

Kuwait: 2001 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Consideration

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Kuwait, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **April 11, 2001**, with the officials of Kuwait on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 11, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

(Note: Page 9, Box 1, has been corrected in this printing of the report.)

- a Public Information Notice (PIN), which summarizes the **views of the Executive Board of June 27, 2001** in considering the staff report that concluded the Article IV consultation.

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INTERNATIONAL MONETARY FUND

KUWAIT

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the 2001 Consultation with Kuwait

Approved by Paul Chabrier and G. Russell Kincaid

June 11, 2001

- The 2001 Article IV consultation discussions with Kuwait were held during March 27–April 11, 2001. The staff representatives were Messrs. Jbili (head), Hussein, Okogu, and Goswami (all MED); Mr. Shaalan, Executive Director for Kuwait, participated in the policy discussions. The authorities consented to the Fund's publication of the staff report prior to the start of the 2001 Article IV consultation mission.
- The staff team met with the Minister of Finance, the Governor of the Central Bank of Kuwait, the members of the Committee for Economic Reform, and the Chamber of Commerce and Industry, and with other senior government officials and bank managers and supervisors.
- Kuwait has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system free from restrictions on the making of payments and transfers for current international transactions. In concluding the 1999 Article IV consultation with Kuwait on March 13, 2000, Executive Directors noted with satisfaction the improvement in the overall macroeconomic situation in 1999, and commended the authorities for maintaining prudent fiscal and monetary policies and tightening bank prudential regulations. However, Directors observed that Kuwait faced the medium-term challenges of raising economic growth and providing employment for its nationals, and called on the authorities to expedite the approval and implementation of the structural reform package that was formulated in 1999. Directors welcomed the progress that Kuwait has made in improving its economic data, including through participation in the General Data Dissemination System, and encouraged them to make further efforts in this area.
- In light of favorable economic conditions and unchanged policy options in Kuwait, this report is kept brief, focusing on key issues only. The authorities released the staff team's concluding statement to the public and intend to publish this staff report.

Contents	Page
Executive Summary	3
I. BACKGROUND	4
II. POLICY DISCUSSIONS.....	5
A. Fiscal Policy	6
B. Monetary Policy	7
C. Structural Reform.....	9
D. Statistical Issues	11
III. STAFF APPRAISAL.....	12
TEXT BOXES	
1. Main Banking Indicators.....	9
2. Economic Reforms.....	11
FIGURES	
1. Selected Economic Indicators, 1995–2001	15
2. Public Finance, 1995/96–2000/01	16
3. Monetary Sector Indicators, 1995–2000	17
4. External Sector Indicators, 1995–2001	18
5. Exchange Rate Movements, January 1995–February 2001	19
TABLES	
1. Selected Economic Indicators, 1996–2002	20
2. Summary of Government Finance, 1995/96–2001/02	21
3. Monetary Survey, 1995–2000	22
4. Summary Balance of Payments, 1996–2002.....	23
5. Vulnerability Indicators, 1997–2000	24
APPENDICES	
1. Fund Relations	26
2. Relations with the World Bank Group.....	28
3. Statistical Issues	30

EXECUTIVE SUMMARY

Background: With the recovery in oil export prices since mid-1999 and the authorities' prudent fiscal and monetary policies, Kuwait's fiscal and external account surpluses have increased significantly in 2000, inflation remained low, the central bank's international reserves rose to the equivalent of 7 months of imports, and the government continued to accumulate assets for future generations. Growth performance in 2000, however, remained weak, reflecting mainly cuts in government capital expenditure and uncertainty regarding the legislative approval of structural reform measures. On the background of improved dialogue between the newly formed government and the National Assembly on key structural reform measures and sustained high oil prices, prospects for 2001 as a whole appear favorable.

Policy Issues:

- **The fiscal policy stance for 2001** remains prudent, but the staff cautioned against raising current expenditure and called for cuts in subsidies and transfers. In spite of the current strong fiscal position, the staff encouraged the authorities to pursue more forcefully their medium-term objective of restructuring the budget to diversify the revenue base, including the elimination of import duty exemptions on a wide range of products, the introduction of a broad-based consumption tax, and the levying of excises on luxury items. In addition, restructuring the budget in conjunction with the privatization and labor market reform should focus on containing the growth of the wage bill, streamlining the civil service, and reducing expenditure on subsidies and transfers.
- **Monetary policy** is consistent with the pegged exchange rate regime, and the financial system is healthy and well supervised. The mission encouraged the authorities to further strengthen supervision of the stock exchange and to facilitate the participation of foreign investors.
- **The Structural reform** process has advanced significantly since late 2000, with the approval by the National Assembly of key elements of the reform package, including the laws on foreign investment and key components of the labor market reform. Other important initiatives such as the privatization law, the reform of the corporate income tax law, and the company law are expected to be approved by the National Assembly by year-end. The staff urged the authorities to put in place the implementing regulations and to introduce a number of measures proposed by the World Bank to energize the private sector.

Statistical Issues: Continued progress has been made in improving the currentness, quality, and coverage of economic and financial statistics. The staff commended the Central Bank's efforts to enhance the collection, coverage, and presentation of the balance of payments data, and encouraged the authorities to sustain the progress made by the Central Statistical Office (CSO, Ministry of Planning) to improve the compilation and reporting of national account data.

I. BACKGROUND

1. **With the recovery in oil export prices since mid-1999, Kuwait has enjoyed a substantial improvement in its financial situation.** The deterioration in Kuwait's terms of trade resulting from the sharp fall in oil prices in 1998 and the first half of 1999 was short-lived. The oil output recovery in subsequent years was facilitated by the substantial rise in oil prices (33 percent in 1999) and the authorities' prudent fiscal and monetary policies. In 2000, Kuwait's average crude oil export prices rose further by 66 percent and its crude oil output, which had declined by 8.7 percent in 1999, also increased by about 6 percent. As a result, the overall fiscal balance (including investment income), which had slipped into a small deficit of about 1 percent of GDP in 1998/99, moved into surpluses of about 29 percent of GDP in 1999/2000, and an estimated 37 percent of GDP in 2000/2001 for the full 12 months.¹ Similarly, the external current account surplus, which had increased to 17 percent of GDP in 1999, surged to the equivalent of 39 percent in 2000. Kuwait continued to accumulate assets abroad while the holdings of international reserves by the Central Bank of Kuwait (CBK) increased to US\$7.5 billion or, the equivalent of over 7 months of imports of goods and services in 2000, up from 4 months in 1998.

2. **Growth performance, however, has remained weak.** This reflected the reductions in oil output in 1999, cuts in government capital expenditure, and uncertainty regarding the legislative approval of structural reform measures. In 2000, real GDP rose by about 1.7 percent equally distributed between the oil and non-oil sectors (Figure 1 and Table 1). The growth of oil GDP (including refining) was dampened by a reduction in refinery output due to fire damage. The non-oil sector (excluding refining) also grew at a low rate of 1.5 percent, down from 2.1 percent in 1999. The weak growth performance of the non-oil sector was less pronounced in government services, construction, telecommunications, and financial services.

3. Inflation, as measured by the consumer price index, eased to 1.7 percent in 2000, reflecting lower import prices and the appreciation of the nominal effective exchange rate of the Kuwaiti dinar. Domestic liquidity, as measured by broad money, picked up in 2000 to 6.3 percent (from only 1.6 percent in 1999), in connection with the disbursement of the UN compensation from Iraq of about US\$2 billion. Claims on the private sector also grew by 5.4 percent, with lending for construction being the strongest, while the growth of credit to industry, trade, and real estate decelerated from its sharp increase in 1999. On the other hand, the banking system's net claims on the government declined by 16.2 percent, primarily due

¹ The budget for 2000/01 was shortened to nine months (July 2000–March 2001) in preparation for changing the fiscal year to April–March as of 2001/02.

to the redemption of government bonds. The Debt Collection Program was completed in 2000 with payment by debtors of their final installment, while the delinquent debtors were referred to the courts. There was a noticeable accumulation of foreign assets by the banking system.

4. **Kuwaiti banks' performance strengthened further in 2000.** Banks' net profits rose by about 23 percent, buoyed by the redemption of low-paying government bonds, and generally improved efficiency. Nonperforming loans remained at about 6 percent of total assets and these were fully provisioned and collateralized. Prudential regulations and supervision have been kept in line with international standards. Activity of the stock exchange, however, weakened further in 2000 with the volume declining by 29 percent and the KSE share price index falling by 6.5 percent.

5. **For 2001, preliminary indications point to a continuing favorable environment in oil markets coupled with a pick up in domestic non-oil activity.** Based on Kuwait's expected average production in 2001 of 1.97 million barrels per day and the assumption of an average oil export price of US\$23.5 per barrel, oil export earnings will remain relatively high, albeit lower than in the previous year, and the balance of payments will record a surplus of about 34 percent of GDP. Based on the 2001/02 budget estimates, the fiscal surplus (including investment income) will narrow to an estimated 21 percent of GDP, owing to lower oil revenue and the budgeted increase in total expenditure (Tables 2–4). In the real sector, the cut in Kuwait's crude oil production in line with the January and March 2001 OPEC agreements will result in a small contraction in real oil GDP. Activity in the non-oil sector, however, is expected to expand at a faster pace (3.8 percent in real terms), driven by rising domestic demand from higher budgetary spending and improved business confidence with the expedited approval of a series of structural reforms (see below). Overall, real GDP growth for 2001 is estimated to remain broadly unchanged at 1.8 percent. Inflation is expected to remain subdued in line with relatively low import prices.

II. POLICY DISCUSSIONS

6. The discussions took place against the background of (i) improved dialogue between the government that was appointed in February 2001 and the National Assembly, and (ii) the establishment of a Committee for Economic Reform aimed at expediting economic reforms and composed of key economic ministers, the Governor of the Central Bank of Kuwait, and private sector representatives.

7. **The macroeconomic situation in Kuwait is sound and the economic fundamentals are strong.** The economy's short-term vulnerability to external or financial shocks is very limited (Table 5). The banking system is healthy and well supervised; the CBK's international reserves are equivalent to more than 7 months of imports of goods and services, and the government has a large cushion of foreign assets; there is no government external debt and private sector companies have small foreign liabilities; inflation is low; and the exchange rate regime is credible and stable. Kuwait faces, however, medium-term

challenges that are structural in nature and are mainly related to the dominance of oil and the state in the economy and the segmentation in the labor market. These have translated into low growth of the non-oil sector and insufficient employment opportunities for Kuwaiti nationals outside the public sector. The structural reform package that is currently under consideration aims at addressing these structural issues.

A. Fiscal Policy

8. **The mission praised the authorities' flexible fiscal policy in dealing with the recent sharp fluctuations in oil prices.** The authorities used the income from their foreign assets to cushion the fiscal situation against the adverse effect of the sharp drop in oil revenue in 1998/99, while containing the growth of government expenditure. During the upturn, fiscal policy remained relatively restrained in 1999/2000, allowing for a replenishment of government foreign assets (Figure 2). The staff underscored, however, that using capital expenditure as a shock absorber has not been helpful to the private sector, and expressed its preference for a broad-based adjustment distributed equally between revenue-raising measures and expenditure cuts, the latter mainly directed at current outlays.

9. **The mission called for expenditure restraint under the current 2001/02 budget.** Total government expenditure is estimated to increase by 15 percent compared to the 12-month equivalent of the previous fiscal year (Table 2). Current expenditure is budgeted to increase by 9 percent, reflecting increases in wages and salaries (5.6 percent), goods and services (7 percent), and transfers and subsidies (29 percent), while capital expenditure is budgeted to rise by 73 percent. The mission recognized that the increase in capital expenditure might be warranted by the reductions of recent years and by the need to maintain key infrastructure to meet the demands of a growing population. It noted, however, that actual spending might turn out to be lower, given the low implementation rate in recent years. The mission expressed concern regarding the increase in current expenditure, which comes after a relatively high growth in the previous year, and cautioned against raising the level of permanent outlays, such as the wage bill. The authorities pointed out that, in part, the increase in transfers and subsidies is due to exceptional and temporary outlays.² Excluding these exceptional outlays, the increase in current expenditure amounts to about 3 percent only. With regard to the wage bill, they explained that the current budget includes payments of social allowances to Kuwaiti nationals who accept to work in the private sector as a part of

² These include in particular, the budgeted payment to the Loans and Savings Bank on account of the cancellation of housing loans (KD 237 million vs. KD 33 million in 1999–2000), and Kuwait's assistance to the Palestinian Authority through the Al Aqsa Fund (KD 46 million).

the labor market reform agreed with the World Bank. Nevertheless, given the vulnerability of the fiscal situation to fluctuations in oil prices, the mission called for continued restraint on current expenditure, including on the wage bill and subsidies. It also pointed out that there was considerable room for reducing transfers and subsidies, which now account for one-fourth of total expenditure and more than 10 percent of GDP. The mission advised that the rise in capital expenditure ought to be limited to economically sound projects, taking into account implementation capacity and the need to curb government ownership in activities that can more efficiently be carried out by the private sector.

