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*Chair  
Saudi*

Date: FEB 3 1978

MEMORANDUM FOR: THE SECRETARY

From: Under Secretary Solomon *AMS*

Subject: Memorandum to the President on Saudi Concerns about the Dollar

1008

During the President's Middle East trip, the Saudis presented a paper outlining their concerns about the impact of dollar depreciation and inflation on the purchasing power of their oil revenues. You asked for a memorandum to the President commenting on the Saudi paper.

The memorandum also alerts the President to Saudi consideration of a switch from the dollar to a currency basket for oil pricing. Given present market uncertainties, such action could have a serious psychological impact on the dollar, even though the long term consequences are uncertain and would depend on future exchange rate developments. The memorandum informs the President of your plans to meet with Abalkhail and suggests that a subsequent letter from the President to King Khalid may prove useful.

Recommendation:

That you sign the memorandum to the President.

Approve \_\_\_\_\_

Disapprove \_\_\_\_\_

DECLASSIFIED

E.O.12958, Sec.3.6

PER *10/1/96* *Tru* *HERE NLC-95-29*

BY *[Signature]* NARS. DATE *11/27/96*

	Initiator	Reviewer IM	Reviewer IS	Reviewer I	Reviewer	Ex. Sec.
Surname	IMM: BNEWMAN	FLWIDMAN	LBOWDEN	FBERGSTEN		
Initials / Date	<i>BMM</i> / <i>2/1/78</i>	<i>FLW</i> / <i>2/1</i>	<i>LB</i> / <i>2/11</i>	<i>FB</i> / <i>2/11</i>	<i>MB</i> / <i>2/3</i>	<i>RS</i> / <i>2/3</i>

THE SECRETARY OF THE TREASURY  
WASHINGTON

FEB 3 1978

## MEMORANDUM FOR THE PRESIDENT

SUBJECT: Saudi Concerns about the Dollar and Inflation

During your Middle East trip, the Saudis expressed concern about the impact of dollar depreciation and inflation on the value of their oil revenues and on their ability to resist further oil price rises. They gave you a short paper outlining these concerns.

## My comments:

The Saudis argue that:

- a) The recent dollar depreciation has reduced the domestic currency value of Saudi reserves -- 83 percent of which are in dollars -- by about 2,257 million riyals (or 1.3 percent).

Comment:

The Saudi analysis is faulty but the basic thrust of their concern is sound. The riyal value of Saudi reserves is not particularly important and in any case is determined by Saudi decisions on the exchange rate of the riyal in terms of the dollar. The more substantive point is the effect of exchange rate changes on the purchasing power of Saudi reserves in terms of Saudi imports. The depreciation of the dollar against other major currencies in the latter part of 1977 raised the dollar cost of Saudi imports. (In 1975-76, the appreciation of the dollar reduced Saudi import costs.) Since the major oil price rise in 1973/74, exchange rate changes have increased the dollar cost of Saudi imports by about 8.3 percent.

- b) Between 1974 and 1977, export price increases in industrial countries (35 percent) exceeded oil price rises (15 percent), in effect reducing the purchasing power of Saudi oil production by \$6 billion per year.

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E.O. 12958, Sec. 3.6

~~SECRET-NODIS~~PER 10/1/92 Tracy H. RE 11C-96-79  
BY Q NARS. DATE 11/27/96

Comment:

The price comparison is misleading. It fails to take account of the 400 percent increase in oil prices in 1973 and early 1974, and is based on data for export price rises which contain a serious upward bias. Even excluding the major oil price increases of 1973/74, our calculations indicate that the export prices of Saudi Arabia's principal suppliers have increased only about 20 percent in dollar terms between 1974 and 1977, while oil prices have risen about 30 percent.

With recent exchange rate developments, there has been a renewal of discussion in OPEC of shifting the basis of oil pricing from the dollar to some form of currency basket. If there were such a shift, the price of oil expressed in dollars would rise when the value of the dollar fell against the basket. When the value of the dollar increased, the dollar price of oil would fall.

The choice of the unit of account for oil pricing is basically under the producing countries' control. There is no particular economic reason why a shift from the dollar would be contrary to U.S. interests -- unless the dollar were to depreciate significantly in relation to the currencies in the pricing basket. But there could be major psychological effects. Given the unsettled conditions in the foreign exchange market, such a step at this time could be interpreted as a lack of confidence in the dollar and as presaging a shift in OPEC investment policy away from the dollar. It could precipitate a serious market reaction.

Intelligence reports indicate that Finance Minister Abalkhail favors a shift from the dollar but that King Khalid is opposed for political reasons. I plan to meet with Abalkhail in Europe around the middle of February, and hope to head him off. Depending on the outcome of my meeting, it may be useful for you to make our concerns known to the King. I will report as soon as I return.

Mika, <sup>3</sup>

W. Michael Blumenthal

CLASSIFIED BY Assistant Secretary Bergsten

EXEMPT FROM GENERAL DECLASSIFICATION

SCHEDULE OF EXECUTIVE ORDER 11652

~~SECRET-NODIS~~

EXEMPTION CATEGORY 5 (b) 1 & 3

AUTOMATICALLY DECLASSIFIED ON \_\_\_\_\_

Impossible to Determine

THE PRESIDENT HAS SEEN.

cc Mike  
Charlie  
J

1. Saudi Arabian Monetary Agency ( SAMA ) has a very active investment program in the U.S.A., where it is directly or through other banking institutions invest its revenues in bonds issued by the American Treasury and as deposit in the American banks.

SAMA investment in the U.S.A. is about 45% of SAMA assests and the rest is distributed arround the World. While the total investment in the treasury's bonds reached 15 billion dollars, the deposits in American banks have reached 8 billion dollars. In Private bonds and stocks SAMA has invested about 3,6 billion dollars.

2. This is not the complete picture of our financial relations, but it is important to mention that 83% of our reserves are in American dollars and only 17% are in other currencies.

3. As a result of the declining of exchange rate of the dollar, the value of the dollar to the Saudi Riyal three months ago was 3,535, but now the Saudi Riyal has appreciated to the dollar where it is 3,49.

Since 83% of our revenue is in dollar so any change in the value of the dollar would affect our reserve. So the Government of Saudi Arabia has lost about 2257 million Riyals.

In as much as the bulk of Saudi Arabia revenue are from oil and in dollar any change in the purchasing power of the dollar is highly important to us. It is a fact that the declining value of the dollar would put those countries who are in favour of an oil freeze in a very difficult position.

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According to the International Monetary Fund the price increase of export from the industrialized countries since 1974 to 1977 has expanded 35% while the oil prices have increased by only 15% during the same period. So the purchasing power of the posted price of oil which is \$13.38 is actually equal to \$9.89.

If we take the total oil production of Saudi Arabia which is about 3 billion barrel per year then the total loss of Saudi Arabia as a result of the increase of exports price from the industrialized countries would be estimated to be 6 billion dollars per year.