the Basic Data presented in the Appendix, Page 125.

and improvements become the property of the original owner. Consequently, direct foreign investment in the UAE is likely to be in the form of partnerships with the local residents.

Problem likely to confront foreign businessmen seeking to establish themselves in the UAE include the following:

- The legal system is relatively complicated.

- There is a severe shortage of manpower and the government is placing restrictions on employers seeking to employ foreigners.

- Living costs for foreign personnel are extremely high.

- Marketing and distribution channels are not very well developed within the Federation.

- The new commercial company law not only requires 51% local ownership for companines operating in UAE, but 100% ownerships in certain areas.

- The UAE has only recently begun drafting laws to protect trademarks, patents and copyrights at the federal level.

On the other hand, expatriation of profits is unrestricted and is expected to remain so. The major problem confronting investors in UAE, foreign or local, is the small size of the market. A wider perspective, and a marketing strategy to cover several countries in the Gulf area, is a necessary condition for success for investors operating in the UAE, especially in light of GCC integration and the concomitant tariff reductions.

At this point, it is important to note that the discovery of oil in the country brought about a dualism in the country's economic structure. On the one hand, there come into being the highly advanced petroleum-related economy, that was closely connected with the economies of the industrialized countries, while on the other hand the country's primitive domestic economy had to keep pace with the leading sector (petroleum) in the national economy. Consequently, the economic structure of the Arab Emirates was characterized by backwardness and dualism.[12]

With oil discovery, petroleum assumed a dominant role in the country's economy. It has not yet, however, been able to rid itself of itsdual nature. While the petroleum sector is technologically a high advanced industry that is closely interlinked with foreign markets, we find that the other sectors of the country's economy, such as industry, agriculture, trade and services are technologically still relatively retarded and, unlike the petroluem industry, locally oriented. Because of this dualism and its economic

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12 Mana Saeed Al-Otaiba, "Petroleum and the Economy of the U.A.E.", 1977, p. 34.

drawbacks, UAE is still unable to raise the level of its other industries to that of the petroleum sector.

In a country whose economy is affected by dualism, it is necessary to endeavor to integrate the country's dominant industry - i.e. petroleum - with the other sectors of the national economy. It can, now, be summarized that as oil receipts decline, development in the other major sectors of the economy moves in the same direction. This is proved after investigating the UAE petroleum sector and its impact on the financial system in Chapter Three.

B. OVERALL ECONOMIC ACTIVITIES & PROBLEMS ASSOCIATED WITH INDUSTRIAL DEVELOPMENT

(i) Overall Economic Activity: The U.A.E., established in December 1971; is a federation of seven largely autonomous emirate, namely: Abu Dhabi, Dubai, Sharjah, Ras Al-Khaimah, Fujairah, Ajman, and Umm Al Qaiwann. The two economically dominant emirates, Abu Dhabi and Dubai, accounted in 1983 for 69% of the population, and 88% of GDP (Table 2). In recent years, however, the other emirates have also experienced relatively rapid development.

TABLE 2: UAE Structure of Population, Employment, and GDP by Emirate 1983.

State	Population (In thousands)	Employment (In thousands)	GDP at Factor cost (Bns Dirh.)
Abu Dhabi	520.7	255.1	64.8
Dubai	307.2	161.7	28.0
Sharjah	185.2	80.7	6.9
Ajman	43.6	13.6	0.9
Umm Al Qaiwann	14.3	7.2	0.4
Ras Al Khaimah	85.3	40.0	3.0
Fujairah	38.2	15.4	1.1
Total	1,194.5	573.8	105.2

SOURCE: Ministry of Planning - Year 1983.

Oil production, which begun in 1962, transformed the economy. Up to the early 1960s, agriculture, herding, and fishing were most important sources of livelihood for much of the population although Dubai was also an important entrepot trading center. Especially after the sharp rise in oil prices in 1973-74, the vast increase in oil export earnings permitted a sharp increase in government expenditure on physical infrastructure, health and education facilities, and social welfare programs as well as on the development of gas and petroleum processing industries. The private sector also benefited from the increased government spending, with the construction, services, banking, and trade sectors showing strong growth. Overall the annual nominal growth of non-oil GDP is estimated to have averaged 25% in 1976-80, although production of crude oil still accounted for nearly 55% of GDP in 1980.[13] Since 1980, however, falling output and prices resulted in a substantial decline in oil earnings. This has necessitated a less expansionary stance of government expenditure policies and, consequently, there has been a marked slowdown in economic activity.

National Income Accounts: National income account data for 1981-82 have been revised recently and data for 1983-84 are only preliminary estimates, subject to revision, and therefore provide only abroad indication of developments in these years. Annual growth of GDP at current market prices averaged over 20% in 1976-81, but this trend was reversed in 1982-83 when GDP declined by an average of 8% annually (Table 3).

In 1984 nominal GDP is estimated to have increased 1%. To a large extent, GDP growth in the U.A.E. is generated by the exports of goods and non-factor services, mainly oil and gas products, which in 1976-81 grew at roughly the same

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[13] Computed on basis of data presented in Table 4.

pace as nominal gross domestic product. In 1982-83, however, exports of goods and services declined by an average of 14.5% per annum, which was the main reason for the general slowdown in economic activity during this period; exports of goods and services are estimated to have increased by 4% in 1984. Imports of goods and non-factor marginally in 1982 and further by an average of 9% per annum in 1983-84, reflecting weak aggregate demand. As a result of these developments, net exports were almost halved between 1980 and 1983, although they recovered in 1984, increasing by almost 22%.[14]

Reflecting the more restrictive fiscal policy, domestic expenditure, which had increased by 24% per annum on average in 1976-81, declined by 3.6% and 5.6% in 1983 and 1984, respectively. Private consumption was especially weak, decreasing by about one third in 1983-84, with a sharp fall in rents in Abu Dhabi and a fall in employment both contributing to the decline. The government consumption continued to expand in 1982-84, although at a less rapid pace than in previous years, as current expenditure policy was less restrictive than development expenditure policy.

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14 Ministry of Planning, "Annual Statistical Abstract", 1984; pp. 423.

TABLE 3. U.A.E: Annual Changes in Use of Resources at Current Prices, 1976 - 84 (In Percent)

	Average 1976 - 80	1980	1981	1982	Prov. 1983	Est. 1984
Domestic Expenditure						
Private Consumption	23.6	18.3	25.9	+3.6	-3.6	-5.6
Government Consumption	25.0	24.4	31.5	7.6	-25.2	-9.8
Gross Investment[1]	20.9	12.7	2.1	1.1	4.3	-0.0
Exports of goods and non-factor services	24.0	50.5	-2.3	-14.4	-14.6	3.9
Gross domestic product at market prices	22.7	37.3	10.3	- 7.2	-8.6	1.0

SOURCE: Ministry of Planning, Year 1984.

[1]Includes change in Stocks.

TABLE 4: U.A.E. Industrial Origin of Gross Domestic Product at Current Prices 1975 - 84 (In Millions of Dirhams)

	1975	1980	1981	1982	1983	Prov. 1984
Crude oil production	26,364	70,532	69,814	55,982	46,145	47,814
Other	13,271	40,938	54,240	59,672	59,078	58,041
Agriculture	329	827	1,036	1,144	1,130	1,240
Mining & Quarying	98	235	257	298	309	328
Manufacturing[1]	369	4,191	8,077	9,436	9,544	9,962
Electricity & Water	209	1,297	1,547	1,851	1,812	2,200
Construction	4,308	9,834	10,475	10,168	10,600	10,250
Trade	3,248	9,094	10,849	10,913	9,905	9,126
Transportation, Storage and communications	1,255	3,731	4,950	5,465	5,110	5,050
Finance and Insurance	76	720	2,109	2,498	2,913	2,595
Real estate	1,592	4,006	4,622	6,634	6,260	5,525
Government Services	1,364	5,989	8,910	8,632	9,759	9,850
Other Services	422	1,014	1,408	1,633	1,686	1,686
Gross domestic product at Factor cost	39,635	111,470	124,054	115,654	105,223	105,855
Indirect taxes and Subsidies	-175	-1,637	-2,954	-3,221	-2,517	-2,130
Gross domestic product at market prices	39,460	109,833	121,100	112,433	102,706	103,725

SOURCE: Ministry of Planning, Year 1984.

[1] Includes natural gas and petroleum processing industries.

Despite lower budgetary spending, gross fixed capital formation remained roughly unchanged in 1980-83 in nominal terms (Table 5). However, a 10% decline in gross fixed capital formation was estimated for 1984 although disaggregated data by sector are not available. To a large extent, the level of investment was maintained in 1980-83, due to rising investment in industrial activities other than crude oil production which offset the reduction in investment in infrastructure resulting from the completion of some major projects. In particular, manufacturing increased its share in total investment to 37% in 1983 from an average of only 23% in 1975-79. Investment in this sector has been concentrated in a few, large, capital-intensive projects that utilize hydrocarbon resources as raw materials or use dry natural gas as fuel. The service sector, which in 1983 accounted for about 11% of gross fixed capital formation, and agriculture, at 2% in 1983, have also increase their share in investment in recent years. Despite the substantial decline in oil production in the 1980s, investment in the petroleum sector has been maintained at a relatively high level, reflecting an ambitious exploration and development program.

The decline in budget development expenditure has affected gross fixed capital formation in other sectors, however, including electricity and water, real estate, and transportation, storage, and communications. Gross fixed

TABLE 5: U.A.E. Estimates of Gross fixed Capital Formation by Sector at Current Prices, 1975-83

(In millions of dirhams)

	Total 1975-79	1980	1981	1982	Provisional 1983
Crude oil production	15,303[1]	5,432	3,863	3,748	3,671
Agriculture	1,104	560	472	482	600
Mining & Quarrying	...	31	86	91	124
Manufacturing[2]	23,912	9,983	11,855	12,800	11,104
Electricity & Water	10,644	2,663	1,900	2,033	2,252
Construction	2,740	715	1,016	1,006	1,180
Trade	4,749	749	611	733	685
Transportation, storage and communication	21,791	4,139	4,779	4,612	4,410
Finance and Insurance	-	93	101	200	114
Real Estate	15,664[3]	2,390	2,000	1,870	2,132
Services	9,644	3,400	3,960	4,108	3,269
Total	105,551	30,155	30,643	31,683	30,041

SOURCE:
Ministry of Planning - Year 1983

[1] Includes mining and quarrying.

[2] Includes the natural gas and petroleum processing industries.

[3] Includes Finance and Insurance.

capital formation in trade has stagnated as there appears to be considerable excess capacity in this sector.

Between 1975 and 1982 the non-oil sector expanded rapidly with nominal value added increasing by 35% (Table 4). However, small declines of 1% and 2% were recorded in 1983 and 1984, respectively, as aggregate demand weakened. Nevertheless, a number of activities, particularly those not directly dependent on government expenditure, continued to perform strongly. These included manufacturing, which expanded by 6% during 83-84, and agriculture which recorded an increase of 3% during the same period. The electricity and water sector continued to expand in 1983-84, reflecting the completion of projects undertaken in previous years while construction stagnated. Value added by the government services sector increased by only 1% in both 1983 and 1984, considerably less than in previous years. The sectors most affected by the general slowdown of economic activity in 1983-84, were trade, real estate, and transporation, storage, and communications. Trade sector activity decreased 16% in this period reflecting the weak private consumption. There was, however, some revival in Dubai's re-export trade which, in previous years, had been seriously affected by regional developments. Value added in the real estate sector fell by 17% in 1983-84, reflecting a sharp decline in rents, estimated at 50% in Abu Dhabi since 1982. Substantial excess capacity appears to be available in this sector, expecially in Abu Dhabi, as well as in many other service activities.

GDP data at constant prices are of a very preliminary nature and are only available for 1980-83. At 1980 prices, GDP declined by about 6.5% in both 1982 and 1983, reflecting falling crude oil output. Non-oil sector growth slowed to an estimated 1.9% in 1983, compared to 23% in 1981 and 7.5% in 1982. Rough estimates suggest that growth resumed in 1984, at about 5%, with the non-oil sector estimated to have recorded 2% growth.[15]

Comprehensive data on the structure of GDP and employment by emirate are available only for 1982. In that year, Abu Dhabi accounted for 63% of GDP and 56% of non-oil GDP. That emirate had a particularly large share in crude oil (71%), in manufacturing (69%) reflecting natural gas and petroleum processing industries, and real estate, as a result of the relatively high rents in Abu Dhabi city. Dubai, the second most developed emirate, had a 26% and 24% share in total and non-oil GDP, respectively. Dubai is traditionally a trading center of regional importance and has particularly well-developed trade, finance and insurance, services, and transportation, storage, and communications sectors.

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[15]SOURCE: Ministry of Planning. Year 1985.

The five smaller emirates accounted for only about 11% of GDP. These emirates, nevertheless, have a 71% share in agricultural production; Sharjah is also a relatively important trading center. Employment is somewhat less concentrated in Abu Dhabi and Dubai; in 1982 a 27% of total employment was in the five smaller emirates.

(ii) Industrial Activities problems: Since the formation of the federation in 1971, the U.A.E. has been largely incoordinated, with the federal government responsible for developing the infrastructure and the individual emirates concentrating on local projects - mainly roads, communications, and social services facilities - were completed and the adoption of further development projects became more difficult. Consequently, the Ministry of Planning was asked to prepare a five-year plan for the early eighties focussing on economic and social projects which would increase the cohesiveness of the Federation.

A five-year plan was drawn up for1981-85. It anticipated federal expenditure on projects totally Dh 16 billion ($ 4.36 billion).[16] Over the five-year period, with a considerable amount to come from the private sector.

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16 "EIU Annual Regional Review", Middle East & North Africa 1985, pp. 251.

The plan had to be revised drastically in 1982 in light of declining oil revenues. At that point it became evident that the plan would serve as no more than a series of guidelines, with most of the meaningful fiscal allocations being decided on a year-to-year basis.

This shows that industrial problems arise due to lack of strategic planning regarding industrial development. There are several problems involved in formulating a coherent development plan for the U.A.E and then adhering to its guidelines:

- It is extremely difficult to anticipate the level of revenues. Since oil sales constitute the major source of government revenue, fluctuations in the price of and demand for oil have far-reaching fiscal implications and as these occur quite frequently, long-range financial commitments are difficult to undertake.

- Costs are likewise difficult to anticipate. Since most development projects entail the use of imported technology, capital goods and raw materials, projects costs can vary considerably.

- The multiplicity of bureaucracies in the emirates makes it difficult to coordinate plans. This causes duplication of projects and makes infrastructural development more difficult.