10. **Improving the structure of the budget to reduce its vulnerability to oil price fluctuations remains an important medium-term objective.** In spite of the current strong fiscal position, the mission encouraged the authorities to pursue more forcefully their medium-term objective of restructuring the budget to diversify the revenue base. The authorities noted that a series of revenue enhancing measures were under consideration, including raising fees and charges on government-provided services (e.g., healthcare and government land rentals) and adjusting the utility tariff rates (water and electricity). The mission called for further efforts to diversify the revenue base, including the elimination of import duty exemptions on a wide range of products, the introduction of a broad-based consumption tax, and the levying of excises on luxury items. In addition, restructuring the budget in conjunction with the privatization and labor market reform should focus on containing the growth of the wage bill, streamlining the civil service, and reducing expenditure on subsidies and transfers. The authorities indicated that budgetary savings would be achieved through the full-year implementation of the limits on child allowances and from the planned merging of a number of ministerial departments.³

11. **The staff commended Kuwait's generous external assistance to developing countries and the authorities' commitment to continue such assistance.**

B. Monetary Policy

12. **Monetary policy has continued to support the pegged exchange rate arrangement, while maintaining price stability.** Against the background of a rising level of bank liquidity in connection with the UN compensation payments, CBK continued to rely on open market operations and direct deposit taking to mop up excess liquidity and maintain stability in the inter-bank money market. In addition, in early 2001, the CBK reduced its discount rate by a cumulative 1.5 percentage points to 5.75 percent roughly in line with the

³ Such as the Higher Planning Council and the Ministry of Planning; and the Ministry of Higher Education and the Higher Education Council.

decrease in U.S. interest rates, thereby keeping the interest rate differential with U.S. dollar deposits within a narrow margin (Figure 3). Noting that the differential has turned negative since early 2000 (i.e., the interest rate on KD deposits is lower), albeit a narrow one, the mission cautioned against allowing the differential in favor of the U.S. dollar to widen further and welcomed CBK's policy of continuing to ensure that domestic interest rates closely track those on U.S. dollar short-term assets. The authorities indicated that they had already explained to the public that the negative interest differential reflected a temporary situation caused by abundant liquidity. The mission agreed with the thrust of the authorities' monetary policies and pointed out that the decline in bank lending rates could help revive private sector activity during the remainder of the year.

13. **The pegged exchange rate regime has remained stable and credible, stemming from the commitment of the central bank backed by large foreign reserves, sound monetary policy, and a well supervised banking system.** The pegged exchange arrangement supported by an open capital account and prudent fiscal and monetary policies has served Kuwait well, keeping inflation low and reinforcing confidence in the economy. Over the last four years, the U.S. dollar—which has a large weight in the basket of currencies to which the Kuwaiti dinar is pegged—has appreciated against other major currencies, leading to an appreciation of the real effective exchange rate of the dinar of about 14 percent (Figure 5). The authorities pointed out that this appreciation had not adversely affected the competitiveness of non-oil activities, as evidenced by the healthy growth of non-oil exports, which continue to benefit from the availability of expatriate work force at internationally competitive wages (Figure 4).⁴ The mission commented that structural reforms would need to be stepped up to raise business efficiency and improve the overall business environment, thereby fostering competitiveness over the medium term.

14. **Prudential regulations and supervision have been kept in line with international standards.** The authorities indicated that further implementation of the Basle Committee's Core Principles for Effective Banking Supervision was ongoing and that the CBK had amended the capital adequacy requirement of 1992 to incorporate market risk.⁵ The CBK's Board of Directors has also proposed an amendment to the law to allow information sharing with other supervisory authorities. This amendment has been approved by the cabinet and is

⁴ The growth in non-oil exports was mainly driven by petrochemicals (ethylene) following the start up of Equate project (see SM/00/23, February 4, 2000). Other exports include fertilizers, metal products, and paper products.

⁵ For a review of Kuwait's financial system, see Appendix VI of the staff report for the 1999 Article IV consultation (SM/00/23; February 4, 2000).

awaiting approval by the National Assembly. The authorities continued with efforts (including in a GCC regional context) to enhance the regulations pertaining to Islamic financial institutions and increase their supervision by the CBK. To the mission's call for the removal of the ceiling on bank lending rates, the authorities responded that this was politically difficult and required amendment of the CBK law as well as the commercial law, and that the ceiling was generally non-binding with most credit extended at below the maximum rate (Box 1).

Box 1. Main Banking Indicators				
	1997	1998	1999	2000
Banks' capital-asset ratio	11.4	12.1	12.7	12.0
Banks risk-weighted capital-asset ratio	22.4	22.5	23.7	22.4
Ratio of banks' nonperforming loans to total loans	10.2	9.9	12.8	12.7
Nonperforming loans from before invasion	8.2	7.3	6.8	6.4
Nonperforming loans since liberation	2.0	2.6	6.0	6.3
Loan provisions as a proportion of nonperforming loans	62.9	68.2	53.0	49.0
Banks' interest rate spread 1/	2.4	2.4	2.9	2.7
Source: Central Bank of Kuwait; and Fund staff estimates.				
1/ Calculated as the difference between weighted average lending and deposit rates on KD loans and deposits.				

15. **The Kuwait Stock Exchange (KSE) recovered during the first quarter of 2001 and the mission welcomed the opening of the stock exchange to foreign investors and the strengthening of regulations regarding disclosure and insider trading.** It encouraged the authorities to further facilitate the participation of foreign investors by expediting the revision of the income tax law, reforming the company law, and further strengthening supervision and the enforcement of regulations.

C. Structural Reform

16. **The structural reform process has advanced significantly since late 2000.** The National Assembly has passed key elements of the reform package, including the laws on foreign portfolio investment (September 2000), foreign direct investment (March 2001), and key components of the labor market reform (May 2000). Additional measures that do not require legislative approval are being introduced, such as increases in fees and charges on government-provided services. Other important initiatives such as the privatization law, the reform of the corporate income tax law, and the company law are expected to be approved by the National Assembly by end-2001. The recent appointment of a Committee for Economic Reform has helped expedite the preparatory work and build broader support for the proposed reform package. The mission encouraged the authorities to capitalize on this synergy by rapidly putting in place the implementing regulations and the needed technical support

structures. It also recommended a quick implementation of a number of proposals made by the World Bank of a regulatory nature aimed at energizing the private sector (including a comprehensive review and reduction of government regulations, the overhaul of the sponsorship system, and simplifying the commercial law).

17. **In the privatization area, the Kuwait Investment Authority (KIA)—the investment arm of the government—has resumed its divestment program.** Having to date sold about KD 800 million of its shares (acquired mostly after the Suk-Al-Manakh stock market debacle of 1982), KIA plans to sell a similar amount of its shares by 2003/04, with the timetable depending on developments in the stock market. KIA plans to sell its shares in the profitable Mobile Telephone Company (MTC), to be followed by the Kuwait Airlines Company and some downstream oil operations such as gas stations and lube blending. The bulk of the privatization operations would take place by 2002/03 after the legislative approval of the privatization law.

18. **To increase effectiveness of the recently passed foreign investment laws,** the staff encouraged the authorities to expedite the issuance of the associated implementing regulations, including with respect to the “negative list” of investments by foreigners, and the processing and licensing of investment applications. Also critical is the revision of the corporate income tax law to reduce the high marginal rate (55 percent), and the approval of the privatization bill to expand the domain available for foreign venture capital.

19. **The mission welcomed the authorities’ efforts to enhance the incentives for Kuwaiti nationals to seek employment in the private sector by extending the payment of social allowances to Kuwaitis working in the private sector (Box 2).** It encouraged the authorities to continue to implement the labor-market reform through market-based mechanisms instead of reliance on quantitative quotas. In particular, the mission pointed out that the 2.5 percent tax on companies to support national employment should be more broadly based and be imposed on all companies, rather than only on those listed in the Kuwait Stock Exchange (KSE); it also highlighted the need for clearly identifying the budgetary impact of labor market reform.⁶

⁶ The 2001/02 budget has allocated about KD 52 million (0.5 percent of GDP) for defraying the cost of extending social and unemployment benefits and training to nationals in the private sector.

Box 2. Economic Reforms

The reforms aim to **diversify the productive base of the economy, promote the role of the private sector, and reduce government ownership and its role in the economy.** The main areas of reform include **foreign direct and portfolio investment, labor market reform, privatization, and WTO-related issues.**

- In September 2000, a law on **portfolio foreign investment** was approved. Under the law, foreigners are now allowed to own and trade shares of joint-stock companies listed on the KSE. The only limitation to the percentage of equity ownership is in banks where some restrictions apply. No single foreign investor or group may own more than 5 percent of the capital of a Kuwaiti bank, except with the approval of the CBK. In total, foreigners may not own more than 49 percent of the capital of a particular bank except with the recommendation of the CBK and approval by the Council of Ministers.
- In March 2001, Kuwait passed a law on foreign direct investment (FDI) to allow foreigners to own **100 percent of Kuwaiti companies** subject to conditions to be determined by the Council of Ministers. A committee on FDI, headed by the Minister of Commerce and Industry, is responsible for issuing FDI licenses (a decision on the application must be reached within a period of 8 months). Companies would enjoy a tax holiday of 10 years, exemption from customs duty on imports of capital equipment and raw materials, and permission to bring in necessary foreign labor. Such companies are protected against expropriation except for public benefit, and with appropriate compensation. An FDI office is to be established soon to process FDI applications.
- A bill on **labor market reform** was approved by the National Assembly on May 10, 2000, and is designed to encourage Kuwaitis to seek employment in the private sector. Under the bill, the number of children for whom a public sector employee is entitled to an allowance has been limited to five (previously there was no limit). Further, the social allowance is to be extended to Kuwaitis in the private sector. An unemployment benefit is also to be paid to Kuwaitis seeking employment in the private sector, while job-placement services (particularly for female graduates) are to be stepped up. These efforts are to be financed by the imposition of a 2.5 percent tax on companies listed on the KSE. To complement these measures, the Civil Service Council is to set a quota for the proportion of Kuwaitis that private companies must employ; companies that fail to meet this target would be subject to sanctions such as exclusion from bidding for government contracts.
- **The privatization bill has been approved by the Finance Committee of the National Assembly,** and is currently awaiting approval by the full assembly (expected before end-2001).
- Kuwait amended its **copyrights law** in 2000 to comply with WTO regulations, while the **patent law** was amended in January 2001, also in line with WTO requirements.
- **Other measures** under consideration include:
 - a. Corporate income tax law: replacing the top rate of 55 percent with a flat rate of 35 percent.
 - b. Review of company law and competition law to make them more effective.
 - c. Increases in fees and charges on government provided services (especially on electricity and water).

D. Statistical Issues

20. **The mission observed that continued progress had been made in improving the currentness, quality, and coverage of economic and financial statistics.** In particular, it commended the CBK's efforts to enhance the collection, coverage, and presentation of the

balance of payments data, and the progress made by the Central Statistical Office (CSO, Ministry of Planning) to improve the compilation and reporting of national account data. It noted that further improvement in national accounts data should cover the compilation and publication of data on private capital formation on the expenditure side, and on household and personal services on the production side. With regard to consumer price data, the mission noted that the time lag in the release of CPI data had also been reduced slightly from 4–5 months to 3 months. It also learned that the new household expenditure survey with updated weights and a revision of the previous basket of goods and services in the consumer price index was expected to be completed shortly. This would significantly improve the quality and timeliness of the CPI statistics. To sustain these efforts, the mission observed that adequate resources would need to be devoted to the CSO.

