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Kuwait: 2002 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Kuwait

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 2002 Article IV consultation with Kuwait, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **September 18, 2002,** 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 November 22, 2002.** 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.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its December 13, 2002 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Kuwait.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

KUWAIT

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the 2002 Consultation with Kuwait

Approved by George T. Abed and Shigeo Kashiwagi

November 22, 2002

The consultation discussion was held in Kuwait from September 7–18, 2002.

The staff team comprised Messrs. Iqbal (Head), Thai, Erbas, Okogu, Al-Ghelaiqah. Mr. Abed was present at the policy discussions.

The Kuwaiti representatives were Dr. Yousef Al-Ebraheem, Minister of Finance; Dr. Al-Manae, Deputy Governor, Central Bank of Kuwait; under-secretaries in the Ministries of Finance and Planning; and other senior government officials. Apart from officials in government ministries and major public sector entities, the mission also met with representatives of commercial banks, the Chamber of Commerce, the Kuwait Stock Exchange, and the Kuwait Petrochemical company (Equate). Mr. Shalaan, Executive Director for Kuwait also participated in the discussions.

The 2001 Article IV consultation was concluded on a lapse-of-time basis in June 2001; the staff report noted that prudent macroeconomic management and higher oil prices contributed to a strengthening of the fiscal and external balances, and commended the authorities for tightening bank prudential regulations. Noting that the performance of the non-oil sector remained weak, due to delays in approving key reform measures, the staff report encouraged the authorities to capitalize on the improved dialogue with the government, the National Assembly, and the private sector to forcefully implement the structural reform program. The staff report stressed the need to strengthen the structure of the budget as part of the authorities' medium-term program. The authorities' decision to participate in the Fund's General Data Dissemination System (GDDS) was commended and they were encouraged to continue work on upgrading the country's database.

Kuwait accepted the obligations of Article VIII on April 5, 1963.

Kuwait has accepted the Fourth Amendment of the Fund's Articles of Agreement.

The authorities have agreed to issue a Public Information Notice (PIN) following the conclusion of the consultation process, and to publish the staff report.

The principal authors of this report are Messrs. Iqbal and Okogu.

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EXECUTIVE SUMMARY

Current Setting

- Over the past several years, Kuwait has pursued prudent fiscal and monetary policies under an open and free exchange and trade system resulting in a strong macroeconomic position despite oil price volatility. While the medium-term macroeconomic outlook remains comfortable, key challenges include: acceleration of non-oil growth in order to meet rising employment needs, reduction in the vulnerability of the economy to oil price shocks, and maintenance of intergenerational equity over the longer term. The authorities have developed a reform strategy centered on structural reforms and fiscal restraint to address these challenges.

- Kuwait recorded an overall fiscal surplus of 23 percent of GDP in 2001, down from about 40 percent in 2000, due largely to the decline in oil export receipts, and an increase in current expenditure. The external current account surplus also moderated to 26 percent of GDP and the net foreign assets of the Central Bank of Kuwait (CBK) rose to the equivalent of about 10 months of prospective imports of goods and services. However, non-oil growth decelerated as the implementation of the comprehensive structural reform package remained slow and private investment stagnated. The financial sector continued to perform well, with the stock exchange recovering strongly.

- In 2002, the macroeconomic position is expected to remain strong—albeit less so than in 2001. The medium-term projections indicate that, under present policies, the fiscal and external positions are expected to remain in surplus, though showing persistent decline. Non-oil growth would recover, but is likely to remain below the rate of population growth.

Staff Appraisal

- Addressing the challenges will call for an accelerated implementation of the authorities' reform program focusing on structural reforms underpinned by a strengthened budget structure. The staff welcomes the authorities' intention to accelerate implementation of structural reforms.

- Implementation of the reform strategy will benefit from: (i) an early enactment of laws and regulations to hasten privatization and private investment; (ii) further deepening and widening of the financial markets; (iii) improvements in the budget structure through reduction in current expenditures; and (iv) flexible application of Kuwaitization coupled with increased focus on retraining and labor market integration to address potential unemployment pressures.

- Good progress has been made in the collection and dissemination of economic data. Areas needing further improvement include the national accounts, private capital flows, foreign direct investment, and consistency of national accounts data with the balance payments.