- As in other Gulf States, there is an obsession with "prestige projects" which are not always viable or desirable. Industries are sometimes developed for which technologies and raw materials have to be imported and little consideration is given to factors such as product distribution.

Along with the Planning problems, there are problems pertaining only to the U.A.E.'s industrial sector:

- Not only are the projects in direct competition with others in the Gulf area, but some, like the cement industry, compete with identical projects in other emirate. Attempts of coordination between planners have been relatively limited, as each emirate has sought to expand its industrial base more or less independently.

- The low level of skills of the national labor force, the small size of the native population, and the relatively high cost of indigeneous labor all make the industrial sector dependent on expatriate labor. In one of the huge industrial projects in Dubai, for instance only on in every thousand laborers is a national. The recent toughening of government attitudes toward foreign labor is likely to mean labor shortages and higher labor costs for most industries.

- Many projects are dependent on imported raw material. Some, like the steel and paper bags factory in Sharjah, had to be closed because of difficulties in obtaining needed input materials.

- Where the private sector is concerned, most industrial projects are opened by prominent families, who run them as part of large business empires. This presents many problems: it intensifies the linkage between industries and services; it hinders national industrial planning, and it creates the possibility of mismanagement and inappropriate financing practices.

- The government is sometimes blamed for not providing enough assistance to private sector industry. Government aid to private-sector industry had been largely limited to moderate protectionism, and concessional financing from the recently formed Industrial bank. There is little subsidization and hardly any assistance in marketing, distribution or technological development. Industrials also complain that the government shows little preference for their products in its purchasing programs.

- Fuel prices in the U.A.E. are not exceptionally cheap by Gulf Standards; they were raised 25% in mid-1983 in the context of fiscal austerity viewed as necessary by the government. Furthermore, as the reduction in oil production has resulted in dwindling supplies of associated natural gas, some major industries (like Dubai) have been forced to use more expensive imported gas.

- So many industries are dpendent on construction that the sad condition of the construction has adversely affected the industrial sector. The cement industry, in particular, has suffered considerably as demand for cement has dropped not only in the U.A.E., but in the entire Gulf region. The National Cement Company (NCC) a privately-owned company in Dubai, has hadto cope with a halving of its prices in 1982.

- The multiplicity of population centers and dependence on export markets in making proximity to port facilities a must for many industries. Some industries are, however, inconveniently located close to areas of raw material production and far from ports.

- The limited population of U.A.E. represents another problem as it suggests that demand for industrial products is likely to be highly precarious. It also implies a strong need for superior marketing and distribution techniques, which are difficult to develop, especially in view of infrastructural constraints.

- The overall reduction of the level of economic activity in the Gulf region limits the possibility of gains for the industrial sector from the tariff-liberatization that has accompanied the development of the Cooperation Council for the Arab States of the Gulf (GCC). Moreover, some tariffs persist on certain industrial products exported to other GCC countries.

- Finally, Iraq, a market of some consequences, especially for construction-related materials is drying up because of the war with Iran and the unavailability of funds.

Figure 1. **OIL PRODUCTION**

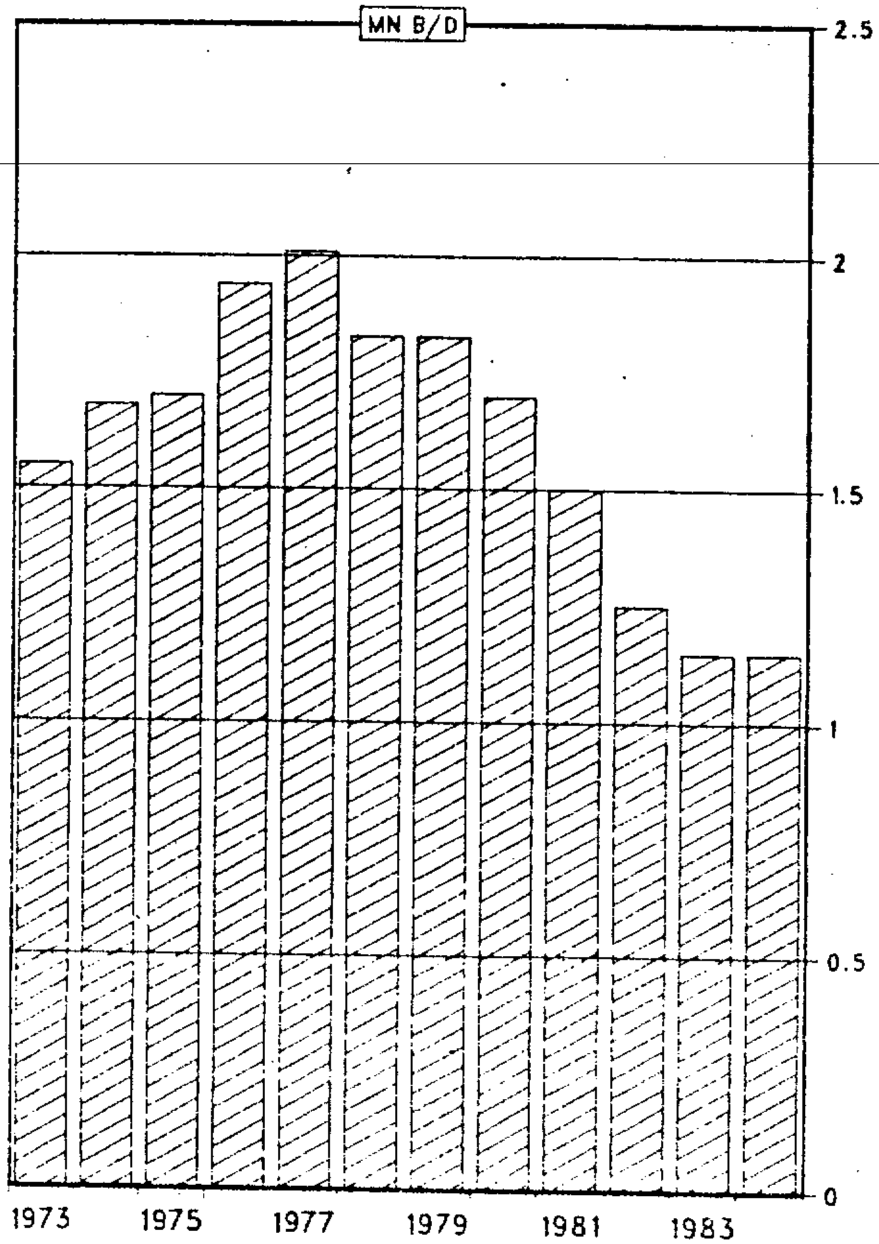
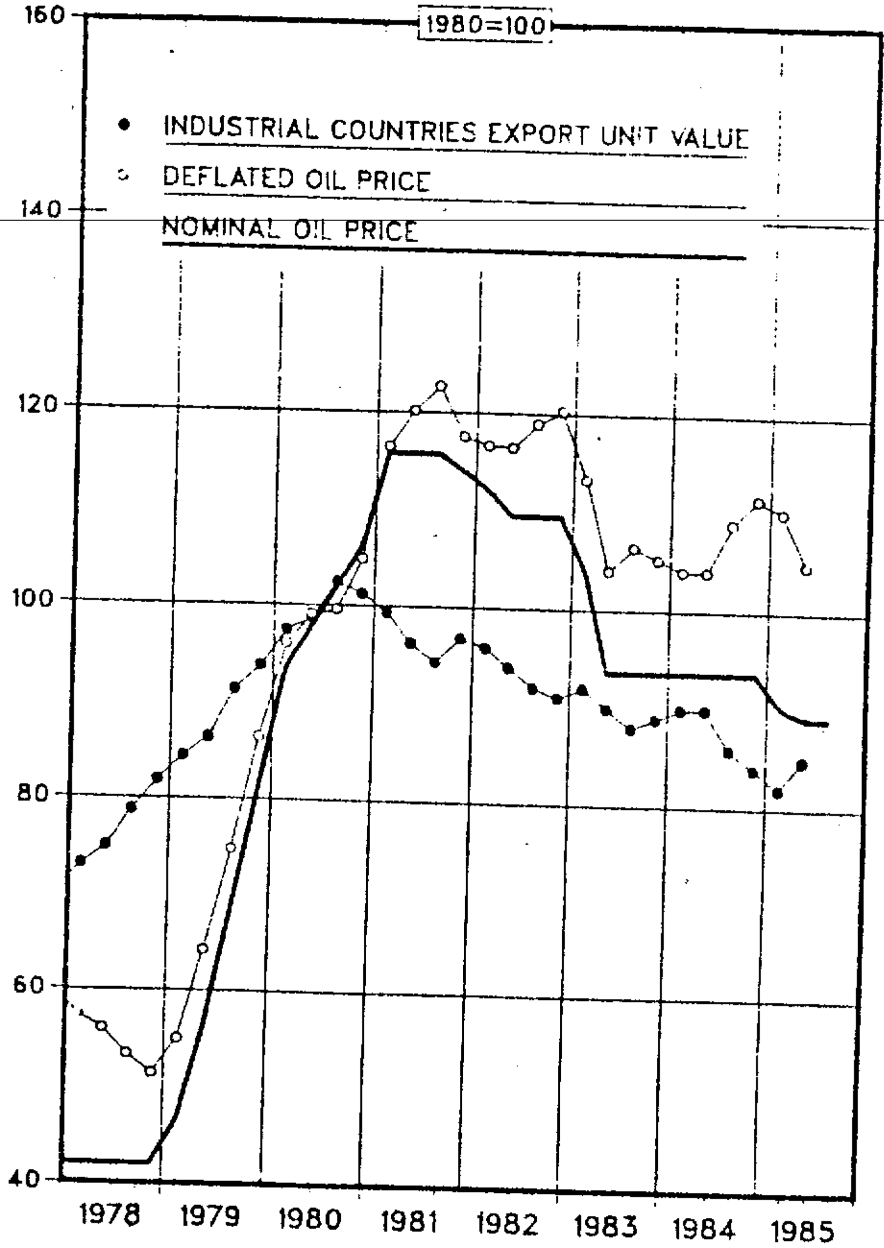


Figure 2. **OIL EXPORT PRICES**



CHAPTER 3

PRESENTATION AND ANALYSIS OF RESULTS (Cont'd)

A. ECONOMIC DEVELOPMENT OF OIL SECTOR

(i) Oil Sector

a. Background

The U.A.E. economy is dominated by the oil sector which, excluding refined petroleum and gas products, was the source in 1984 of 87% of budget revenues, 73% of merchandize exports, and 46% of Gross Domestic product. Oil was first discovered on a commercial scale in 1958 in Abu Dhabi, with production beginning in 1962. Liftings from Dubai and Sharjah started in 1970 and 1974. respectively. Ras Al-Khaimah joined the ranks of the oil producing Emirates in 1984. Production expanded rapidly in the 1960s and early 1970s, peaking at about 2 million barrels daily (mbd) in 1977; subsequently, oil production declined to 1.18 mbd in 1983 and 1.17 mbd in 1984. Concurrently, oil export receipts decreased from U.S. $19.4 billion in 1981 to US $ 11.7 billion in 1984. The U.A.E. share in the organization of Petroleum Exporting Countries (OPEC) crude oil production has been kept roughly constant in recent years, amounting to 6.5% of total OPEC production in 1983 compared with 6.3% in 1977. However, parallel with the decline in the OPEC share of the world oil market, by 1984 the U.A.E. accounted for only 2.1% of world crude oil production against 3.2% in 1977.

As in most major oil producing countries, the oil and gas industry has diversified greatly its output in recent years. The UAE is now mostly self-sufficient in refined petroleum products and substantial surpluses are available for export. No official data on production capacity and reserves are available but oil industry sources put proven reserves and potential capacity at 36 billion barrels and 3 mbd, respectively. The estimated reserves/production ratio, at 84 years, is exceeded by Iraq, Kuwait and Saudi Arabia among the World's oil producing countries.

In the U.A.E., the oil industry is regulated almost entirely at the emirate level. As a result, institutional arrangements, including theextent of government control, vary considerably among the various oil producing emirates.

Established in November 1971, the wholly state-owned Abu Dhabi National Oil Company (ADNOC) has a dominant position in the industry through its holdings in producing companies. The Abu Dhabi Marine Operating Company (ADMA-OPCO) and the Abu Dhabi company for onshore oil operations (ADCO), which together accounted for an estimated 88% of total Abu Dhabi production in 1984, are 60% owned by ADNOC.

Outside the ADNOC Group of companies, a number of smaller, entirely foreign-owned companies still operate in Abu Dhabi, including the Bunduq Oil Company, The Abu Al Bukoosh Oil Company, and the Amerada Hess Oil Company; these account for 12% of total oil production.

In addition to crude oil production, ADNOC has interest in many downstream activities. It owns and operates two refineries, it has a majority interest in a number of smaller companies that provides exploration, and production services such as drilling, production of drilling chemicals, construction of offshore facilities, and the construction and maintenance of oil and gas pipelines, and the marketing of domestic participation crude from ADCO and ADMA.

Government ownership of the oil industry is somewhat less extensive in the other emirates. The foreign-owned Dubai Petroleum Company (DPC) has continued to explore, produce, and market oil in Dubai, even though the Dubai government officially took full control of the oil industry in 1975. The DPC operates all the major fields in Dubai with the exception of the Morgham field, which was discovered by ARCO Dubai in 1982. Apart from DPC, a number of foreign companies are now exploring for oil in offshore areas.

Oil production in Sharjah at both the Sajaa and Mubarak fields is also in the hands of foreign companies. The Sharjah government, however, has acquired a 60% share in the Sharjah Liquefaction Company, an LPG project expected to come into operation in 1987, and a 51% share in the Sharjah Economic Development Corporation which is planning the construction of a fertilizer plant. In Ras Al-Khaimah, exploration and development activities are undertaken by Gulf Offshore Ras Al-Khaimah, which is 50% owned by the Emirate Government. In 1983 the Ajman Government established the Ajman National Oil Company in which it holds a minority share (18.4%).

Abu Dhabi is by far the largest producer of the seven emirates: its average daily production in 1983 was 0.78 million barrels. Dubai is the second largest, averaging 0.33 mbd in 1983, with Sharjah a distant third, having an average production of 0.04 mbd in 1983.

b. Output, exports, and prices.

Comprehensive data on oil output and exports have not been published since 1982. The estimates in TABLE (6) are based on partial data provided by the UAE. Central Bank, various national institutions concerned with the oil sector, and oil industry journals.