21. **In the fiscal area, the mission underscored the need to make the budget a better tool of fiscal policy and economic analysis by improving and modernizing the current budget presentation.** In this respect, the authorities expressed interest in receiving the Fund's technical assistance to help modernize and improve the current budget presentation. Also, the mission encouraged the authorities to consolidate the fiscal accounts by incorporating data on domestic and foreign investment income, asset transactions, transfers of profits of public enterprises, and interest payments on all debt. The authorities maintained that the resources and assets of the Reserve Fund for Future Generations could not be made public by law.⁷ Finally, the mission reiterated the need to shorten the time lag in reporting fiscal data to the Fund for publication in *Government Finance Statistics*.

22. **Money and banking data are reported to the Fund on a regular and timely basis, and balance of payments data reporting has continued to improve in both coverage and timeliness.** The mission welcomed the enhancements that were made in the estimation of the travel services and the ongoing efforts to improve the compilation of data on private capital flows in collaboration with the Taxation Department of the Ministry of Finance. The mission encouraged the authorities to publish quarterly data on Kuwait's oil production and prices.

III. STAFF APPRAISAL

23. **Improved terms of trade and sound macroeconomic policies have helped strengthen Kuwait's financial situation in 1999 and 2000.** The fiscal and external positions recorded large surpluses in both years, inflation was low, the banking system remained strong and well supervised, and Kuwait continued to accumulate foreign assets that

⁷ While the authorities provide Fund missions with the necessary data to put together a consolidated fiscal presentation, the latter is not included in the budget presentation.

generated a steady stream of investment income. However, growth in the non-oil sector remained low and stock market prices were depressed reflecting uncertainty regarding the approval of key economic reforms. With the progress achieved on the latter front in recent months, a renewed optimism is expected to help revive private sector activity and the stock market in 2001. Nonetheless, continued structural reforms are needed to allow Kuwait to achieve and sustain higher growth rates over the medium term.

24. The authorities need to capitalize on the improved dialogue between the government, the National Assembly, and the private sector to move forcefully to implement their structural reform program. The recent legislative approval of the laws on foreign direct and portfolio investments are welcome along with key elements of the labor market reform. The recently formed Committee for Economic Reform should expedite the preparatory work and build broader support for the proposed reform package. In this respect, the staff urges the authorities to approve other important laws, including the privatization law, the company law, and the income tax reform. The staff also encourages the authorities to put in place the implementing regulations and the needed technical support and recommends an expedited implementation of a number of proposals (developed in collaboration with the World Bank) aimed at energizing the private sector.

25. The authorities should restrain fiscal spending in the face of higher oil revenue under the current 2001/02 budget. While recognizing that the increase in capital expenditure might be warranted following cutbacks in recent years, the staff underscores the need to resist pressure to raise current expenditure, given the durable nature of much of such increases as well as the vulnerability of public finances to volatile oil prices. The authorities should persevere with their medium-term objective of restructuring the budget, in conjunction with other structural reforms, including in particular, containing the growth of the wage bill, streamlining the civil service, and reducing expenditure on subsidies and transfers. The rise in capital expenditure should be limited to economically sound projects, and take into account the need to reduce the size of the public sector. The staff welcomes the authorities' intentions to achieve savings on various current expenditure items, and improve the collection of non-oil revenue. Further efforts are called for to diversify the revenue base, including the elimination of import duty exemptions on a wide range of products, the introduction of a broad based consumption tax, and the levying of excises on luxury items.

26. Monetary policy is rightly focused on maintaining the credibility of the pegged exchange rate arrangement and achieving price stability. In particular, the CBK should keep the interest rate differential with U.S. dollar deposits within a narrow margin by reducing its discount rate in line with the decline in U.S. interest rates. Also, the efforts of the CBK to maintain stability in the inter-bank money market and mop up excess liquidity have been commendable. Efforts to complete compliance with the Basle Committee's Core Principles for Effective Banking Supervision are strongly supported. The recent recovery of the stock exchange attests to the general improvement in business climate, including the opening of the KSE to foreign investors and the strengthening of regulations regarding disclosure and insider trading. The authorities are encouraged to further facilitate the

participation of foreign investors by expediting the revision of the income tax law, reforming the company law, and further strengthening supervision and the enforcement of regulations pertaining to the stock exchange.

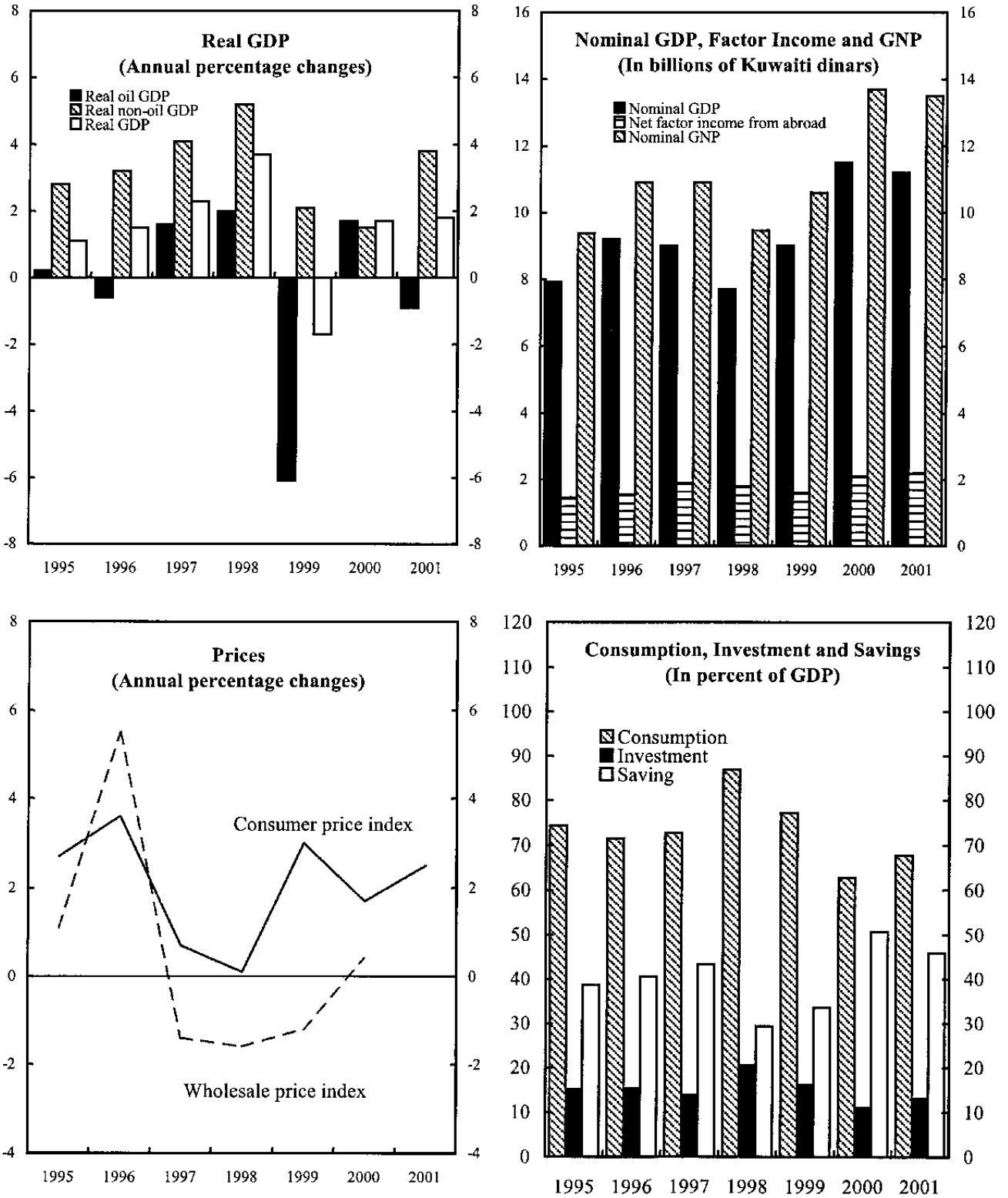
27. **The pegged exchange arrangement, open capital account, and prudent fiscal and monetary policies have served Kuwait well, keeping inflation low and reinforcing confidence in the economy.** While sharing the authorities' views that the recent appreciation of the real effective exchange rate has not seriously affected the competitiveness of non-oil activities, the authorities are encouraged to closely monitor indicators of competitiveness and step up structural reforms, which would raise private sector productivity.

28. **The authorities are commended for maintaining a generous foreign assistance program.**

29. **The quality and timeliness of data provision for the conduct of surveillance are adequate.** The authorities' participation in the General Data Dissemination System and their intention to continue to upgrade their database are commendable. In particular, the recent progress in data compilation and dissemination on national accounts and the balance of payments is welcome. The CSO efforts to improve the national accounts and price data should be sustained, including through provision of adequate resources. In particular, there is a need to complete the household expenditure survey to update the CPI statistics. The Central Bank is encouraged to persevere with its efforts to improve balance of payments data on private capital flows. In addition, to enhance the transparency of fiscal data, the fiscal accounts should be consolidated, and the time lag in reporting data to the Fund shortened. The authorities' intention to modernize and improve the budget presentation in an effort to improve the economic assessment of fiscal policy is welcome.

30. It is proposed that the next Article IV consultation with Kuwait be held on the standard 12-month cycle.

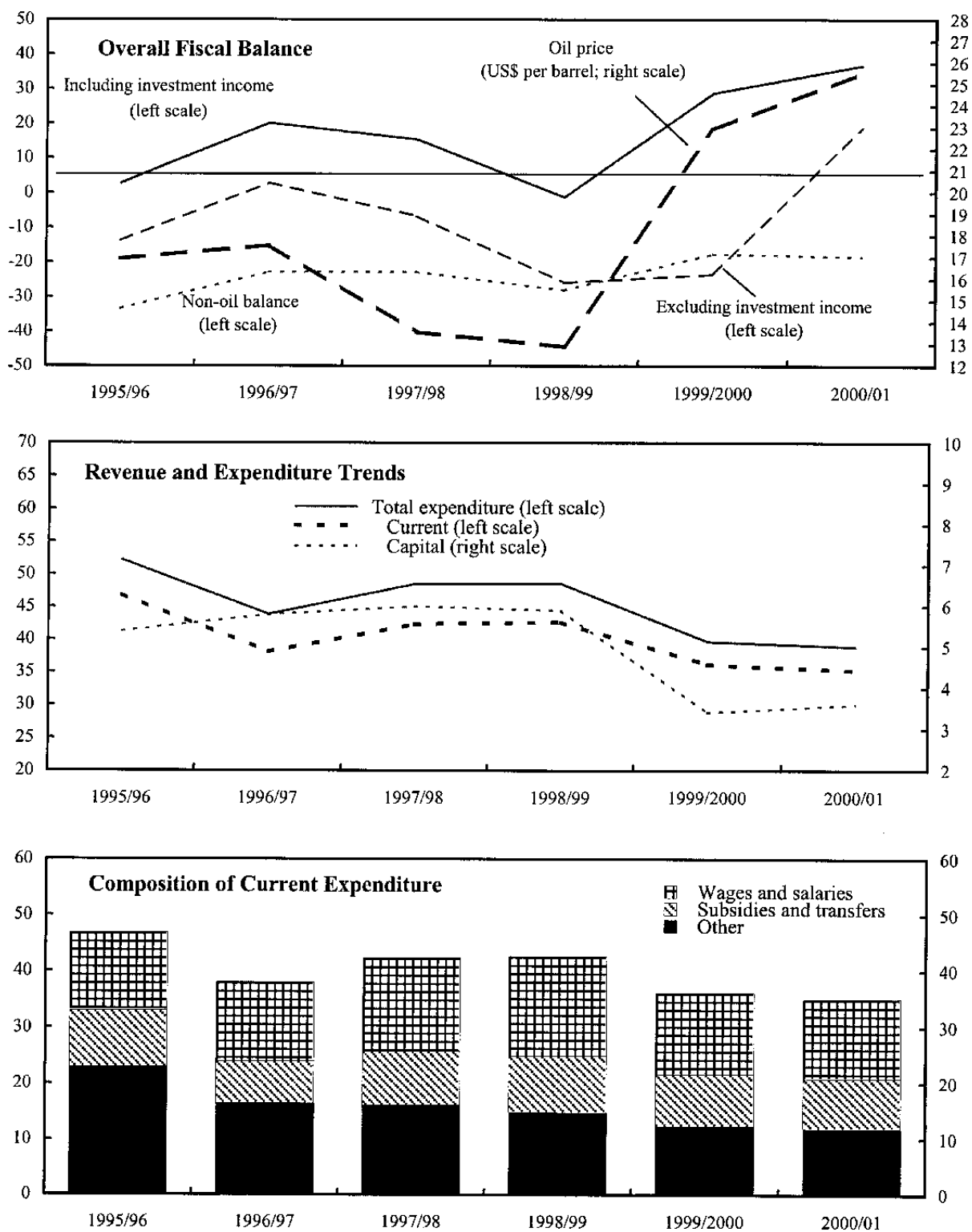
Figure 1. Kuwait: Selected Economic Indicators, 1995–2001



Sources: Data provided by the Kuwaiti authorities; and Fund staff estimates and projections.

