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The Overnight Reports, printed on yellow paper as the final section, will often contain materials that update other articles in the *Daily*.

KUWAIT: Awash With Oil Money

[redacted]

Recent and prospective oil price increases will lead to record budget and current account surpluses in Kuwait unless the government takes the unlikely step of changing its restrictive spending habits. The financial surplus--along with the likelihood that oil in the ground will appreciate faster than most foreign investments--will put pressure on the government again to reduce oil production. In a similar situation at the time of the 1973-74 oil price hikes, the government brushed aside visions of industrial grandeur in favor of moderate economic growth, prudent foreign investments, and reduced oil production. [redacted]

Kuwait was already one of the most affluent and economically developed members of OPEC at the time of the 1973-74 oil price hikes. Since then, a large part of its enormous financial inflows has gone to extend one of the most advanced welfare states in the world. Profiting from past mistakes, Kuwait restrained government spending for industrialization and hence has suffered fewer economic and social dislocations than other Persian Gulf oil producers did in the late 1970s. [redacted]

The fiscal year 1980 budget approved this summer demonstrates continued government interest in restraining spending, especially for industrial projects. Planned outlays of slightly more than $8 billion are only 16 percent above those in the previous budget. If inflation remains in last year's range, as seems likely, government spending will show little real growth. Less than 2 percent is slated for development, and no plans for major industrial projects are on the books. [redacted]

The government projects revenues to increase 40 percent, to $11.7 billion--probably a gross understatement. If the current high level of oil production continues through the fiscal year, oil revenues alone should be about $19 billion because of the oil price increases last month and the large volumes of oil being sold at spot

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market prices. Thus Kuwait is likely to have a record budget surplus, and the current account surplus could top $15 billion. [redacted]

Kuwait does not have a planned economy, and the government probably has no program for spending the huge revenues that will be coming in for the foreseeable future. Although the Ministry of Planning, with assistance from the World Bank, is beginning work on a program for 1981-85, the government is reluctant to commit itself to a long-term plan. [redacted]

In the absence of any official development plan, no dramatic increase in spending is likely. Now that a $1 billion liquefied petroleum gas complex has been completed, an upgrading of gasoline production capacity is the only large hydrocarbon-based project still on the books. Other ambitious projects such as steel mills have apparently been shelved permanently. [redacted]

Restraint in industrial growth appears to have widespread support. Kuwaitis do not want industrial projects that would require more foreign labor; expatriates already comprise 53 percent of the population and 70 percent of the labor force. Kuwaitis also are reluctant to approve projects that could damage the environment. Most important, the sophisticated and well-traveled Kuwaitis have come to appreciate investments--whether at home or abroad--for their economic viability rather than their prestige. [redacted]

Given social, manpower, and environmental constraints, Kuwait probably will not push nonoil growth above the moderate pace maintained since the 1973-74 oil price hikes. Real economic growth of 6 to 8 percent a year, along with upward pressure on oil demand and prices, would leave Kuwait awash in cash. The government now requires that 10 percent of revenues be put into a Future Generations Reserve Fund, which is invested abroad. Income from these investments is retained by the Fund and cannot be drawn for budgetary use for at least 25 years. [redacted]

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Despite some economic diversification and careful foreign investment, Kuwait will still have a one-commodity economy for the immediate future. Oil contributes 75 percent of GDP, more than 80 percent of government revenues, and almost all export earnings. In an attempt to stretch out oil reserves for future generations Kuwait in 1975 imposed a ceiling on output of 2 million barrels per day (not counting 300,000 barrels per day from the Neutral Zone). Oil production from Kuwait proper had been about 2.7 million barrels per day in 1973. Because of continued rises in oil prices, Kuwait could probably cut output to 1 million barrels per day or less and still have ample funds to cover imports without dipping into investment income. [redacted]

The inability of Kuwait's domestic economy to absorb expected oil earnings and the increasing real value of oil in the ground will put pressure on the government to reduce oil production further. The need to save oil reserves for future generations, long a sensitive issue among conservatives, had been politicized by Arab nationalists in Kuwait's National Assembly before it was dissolved in 1976. Given the current religious and social unrest caused by dissatisfied Shias, the government is in no mood for a national debate with conservationists. [redacted]

The government is likely to bring output from its current level of about 2.2 million barrels per day down to the ceiling of 2 million barrels per day this year, and it has stated its intention of lowering the ceiling to 1.5 million barrels per day some time before 1985. It remains, nonetheless, sensitive to the ramifications of a major oil cutback on the West. [redacted]