The U.A.E's output of crude oil and condensates was on a declining trend between 1977 and 1983, Falling to 1.18 mbd in 1980 from 2.00 mbd. This was due initially to conservationist policies pursued by Abu Dhabi, but after 1981 it reflected the UAE's efforts as a member of

OPEC to contribute toward the stabilization of the world oil market through output ceilings. In 1984 production declined marginally to 1.17 mbd, and as of November 1, 1984 the U.A.E. accepted a reduction in its OPEC production ceiling for: crude oil from 1.1 mbd to 950 thousand barrels daily (tbd).

Despite the generally weak world oil market, a level of production barely half that of 1977 and considerable excess capacity, Abu Dhabi has maintained an extensive development and exploration program in recent years, pursuing a policy of conserving existing fields and exploring for new hydrocarbon deposits. Currently, the major active oil sector project is an enhanced recovery program which aims at raising production capacity for the entire onshore concession to onemillion barrels daily in the 1990s, by using more advanced technology, optimizing recovery, and providing a 20-year production plateau from existing fields; in particular it aims at rectifying faults which have resulted from the previous uneven development of the fields.

In constrast to Abu Dhabi, Dubai has maintained a relatively stable level of crude oil production since 1977, between 330 tbd and 365 tbd, which is reported close to full capacity. Production did decrease to 334 tbd in 1983, the lowest level in six years, but increased by 4.2% in 1984.

TABLE 6 U.A.E. Production and Exports of Crude Oil and Condensates, 1977-84
(In Millions barrels)

	Total U.A.E.	Total Daily Average
Production		
1977	729.5	2.00
1978	668.3	1.83
1979[1]	668.3	1.83
1980	626.0	1.71
1981	548.2	1.59
1982	462.4	1.27
1983	429.7	1.18
1984[2]	425.6	1.17
Exports		
1977	725.8	1.99
1978	664.9	1.82
1979	659.0	1.81
1980	621.1	1.70
1981	519.1	1.42
1982	427.5	1.17
1983	381.2	1.04
1984[2]	373.7	1.02

SOURCE: Ministry of Petroleum and Mineral Resources, Central Bank, Various Oil Publications. Year 1985

[1] In February 1979, the Abu Dhabi: Petroleum Co.'s Operations were taken by ADCO.

[2] Preliminary Estimates.

As a result of themore intensive exploitation of the existing fields, the potential production span of the most important fields in Dubai could be relatively short. In order to forestall a drop in production in the near future, the Dubai Government allocated seven more concessions in 1983, thereby making available for exploration theentire onshore and offshore land area of the emirate.

Oil pricing policies differ significantly among the emirates, Abu Dhabi prices are largely determined within the framework of the OPEC Agreement (TABLE 7). After the surge recorded in 1979-80, oil prices have been under constant pressure; a number of small downward adjustments were carried out in 1981-82. Moreover, effective March 1, 1983 official selling prices for the U.A.E's crude oil exports were reduced by US $ 5 per barrel as agreed within OPEC. Prices in 1985 were reduced twice and settled at $ 1.16 per barrel on February 1,1985.

Mirroring price and volume development, export receipts have fluctuated considerably in recent years. Despite a decrease in export volume, oil exports rose to a record of US $ 19.4 billion in 1980 from US $ 12.9 billion in 1979. After recording a small decline(6%) in 1981, export receipts fell 21% in both 1982 and 1983.

TABLE 7 U.A.E: Selling Prices of Representative Crude Oils, 1981-85

(In U.S. dollars per barrel).

	Abu Dhabi						Dubai	Sharjah
	Murban	Umm Shaif	Zakum & Bunduq	Mubarraz	Abu Al Bukhoosh	Arzanah	Tateh	Mubarek
Official selling prices effective from:								
Jan 1,81	36.56	36.36	36.46	36.40	35.75	36.71	35.93	36.62
Nov 1,81	35.70	35.50	35.60	35.54	34.89	35.85	33.86	35.76
Jan 1,82	35.50	36.30	35.40	35.34	34.69	35.65	33.86	35.56
Mar 20,82	34.56	34.36	34.46	34.38	33.95	34.71	33.86	34.62
Mar 1,83	29.56	29.36	29.46	29.38	28.95	29.71	28.86	29.62
Jan 1, 85	29.31	29.11	29.21	-	-	-	-	-
Feb 1, 85	28.15	28.06	28.10	-	-	-	-	-

SOURCES: Department of Petroleum in Abu Dhabi, Various Oil Publications. Year 1985.

While in 1982 a decrease in export volume accounted for most of the decline, in 1983 export volume fell by 11% and average export prices by about 9%. Oil exports in 1984 are tentatively estimated to have been roughly at the previous year's level with no significant changes in either average prices or volume.

Energy consumption has grown rapidly in the UAE, as a result of the growing population, increasing industrialization and the subsidization of energy prices. The consumption of refined energy productsincreased from 79 tbd in 1980 to 92 tbd in 1981 and 114 tbd in 1982.

In order to curb the growth in consumption demand and also to reduce government expenditures of increasing fiscal pressures, the government raised the price of gasoline by 15% in 1982. The price was further increased in May 1983 by 23-40%, after a brief period during which gas stations closed as EGPC (Emirates General Petroleum Corporation) discontinued deliveries as a result of its failure to obtain subsidy payments from the Ministry of Finance. On May 4, 1983 the U.A.E. introduced for the first time a country wide uniform price system for refined product sales, raising the prices of these products by 31.2-36.4% and eliminating all subsidies; all Petroleum products are now marketed at international prices plus distribution costs.

c. Oil Revenues.

Oil revenues provide almost 90% of total government revenues. In addition to the net proceeds received as a result of joint ventures a production sharing arrangements, foreign companies are taxed on the basis of a royalty on the posted price for each barrel of equity oil marketed by the companies as well as through an income tax levied on net receipts computed on the basis of the posted price less production costs and royalty payments on a per barrel basis. Estimates of net domestic receipts shown in Table (8). should be treated with caution as official data on production costs are not available and the margin of error on the estimates might well be large. Furthermore, while royalty levies and income tax rates in Abu Dhabi have remained unchanged in recent years at 20% and 85%, respectively, tax arrangements in Dubai and Sharjah are not known; it has assumed that they are comparable to Abu Dhabi's.

The U.A.E.'s net domestic oil receipts are estimated to have been halved between 1980 and 1984. To a large extent, this mirrored a 40% decrease in export value but production costsalso rose during this period resulting in lower income tax payments. Production costs, which have always been high in the UAE relative to those elsewhere in the Arabian Peninsula, have escalated further since 1981 because of higher capital changes resulting from unsuccessful exploration activities, particularly in

TABLE 8: Estimated Net Domestic Oil Receipts[1] and Exports, 1978-84.

(In Millions of U.S. dollars)

	Net Domestic Oil Receipts				Oil Exports
	Abu Dhabi	Dubai	Sharjah[2]	Total	Total
1978	5,923	1,378	37	7,338	8,679
1979	9,191	2,232	37	11,460	12,875
1980	13,885	3,607	46	17,538	19,440
1981	13,380	3,897	56	17,341	18,306
1982	9,846	3,801	38	13,685	14,465
1983	6,049	2,865	156	9,070	11,441
1984	5,088	2,605	510	8,203	11,700

SOURCE: U.A.E. Central Bank. Year 1985.

[1]Total estimated domestic receipts from oil exports net of production costs and foreign profits. Includes revenue retained by the Rulers and by ADNOC. These estimates of oil receipts are higher than those derived from the budgetary data.

[2]Exludes the Islamic Republic of Iran's one-half share of receipts.

the Khuff region. The 10% decrease in net domestic revenue for the U.A.E. as a whole in 1984 was due to an increase in production costs from the higher cost of newly installed capital equipment and a shortening of the period allowed for its amortization.

The decline in net domestic revenues was particularly sharp in Abu Dhabi, where such revenues in 1984 were the equivalent of only 37% of their 1980 level. Average net domestic revenue per barrel declined from nearly US $ 35 per barrel in 1981 to just over US $ 23 in 1984. The Abu Dhabi share is estimated UAE net domestic oil revenues was reduced to 62% in 1984 from 81% in 1978.

(ii) UAE Allocation of Oil Revenues.

Oil revenue is taken to mean all payments received by the States from the working oil companies, that is, income tax, royalties, bonuses, rent and import duties. In order to understand the allocational pattern employed by the government, a model is simulated that relates oil revenues to expenditure.

The expenditure of Oil Revenue will be considered under five main headings: current expenditure, capital expenditure, the allocation to the ruling family, expenditure on Land purchase schemes, and finally allocation to the reserve fund. Each of these main items is broken down into functional allocations, for example, current expenditure on social services, current expenditure on public utilities etc., in order to show the structural change and development of the public revenue, public expenditure and public reserve and to indicate the role played by oil revenues.

In the analytical model illustrated in Figure 3 the following terms require definition:

- Annual oil revenue: All revenue received by the States in one fiscal year.
- Oil revenue spent: Annual oil revenue minus any allocation to the reserve fund; plus any sum withdrawn from the reserve fund to finance public expenditure.
- Annual available oil revenue: Annual oil reserve plus any sum withdrawn from the reserve fund to finance public expenditure.
- Net allocation of total oil revenue: The final actual allocation of the total oil revenue received in the period studied.
- Gross deficit: Total deficit caused by the failure of the self-revenue of any particular group of services to cover their expenditure.
- Total gross deficit: The total deficit on all public services and other allocations reckoned against their total internal revenue.

- Proportional contribution of oil revenue spent: The proportional contribution of oil revenue spent to meet the gross deficit.

- The Model itself is built as follows:

  Set One: Revenue

  1. All Revenue is divided into groups, for example, oil revenue, revenue from social services, revenue from public utilities etc.

  2. Each group is divided into subgroups for example, social services are divided into education, health, social affairs etc.

  3. All revenue information available about every subgroup, starting with the total public revenue received in any fiscal year, is used as input data.

  4. From the information noted in 3 above, the following can be calculated: (a) the total revenue received by any group of services; (b) the revenue of the administration and others; computed as follows: the revenue of the administration and others = total Public revenue - (Total revenue of Group 1 + Group 2 + ... + Group n - 1); and (c) a summary Table including totals of all groups and the grand total.

Set Two: Expenditure

1. Expenditure is organized by the same method as that used for organizing revenue, that is it is divided into groups and subgroups.

2. Group totals are computed, the total for administration and others, and the summary Table as was done in Set One, 4(a), (b), and (c).

3. The following is then computed: (a) Oil revenue spent = annual oil revenue minus allocation to, or plus withdrawal from, the reserve fund; (b) allocation to the reserve fund = annual oil revenue minus oil revenue spent.

Set Three:

1. Set Three = Set One minus Set Two

2. From the summary table in Set Three the following is computed: (a) Gross deficit: Gross deficit on each group of services' self revenue; (b) total gross deficit: The total of the gross deficits of all the groups.

3. Proportional Contribution of oil revenue spent to meet all services' deficit ex-

pressed as a percentage.

$$\frac{\text{Oil Revenue}}{\text{Total Gross deficit}} \times 100$$

4. Allocation of oil revenue spent = proportional contribution of oil revenue spent x gross deficit.

5. Allocation of annual available oil revenue is the allocation of annual available oil revenue to items of expenditure and reserve.

6. Net allocation of total oil revenue: actual allocation of all oil revenues received during the period studied. At this stage the reserve fund maybe regarded as an intermediary account where oil revenue is kept until need arises. This, when presenting structural change in oil revenue allocational pattern structure, it should be noted that, though in most years the annual available oil revenue equals the annual oil revenue, it could be larger when public expenditure is additionally financed from the reserve.

Let us consider the allocational pattern in Abu Dhabi for the years 1982 - 1983:

Public Revenue: Total Revenue received from both current and capital receipts equalled in 1983 Dh 21516.4.

Figure 3[1] Simplified Form of the data computing model

Set One	Set Two	Set Three
Revenue total	Expenditure total	Surplus or Deficit
Year 1978 1300	1978 1200	1978 100
1900 1984 Total TR	1984 Total 1950 TE	1984 - 50
G_1 Oil Revenue	G_1 (Oil)	Oil
950	0	950
1800	0	1800
G_2 Social Services	G_2 Social Service	Social Services
6 11 2	20 6 19	-14 5 -12
20 4 0	100 25 40	= 80 21 40
Gn-1 Capital item	Gn - 1	Gn - 1
0 0	25 12	-15 -12
0 0	200 150	200 150
(G_N) Others	G_N Others	G_N Others
Computed as Total Annual Revenue - Total Annual Revenues of $(G_1+G_2+.....+G_N 1)$	Computed as: Total Annual Expenditure - Total Annual expenditure of $G_1+G_2...+G_N-1)$	Revenue - Expenditure .....
Summary Table	Summary Table	Summary Table

Yr.	G_1	G_2	..G_N	Total
'78	950	19	.....	...
'84	1800	24	...	...
T.	... ..		...	...

Yr.	G_1	G_2	... G_N	T.
'78	0	45	... ..	..
'84	0	165	... ..	..
T.	...	...	... ..	..

Yr.	G_1	G_2...	G_N	T.
'78	950	-26	...	...
'84	1800	141	...	...
T.	... ..		...	...

[1]Al-Kuwari, "Oil Revenues in Gulf Emirates" 1978, Pp 73.

This is shown in Table (9). The main feature as shown in the Table is the overwhelming dependence on oil revenue. The other sources of revenue represent only 12% of total revenue received during the year.

Public Expenditure: Total Expenditures amounted Dh 22168.3 in 1983. Expenditures are divided into capital and current expenditures which declined during the period from 1979-83. due to the conservative attitude assumed by the government. Abu Dhabi government expenditure is shown in Table 10.

So, Oil Revenues are allocated among the following:

1- Expenditures (shown in Table 10).

2- Ruling Family: The allocation pattern is, unfortunately, not available for the period studied.

3- Reserve fund account: The allocation to this item tended to fluctuate. In fact, no special attention was given to building a state reserve, and thus the allocation to the reserve fund is determined by the needs of other allocations.

It is, thus, unrealistic to determine the exact allocational pattern during this period with the presence of information shortage.

We can only summarize, that, even though expenditures are declining, the government is always in a deficit position. In the period where the country was experiencing growth and development, oil revenues were spent on large projects, and thus large amounts were reported as expenditures.

Later, during the period of 1982 and up to now, oil revenues are continuously downward sloping resulting in a decline in expenditures spent on development. This situation is due to the weak demand in the oil market, thus, depressing oil prices and deteriorating the economic acitivity of U.A.E. Consequently the trend is an ever-existing deficit position in the U.A.E. Government since 1980. Other sources reported actual deficits in 1983 at Dh 3, 668.4 rather than only Dh 651.9. This shows the following:

1- The unreliability of most statistical information reported by the government.