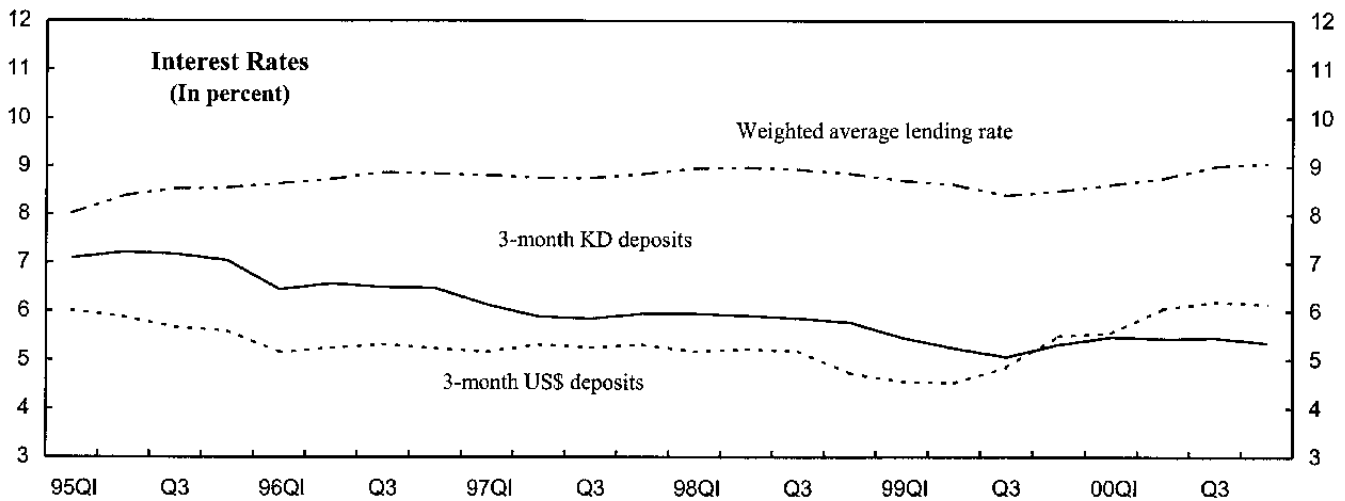
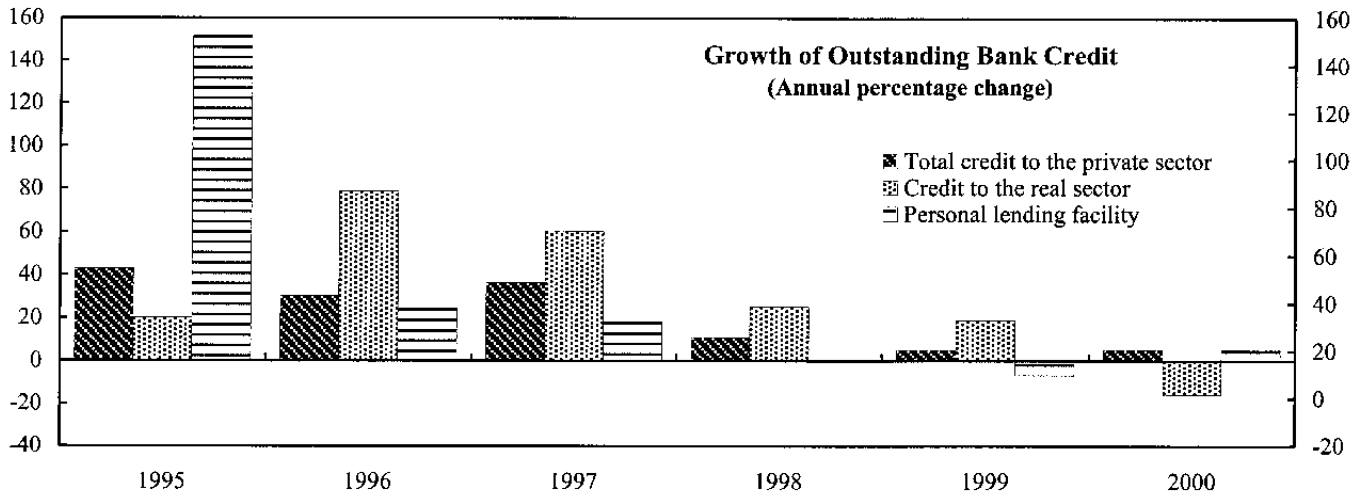
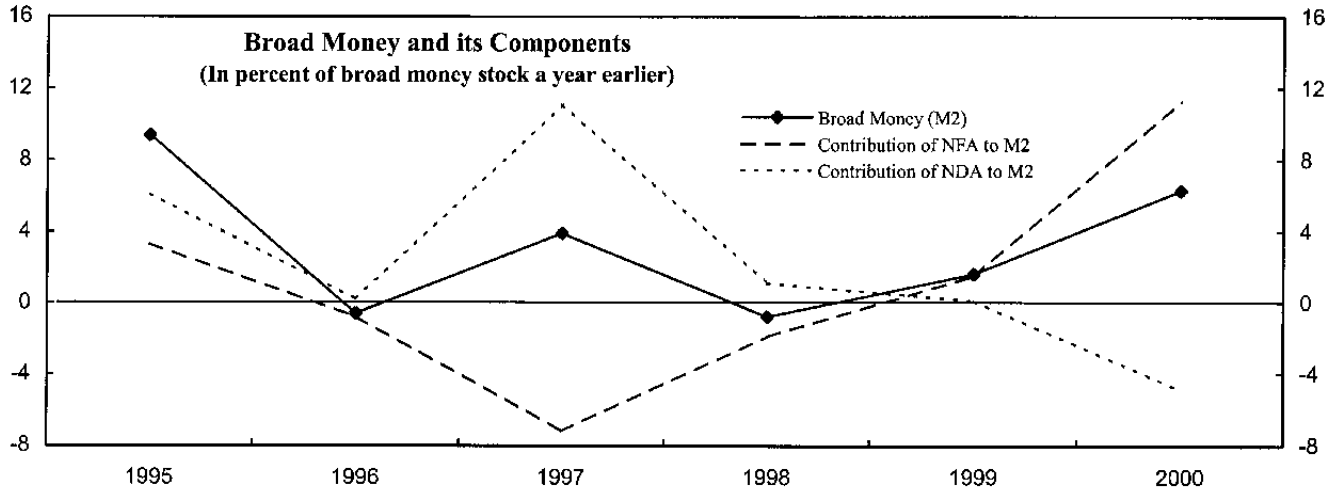
Figure 2. Kuwait: Public Finance, 1995/96–2000/01

(In percent of GDP)



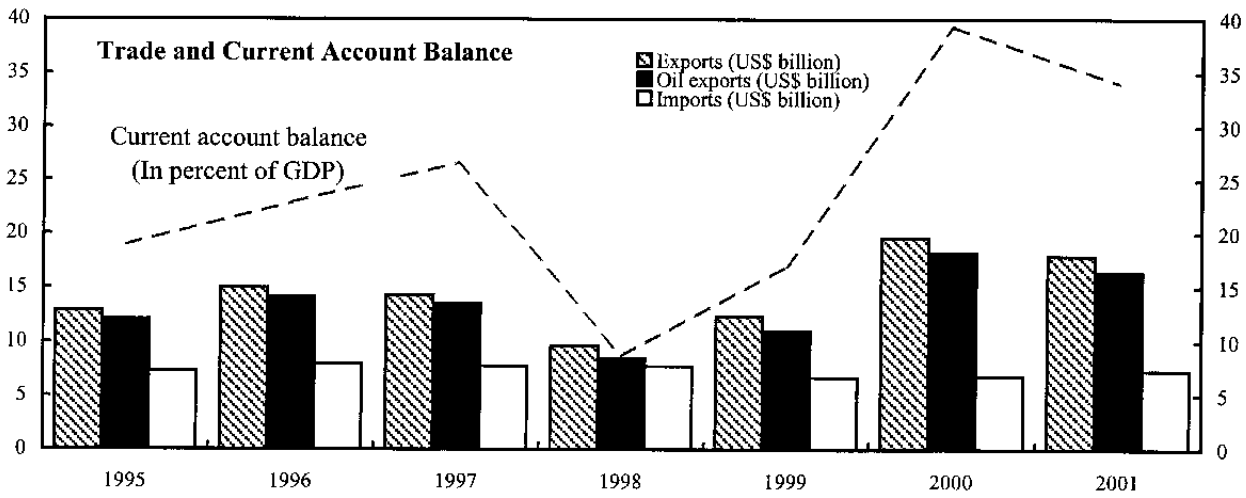
Sources: Kuwaiti authorities; and Fund staff estimates and projections.

Figure 3. Kuwait: Monetary Sector Indicators, 1995–2000

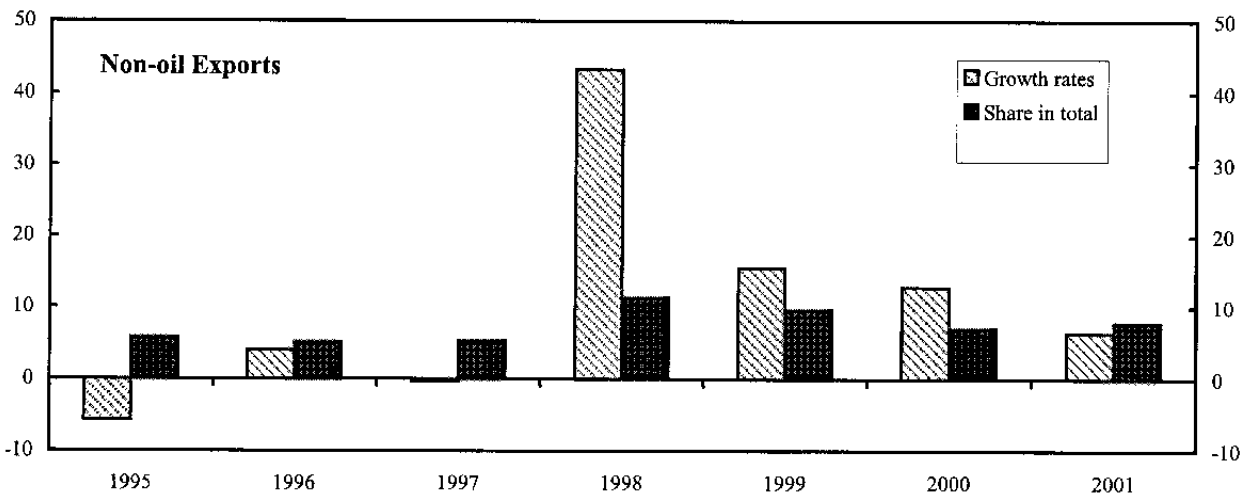
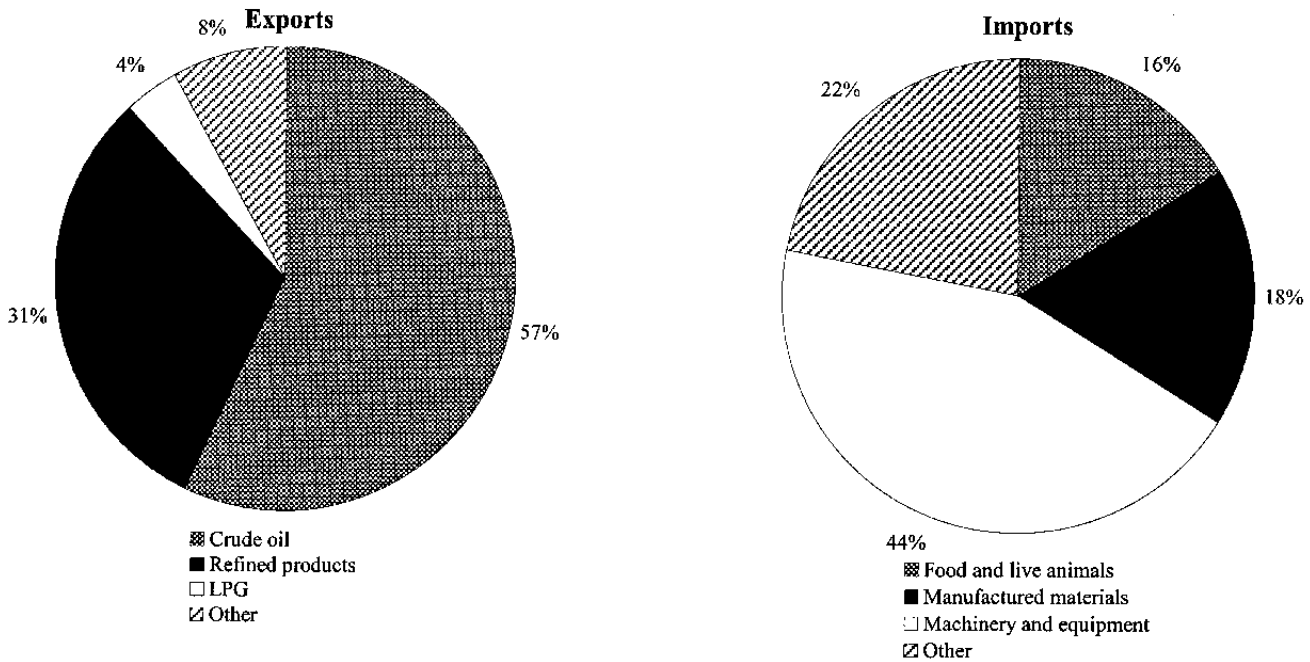


Source: Central Bank of Kuwait.

Figure 4. Kuwait: External Sector Indicators, 1995–2001



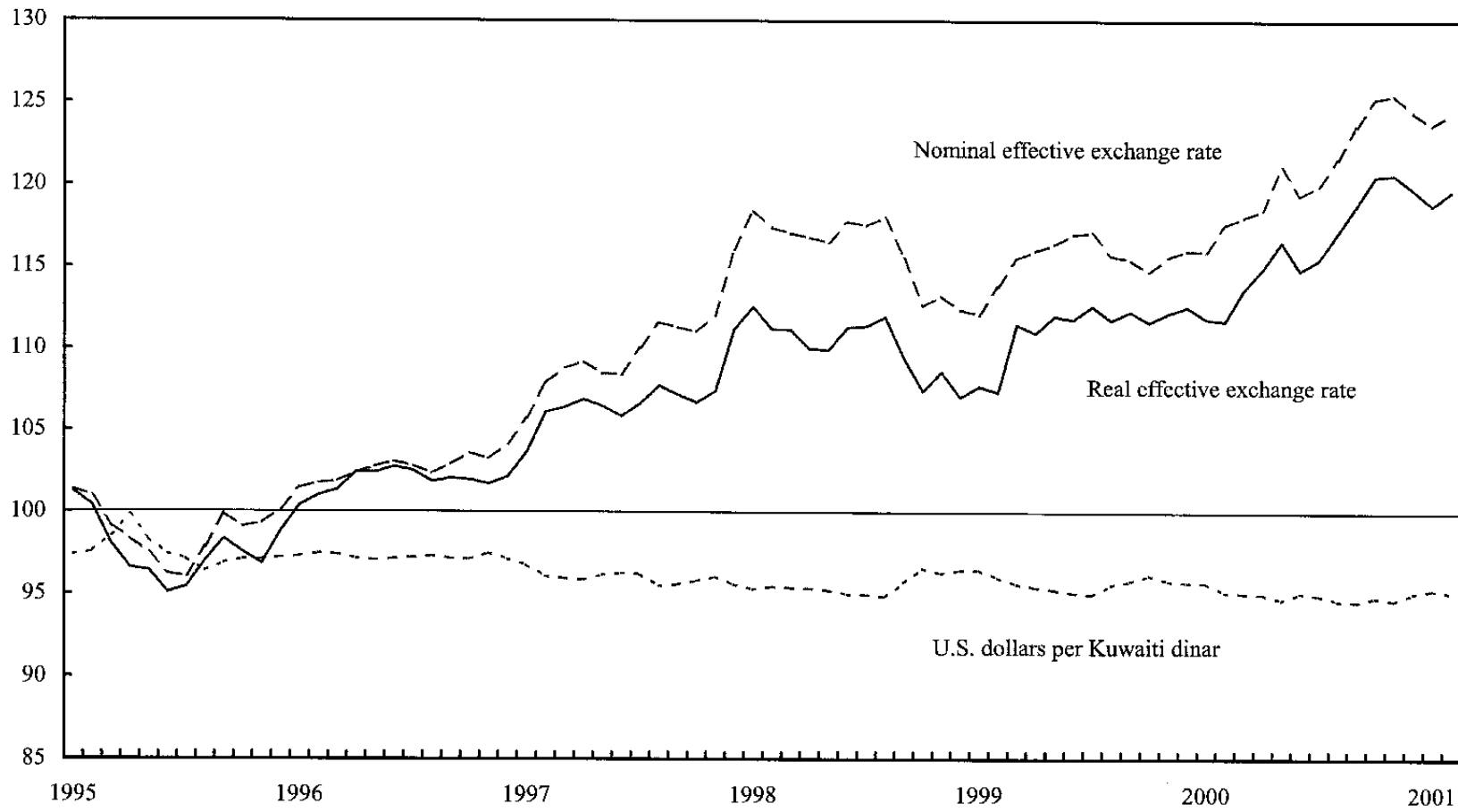
Commodity Composition of Foreign Trade, 2000



Sources: Data provided by the Kuwaiti authorities; and Fund staff estimates and projections.

Figure 5. Kuwait: Exchange Rate Movements, January 1995–February 2001

(1990=100)



Sources: IMF, *Information Notice System*; and Central Bank of Kuwait.

Table 1. Kuwait: Selected Economic Indicators, 1996–2002

	1996	1997	1998	1999	Prel. 2000	Projections	
						2001	2002
Nominal GDP (market prices, US\$ millions)	31,072	29,866	25,406	29,770	37,781	37,065	36,002
Crude oil production (millions barrels per day)	2.01	2.01	2.05	1.87	1.98	1.97	2.00
Kuwait crude export price (US\$ per barrel)	18.3	16.8	10.3	15.5	25.7	23.5	20.5
	(Percent changes)						
Production and prices							
Nominal GDP	17.4	-2.6	-14.5	17.2	27.7	-2.5	-2.9
Nominal non-oil GDP	4.0	3.3	5.7	3.7	3.4	6.1	6.1
Real GDP	1.5	2.2	3.7	-1.7	1.7	1.8	3.0
Real oil GDP	-0.6	1.6	2.0	-6.1	1.7	-0.9	1.5
Real non-oil GDP	3.2	4.1	5.2	2.1	1.5	3.8	4.0
Consumer price index	3.6	0.7	0.1	3.0	1.7	2.5	2.5
	(In percent of GDP)						
Public finance 1/							
Total revenue, <i>Of which</i> :	54.9	63.8	63.7	47.1	68.2	75.5	65.2
Oil and gas revenue	36.1	42.9	38.2	26.8	46.4	55.2	42.4
Investment income 2/	16.0	17.3	22.5	16.9	19.1	17.8	19.2
Total expenditures	52.2	43.8	48.4	48.5	39.6	38.8	43.9
Current	46.8	38.0	42.3	42.6	36.1	35.2	39.2
Capital	5.4	5.8	6.0	5.9	3.4	3.6	4.7
Fiscal balance (deficit -)	2.7	20.0	15.3	-1.3	28.6	36.7	21.3
Fiscal balance excluding investment income (deficit -)	-13.3	2.7	-7.2	18.2	9.5	18.9	2.1
	(Changes in percent of broad money stock)						
Money and credit							
Foreign assets (net)	-0.8	-7.2	-1.9	1.5	11.3	3.6	...
Domestic assets (net)	-0.7	11.1	1.1	0.1	-4.9	2.5	...
Claims on government (net)	-10.8	-2.7	-1.4	-2.7	-7.3	-2.6	...
Claims on nongovernment sector	9.5	16.9	7.3	3.6	3.9	5.0	...
Broad money	-0.6	3.9	-0.8	1.6	6.3	6.1	...
	(Percent per year)						
Interest rates 3/							
Kuwaiti dinar three-month deposits	6.47	5.95	5.77	5.32	5.35	4.11	...
U.S. dollar three-month deposits	5.24	5.31	4.73	5.50	6.15	4.48	...
	(In US\$ millions, unless otherwise indicated)						
External sector							
Exports	14,945	14,279	9,616	12,278	19,573	17,874	16,182
<i>Of which</i> : oil and refined products	14,132	13,467	8,470	11,029	18,162	16,383	14,592
Imports	-7,949	-7,747	-7,715	-6,710	-6,845	-7,262	-7,706
Current account	7,107	7,930	2,214	5,061	14,865	12,589	10,257
In percent of GDP	22.9	26.6	8.7	17.0	39.3	34.0	28.5
Overall balance	-46	-65	496	876	2,616	659	556
In percent of GDP	-0.1	-0.2	2.0	2.9	6.9	1.8	1.5
International reserve assets	3,621	3,556	4,052	4,928	7,544	8,203	8,759
In months of imports of goods and services	3.3	3.3	4.1	5.0	7.5	8.0	8.2
Total external debt (including private sector)	4,550	5,245	5,546	6,135	5,164	...	...
In percent of GDP	14.6	17.6	21.8	20.6	13.7	...	...
	(Percentage change)						
Exchange rates							
Exchange rates (US\$ per KD, period average)	3.34	3.30	3.28	3.28	3.26	3.26	3.26
Nominal effective exchange rate	3.9	7.2	5.5	-0.6	4.7	...	...
Real effective exchange rate	4.3	4.9	3.1	0.9	4.8	...	...

Sources: Data provided by the authorities; and Fund staff estimates.

1/ On a fiscal year basis (July–June).

2/ Includes profit of public enterprises.

3/ In 2001, for end March.