2- The expenditures figure was far beyond than estimated during the year. Certain expenditure items are recorded without investigation where no details are available on such items.

In 1984, provisional estimates of government deficit was reported at Dh(2793) of which Dh 1, 563 million was financed by borrowing. This figure as compared to 1983 depends largely on the ability of Abu Dhabi government in controlling its actual expenditures and Revenues in order

TABLE 9:

Abu Dhabi Government Revenues by

Source - 1982 - 83

Revenues	1983	1982
Current Receipts:		
- Petroleum Royalties and taxes	19000	27495.1
- Recurrent Depatment Revenues	970	1802.2
Total	19970.9	29297.3
Capital Receipts		
- Grants	-	-
- Foreign Government Loans	853.7	168.3
- Capital Receipts	-	-
- Payments of internal loans	691.8	632.7
- Other Capital Receipts	-	0.7
Total	1545.5	801.7
Total Revenue	21516.4	30099

SOURCE: Abu Dahbi, Statistical Yearbook 1983.

TABLE 10:

Abu Dhabi Government Expenditure
by Economic Classification

1982 - 1983

Economic Classification	1983	1982
Current Expenditures		
- Wages and Salaries	1300.9	1446.2
- Purchase of Goods and Service	1596.6	1987.0
- Miscellaneous Transfers	669.0	1105.3
Total	3566.5	4538.5
Contribution to U.A.E. Budget	9500	13379
Capital Expenditure		
- Gross Capital formation	4805.4	5461.9
- Miscellaneous Capital transfer	4296.4	6174.9
Total	9101.8	11636.3
Total General Expenditure	22168.3	29553.8

SOURCE: Abu Dhabi Statistical Yearbook 1983.

TABLE 11:

The Gross Surplus of Abu Dhabi Government 1982-83.

Surplus	1983	1982
- Total Current Receipts	19970.9	29297.3
Total Current Exp.	13066.5	17917.5
Surplus on Current A/c	6904.4	11379.8
- Total capital Receipts	1545.5	801.7
Total Capital Exp.	9101.8	11636.3
Deficit on Capital A/c	(7556.3)	(10834.6)
Gross Surplus	(651.9)	545.2

SOURCE: Abu Dhabi Statistical Yearbook 1983.

to achieve a level of minimum variances with budgeted figures.

However, the unstability of the oil market, and the presence of recession characterizing the Gulf economy in general provide a challenge to the U.A.E. Government.

(iii) Oil Revenues and Government Development Expenditures.

The sharp increase in petroleum revenues after 1979 enabled the authorities to expand total outlays rapidly. The rapid growth in current expenditures was associated with a steep rise in all expenditure categories, namely wages and salaries, purchases of goods and other services, and subsidies and transfers. The large increases in subsidies and transfers recorded in 1980 and 1981 reflected mainly substantial compensation and transfer payments made by Abu Dhabi Government to nationals for Land and Building acquired for public use; Federal government also increased in both these years. Since a considerable portion of the country's infrastructure had been established by 1980, and given the longer planning period associated with development projects, the growth of development expenditures was not as pronounced as that of other expenditures. Never-the-less, development outlays increased by about 23% in 1981, with about one third of development expenditures spent on water, gas, and electricity projects.

With the decline in revenues after 1981, government development expenditures policy has aimed at containing the size of the emerging fiscal deficits without unduly affecting the quality of services provided by the public sector. With no large projects initiated after 1982, development expenditures declined across the board, from a peak of Dh 10.2 billion in 1982 to Dh 6.4 billion in 1984.

As had also been the case with respect to the increase in expenditures during the 1979-81 period, the subsequent reduction in budget expenditures was not uniform among the federal and emirate governments, reflecting partly varying oil production policies at the emirate level. Table (12) shows a consolidated Government Development Expenditures as compared to oil receipts during the period 1980-84:

TABLE 12: Government Development Expenditures
1980-84
(In Millions of dirhams)

Year	General Adm. and defense	Education	Health	Housing	Other Social Services
1980	176.8	237.5	129.5	1,151.2	36.4
1981	319.7	257.9	123.4	1,244.1	454.3
1982	369.2	163.2	342.4	956.7	437.6
1983	366.3	151.3	121.8	757.2	332.8
1984	292.9	78.3	70.2	784.8	216.6

Year	Economic Services	Agriculture & Fishing	Manufacturing Construction	Water Elect. And Gas
1980	5,132.4	(151.9)	(1,933.0)	(1,818.6)
1981	6,504.9	(282.4)	(1,268.7)	(3,011.6)
1982	6,888.3	(292.0)	(1,540.9)	(3,412)
1983	6,242.3	(328.7)	(1,311.9)	(3,365)
1984	4,618.8	(191.1)	(988.1)	(2,498)

Year	Communication & Transport	Other	Not Allocated
1980	(2,017.6)	(56.3)	415.7
1981	(1,839.3)	(102.9)	(454)
1982	(1,533.7)	(109.2)	1,069.2
1983	(1,222)	(12.3)	1,537.1
1984			356.6

SOURCE: Ministry of Finance and Industry. Year 1985.

TABLE 12 (Cont'd) : Percentage Change in Total Development expenditures as compared to percentage change in Oil receipts.

Year	Oil Receipts	Approx. % Change	Total Dev. Exps.	Approx. % Change
80	44,597.3	-	7,604.7	-
81	45,912.7	2.9%	9,358.2	23.5%
82	34,709.4	(24%)	10,226.6	9%
83	26,475.3	(24%)	8,506.8	(17%)
84[1]	24,231.4	(8%)	6,418.2	(24%)

[1]Provisional

Notes on Table 12:

1- In the year 1981, as oil revenues increased by 2.9% only, there was an increase in development expenditures of 23.5%. This shows the extravagant government spending during the period of economic growth on prestigeous projects.

2- In year 1982, Oil revenues dropped by 24%, there was a slight increase of 9% in development expenditures, representing spending by the government on unfinished projects.

3- In the following periods of 83 and 84, oil revenues dropped still further, but at a lower rate than in previous years, development expenditures declined sharply i.e. at an increasing rate.

4- This Table shows the relationship between oil revenues and amount spent by government on development. Eventhough, observation taken (Number of years)..... is small, but it gives an insight of what might happen in the near future i.e. as long as oil receipts are falling, development programs and expenditures will fall also. This depends, however, on the fiscal policies assumed by the government.

5- This Table cannot clearly identify the rate developmental expenditures decline with the drop of oil revenues. Other factors has to be considered as development expenditures is only one item of the total allocational pattern.

6- This Table shows amount spent on development, but doesn't depict economic development in real terms.

7- Other Sources of revenue are assumed to have minor significance on the % change in development expenditures.

IV. FACTORS DETERMINING THE ALLOCATION OF OIL REVENUES.

For the purpose of clarification, factors affecting the allocational pattern are divided into two categories: (a) Specific, (b) and General.

Specific factors are:

a- Factors which have affected the growth of current expenditure:

1. Overstaffing in Public Sectors
2. Increasing Demand for Social Services.
3. Policies concerning the pricing of Public goods and Service in order to subsidize the production of these goods and services.
4. The increasing Expense of Maintenance.
5. The Socially Pervasive nature of Current Expenditure.
6. Establishment of new ministries and government agencies.

(b) Factors affecting the allocation to capital Expenditure:

1. The Need to build-up the physical infrastructure and develop the public utilities.
2. The Need for planning.
3. Pressure from other allocation, particularly those to current expenditure and the ruling family.
4. Absorptive capacity of the Construction Sector.

(c) Factors affecting the allocation to the Ruling family:

1. Influence of history or pre-oil practices on the allocational pattern.
2. Limits on the Ruler's Absolute Power
3. The effect of the constitutional stage.

4. The peculiarity of the Source of oil revenue

(d) Factors affecting the Allocation to Reserve Funds.

1. Government Financial Administration Policies.
2. Pressures from other items of Expenditure.
3. The Poor achievement of the Reserve Fund Investments in the Past.
4. Availability of Surpluses.

General factors are:

a- Social impact: The social attitudes and mentality of the people of the U.A.E. have been the main factors in determining the pattern by which their oil revenues were allocated. Their belief in chance, their tendency concept of sharing natural wealth, their concept of the state's role in economic life, and their educational status have all been active factors pushing governments in a certain direction in their channelling of oil revenues.

b- Political impact: Great democracy and increasing Public participation in governments have changed the allocation of oil revenues. At present direct allocation to themembers of the ruling families no longer exists, and the proportional allocation to the rulers is considerably reduced. However, although the political effects have been reduced, they have by no means disappeared and in fact still play a considerable role. Also, we should not forget external pressures; illustrated by the pressure from the British government and to a lesser extent pressure from the Arab World, in affecting the channels through which oil revenues have been allocated. Internal pressures exerted by different sectors of society have great influence. However, with increasing education, democracy, and world wide contact, internal pressure seems to favor social and economic policies designed to utilize oil rewenues in more productive ways.

c- Economic Impact: The economic impact results from the limited resources of the emirates, the economic consequences of their small size, and excess oil revenues. These are the main economic factors affecting the allocational patterns of the emirates' oil revenues. The lack of natural resources, the small size of the population, and the small markets limit the opportunities to attract the income derived from the exploitation of petroleum resources. Receipt of oil revenues above the level which the local economies can productively absorb makes it easy for the government to use these revenues to satisfy all demands from various sectors of the society, even when such demands are economically unproductive.

d- Gegraphical Impact: The characteristics of the location and surrounding region of the U.A.E. have had two major effects on the allocational pattern of oil revenue. The first effect springs from the emirates' resource base and the degree of regional different action. The regional similarity in resource base (petroleum) has reduced to a minimum or even precluded opportunities for comparative advantage which might be grasped if other countries in the region were lacking petroleum resources. The second effect maybe located to locational factors.

Among these the most important factors are the relative cultural isolation and the macro-regional absence of perceived or obvious opportunities for investment.

e- Administrative Impact: The emirates' oil revenues offered golden opportunities for the governments to avoid one of the main problems in the process of economic development, that is the problem of the mobilization of financial resources for purposes of productive investment. But, due partly to the lack of Long-term strategies for economic and social development, the governments failed to produce the necessary plans to allow the productive channelling of these resources, and the absence of such guidelines also led to considerable waste. The absence of a clear and well-defined long-term strategy will encourage long-term wrong practices creating wrong economic incentives.

With the increasing dependence of the population on the State to provide social services free of charge, and the increasing realization of the poor achievement of past policies by the government organizations and political institutions, an effective and balanced policy is required to produce the necessary alteration to minimize the long-term effects of problems hindering economic and social growth. However, those who are the decision-makers in the emirates' have only recently begun to recognize the presence of problems. The first effect of their realization had been a restraint on the growth of certain allocations and raised some questions such as the overstaffing of the public sector and its effect on economic development.

These are in brief the principal factors which have determined the broadly-based policies of allocating oil revenues in the emirates. The summary exploration of these factors has shed light on their underlying causes; causes which must be understood and dealt with in a proper way if any alternation of the prevailing pattern of oil revenue allocation is to be affected.

Figure 4. **MONEY SUPPLY**

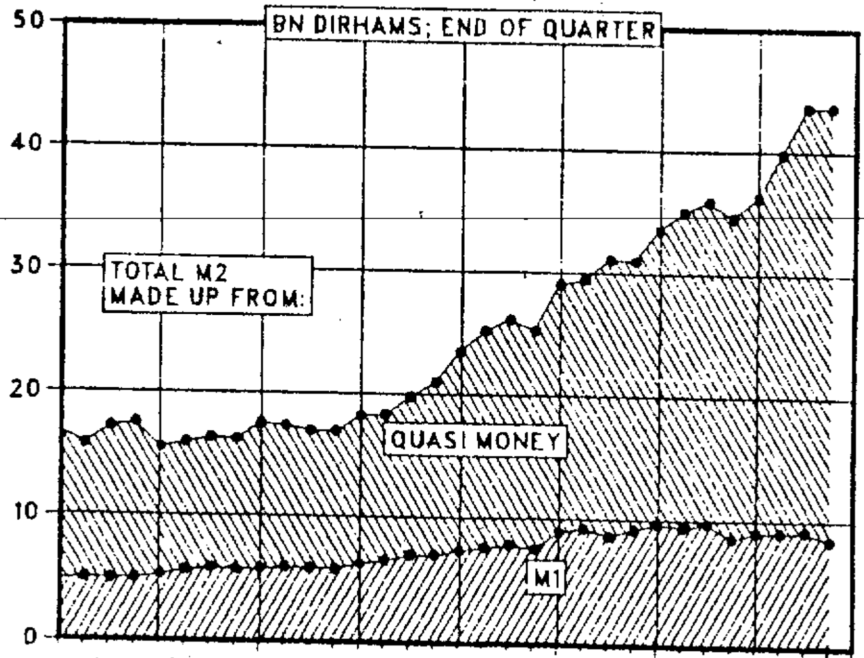
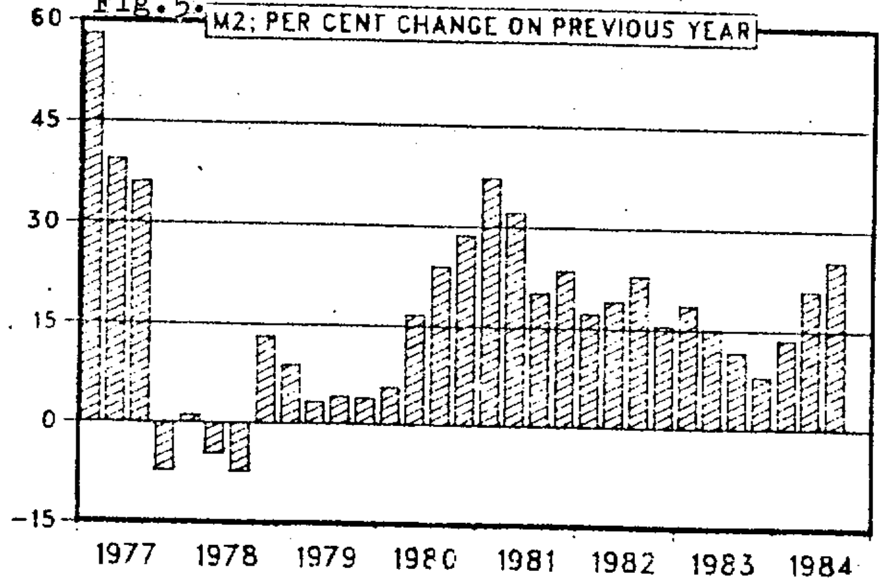


Fig.5.



V. OIL SECTOR PROBLEMS:

The UAE has invested heavily in the Petroleum Sector. However, the prospects of this Sector are quite uncertain considering the following problems: intense competition abroad with the discovery of new oil extracts. The decline in oil production and oil revenues, the limited domestic market, the inability of the Gulf States to agree on the pricing policies and production quota of each state, the declining monopoly power of the OPEC, and Finally, the pressure and political games, exerted by the developed countries on the Gulf State governments. Solutions to these problems are far from being foreseen in the near future.

B. ECONOMIC DEVELOPMENT OF THE FINANCIAL SECTOR

(i) Institutional developments: The banking system in the U.A.E. comprises the Central Bank, 24 domistic commercial bank (166 branches), 29 foreign commercial banks (126 branches), 3 restricted license banks (no branches),[17] 13 foreign bank representative offices, specialized banks and financial institutions and a number of money changers.

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[17] Restricted Licence banks are international banks authorized to conduct international operations in the UAE, but prohibited from engaging in domestic retail banking and and from accepting deposits from residents.

The Central Bank has imposed a moratorium on the opening of new foreign banks and operates a restrictive policy in granting licenses to new domestic banks. Financial institutions applying for licenses from the Central Bank must be joint-stock companies of limited liability; capital must not be less than Dh 50 million and the share of U.A.E. nationals must at no time form less than two thirds of the company's board of directors; the chairman of the board should in all cases be a U.A.E. national. In response to a Central Bank directive that the number of branches of Foreign Banks not exceed (8) for each bank, a total of (72) such branches were closed in 1982 and 1983. In October 1982 an Industrial bank was established to provide long-term finance to the manufacturing sector.

During the mid-1970s, the rapid growth of oil export earnings and the concurrent increase in domestic economic activity gave use to a proliferation of banking institutions.

In 1977 some banks became seriously overextended; this, in combination with a highly inflationary situation and speculation against the national currency, led to a banking crisis. In response, the monetary authority, the Currency Board, was converted in December 1980 into a Central bank with greatly enhanced powers of bank regulation and supervision.

A major concern of the Central Bank its inception has been to maintain adequate liquidity for the banking system and to strengthen the commercial banks' financial structure. To this end, the Central bank has introduced more regorous supervision and auditing of commercial banks and has tightened reserve and capital requirements. Commercial banks are now required to provide the Central bank with comprehensive data on transactions with main offices or branches abroad and on other aspects of their operations, as well as to publish externally audited financial statments. Directives have also been issued (1) requiring banks to adjust their paid-up capital to a minimum of Dh 40 million or, for banks having total assets over Dh 600 million, to maintain at all times a minimum capital assets ratio of 1.15, (2) requiring banks to establish special reserves by transferring at least 10 percent of annual net profits until the reserveis equal to 50% of capital, and (3) requiring banks to prepare and submit annual accounts for evaluation by the Central bank, whose authorization is required for any payment of dividends by individual banks. With regard to the quality of bank credit, the Central bank has established a Risk Bureau, which collates credit information on individuals with accounts in different banks. By the end of 1984, most banks had complied with a Central bank directive that loans extended to individual directors not exceed 5% of their capital and that total loans to a bank's board of directors not exceed 25% thereof.

All money changers are required to obtain a license from the Central bank. Capital must not be less than Dh 500,000 and local participation in the business must not be less than 60% of capital. All money exchange houses are required to provide a bank guarantee of 30% of the minimum capital in favor of the Central bank.

During 1984 the Central bank took various steps to improve accounting practices among the commercial banks and to increase their provisions against bad and doubtful debts. With respect to disaggregate their loan portfolios into four categories: Unclassified, substandard, doubtful, and lost. A provision of 100% was required against the last category as well as against the amounts of expected losses or loans classified as substandard or doubtful. Also, banks were instructed to credit interest on loans by more than six months to an "interest in suspense" account and not to the profit and loss account.

(ii) Monetary developments: Monetary data for 1984 provided by the Central Bank differs in coverage from those of previous years in that a one-time change in reporting requirements by commercial banks entailed an upward adjustment during the year of Dh 10 billion in foreign exchange deposits maintained with the banks by residents and include in quasi-monetary deposits, matched by a corresponding upward adjustment in the net foreign asset position of the commercial banks themselves. Although most of the deposits concerned are believed to have been received by the banks in earlier years, it has not been possible to make retroactive corrections in the monetary accounts, therefore, the full amount of the Dh 10 billion foreign exchange deposits has been omitted from the monetary accounts, as shown in Table (13), to allow comparison with previous years.

After taking into account this downward adjustment in quasi money recorded as outstanding at end-1984, domestic liquidity increased by only Dh 500 million in 1984. This, the decelerating trend of domestic liquidity expansion which characterized monetary developments in both 1982 and 1983 and continued in 1984, at less than 2% during the year excluding the effect of the change in statistical coverage, domestic liquidity expansion wassharply lower than the rate of 8% recorded in 1983. For the second

TABLE 13. U.A.E.: Factors affecting Changes in Domestic Liquiduty, 1980 - 84

Changes During Period	1980	1981	1982	1983	1984[1]
			(In Millions of dirhams)		
Foreign assets (net)	6.663	8,583	3,540	-1,448	4,313
Foreign assets	8,293	14,178	7,023	-2,688	-227
Foreign liabilities[2]	-1,630	-5,595	-3,483	1,240	4,540
Domestic assets (net)	-1,310	-3,012	1,023	4,135	-3,813
Claims on government (net)	-3063	-2,768	3,383	3,738	-280
Claims on private sector & official entities	3,992	4,921	1,595	1,633	-328
Capital & reserves	- 1390	-4,188	-3,540	-1,470	-469
Other items (net)[3]	- 849	-977	-415	234	-2,736
Domestic Liquidity	5,353	5,571	4,563	2,687	500
Money	1,086	1,614	770	-615	-233
Quasi-Money	4,267	3,957	3,793	3,302	733
		(In Percent)			
Claims on private sector and official entities	17.7	18.5	5.1	4.9	- 0.9
Domestic liquiduty	29.3	23.6	15.6	8.0	1.4
Money	(17.3)	(22.0)	(8.6)	(6.3)	(-2.6)
Quasi-Money	(35.6)	(24.4)	(18.6)	(13.8)	(2.7)

Source: U.A.E. Central Bank. 1985

[1]Data for 1984 exclude Dh 10 billion of foreign assets and Quasi-monetary liabilities which reflect a one-time change in reporting requirements by commercial banks in 1984.

[2]Increase in Foreign liabilities (-)

[3]Increase in net liabilities (-)

year in a row, the narrow money component of domestic liquidity fell in 1984 (by 2.6% compared with 6.3% in 1983), reflecting the continued weakness of activity in the economy's non-oil sectors and associated decline in demand for transaction balances.

Domestic credit (claims on the private sector and official entities), which had increased by 5% per annum in the preceding two-year period, declined by about 1% in 1984. In Table (14), outstanding commercial bank credit is shown to have increased by some Dh 0.8 billion during 1984 (2.4%); however, this is wholly accounted for by an increase of about Dh 1.1 billion in claims on "other financial institutions". Construction and trade credit declined by 2.5% and 3.5%, respectively, while the relatively minor amounts of credit outstanding for agriculture, mining and quarrying, and transport, stage and communications each increased significantly in 1984 (by 10-26%). The net foreign asset position of the commercial banks increased more than twofold in 1984, to Dh 23.6 billion by the end of the year; however, excluding the Dh 10 billion of foreign assets held as a counterpart to the newly recorded foreign exchange deposits held by residents with the commercial banks, the net foreign asset position of the commercial banks increased by about Dh 3.3 billion in 1984 compared with about Dh 1.8 billion in 1983

Table 14: UAE Distribution of Commercial Bank Credit by Economic Activity. 1980 - 1984.[1]

(In millions of dollars)

	1980	1981	1982	1983	1984
Agriculture	103.7	105.8	111.5	135.7	171.5
Mining and quarrying	251.0	475.2	194.8	404.7	455.9
Manufacturing	2,031.4	2,147.1	2,096.4	2,039.1	2,013.8
Electicity, gas and water	-	0.1	0.7	53.4	7.8
Construction	9,346.7	10,988.3	10,385.3	10,770.0	10,497.2
Trade	11,252.4	12,849.9	14,095.8	14,758.6	14,241.7
Wholesale[2]	(8,963.9)	(10347.8)	(11,084.5)	(11,746.6)	(11,105.4)
Retail	(2,288.6)	(2,502.2	(3,011.3)	(3,012.0)	(3,136.3)
Transport, storage, & communications	657.2	903.1	882.0	910.0	1,002.6
Other finanical institutions	557.8	479.5	573.5	816.6	1,929.6
Other	2,808.8	3,851.4	5,162.6	5,502.0	5,907.0
Total	27,009	31,800.4	33,502.6	35,390.1	36,227.1

SOURCE: U.A.E. Central Bank

[1]Credit to the domestic private sector and official entities; excludes loans to banks. Classification is based on main business activity of the borrower.

[2]Includes Credit for imports.

TABLE 15: U.A.E. Monetary Survey, 1980 - 1984[1]
(In millions of dirhams)

End of Period	1980	1981	1982	1983	1984[2]
Net foreign assets	9,548.9	18,131.5	21,672.3	20,224.6	34,537.7
Foreign assets	28,279.4	42,457.0	49,480.3	46,792.5	56,565.9
Monetary authority	(7,482.6)	(12,181.6)	(12,627.1)	(9,572.1)	(10,457.1)
Commercial banks	(19,406.4)	(29,053.5)	(35,052.4)	(35,013.9)	(44,421.3)
Restricted license banks	(1,390.4)	(1,221.9)	(1,800.8)	(2,206.5)	(1,686.7)
Foreign liabilities	-18,730.5	-24,325.5	-27,808	-26,567.9	-22,028.2
Monetary authority	(-390.1)	(-233.3)	-(7.7)	-(6.3)	- (5.2)
Restricted License banks	(-1,559.7)	(-1,541.5)	(-1,260.7)	(-1,894)	(-1,221.2)
Commercial banks	(-16,780.7)	(-22,550.7)	(-26,539.6)	(-24,667.6)	(20,801.)
Domestic assets (net)	14,044.9	11,033.6	12,056.2	16,191.2	12,378.9
- Claims on Government (net)	-5777	-8,544.9	-5,161.6	-1,423.4	-1,703
Claims	(3,618.9)	(3,591.9)	(4,752.1)	(5,253.6)	(5,372.7)
Deposits	(-9,395.9)	(-12,136)	(-9,913.7)	(-6,677)	(-7,075.7)
- Claims on official entities	963.8	1,131.9	1,027.7	921.1	751
- Claims on private sector	25,593	30,345.9	32,044.4	33,784.6	33,627.1
- Cliams on other financial institutions	619.6	543.0	927.5	1,236.4	2,349.1
- Capital & reserves	-6,117.4	-10,305.3	-13,845.2	-15,314.9	75,783.6
- Other items (net liabilities)	-1,237.1	-2,137.1	2,936.6	-3,012.6	-6,861.7
Money & quasi-money	23,593.8	29,165.1	33,728.5	36,415.8	46,916.6
Currency outside banks	2,142.5	2,770.8	2,989.6	2,878.8	2,929
Monetary and Quasi-monetary depsosits	21,451.3	26,394.3	30,739.0	33,537	43,987.6
Monetary deposits	(5,211.8)	(6,198)	(6,749)	(6,245.4)	(5,962)
Quasi-Monetary deposits	(16,239.5)	(20,196.3)	(23,990)	(27,291.6)	(38,052)

SOURCE: Central Bank 1985. [1]includes restricted license banks. [2]Data for 84 include Dh 10 billion of foreign assets & quasi monetary liabilities which reflect a change in reporting requirements.

TABLE 16: U.A.E. Banking System's Holdings of Net Foreign Assets,1980-84

(In millions of dirhams)

End of Period	1980	1981	1982	1983	1984
Foreign assets (net)	9,548.9	18,131.5	21,672.3	20,224.6	34,537.7
Monetary authority	7,092.5	11,948.3	12,619.4	9,565.8	10,452.7
Foreign assets	(7,482.6)	(12,181.6)	(12,627.1)	(9.572.1)	(10,457.9)
Foreign liabilities	(390.1)	(,233.3)	(7.7)	(6.3)	(5.2)
Commercial banks	2,625.7	6,502.8	8,512.8	10,346.3	23,619.5
Foreign assets	(19,406.4)	(29,053.5)	(35,052.4)	(35,013.9)	(44,421.3)[1]
Foreign liabilities	(16,780.7)	(22,550.7)	(26,539.6)	(24,667.6)	(20,801.8)
Restricted license banks	-169.3	-319.6	540.1	312.5	465.5
Foreign assets	(1,390.4)	(1,221.9)	(1,800.8)	(2,206.5)	(1,686.7)
Foreign liabilities	(1,559.7)	(1,541.5)	(11,260.7)	(1,894.0)	(1,221.2)
Memorandum items					
Foreign currency deposits	5444	7,653.8	7,330.8	6,933.3	16,524.5
With Commercial banks	5,376.6	7,582	7,248.1	6,859.2	16,477.4[1]
With restricted license bks.	67.4	71.8	82.7	74.1	47.1

SOURCE: U.A.E. Central Bank. 1985

[1] includes the Dh 10 billion in foreign assets/foreign currency reposits reported by the commercial banks at end-1984 as a result of one time change in their reporting requirements in 1984.

(Tables 15, 16). Having declined by about Dh 3.0 billion in 1983, the net foreign asset position of the Central Bank improved by Dh 0.9 billion in 1984, to Dh 10.5 billion at year-end, reflecting mainly an increase in the conversion of oil export proceeds for financing domestic government expenditures relative to the supply by the Central Bank of foreign exchange for financing imports. If the foreign exchange deposits held with the commercial banking system by residents (Dh 16.5 billion) are netted out, the banking system's total net foreign assets holdings rose by Dh 4.7 billion in 1984 compared with a decline of Dh 1.1 billion recorded in 1983. During 1984, the net unclassified liabilities of the commercial banks rose by Dh 3.8 billion while the recorded increase in the banks' capital and reserves fell to Dh 0.4 billion from Dh 0.8 billion in 1983. In fact, however, a large part of the recorded increase in "unclassified liabilities" in 1984 reflected a buildup of bank provisions for bad and doubtful outstanding loans which had been classified under "capital and reserves" in earlier years.