Table 2. Kuwait: Summary of Government Finance, 1995/96–2001/02 1/

	1995/96	1996/97	1997/98	1998/99	Act. 1999/2000	Est. 2000/01	Budg. 2001/02	Proj. 2001/02
(In millions of Kuwaiti dinars)								
Total revenue	4,729	5,855	5,349	3,965	7,052	8,642	3,659	7,260
Oil and gas	3,114	3,936	3,208	2,254	4,795	6,321	3,263	4,723
Investment income and transfer of profits of public entities 2/	1,380	1,584	1,887	1,419	1,976	2,083	...	2,141
Other 3/	235	335	254	291	282	282	325	325
Capital	1	82	1	1	0	0	71	71
Total expenditure	4,498	4,021	4,064	4,076	4,091	4,437	5,102	4,887
Current	4,030	3,488	3,557	3,584	3,735	4,025	4,390	4,363
Wages and salaries	1,196	1,293	1,396	1,490	1,498	1,631	1,722	1,670
Goods and services	1,268	1,075	959	899	938	1,025	1,098	1,043
Interest on domestic debt 4/	408	316	291	269	252	239	114	266
Interest on foreign debt 2/	81	29	5	7	5	5	0	0
Transfers abroad	219	82	97	69	84	92	126	120
Subsidies and transfers	858	693	809	850	958	1,033	1,330	1,264
Capital	468	533	507	492	356	412	712	523
Overall balance	231	1,834	1,285	-111	2,961	4,206	-1,443	2,373
Financing	-231	-1,834	-1,285	111	-2,961	-4,206	1,443	-2,373
Domestic (net)	-135	-231	-647	130	-451	-1,035		-450
Banks	-38	-53	-200	77	-534	-1,170		-585
Nonbanks	-97	-178	-448	53	84	135		135
External	-958	-482	0	0	0	0		0
Reserve funds	862	-1,121	-638	-19	-2,510	-3,171	1,443	-1,923
(In percent of GDP)								
Revenue	54.9	63.8	63.7	47.1	68.2	75.5	33.0	65.4
Oil and gas	36.1	42.9	38.2	26.8	46.4	55.2	29.4	42.5
Investment income	16.0	17.3	22.5	16.9	19.1	17.8	...	19.3
Other	2.7	3.6	3.0	3.5	2.7	2.5	2.9	2.9
Expenditure	52.2	43.8	48.4	48.5	39.6	38.8	46.0	44.0
Current	46.8	38.0	42.3	42.6	36.1	35.2	39.5	39.3
Wages and salaries	13.9	14.1	16.6	17.7	14.5	14.2	15.5	15.0
Goods and noninterest services	14.7	11.7	11.4	10.7	9.1	9.0	9.9	9.4
Interest on domestic and foreign debt	5.7	3.8	3.5	3.3	2.5	2.1	...	2.4
Subsidies and transfers	10.0	7.5	9.6	10.1	9.3	9.0	12.0	11.4
Capital	5.4	5.8	6.0	5.9	3.4	3.6	6.4	4.7
Overall balance	2.7	20.0	15.3	-1.3	28.7	36.7	-13.0	21.4

Sources: Ministry of Finance; Central Bank of Kuwait; and Fund staff estimates.

1/ Fiscal year has been changed to April–March effective 2001/02; before then it was June–July.

2/ Excluded from national budget presentation.

3/ Excludes revenues from utility tariffs (included in the national budget presentation).

4/ Covers interest on treasury bills and bonds, and on DCP bonds. Only the latter is included in the national budget presentation.

Table 3. Kuwait: Monetary Survey, 1995–2001

	1995	1996	1997	1998	1999	Prel. 2000	Est. 2001
(End-period stocks in millions of Kuwaiti dinars)							
Foreign assets (net)	2,514	2,456	1,929	1,784	1,899	2,763	3,059
Central bank	1,053	1,049	1,034	1,080	1,320	2,005	2,175
Local banks	1,462	1,408	895	704	579	758	884
Domestic assets (net)	4,926	4,875	5,687	5,772	5,780	5,402	5,603
Claims on government (net)	4,775	3,981	3,782	3,678	3,475	2,911	2,701
Central bank (net)	-158	-219	-237	-205	-392	-532	-647
Claims	2	41	39	0	45	0	0
Deposits (increase -)	160	260	276	205	437	532	647
Local banks (net)	4,932	4,199	4,019	3,883	3,867	3,443	3,348
Claims	5,392	4,573	4,363	4,140	4,062	3,628	3,163
Government debt bonds	3,394	2,845	2,389	2,246	1,931	1,491	1,027
Public debt instruments	1,998	1,728	1,974	1,895	2,132	2,137	2,136
Deposits (increase -)	459	374	344	257	195	185	185
Claims on nongovernment sector	2,805	3,503	4,745	5,303	5,572	5,872	6,283
Credit facilities	2,436	3,173	4,324	4,802	5,015	5,252	5,620
Local investments	369	330	420	501	557	620	663
Other items (net)	-2,654	-2,609	-2,840	-3,209	-3,267	-3,382	-3,382
Broad money	7,375	7,331	7,601	7,557	7,678	8,164	8,662
Money	1,185	1,243	1,277	1,143	1,371	1,468	...
Quasi money	6,190	6,088	6,324	6,413	6,307	6,696	...
<i>Of which</i> : Foreign currency deposits	1,308	1,257	1,326	1,037	881	895	...
(Annual percentage change)							
Foreign assets (net)	9.6	-2.3	-21.4	-7.5	6.4	45.5	10.7
Central bank	-2.5	-0.4	-1.4	4.5	22.2	51.9	8.5
Local banks	20.5	-3.7	-36.4	-21.4	-17.7	31.0	16.6
Domestic assets (net)	10.7	-1.0	16.7	1.5	0.1	-6.5	3.7
Claims on government (net)	-2.7	-16.6	-5.0	-2.7	-5.5	-16.2	-7.2
Central bank (net)	48.3	-38.8	-8.4	13.5	-91.3	-35.6	-21.7
Local banks (net)	-5.4	-14.9	-4.3	-3.4	-0.4	-11.0	-2.7
Claims on nongovernment sector	43.8	24.9	35.5	11.8	5.1	5.4	7.0
Other items (net)	-10.2	1.7	-8.9	-13.0	-1.8	-3.5	0.0
Broad money	9.4	-0.6	3.9	-0.8	1.6	6.3	6.1
Money	5.2	4.9	0.4	-8.3	19.9	7.0	...
Quasi money, <i>Of which</i> :	10.2	-1.6	4.6	0.7	-1.7	6.2	...
Foreign currency deposits	18.0	-3.9	-8.2	-10.1	-15.1	1.6	...
(Change in percent of broad money stock a year earlier)							
Foreign assets (net)	3.3	-0.8	-7.2	-1.9	1.5	11.3	3.6
Central bank	-0.4	-0.1	-0.2	0.6	3.2	8.9	2.1
Local banks	3.7	-0.7	-7.0	-2.5	-1.7	2.3	1.5
Domestic assets (net)	7.1	-0.7	11.1	1.1	0.1	-4.9	2.5
Claims on government (net)	-2.0	-10.8	-2.7	-1.4	-2.7	-7.3	-2.6
Central bank (net)	2.2	-0.8	-0.2	0.4	-2.5	-1.8	-1.4
Local banks (net)	-4.2	-9.9	-2.5	-1.8	-0.2	-5.5	-1.2
Government debt bonds	-6.7	-7.4	-6.2	-1.9	-4.2	-5.7	-5.7
Claims on nongovernment sector	12.7	9.5	16.9	7.3	3.6	3.9	5.0
Other items (net)	-3.6	0.6	-3.2	-4.8	-0.8	-1.5	0.0
Broad money	9.4	-0.6	3.9	-0.8	1.6	6.3	6.1
Money	0.9	0.8	0.1	-1.4	3.0	1.3	1.1
Quasi money	8.5	-1.4	3.8	0.6	-1.4	5.1	5.0

Source: Central Bank of Kuwait; and Fund staff projections.

Table 4. Kuwait: Summary Balance of Payments, 1996–2002

(In millions of U.S. dollars)

	1996	1997	1998	1999	Est. 2000	Projections	
						2001	2002
Current account	7,107	7,930	2,214	5,061	14,865	12,589	10,257
Goods (trade balance)	6,997	6,532	1,901	5,568	12,728	10,612	8,476
Exports	14,945	14,279	9,616	12,278	19,573	17,874	16,182
Oil and oil products	14,132	13,467	8,470	11,029	18,162	16,383	14,592
Non-oil	813	812	1,146	1,249	1,411	1,492	1,590
Imports	-7,949	-7,747	-7,715	-6,710	-6,845	-7,262	-7,706
Services	-3,580	-3,372	-3,780	-3,612	-2,895	-3,072	-3,259
Transportation	-641	-353	-427	-378	72	...	...
Travel	-2,308	-2,189	-2,310	-2,178	-2,353	...	...
Other services	-631	-831	-1,043	-1,056	-614	...	...
Investment income	5,180	6,276	5,868	5,110	6,916	7,176	7,441
Receipts	6,409	7,743	7,163	6,095	7,529	7,919	8,156
General government 1/	3,884	5,225	4,664	4,061	4,915	5,143	5,277
Other 2/	2,525	2,518	2,498	2,034	2,614	2,776	2,880
Payments	-1,229	-1,467	-1,295	-985	-613	-743	-715
General government	-631	-933	-492	-227	-26	-27	-28
Other	-598	-534	-804	-759	-587	-716	-687
Current transfers	-1,490	-1,506	-1,775	-2,004	-1,884	-2,127	-2,402
Capital and financial account	-7,835	-6,342	-2,842	-5,002	-12,246	-11,930	-9,701
Capital account (official grants)	-204	-132	79	703	1,959	100	100
Financial account	-7,631	-6,211	-2,920	-5,705	-14,205	-12,030	-9,801
Direct investment	-1,393	989	1,926	49	-238	...	...
Abroad	-1,740	969	1,867	-23	-254	...	...
In reporting country	347	20	59	72	16	...	...
Portfolio investment	-761	-6,926	-4,768	-2,559	-12,328	...	...
Assets	-788	-6,926	-4,768	-2,638	-12,582	...	...
Liabilities	27	0	0	79	254	...	...
Other investment	-5,477	-274	-79	-3,197	-1,640	...	...
Trade credits	-344	-46	351	-841	-274	...	...
Loans	-3,774	-4,978	-535	-283	-346	...	...
Currency and deposits	3,083	-36	269	-1,850	-1,320	...	...
Other	-4,442	4,786	-164	-223	300	...	...
Net errors and omissions 3/	682	-1,652	1,124	817	-3	0	0
Overall balance	-46	-65	496	876	2,616	659	556
International reserve assets (-increase)	46	65	-496	-876	-2,616	-659	-556
Memorandum items:							
Current account/GDP (in percent)	22.9	26.6	8.7	17.0	39.3	34.0	28.5
Overall balance/GDP (in percent)	-0.1	-0.2	2.0	2.9	6.9	1.8	1.5
International reserve assets 4/	3,621	3,556	4,052	4,928	7,544	8,203	8,759
Total reserves minus gold	3,515	3,452	3,947	4,824	7,439.7	8,099	8,655
Gold (national valuation)	106	104	105	104	104.2	104.2	104.2
In months of imports of goods and services	3.3	3.3	4.1	5.0	7.5	8.0	8.2

Sources: Central Bank of Kuwait, and Fund staff estimates.

1/ Kuwait Investment Authority, Kuwait Petroleum Corporation, Kuwait Fund for Arab Economic Development, Public Institute for Social Security, Kuwait Airways Corporation, and Bank of Credit and Savings.

2/ CBK, local banks, investment, insurance companies, and non-financial private sector.

3/ Includes other unclassified private sector flows.

4/ As reported in IFS.