At the end of 1984, currency in circulation and monetary deposits accounted for 18.9% of domestic liquidity compared with 25.1% at end-1983 (Table 17); excluding the Dh 10 billion in newly recorded foreign exchange deposits as noted above, the corresponding ratio was 24.1% at the end of 1984. Following the easing of reserve requirements on saving and time deposits in May 1982 From 79 to 6% and 5%, respectively, while reserve requirements on demand deposits remained at 7%, commercial banks have encouraged customers to place in savings and time deposits liquid balances in excess of those required for current transactions. As shown in Table (18), there have been significant improvements in the asset and liability structure of the Commercial banks in recent years. For example, the ratio of capital and reserves to total assets increased from 10.6% in 1980 to 14.5% in 1983, while the ratio of private sector credit to total assets declined from 48.5% to 42% during the same period, and further to 36.4% at end-1984, while the ratio of capital and reserves to total assets is shown to have declined to 13.1% by the end of 1984, this is wholly accounted for by the shift of certain provisions against bad and doubtful loans from "capital and reserves" to "unclassified liabilities" in the balance sheets of Commercial Banks. Overall, recent developments as described above point to an improvement in commercial bank credit operations during the period. At the same time the increase in the ratio of liquid assets (reserves and foreign assets) to total liabilities from 41.8% in 1980 to 47.8% in 1983 and 52.4% in 1984 (or 46.6% if the foreign asset counterpart of the newly recorded foreign exchange deposits held by residents with the commercial bank is excluded is indicative of a concurrent improvement in the liquidity position of the commercial banking system as a whole.

TABLE 17: U.A.E: Composition of domestic Liquidity - 1980 - 84

(In percent)

End of Period	1980	1981	1982	1983	1984
Currency	9.1	9.5	8.9	7.9	6.2
Monetary deposits	22.1	21.3	20.0	17.2	12.7
Quasi-Monetary deposits	68.8	69.2	71.1	74.9	81.0
Foreign currency deposits	(23.1)	(26.2)	(21.7)	(19.0)	(35.2)

SOURCE: TABLE (15)

As shown in Tables (15, 16), there have been substantial changes in recent years in the compostion of the banking system's assets and liabilities. The net foreign assets position of commercial and restricted license banks increased about tenfold between 1980 and 1984 (end-year position), reflecting a concurrent strengthening of the liquidity position of the banks as well as their growing role as intermediaries between the domestic and international financial markets. At the end of 1979, the net foreign asset position of the commercial banks including the restricted license banks, had in fact been negative by almost Dh 2.0 billion, making it imperative for the monetary authority to give priority to regulatory measures which would facilitate a strengthening of the liquidity position of the commercial banking system. Together with a steady growth of financial savings in the domestic economy, these measures succeeded in bringing the net foreign asset position of the commercial banks and restricted license banks to Dh. 24.1 billion by the end of 1984. Concurrently, the net foreign asset position of the Central bank, which stood at Dh 4.9 billion at end-1979, had increased to Dh 7.1 billion a year later and further to Dh 12.6 billion by end 1982. During the the following year, however, the Central Bank's net foreign asset position detriorated by almost one fourth, reflecting primarily a drawdown of government deposits with the Bank (Table 19) to finance part of the deficit in government fiscal operations in 1983. With the amount of government deposits levelling off in 1984, and with increased conversion of oil export proceeds for financing fiscal expenditures, the net foreign asset position of the Central Bank improved in 1984 to Dh 10.5 billion by year end.

TABLE 18 U.A.E.: Commercial Bank Balance Sheets
Selected Ration 1980-84
(Ration in percent)

End of period	1980	1981	1982	1983	1984
Capital and reserves/ total assets	0.106	0.125	0.139	0.145	0.131
Private Sector Credit/ Total assets	0.485	0.445	0.410	0.420	0.364
Capital and reserves/ Private Sector credit	0.219	0.281	0.339	0.346	0.360
Liquid reserves/total liabilities	0.044	0.038	0.039	0.039	0.039
Net Foreign assets/ domestic liabilities	0.074	0.145	0.167	0.188	0.333
Liquid assets/total liabilities	0.418	0.470	0.492	0.478	0.524

SOURCE: Central Bank = Consolidated Balance Sheet of Commercial banks 1980-84.

Although the Government Sector has realized large surpluses on its external current account transactions during most of the past decade, only a small part thereof has taken the form of public sector deposits with the domestic banking system. Thus, government deposits with the banking system amounted to about Dh. 7.1 billion at end-1984, which was lower by Dh 2.3 billion than the corresponding amount at end-1980. On the other hand, deposits of official entities with the banking system rose steadily between 1980 and 1984 due mainly to growing working capital requirements of such

TABLE 19: Central Banks Accounts - 1980 - 1984

(In millions of dirhams)

End of period	1980	1981	1982	1983	1984
Foreign assets	7,482.6	12,181.6	12,627.1	9,572.1	10,457.9
Balances abroad	(3,582.5)	(4,221)	(3,918.8)	(2,300.9)	(3,388.8
Investments	(3,248)	(6,651.4)	(7,944.5)	(5,944.5)	(5,722.8
Other 1[1]	(422.1)	(998.1)	(980.4)	(897.0)	(879.2
IMF reserves position 2	(230.0)	(311.1)	(375.1)	(429.7)	(466.6
Claims on government	1,314	1,173.1	1,111.1	1,058.6	1,024
Claims	(1,544)	(1,484.2)	(1,486.2)	(1,488.3)	(1,490.6
Less IMF position of reserve 2	(-230)	(-311.1)	(-375.1)	(-429.7)	(-466.6
Claims on private sector	6.1	5.3	5.0	4.6	5.4
Claims on other financial institutions	13.5	6.5	3.5	-	-
Claims on commercial banks	688.5	335.3	239.1	1,469.2	1,030.8
Claims on official entities	5.3	-	11.7	11.7	5.3
Unclassified assets	295.	382.8	595.6	480.9	518.2
Assets - Liabilities	9,805	14,084.7	14,593.3	12,597	13,041.7
Reserve Money	4,450.5	5,320.6	6,044.4	5,992.2	6,529.3
Currency outside banks	(2,142.5)	(2,770.8)	(2,989.5)	(2,878.8)	(2,929)
Cash held by banks	(253.8)	(271.2)	(282.2)	(267.7)	(242.6)
Bankers' deposits 3	(2,054.2)	(2,278.6)	(2,772.7)	(2,845.7)	(3,357.3)
Quasi-monetary deposits	0.1	-	-	0.1	0.1
Government deposits	4,151.7	6,345.1	5,215.8	2,615	2,441.7
Foreign liabilities	390.1	233.3	7.7	6.3	5.2
Capital Accounts	594.1	1,908.5	2,927.2	3,609.6	3,626.3
Unclassified liabilities	218.6	277.2	398.1	373.9	439.1

SOURCE: Central Bank

[1] Mainly gold

[2] Excluding lending

[3] Includes restricted banks.

entities. While commercial bank claims an official entities showed little change during the period, such claims on government rose from about Dh 2.3 billion in 1980 to about Dh 4.3 billion at the end of 1984. At the same time, claims on the private sector increased from Dh 25.6 billion to Dh 33.6 billion, with the rate of increase slowing down markedly with the emergence of a shock in domestic economic activity after 1981, and with a marginal decline being recorded in 1984.

The distribution of commercial bank credit to the private sector has remained relatively little changed in recent years, with construction and trade credit accounting for 68% of total credit outstanding at the end of 1984, compared with 72% in 1983, while the share of manufacturing was unchanged at about 61%.

Following the abolition in October 1982 of ceilings on interest rates on deposits of less than Dh 5 million, all deposit and loan interest rates in the U.A.E.'s commercial banking system are free of official restrictions. During 1984, average lending and deposit interest rates moved within a narrow range, amounting to 12.53% and 9.54% at the end of the year, respectively. The Emirates Industrial Bank, whose loan operations have remained limited relative to those of the Commercial banks since its establishment in 1982, charges 4% interest per annum on its loans plus onehalf of 1% to cover administrative fees.

The major problem facing the Central bank is credibility. Since it is a fairly recent creation, it has not yet established itself to the point where it commands universal respect. The regulations it enacts have a tendency to be confusing, partly due to inadequate legal expertise in the financial sector, and lack of coordination and adequate monitoring encourage non-compliance and outright cheating by banks. For example, the directive issued in July 1982, prohibiting bank directors from borrowing more than 5% of their bank's capital was uproductive to the extent that many banks failed to comply within the given period.

The most notable bank failing to comply with the aforementioned Central bank directive was Dubai's Union Bank of the Middle East, (UBME) Abdel Wahab Galadari, 46% owner and outgoing chairman, had arranged for UBME to loan his many companies $ 380 million and provide an additional $270 million in loan guarantees.[18] By the end of 1983, it became apparent that he could not pay back the loans he owed UBME to satisfy the Central Bank directive. The Central bank intervened in November, 1983, removing Galadari from the Chairmanship and appointing a new management team headed by Al-Tayer, the State Minister of Finance. The Central bank was able to avert the collapse of UBME but at a cost of a long and protracted court battle with Galadari. The crisis

[18] Meri Report, "United Arab Emirates", 1983; pp. 115.

was judged to have been fairly well handled by the Central bank, but it revealed a number of weaknesses in the U.A.E. financial system.

(ii) The Weaknesses and Prospects of the Financial System:

The weaknesses of the financial system mirror the the problems that plague the economy. Primarily the focus is on the banking sector, which is suffering from the following:

- The decline in government oil revenues has limited a major source of liquidity for the banks. The liquidity problem is so severe that the gap between total bank loans ($11.36 billion in June 1983) and total bank deposits ($10.14 billion in June 1983) has reached a dangerous level.

- Growing fiscal conservatism has limited the rate at which the government inspects liquidity into the economy. The money supply, measured as currency held by the public and demand deposits, fell, for the first time in years, by 6.3% in 1983.

- The liquidity problems of the construction and trade sectors are spilling over into the banking sector. As investors engaged in the service sector encounter cash flow difficulties, their ability to meet short-term obligations to the banks from which they are heavy borrowers is reduced.

- There is no secondary market for certificates of deposit issued by banks and financial institutions. This is making it difficult for banks to engage in creative liability management at a time when the need for it is acute. In effect, the inter-bank market rate dictates the interest rate on the dirham, which is one of the reasons why interest rates are high.

- Remittances sent abroad by foreign workers represent a serious outflow of funds at the expense of domestic liquidity.

- The opportunities for investment at home are quite limited, due to the small population and infrastructural constrainsts. Consequently, capital is exported on a large scale. The net foreign assets (assets minus liabilities) of commercial banks stood at Dh 9.14 billion at the end of 1983 which is not an indication of strength, but rather points to the lack of adequate sovereign risk.

- There is considerable regional imbalance in the flow of funds, with Dubai and the northern Emirates accounting for 62.5% of bank credit, to Abu Dhabi's 37.5%. Dubai and the northern Emirates contribute 57.1% of deposits while Abu Dhabi contributes 42.9%.

- The most serious problem and weakness of all is overbanking. Considering the small size of the population and the limited opportunities for investment, the small industrial base, and the fact that Bahrain has largely preempted the possibility of extensive off-shore banking, the U.A.E. has far more banks than the system can support. Such serious overbanking is making it difficult for the smaller more recently formed banks, to compete for deposits, especially in light of the liquidity squeeze.

Prospects of the financial system: The Central Bank has largely contained the UBME crisis, but the weaknesses of the financial sector persist. Solutions will have to focus on:

- bank mergers (which the Central Bank is eagerly promoting);
- strict enforcement of Central bank directives;
- the development of a secondary market for bank certificates of deposit;
- Continued fiscal rationalization;
- the floating of the dirham to discourage arbitrage operations which have led to a major transfer of funds and artificially maintained interest rates at a high level.

It is of emphasis to state at this point that the banking activity in the U.A.E. prior to the discovery of oil was of a very limited nature and was restricted to local branches of a few foreign banks whose services were at the time adequate to cope with the country's trade that was mainly concentrated in Dubai Emirate.

Following the discovery of oil, the banking system in the U.A.E. evolved rapidly in order to cope with the growing needs of the oil industry and the country's expanding local and foreign trade.

Government Finance; the Surplus/deficit problem: Oil receipts are the main source of revenue for the Emirate governments, with the Federal government financing its operations with contributions from Abu Dhabi and Dubai as well as proceeds from certain administrative fees and charges and returns on investment. In principle, Abu Dhabi and Dubai are to transfer 50% of their oil revenues to the federal government.

Adequate fiscal data are not available for all public sector entities in UAE and suffer from a number of deficiencies, as for example, data on Abu Dhabi's oil revenues do not include revenues which are retained by the Ruler or ADNOC or transferred directly to the Abu Dhabi Investment Authority (ADIA), and no fiscal data are available on Dubai's oil receipts. Additionally, the data suffer from a discrepancy between recorded emirate contributions to the federal budget and recorded federal receipts from the emirates. The exclusion of some of Abu Dhabi's and Duabi's oil receipts, together with the exclusion of the fiscal accounts of Sharjah and Ras Al-Khaimah whose oil sector earnings have increased rapidly in recent years, have resulted in large discrepancies between the consolidated fiscal data, and related balance of payments and oil output data.

Following a three-year period of modest growth in consolidated government revenues and expenditures, oil revenues increased sharply in 1980, permitting the authorities to expand rapidly total outlays, especially for current purposes and on foreign grants and loans. However, as the rise in revenues surpassed the expansion in government outlays by a wide margin, a record surplus of Dh 10.2 billion was registered in 1980. In 1981 the fiscal surplus declined to Dh 5.3 billion as oil revenues stagnated while further increases in current and development spending and in foreign grants and loans caused total outlays to expand by 19%. Since then, the continued decline in oil output, accompanied by a fall in oil prices, has resulted in a decrease in government revenues from Dh 48.8 billion in 1981 to Dh 27.9 billion in 1984. Faced with prospective fiscal imbalances, the emirate and federal authorities have sought to curtail their expenditures, especially on items which do not affect significantly the domestic economy or on which outlays had expanded rapidly in 1980-81. Thus, foreign grants and loans declined from Dh 9.3 billion in 1981 to Dh 1.2 billion in 1984, while domestic loans and equity participation declined by about Dh 1.5 billion to Dh 0.7 billion and development outlays were reduced by Dh 2.9 billion to Dh 6.4

billion during the same period. Despite the expenditure reduction, however, an overall deficit of Dh 3.0 billion (equivalent to about 2.7% of GDP) emerged in 1982 and widened to Dh 5.2 billion in 1983 (5.1% of GDP). The deficit is provisionally estimated to have declined to Dh 2.5 billion in 1984 (2.3% of GDP).

The federal government budget deficit was mostly financed by a drawdown of reserves in 1983 and by loans (Dh 1.0 billion from Abu Dhabi and Dh 0.3 billion from Dubai) together with the bulk of receipts from the liquidation of the federal government"s share in the capital of the Real Estate Bank (0.7 billion) in 1984.

There are three sources of revenue to the federal government;

1- Oil, which assumes the predominant portion of government revenues. The level of recorded budgetary oil revenues in any one year depends both on the valve of oil exports, net of production costs and foreign company profits, and the proportion of export proceeds used by Rulers of the Emirates to finance extra-budgetary expenditures and investments. Abu Dhabi's oil revenues have generally been quite closely related to the Emirate's oil export receipts and are therefore sensitive to changes on oil export proceeds. In constrast, recorded Dubai oil revenues are not directly related to oil export proceeds as they are derived as the difference between the expenditures of the Emirate and municipality of Dubai and their non-oil revenues. As a result, oil revenues as recorded in the budgetary accounts are not comparable with those used in the balance of payments estimates.

2- Customs duty collections, the principle source of non-oil revenues besides investment income, have reflected changes in import levels as well as tariff rates in recent years.

3- Other revenues, mainly departmental changes, fees, interest on government deposits, returns on government equity, and newly introduced fees for medical services generated increased domestic revenues in the second half of 1984.

The reductions in federal budget expenditures, due to decline in oil receipts, affected almost all government expenditure categories, namely current and as shown before development outlays, domestic loans and equity, and foreign grants with most of the decline being achieved through curtailment of foreign aid.

As was budgeted for the year 1985, total revenues are expected to decline because of the cut in the UAE's OPEC output quota by 14% in November 1984, and because of the continued increases in oil production costs. With Abu Dhabi absorbing most of the output reduction, its oil revenues.

are anticipated to decline in 1985, while Dubai's oil revenues were estimated to be approximately unchanged from 1984 level. Since federal and Abu Dhabi budget expenditures are expected to show little change, and with some decline likely in Abu Dhabi's contribution to the federal budget out of its oil revenues, both Abu Dhabi and Federal government were expected to record fiscal deficits in 1985 higher than those of 1984. With Dubai's budget expenditures expected to increase mainly because of expanded development outlays, the consolidated government budget deficit is also likely to widen in 1985.

In a continuation of its efforts to contain its expenditures without unduly affecting the public services, the Abu Dhabi government hasbeen releasing its departmental allocations for 1985 on a monthly basis (equivalent to one twelfth of the previous year's allocations), and has also ceased hiring new staff and revised development spending plans. In the case of Dubai, a number of new projects were started in 1985, particularly the airport arrivals terminal, the Ruler's Court, and electricity and sewerage projects. In addition, the Dubai Municipality increased its allocation for transfers and public housing as well as its allocation for new municipal project. The resultant increase, however, in the emirate development expenditures in 1985 is not expected to be very large.

Promoted to world financial prominence with per capita

GDP ranking them among the highest in the world scale, the U.A.Es remain, none-the-less structurally vulnerable. They are depleting their unique resource while unable to use productively all the proceeds of oil sales domestically. Depletion of non-renewable resources on the one hand and the limited domestic absorptive capacity on the other are the formidable twin problems plaguing the UAE economy. No serious economic policy can be formulated without due regard to these hard facts. Oil extraction is not 'production' in the proper sense of adding to value; rather it is a transformation of real asset (oil) into foreign exchange. Therefore, what is usally referred to as income is a misnomer. In fact there is little income earned; by and large there is only an exchange of assets. The draw-down in oil reserves should be debited against the oil sales revenues' credit before estimating the oil income. That is, earnings from oil sales should be reduced or offset by a sum reflecting the reduced value of the remaining inventories of oil in order to reach a proper assessment of the oil value added on income.

Oil production implies, then, an act of disinvestment and unless matched by a corresponding investment the country's wealth could be seriously endangered. In oil producing countries the overwhelming concern seems to be a conservation principal understood in the widest sense. Conservation policy doesn't necessary mean a reduction of oil production, but rather maintaining the real value of the country's assets, (for example oil) or financial assets. The real issue is not to keep as much oil as we can under the ground; it is rather to maintain or to increase the value of the country's wealth. It is perfectly consistent with the conservation principle to produce more oil rather than less if the proceeds of oil sales are put to a more productive use than simply keeping oil under the ground.

Investing oil proceeds is thus the crux of all oil production policies. Investment includes foreign after a discount for external risks and domestic investment are vital elements to U.A.E. economic survival regardless of the following two problems: the abosorptive capacity that limits the extent of domestic investment, and the world inflation that threatens to erode foreign investment.

By the end of 1978, it has been noted that 20% of OPEC surplus funds (saving) one of which is U.A.E., have been allocated directly or indirectly through the world bank and other multilateral lending institutions to the developing countries. The rest of OPEC's surpluses were channelled to the OECD countries and their financial institutions.

This motification sheds a vague light on how the government used its surplus funds during 1978-1984. In my opinion surplus funds were allocated to the following accounts:

a- Reserve fund account including foreign exchange b- Foreign investment account (Direct)

e- Domestic saving account

d- Indirect foreign investment account as presented in OPEC Savings.

There might be other accounts which I consider confidential and not for public use. It is not for me to comment on whether surpluses/or oil revenues are efficiently allocated by the government. However, it is important to point out that the deficit problem will continue in the U.A.E. as long as the government, first, is unable to provide industrial and economic diversification and second, its failure to place its oil surpluses in such a way as to increase the world real investment and not just the volume of financial assets. Investment in the Third world would seem to be a step in that direction. In this case the effectiveness of U.A.E. acting alone would be very limited, if it existed at all. On the other hand, there exists a great prospect for success if the Gulf States would agree to coordinate their investment policies using an accounting unit, (the Gulf Dinar), for oil pricing and lending which could be a mechanistic device to hedge against inflation.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS AND SUMMARY

Conclusions:

Economic development is taken here to mean an increase in real per capita income associated with structural changes such as to produce self-sustaining growth forces in the economy. Development means that production functions are constantly changed and that capital is being constantly accumulated in all sectors and all regions.

A sustained and rapid economic development can be achieved only through structural change in an economy permitting the utilization of all the existing and potential resources of the society in any sector, and not encouraging dependence on any one sector at the expense of neglecting or hindering an exploitation of the potentiality of others. The structural change that is required cannot be confined to economic areas alone, but must extend to social, political and cultural areas, for such a wide-ranging change, it is necessary to enable a society to utilize all itsresources efficiently and productively, and thus raise its per capita income in the short-term while at the same time sustaining long-term growth.

One of the crucial steps in sustaining economic development, a part from increasing capital formation and modernizing social institutions, consists in preparing and mobilizing human resources, and selecting economic incentives to direct human efforts to the fields where they are most needed in order to promote economic development.

In the past, 38 years, the Emirate's economy has undergone a considerable change. The main cause of this change has been the development of petroleum resources, which has affected the UAE economic progress in two ways. Firstly, the oil industry has had a direct impact on the local economy, providing employment, increasing capital formation, and supplying the domestic market with cheap fuel and raw materials. Secondly, the industry has provided revenue for the government. Since the early 1950s, this revenue has been by far the most important factor in the economic development of the U.A.E. From it has come all the existing social overhead capital. Almost all public and private assets have been accumulated from it. Also all the improvements in education, health, supported by the oil revenue.

The discovery of oil brought about a fundamental change in all aspects of the national economy and have led to the emergence of other industries even though in its limited capacities. The oil sector bears the responsibility of developing the other economic sectors and of intergrating them all into a balanced economy that will in course of time, hopefully, reduce the country's dependence on a single source of income. Therefore, and with no doubt, oil brought about growth to the economy of UAE, but it is a rapid one. This rapid growth presented in the period of 1975 up to 1984 created serious problems that the government must confront. The liquidity and unprecedented growth in public expenditure fueled additional private expenditure. Given the UAE's small population, however, less than 20% of the income was privately consumed. Because of the limited production base of the economy, consumption and investment demand has to be satisfied through imports. In order to satisfy the growing level of aggregate demand, imports had to be increased, both in absolute terms and as a proportion of GDP. Imports, could not, however keep pace with growing demand in UAE, as they faced strong infrastructural constraints, namely, the capacity of port facilities.

Over and above this, UAE's policies for developing and utilizing their human resources have failed to create the skills and develop the talents most needed for economic development and have failed to utilize existing skills inefficient productive activity. Additionally, most of their policies have resulted in a great waste of resources (human and capital) which hindered the Emirate's achievement of real economic development.

Recommendations:

In view of strategic and political importance of oil throughout the world, it would be hard to visualize the various aspects of the oil industry and its international importance without delving deeply to the very roots of this industry and of studying supply demand and price relationships in the light of which responsible national authorities can plan realistically for the future of the country's oil industry. In looking ahead to the future, they must keep in close touch with the trend of events throughout the world and should maintain their close interest in OPEC and in bilateral economic relations with different countries of the world.

The following recommendations are offered for consideration by the authorities in the UAE.

First: Since oil is an irreplaceable asset it must be used in the best possible national interest based on the following considerations:

(a) To avoid excessive production; the output may be limited to the level necessary for development purposes, in order to extend the lives of their oilfields.

(b) To use oil as a raw material for the manufacture of a wide range of products; its use as a cheap fuel should be avoided.

(c) To utilize oil revenues in the best possible manner, a portion of oil revenue should be allocated to the development of import substituting industries. The purpose in developing such industries should be to reduce countries' dependence on foreign imports.

(d) To guard the country's national reserve for periods of economic difficulties.

Second: The country should seek a balanced growth of the economy. In order to achieve such a growth a greater attention must be given to the development of resources such as agriculture, and tourism during winter months. The government should revive the pearl fishing industry employing new technologies, thus providing better employment opportunities to the nationals. The government should try with the help of Abu Dhabi's financial resources and Dubai's commercial potentials to establish an international financial market.

Third: The policyof developing the country as a whole should be the cornerstone of the economic policy of the government to ensure better integration between different emirates.

Fourth: They should reaffirm the importance of economic coordination and integration within the federation, the Arabian Gulf countries and troughout the Arab world, because regional economic integration is the effective means for economic independence and better competitive power. In competitive world of today there is really no place for small economic edifices.

Fifth: The danger of continuing the traditional mode of spending hard earned revenues should be recognized.

An attempt should be made to induce structural change and generate forces capable of sustaining growth. They can easily avoid pouring the new increase, if any, into the financing of transfer payments and current expenditure, is self-defeating in its nature and purposes. It is important that the policy formulations must reform their financial policies to promote production instead of subsidizing consumption. The need and adoption of this alternative approach necessitates a transional period that the U.A.E. should pass through inorder not to feel the sudden change in their present economic way of life.

The development-oriented approach realizes the vulnerability of the prosperity period the emirate's enjoyed and recognizes the need to utilize the oil wealth to develop other sources of national income. This approach stresses the importance of petroleum resources rather than oil revenues as a base for economic development. The oil revenues should be distinguished from ordinary public revenue. Since oil revenue is non-recurrent public revenue, it would be dangerous to depend on it to support current consumption and the regular financing of the administration. Such a danger supports the argument for utilizing the revenues received from exporting national assets to build new national assets, equal to if not exceeding the value of those lost. Thus, a policy of channelling oil revenues into activities according to their potential productivity.

Another point stressed by the economic-development approach is the need for an Investment Fund rather than a Reserve Fund. Reserve Funds have been regarded as a pool of liquid capital which could be drawn on at any time.

Hence, whenever the rate of growth of annual oil revenues slowed and the pressure of other items of expenditure increased, the reserve fund, which is inverted mostly in short call 'monetary' investment, was brought in to bridge the gap. An Investment fund can provide UAE ameans for long-term national and international investment, i.e. diversification of the source of national income. Another solution provided by the approach, is that the government need gradually to run down their policy of subsidies, to recover a reasonable price for the services rendered by the government departments and to cut waste and lavish spending by adopting fiscal policies that make people contribute to the public burden instead of depending on the return attained by the government.

Enlarging the productive-absorptive capacity should be the core of the emirate's development strategy. Economic and investment policies integration provides one solution to the problem of the smallness of the market.

Six: Achieving and sustaining growth needs more than scattered administrative decisions, it needs rather a comprehensive strategy that can indicate goals and provide the means for achieving them. UAE should assess the real opportunities open to them, prepare policies to grasp them and then building a strategy that harmonizes these policies and direct the society's scarce resources, of which human and oil wealth are the most important, so as to improve development prospects and call into action forces capable of sustaining growth. Professor Sayigh Yusuf[19] advanced eight points by which real economic development is ensured. The eight determinants are summarized as follows:

1- Rise in the level of economic performance within a balance sectorial pattern associated with the acquisition of the values of discipline, rationality, incentives and scientific casuality... It must be the result of society's abilities and efforts, not the activity of enclave sectors.

2- Provision of an expanded volume and improved quality of goods and services to satisfy the basic needs of the population.

3- Wider opportunities for productive employment.

4- Evening out the pattern of income distribution.

5- Allied to income distribution, the narrowing of the "development gap" among the Arab countries.

6- Evolving the capability of the social, cultural and political environment to provide the economy with ideas, knowledge and skills, attitudes and institutions necessary for the efficient operation of the economy.

7- Achievement of a wide measure of popular participation in the process of development.

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[19] M.S. El Azhary "The Impact of Oil revenues on Arab Gulf Development" Westview Press, Boulder, Colorado, pp. 38.

8- Achieving the widest measure possible of collective (regional) self-reliance in development.

At first sight of the financial data published by the government, the reader assures the economical development of UAE. Unfortunately, it is not a genuine one. With the exception of determinant number 4, UAE has failed to achieve or even to strive for the other determinants. They wanted to build, to grow fast and to live luxuriously ever-after. However, they forgot that as the future holds prospects, it also carries emmense problems and obstacles. Intuition and initiativeness will not be the basis for facing 1985-86 nowadays difficulties as they were the core of the 1977-82 development program. Strategic planning is a requirement or a prerequisite to every development course.

Summary:

The UAE has a federal planning ministry, but no country in the Gulf provides a better example of the fruits of unco-ordinated planning, with numbers of international airports and modern harbours, plus the still-empty and still unused triple drydock in Dubai. At one stage, in 1977, the pace of "development" in the UAE had become so fenetic that in some individual Emirates, for example, Sharjah, the development effort had acquired its own momentum.

The Federal structure is rendered unstable by the rivalry between the two largest sheikhdoms, and by the economic division between Abu Dhabi and Dubai and the poorer northern emirates. Defence and internal security are major issues. The UAE is heavily dependent upon imported Labor including Palestinians, Iranians, Pakistanis and Indians. It is uncomfortably close to Iran but has not been affected, to date, by any overspill from the Gulf war.