Table 5. Kuwait: Vulnerability Indicators, 1997–2000

(In percent, unless otherwise indicated)

	1997	1998	1999	2000
External solvency indicators				
REER (CPI based, period average)	4.9	3.1	0.9	4.8
External debt including private sector (in millions of U.S. dollars) 1/	5,245.0	5,546.0	6,135.0	5,214.0
Short-term debt (original maturity) 1/	4,254.0	4,442.0	4,788.0	4,077.0
Medium- and long-term debt 1/	991.0	1,104.0	1,347.0	1,137.0
External debt/GDP	17.6	21.8	20.6	13.7
External debt/total exports of goods and services	32.7	48.7	44.2	23.5
Short-term debt/total exports of goods and services	26.5	39.0	34.5	18.2
External debt service/total exports of goods and services	45.3	21.3	7.4	4.6
Public sector solvency indicators				
General government domestic debt/GDP (TBs and bonds)	24.7	26.2	25.8	21.3
Interest payments/total revenue	5.5	7.0	3.6	2.8
Distribution of the public domestic debt by holders				
Local commercial banks	88.3	93.5	91.2	86.4
Other (including nongovernment public institutions)	11.7	6.5	8.8	13.6
Oil revenue/total revenue	60.0	56.9	73.0	73.0
External liquidity indicators				
Total official net foreign assets (in millions of U.S. dollars)	3,398.0	3,583.0	4,339.0	6,558.0
CBK	3,397.2	3,582.5	4,338.9	6,558.0
Other	...	...	...	...
CBK gross foreign assets (in millions of U.S. dollars) 2/	3,416.0	3,590.0	4,347.0	6,571.0
In months of imports of goods and services	3.2	3.2	4.4	6.7
Relative to short-term external debt	80.3	80.8	90.8	161.2
Relative to M0	242.5	242.6	226.0	375.7
Relative to M1	83.4	94.7	96.4	136.9
Total official net foreign assets/M3	13.5	14.3	17.2	24.5
Commercial banks' net foreign assets (in millions of U.S. dollars)	2,941.0	2,334.0	1,903.0	2,529.8
Foreign assets	6,956.0	5,929.0	5,874.0	6,440.0
Foreign liabilities	4,015.0	3,595.0	3,971.0	3,910.0
Oil exports/total exports	94.3	88.1	89.8	92.8
Financial sector indicators				
Increase in net bank profits 3/	12.6	-9.2	13.7	20.9
Ratio of net profits to total bank assets	1.8	1.6	1.8	2.0
Ratio of net profits to total shareholders' equity	15.8	13.8	15.3	17.6
Banks' capital-asset ratio	11.1	11.4	11.6	11.5
Banks risk-weighted capital-asset ratio	22.4	22.5	23.7	22.4
Banks' leverage 5/	9.0	8.8	8.6	8.7

Table 5. Kuwait: Vulnerability Indicators, 1997–2000

(In percent, unless otherwise indicated)

	1997	1998	1999	2000
Financial sector indicators				
Banks' liquidity ratio 6/	45.0	44.2	44.5	50.5
Ratio of banks' nonperforming loans to total loans	10.2	9.9	12.8	12.7
Nonperforming loans from before invasion	8.2	7.3	6.8	6.4
Nonperforming loans since liberation	2.0	2.6	6.0	6.3
Loan provisions as a proportion of nonperforming loans	62.9	68.2	53.0	49.0
Ratio of bank lending to total domestic credit facilities				
Stock market-related 7/	7.7	6.1	4.3	4.7
Real estate 7/ 8/	15.6	17.5	19.9	16.3
Total (stock market, real estate) 7/	23.3	23.6	24.3	21.0
Ratio of bank lending to banks' own funds				
Stock market-related 4/	23.7	19.9	14.4	15.7
Real estate 4/ 9/	47.9	57.3	66.5	53.9
Total (stock market, real estate) 4/	71.6	77.2	80.9	69.6
Banks' interest rate spread 9/	2.9	2.6	2.8	3.0
Investment companies' capital and reserve/total assets	40.6	38.6	39.5	37.4
(In millions of Kuwaiti dinars)				
Net foreign assets of banks 10/	895.2	704.0	579.0	773.3
Net foreign assets of investment companies 11/	612.9	601.0	706.0	790.8
Open foreign exchange position of banks 12/	-4.6	26.0	19.4	6.8

Source: Central Bank of Kuwait, and Fund staff estimates.

1/ Estimates based on ratios approximated from the joint BIS-IMF-OECD-World Bank database.

2/ Excludes SDRs and IMF reserve position.

3/ For net profits in 1998 and 1999, excluding two banks not listed in the Kuwait Stock Exchange.

4/ For 1998, as of September.

5/ Ratio of total liabilities to banks' own funds.

6/ Ratio of liquid assets (including public debt instruments and investments in local and foreign shares) to total liabilities (including deposits held by nonresidents as well as deposits of foreign banks).

7/ For 1999, as of September.

8/ Ratios may be overestimated due to loan classification problems by the local banks.

9/ Calculated as the difference between weighted average lending and deposit rates on KD loans and deposits.

10/ For 2000, revised from the figure provided in Table (3) of the Staff Report.

11/ Equals nonresident assets minus nonresident liabilities, excluding own funds.

12/ A (-) sign indicates a short position.

Kuwait: Fund Relations

(As of April 30, 2001)

I.	Membership Status:	Joined September 13, 1962 Article VIII on April 5, 1963	
II.	General Resources Account:	SDR Million	% Quota
	Quota	1,381.10	100.0
	Fund holdings of currency	993.77	72.0
	Reserve position in Fund	387.33	28.0
	Financial Transactions Plan Transfer (net)	0.00	
III.	SDR Department:	SDR Million	% Allocation
	Net cumulative allocation	26.74	100.0
	Holdings	74.38	278.1
IV.	Outstanding Purchases and Loans:	None	
V.	Financial Arrangements:	None	
VI.	Projected Obligations to Fund:	None	
VII.	Exchange Rate Arrangement:		

The Kuwaiti dinar is pegged to an undisclosed currency basket. The central bank normally maintains buying/selling rates for the U.S. dollar at one sixteenth of 1 percent on either side of the currency-basket-derived exchange rate: US\$1=KD 0.30800 as of end-April 2001.

VIII. Article IV Consultations:

The latest Article IV consultation was completed by the Executive Board on March 13, 2000. The Staff Report was issued on February 4, 2000 (SM/00/23) and the associated Statistical Appendix on February 8, 2000 (SM/00/27).

IX. Technical Assistance:

FAD	Advisory mission	April 1992
MAE	Advice on bank report forms	October 1992
FAD	Advice on fiscal reform	February–March 1993
STA	Multi-topic statistics mission	April–May 1994
FAD	Budget advisor	September 1993–October 1994
MED	Macroeconomic model	September 1996
MAE	Early warning system and banks supervision	May 1997

STA	Balance of payments statistics	November 1998
MAE	Monetary policy instruments	November 1998
MAE	Early warning system	December 1998
MAE	Monetary policy issues	March 1999
MAE	Bank supervision	April 1999
INS	Financial programming	April 1999
MAE	Bank deposit insurance scheme	October/November 1999
STA	Seminar on GDDS	February 2000

X. **Resident Representative:** None

XI. Kuwait has consented to the quota increase under the Eleventh General Review of Quotas; it has not yet accepted the Fourth Amendment of the Articles of Agreement.

KUWAIT

Relations with the World Bank Group As of March 31, 2001

At the request of the government, the World Bank has been providing Kuwait with technical assistance in the following broad areas:

- **Post-war Reconstruction.** In January 1991, the Bank submitted to the government a report, *Kuwait: Emergency Relief Program* that included action plans and a framework for reconstruction following liberation.
- **Privatization.** The World Bank has carried out a study of privatization strategies in the industrial, services, health, telecommunications, power, ports, and transport sectors, (*Kuwait: A Privatization Strategy*, 1993); assisted delegations from the National Assembly and the KIA in studying worldwide experience in the implementation of privatization (1994–97); and provided assistance on the draft and privatization law. Also, the World Bank has been advising the KIA on the divestiture phase of the privatization program.
- **Development Strategy.** The *Country Economic Memorandum* (CEM) prepared in 1995 focused on the role of government and public sector productivity; fiscal policies and public saving; welfare and subsidization; and the labor market and employment policies. The World Bank also provided the National Assembly with its views on the draft Five-Year Plan (1996), and advised on the draft reform plan prepared by the Higher Committee for Economic Development and Reform over the period 1998–99. Also, the World Bank in collaboration with Kuwait’s Higher Planning Council, and Kuwait University has in early 2001 completed a study on “Energizing the Private Sector” in Kuwait.
- **Reform Implementation.** Based on the recent study on “Energizing the Private Sector,” as well as other technical assistance activities, the Government of Kuwait has requested Bank assistance in implementation of the various reform initiatives, including the institutional set-up for an implementation agency. The Government of Kuwait and the Bank are currently exploring mechanisms for more Bank technical assistance involvement in this regard.
- **Public Awareness.** As a first step to support the Economic Reform Program, the Bank is managing on behalf of the Government a *Public Awareness Campaign* for its reform agenda in April 2001.
- **Small Business Promotion.** The World Bank has provided technical assistance, which has led to the establishment of the Kuwait Small Projects Development Company (KSPDC). The World Bank is currently advising KSPDC on its operations.

- **Labor Market.** The World Bank, in partnership with Kuwait Institute for Scientific Research (KISR), carried out a labor market study. The study includes a household survey, and an employee/employer survey. The study was conducted at the request of the Higher Committee for Economic Reform and Development and was completed in January 1999. In March 1999, a presentation of the main recommendations of the study was made to the Higher Planning Council. The presentation was attended by three ministers, namely Finance, Planning, and Education. Some recommendations of the study were proposed by government for legislative approval.
- **General Public Reform.** The World Bank has been advising government on various reform initiatives, and has provided ad hoc technical assistance on various topics. In November 2000, the Bank finalized an Evaluation of the Offset Program in Kuwait, which assessed the current structure and presented options for reform. As for ad hoc issues, the Bank made a presentation to high-level decision makers on WTO issues and how Kuwait can benefit from its membership in WTO. Another presentation was made on Investment Promotion.
- **Education Expenditure Analysis Study.** The World Bank is currently in discussions with the Ministry of Education and Higher Education to launch a Public Expenditure Review for the Education Sector. A mission was launched and a Study Terms of Reference was agreed with government in July 2000. The main study mission is expected in the first half of 2001.

Kuwait: Statistical Issues

A. National accounts and production

Improvements have been made in restoring the database after liberation, and the Central Statistical Office has now prepared estimates of GDP at current prices through 2000, constant price GDP statistics are also available through 2000, although the 2000 estimates are provisional. The base year for the constant price data has been shifted from 1972 to 1984. Continued progress, especially in the estimation of value-added data for the oil sector, requires the dedication of adequate resources and improved coordination between the Ministries of Planning, Oil, and Finance. STA has been providing the Ministry of Planning with technical assistance (including fielding of a resident expert) in a project to evaluate and enhance Kuwait's national accounts and price data. It would also be useful if the Central Bank of Kuwait (CBK) would publish information on the oil sector in the Quarterly Statistical Bulletin on output, refining, domestic consumption, export price for crude and refined products and the domestic price of petroleum products. These data are readily available from the Ministry of Oil.

B. Price statistics

Completion of the household expenditure survey (April 1999–March 2000), with new weights, and a revised basket of goods and services for the consumer price index is expected before the end of 2001. This will significantly improve the quality of the CPI index, which is currently prepared using the old basket based on consumer expenditures during 1978. In addition, the CPI needs to be published on a more timely basis (the lag in its release has averaged at about 3-4 months). The wholesale price index (WPI) also needs to be revised to a more modern statistical measure, such as a producer price index (PPI), which is also more useful for national accounting needs. Also, consideration should be given to compiling data on wage rates and developments in the private sector.

C. Government finance statistics

Kuwait reports regularly annual GFS data for publication in *Government Finance Statistics Yearbook* (GFSY) and monthly GFS data for publication in *IFS*. However, since 1987, Kuwait has not reported major components of its extrabudgetary revenues (investment income and transfers of profits of public institutions), extrabudgetary expenditures (interest on foreign debt and treasury paper), and financing operations conducted by two reserve funds. Data on investment income, and on interest on foreign debt and treasury paper, however, are usually provided to Article IV consultation missions. The authorities have made some progress in fiscal data presentation, but the lack of a suitable classification of data on the execution of the budget remains a constraint on monitoring effectively fiscal developments during the year. Moreover, data on the operations of the Public Institute for Social Security are not made available. Much of the weaknesses in the fiscal accounts stem from the limitations on the sharing of information between various government agencies.

STA has recently indicated to the authorities that operations of the two reserve funds should be classified as part of government as they perform activities for public policy purposes (management of debt and assets, and financing of the budget).¹ The authorities have also been briefed on the IMF's ongoing work to enhance the transparency of fiscal accounts and presentation detailed in the "Code of Good Practices on Fiscal Transparency" and were encouraged to adopt some of the practices recommended in the Code.