The fall in oil demand and revenues has exacerbated domestic rivalries, with Abu Dhabi having to act as a swing producer within the UAE while Dubai and Sharjah produce at capacity.

Government oil revenues have been declining at the Federal level and in Abu Dahbi. Abu Dhabi and Dubai have shown reluctance to finance more than limited Federal deficits. Thus spending has been cut UAE-wide, with the poorer Emirates badly affected.

The Financial sector has been shaken by the difficulties of several Emirate banks, and, in Dubai, authorities have been obliged to intervene. The Central bank has been forced into a promiment supervisory role.

Infrastructural projects are largely complete and opportunities for diversification are limited. The outlook for a recovery in Government spending is poor while oil markets remain depressed. After the housing boom, construction and related industries are passing through harsh recession period. The end product in the UAE today is a society which has many actual and potential problems, especially political problems, a society in which enormous sums of money have been wasted over the last 10 to 15 years, a society in which the average citizen enjoys an infinitely higher standard of living than any of his ancestors ever could have dreamed of. To this society, it is advisable to pursue a comprehensive strategic plan based on a development oriented approach to attain and sustain real growth by allocating petroleum resources efficiently and effectively among all other sectors of the economy.

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Appendix

U.A.E. - BASIC DATA

Area	77,000 sq.km.
Population (1982 estimate)	1,186,000
GDP per capita (1983 estimate)	US $ 23.412

(In billions of barrels)

	1981	1982	1983	Estimate 1984
Crude Oil Production	548	462	430	426
Abu Dhabi	414	329	294	273
Dubai	131	131	122	127
Sharjah	4	3	14	22
Ras-Al-Khaimah	-	-	-	3

National Accounts (At Current Prices)

(In billions of dirhams)

	1981	1982	1983	1984
Private final consumption	24.9	26.8	20.1	18.1
Government final Consumption	21.5	22.0	27.2	27.9
Gross Fixed Investment	30.6	31.7	30.0	27.4
Change in stock	1.2	0.5	0.7	0.3
Domestic Expenditure	78.2	81.0	78.7	73.7
Exports of goods and non-factor services	33.7	71.6	61.1	63.5
Imports of goods and non-factor services	-40.8	-40.2	-36.5	-33.5
Gross Domestic Product (at current prices)	121.1	112.4	102.7	103.7
Real gross domestic products	(Rate of change)			
Total GDP	3	-6	-6	5
of which: Non-oil	23	8	2	2

U.A.E. - BASIC DATA (Cont'd)

(In billions of U.S. dollars)

	1981	1982	1983	Prov. 1984
Balance of Payments				
Exports, F.O.B., of which:	21.83	18.2	15.4	16.1
Crude Oil & Gas	(19.5)	(16.0)	(12.8)	(13.2)
Imports, F.O.B.	-8.6	-8.1	-7.2	-6.4
Services & private transfers (Net, of which:	-2.9	-2.4	-2.6	-2.4
Investment income (Net)	(1.9)	(2.0)	(1.5)	(1.2)
Private transfers	(-2.3)	(-2.2)	(-1.6)	(-1.5)
Official grants	-1.1	-0.7	-0.4	-0.2
Current account balance	0.2	7.0	5.2	7.1
Official loans (Net)	-1.6	-1.0	-0.8	-0.2
Other official capital	-1.3	-0.7	-0.6	-0.8
Errors & Omissions (including private capital)	-4.0	-4.3	-4.2	-6.6
Net Foreign assets of banking system (increase -)	-2.3	-1.0	0.4	-1.1
Central Bamk	(-1.3)	(-0.2)	(0.8)	(-0.2)
Commercial banks	(-1.0)	(-0.8)	(-0.4)	(-0.9)
Exchange rate (period averages)				
Dirhams per SDR	4.3287	4.0528	3.9243	3.7628
Dirhams per U.S.Dollar	3.6710	3.6710	3.6710	3.6710

SOURCE: International Monetary Fund, International Financial Statistics.

U.A.E. - BASIC DATA (Cont'd)

	1981	1982	1983	Provisional 1984
Government Finances				
Revenues, of which:	8.8	37.6	29.2	27.9
Oil	(45.9)	(34.7)	(26.5)	(24.2)
Expenditures, of which:	43.5	40.6	34.4	30.3
Current	(22.1)	(21.9)	(21.4)	(21.2)
Development	(9.4)	(10.2)	(8.5)	(6.4)
Foreign Grants & Loans	(9.3)	(6.0)	(3.1)	(1.2)
	(Annual Change in Dh Millions)			
Monetary Survey				
Net Foreign Assets	8,583	3,540	-1,448	4,313
Net Domestic Assets	-3,012	1,023	(4,135)	-3,813
Claims on Government (Net)	(-2,768)	(3,383)	(3,738)	(-280)
Claims on private Sector & official entities	(4,921)	(1,595)	(1,633)	(-328)
Captal & reserves	(-4,188)	(-3,540)	(-1,470)	(-469)
Other items (Net)	(-977)	(-415)	(233)	-2,736
Domestic Liquidity	5,571	4,563	2,687	500
	(Annual Change in percent)			
Credit to private sector and official entities	18.5	5.1	4.9	-0.9
Domestic Liquidity	23.6	15.6	8.0	1.4

Figure 6. **FOREIGN TRADE**

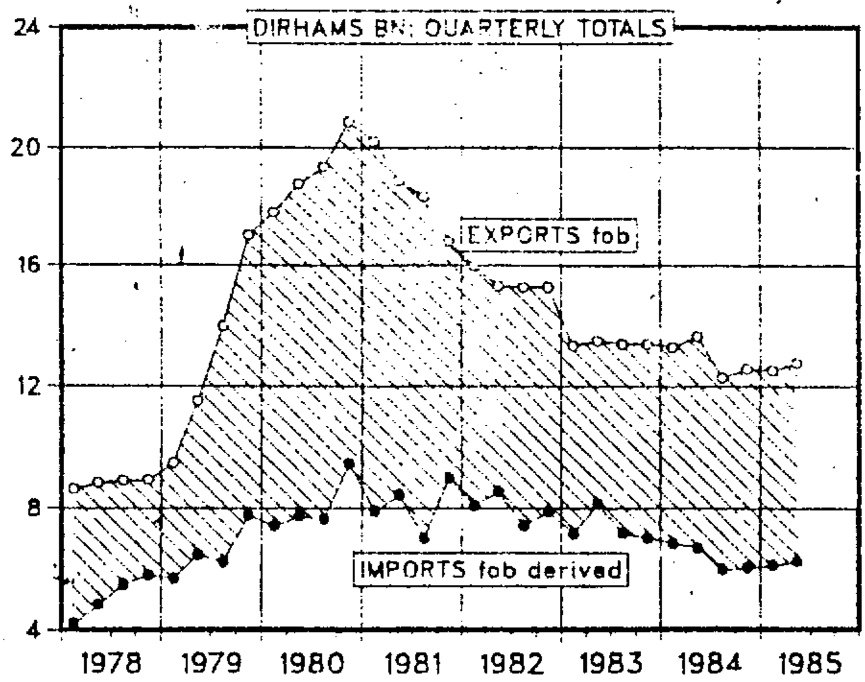

Fig. 7. **GROSS FIXED INVESTMENT**

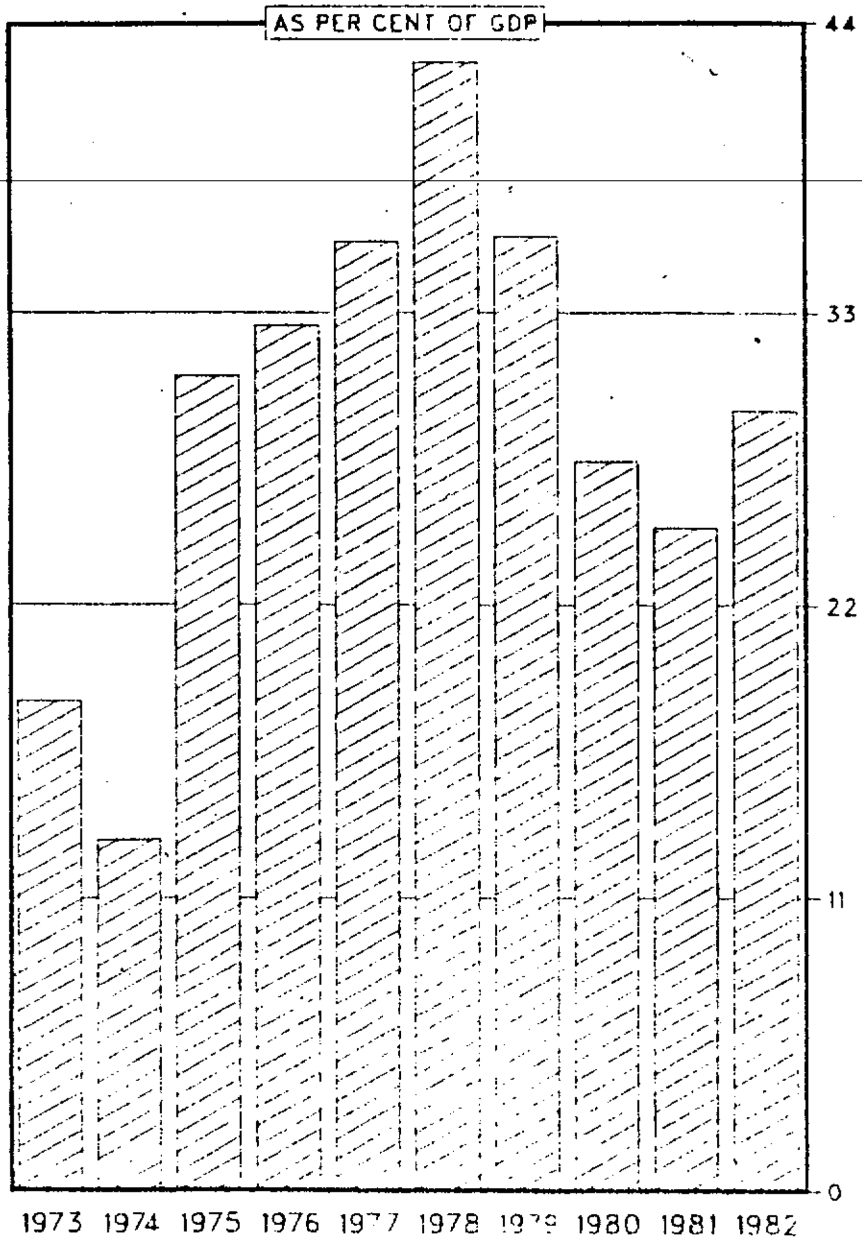

Figure 8.

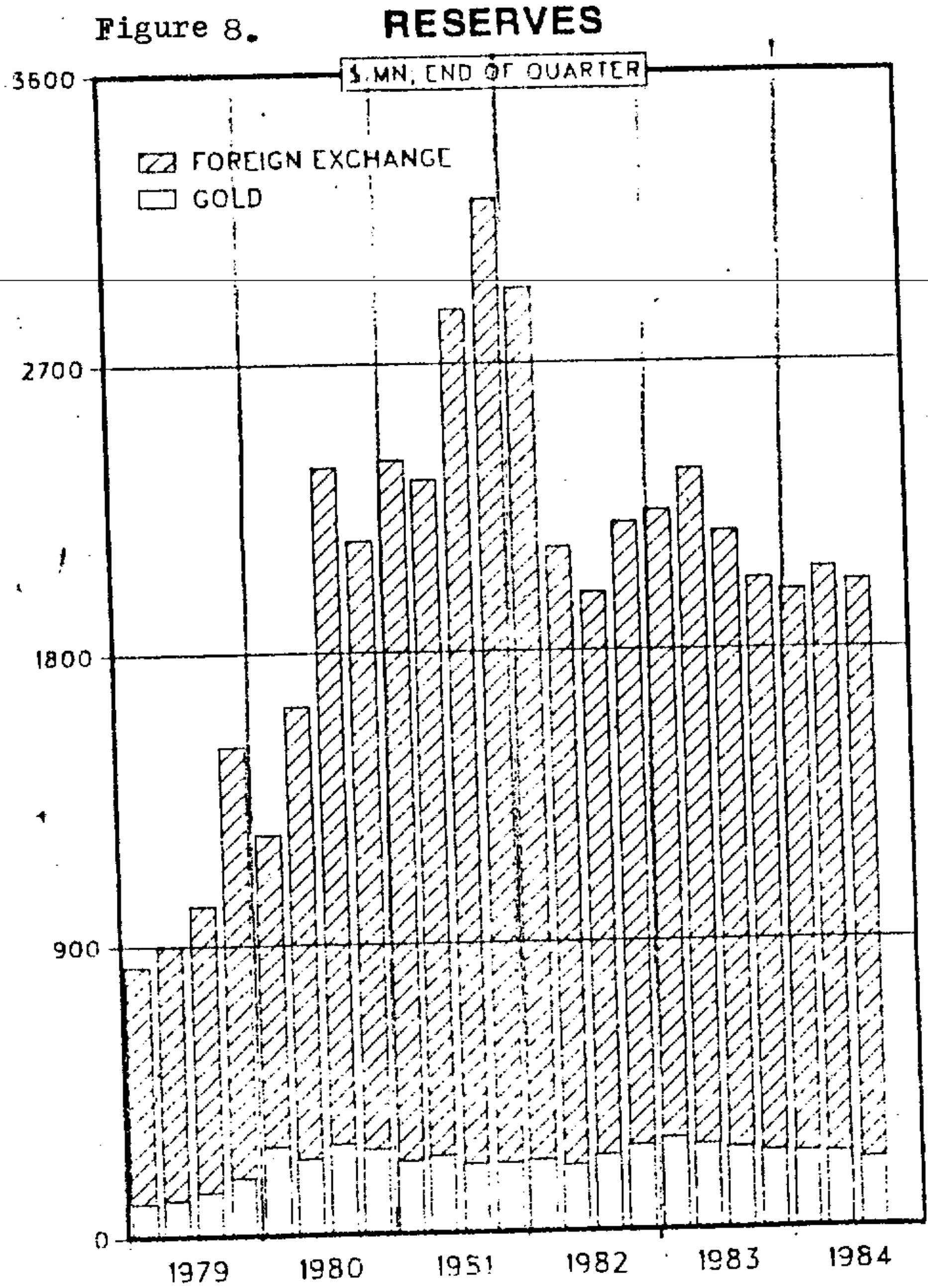
RESERVES
$.MN, END OF QUARTER
FOREIGN EXCHANGE
GOLD
3600
2700
1800
900
0
1979
1980
1951
1982
1983
1984

Figure 9. **EXCHANGE RATE**