D. Money and banking statistics

Money and banking data are reported on a regular and timely basis. Coverage in *IFS* of the data on deposit money banks and other banking institutions for January 1981 onward was revised according to recommendations of the 1994 STA multisector mission. The central bank publishes monthly data on customer deposit and interbank interest rates, but needs to disseminate monthly data on bank average lending rates (that are usually provided to the Statistics Department) through publication in the CBK's statistical bulletins.

E. Balance of payments statistics

Kuwait's balance of payments data have undergone substantial improvements, both in coverage and methodology. Since beginning 1997, the CBK has compiled and disseminated detailed annual data in accordance with the methodology of the BPM5. Quarterly balance of payments and a detailed annual statement of Kuwait's international investment position are also being compiled since 1997 by the CBK but have not been published yet. Data on capital flows of the nonfinancial private sector (including foreign direct investment abroad and portfolio investment abroad) are currently not being compiled but measures are being taken (including collaboration between the CBK and the Tax Department of the Ministry of Finance) to correct this omission (which has led to a large "errors and omissions" item in the BOP statistics). Enhancements were made in the estimation of travel services, but further improvements are needed in compilation practices and in the estimation of data on several service items and private transfers.

F. Data dissemination

Kuwait is a GDDS pilot country for member countries of the Arab Monetary Fund; its participation in the GDDS project would allow it to enhance its macroeconomic statistical database system, and eventually participate in the SDDS. A GDDS mission to Kuwait in February 2000 noted the uneven quality of the existing statistical base and observed that political commitment would be important for progress in data dissemination. The Central Bank of Kuwait has established a web page and the following data are made available online to the public: money and banking (monthly); balance of payments (annually); trade balance

¹ During a GFS seminar in Kuwait in June 1999 and in correspondence with the Ministry of Finance in August 1999.

(monthly); exchange rate (average, monthly); GDP by sector and expenditure at current and constant prices (annually, with a three-year lag for constant price data); public finance (selected data are available monthly); CPI and WPI (monthly with about a four-month lag); and securities market indicators (quarterly). In addition, the Kuwait Investment Authority makes available via its web page: stock market indices, volume and value of securities traded, and privatization schedules and information.

Kuwait: Core Statistical Indicators
(As of May 15, 2001)

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index 2/	Exports/ Imports	Current Account Balance	Overall Government Balance 3/	GDP/ GNP 4/	External Debt/ Debt Service 9/
Date of latest observation	29/4/01	04/01	04/01	04/01	03/01	04/01	Q400	12/00	2000	FY99/00	2000	...
Date received	29/4/01	05/01	05/01	05/01	05/01	05/01	3/01	03/01	03/01	03/01	03/01	...
Frequency of data	D	M	M	M	M	M	M	M	A	A 5/	A	...
Frequency of reporting	D	M	M	M	M	M	M	M	A	A	A	...
Source of update	Central Bank of Kuwait (CBK)	CBK	CBK	CBK	CBK	CBK	Central Statistical Office (CSO)	CBK	CBK	Ministry of Finance	CSO	...
Mode of reporting	Fax QSB 6/ MMS 7/	STA reports, QSB, MMS, on-line	STA reports, QSB, MMS, on-line	STA reports, QSB, MMS, on-line	STA reports, QSB, MMS, on-line	STA reports, QSB, MMS, on-line	CTA reports, QSB	STA reports, QSB, on-line	STA reports, QSB	QSB, STA reports	STA reports, QSB	...
Confidentiality 8/	U	U	U	U	U	U	U	U	U	U	U	...
Frequency of Publication	D	Q	M, Q 7/	M, Q	M, Q	M	M	Q	A	Not pub. on Fund standards	A	...

1/ Central Bank of Kuwait only. Government external assets are confidential.

2/ CPI remains delayed.

3/ Fiscal year data only.

4/ Real GDP data not available beyond 1996

5/ Higher frequency data available only in national format.

6/ Quarterly Statistical Bulletin.

7/ Monthly Monetary Statistics.

8/ U stands for Unrestricted.

9/ Except for a small volume of trade credits, Kuwait has no public external debt.



INTERNATIONAL MONETARY FUND

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June 29, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Kuwait

On June 27, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Kuwait.¹

Background

The recovery in oil export prices since mid-1999 and the authorities' fiscal and monetary policies have resulted in substantial improvement in Kuwait's financial situation in 2000. Kuwait's average export price of crude oil rose by 66 percent and its crude oil output, which had declined by 8.7 percent in 1999, also increased by about 6 percent. As a result, the overall fiscal balance (including investment income), which had slipped into a small deficit of 1.3 percent of GDP in 1998/99, moved into surpluses of about 29 percent of GDP in 1999/2000, and an estimated 37 percent of GDP in 2000/01 for the full 12 months.² Similarly, the external current account surplus, which had increased to 17 percent of GDP in 1999, surged to the equivalent of 39 percent of GDP in 2000. Kuwait continued to accumulate assets abroad while the holdings of international reserves by the Central Bank of Kuwait (CBK) increased to US\$7.5 billion in 2000, or the equivalent of over seven months of imports of goods and services. Domestic liquidity, as measured by broad money, picked up by 6.3 percent in 2000 from only 1.6 percent in 1999 in connection with the disbursement of the United Nations' compensation from Iraq of about US\$2 billion. Claims on the private sector also grew by 5.4 percent, with lending for construction being the strongest, while the growth of credit to industry, trade, and real estate decelerated from its sharp increase in 1999. Activity in

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the June 27, 2001 Executive Board discussion based on the staff report.

² The budget for 2001/01 was shortened to nine months (July 2000-March 2001) in preparation for changing the fiscal year to April-March as of 2001/02.

the stock market, however, weakened further in 2000 with the volume declining by 29 percent and the average share price on the Kuwait Stock Exchange falling by 6.5 percent.

Growth performance in 2000 remained weak with real GDP rising 1.7 percent, reflecting the cuts in government capital expenditure and initial uncertainty regarding the legislative approval of structural reform measures. Despite a rise in crude oil production, the growth of oil GDP (including refining) was dampened by a reduction in refinery output due to fire damage. Inflation, as measured by the consumer price index, eased to 1.7 percent in 2000, reflecting lower import prices and the appreciation of the nominal effective exchange rate of the Kuwaiti dinar.

The structural reform process has advanced since late 2000. The National Assembly has passed elements of the reform package, including key components of the labor market reform (May 2000), the laws on foreign portfolio investment (September 2000), and foreign direct investment (March 2001). Additional measures that do not require legislative approval were introduced, such as increases in fees and charges on government-provided services. Other important initiatives such as the privatization law, the reform of the corporate income tax law, and the company law were expected to be approved by the National Assembly by year-end. A Committee for Economic Reform has been recently formed to help expedite the preparatory work and build broader support for the proposed reforms.

Executive Board Assessment

Directors noted that the improved terms of trade and sound macroeconomic policies had helped strengthen Kuwait's financial situation in 1999 and 2000. The fiscal and external positions recorded large surpluses in both years, inflation was low, the banking system remained strong and well supervised, and Kuwait continued to accumulate foreign assets that generated a steady stream of investment income. However, at the same time directors noted that growth in the non-oil sector remained low and stock market prices were depressed, reflecting uncertainty regarding the approval of key economic reforms. Directors felt that with the progress achieved on the latter front in recent months, a renewed optimism was expected to help revive private sector activity and the stock market in 2001. Nonetheless, they believed that continued structural reforms were needed to allow Kuwait to achieve and sustain higher growth rates over the medium term.

Directors encouraged the authorities to capitalize on the improved dialogue between the government, the National Assembly, and the private sector to move forcefully to implement the structural reform program. They noted the recent approval of the laws on foreign direct and portfolio investments and key elements of labor market reform. The recently formed Committee for Economic Reform should also expedite the preparatory work and build broader support for the proposed reform package. Directors called on the authorities to approve other important laws, including the privatization law, the company law, and the income tax reform. They also encouraged the authorities to put in place the implementing regulations and the needed technical support and recommended an early implementation of the proposals (developed in collaboration with the World Bank) aimed at energizing the private sector.

Directors called on the authorities to restrain fiscal spending in the face of higher oil revenue under the current 2001/02 budget. While recognizing that the increase in capital expenditure might be warranted following cutbacks in recent years, directors underscored the need for the authorities to resist pressure to raise current expenditures and to persevere with their medium-term objectives of restructuring the budget, in conjunction with other structural reforms, including in particular, containing the growth of the wage bill, streamlining the civil service, and reducing expenditure on subsidies and transfers. Directors also suggested that the rise in capital expenditures should be limited to economically sound projects, and that authorities should take into account the need to reduce the size of the public sector. They also welcomed the authorities' intentions to achieve savings on various current expenditure items, and to improve the collection of non-oil revenue. Directors called for further efforts to diversify the revenue base, including the elimination of import duty exemptions on a wide range of products, the introduction of a broad based consumption tax, and the levying of excises on luxury items.

Directors noted that monetary policy was correctly focused on maintaining the credibility of the pegged exchange rate arrangement and achieving price stability. The CBK's actions to keep the interest rate differential with U.S. dollar deposits within a narrow margin and its efforts to maintain stability in the interbank money market and mop up excess liquidity have been commendable. Directors strongly supported efforts to complete compliance with the Basel Committee's Core Principles for Effective Banking Supervision. Directors noted that the recent recovery of the stock market attests to the general improvement in business climate, including the opening of the stock exchange to foreign investors and the strengthening of regulations regarding disclosure and insider trading. They encouraged the authorities to further facilitate the participation of foreign investors by expediting the revision of the income tax law, reforming the company law, and further strengthening supervision and the enforcement of regulations pertaining to the stock exchange.

Directors also observed that the pegged exchange arrangement, open capital account, and prudent fiscal and monetary policies had served Kuwait well, keeping inflation low and reinforcing confidence in the economy. While sharing the authorities' views that the recent appreciation of the real effective exchange rate has not affected the competitiveness of non-oil activities, directors encouraged the authorities to closely monitor indicators of competitiveness and step up structural reforms, which would raise private sector productivity.

Directors also noted that the quality and timeliness of data provision for the conduct of the surveillance was adequate and commended the authorities for maintaining a generous foreign assistance program.

Directors also commended the authorities' on their participation in the Fund's General Data Dissemination System (GDDS) and their intention to continue to upgrade their database. Directors supported the Central Statistical Office (CSO) efforts to improve the national accounts and price data, which should be sustained, including through provision of adequate resources. They encouraged the central bank to persevere with its efforts to improve balance of payments data on private capital flows. Directors stressed that, to enhance the transparency

of fiscal data, the fiscal accounts should be consolidated and the time lag in reporting data to the Fund be shortened. Directors backed the authorities' intention to modernize and improve the budget presentation in an effort to enhance the economic assessment of fiscal policy.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Kuwait: Selected Economic Indicators, 1997–2000

	1997	1998	1999	Prel. 2000
	(Percent change)			
Production and prices				
Real GDP	2.2	3.7	-1.7	1.7
Real non-oil GDP	4.1	5.2	2.1	1.5
Consumer price index	0.7	0.1	3.0	1.7
	(In percent of GDP)			
Financial variables 1/				
Total revenue	63.8	63.7	47.1	68.2
Of which:				
Oil and gas revenue	42.9	38.2	26.8	46.4
Investment income 2/	17.3	22.5	16.9	19.1
Total expenditure	43.8	48.4	48.5	39.6
Fiscal balance (deficit-)	20.0	15.3	-1.3	28.6
Change in broad money (in percent)	3.9	-0.8	1.6	6.3
Interest rates 3/	5.95	5.77	5.32	5.35
	(In billions of U.S. dollars, unless otherwise indicated)			
External sector				
Exports	14.3	9.6	12.3	19.6
Of which:				
Oil and refined products	13.5	8.5	11.0	18.2
Imports	7.8	7.7	6.7	6.9
Current account	7.9	2.2	5.1	14.9
In percent of GDP	26.6	8.7	17.0	39.3
International reserve assets	3.6	4.1	4.9	7.5
In months of imports of goods and services	3.3	4.1	5.0	7.5
Real effective exchange rate (percent change)	4.9	3.1	0.9	4.8

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Public finance data are on a fiscal year basis (July–June).

2/ Includes income from government foreign assets and transfer of profits of public entities.

3/ Three-month interbank rate.