I. Background and Recent Developments

1. **The 2002 consultation discussions took place against the backdrop of reduced oil export receipts as compared with 2000 levels, and uncertain regional security conditions.** While macroeconomic conditions remain comfortable, the main challenges of economic policy in Kuwait continue to be how to accelerate sustained non-oil growth in order to meet the growing demand for employment, ensure intergenerational equity, and to reduce the vulnerability of the economy to oil market fluctuations. A structural reform package is being implemented gradually; the pace of implementation could pick up following elections for the National Assembly next year. There have been important improvements in the generation and dissemination of economic data.

2. **Real GDP growth fell slightly in 2001 in a noninflationary environment.** This followed a 2 percent fall in oil output, in line with OPEC quota cuts, and weak non-oil economic growth, as private sector investment remained broadly unchanged (Table 1 and Figure 1). With the terms of trade deterioration, nominal GDP is estimated to have fallen by over 8 percent in 2001 after increasing by about 24 percent in 2000.

3. **The macroeconomic position remained strong.** The fiscal surplus moderated to about 23 percent of GDP in 2001/02 from 40 percent in 2000/01, primarily because of lower oil revenue and an increase in total expenditure, mainly on subsidies and transfers, and capital outlays (Table 2; Figure 2).[1] The external current account surplus, though smaller than in 2000, also remained large at 26 percent of GDP in 2001 (Table 3; Figure 3). While the trade account weakened mainly because of a 17 percent fall in oil export receipts, the balance on the services account deteriorated reflecting, in part, a fall in investment income in line with developments in international financial markets. The capital and financial account, however, recorded a sharp decline in net outflow due, largely, to a drop in portfolio investment abroad in response to weaker international equity markets. In the process, Central Bank of Kuwait's (CBK) international reserves increased to the equivalent of about 10 months of prospective imports of goods and services (from 7.4 months in 2000). The stock of foreign assets in the Reserve Fund for Future Generations (RFFG) is estimated to have risen by an amount equivalent to about 20 percent of GDP in 2001/02.

4. **Growth of broad money accelerated to 13 percent in 2001 from 6 percent in 2000 (Table 4; Figure 4).** Private sector credit growth picked up strongly in response to low interest rates; most of the increase went to finance personal loans to consumers, real estate lending, securities trading, and loans to nonbank financial institutions, with limited impact on the growth of non-oil GDP. Following trends in global financial markets, the CBK reduced its

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[1] The fiscal year corresponds to April 2001–March 2002.

discount rate seven times in 2001 and another time so far in 2002, bringing the rate down to the present 3.75 percent with the differential of the Kuwaiti dinar deposit rate over the U.S. dollar rate remaining at the broadly historical 75 basis points. Mainly reflecting movements in the U.S. dollar vis-à-vis the currencies of Kuwait's other trading partners, the KD, which is pegged to a basket of currencies with a large weight of the U.S. dollar, appreciated by about 5 percent in 2001 after appreciating by about 8 percent during 1998–2000, in real effective terms (Figure 5). This trend was subsequently reversed in 2002 as the U.S. dollar weakened against other major currencies.

5. **Available indicators suggest that the financial sector continued to perform well in 2001.** Kuwait's banks appear to be sound, well capitalized, and profitable. Total nonperforming loans, which are adequately provisioned, have declined steadily, with only 5 percent of loans extended since the invasion falling into the nonperforming category (Box 1). Prudential regulation and supervision have been kept in line with international standards. The CBK has introduced a system of market risk analysis in the assessment of capital adequacy, thus completing the observance of 21 out of 25 Basel Core Principles (BCP).[2] The Kuwait Stock Exchange (KSE) law was liberalized in August 2000 to allow foreigners to participate in the market. The stock price index recovered strongly in 2001 and early 2002, reversing the downward trend from its peak in 1997, in part because of the improved liquidity situation following the large inflows from the UN compensation fund, the sale by the Kuwait Investment Authority (KIA) of a large proportion of its shares in the telecommunications company and the remaining shares in the banking sector, and low interest rates (Box 2; Figure 6).[3]

6. **Progress has been made in the preparations for implementing structural reforms, with focus during 2001 being on creating the necessary institutional and legal framework (Box 3).**[4] The privatization process has moved slowly so far. Public road transportation system

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[2] The remaining four BCPs (BCP 1.6, 4, 24, and 25), which are identified in Box 1 will be incorporated following the adoption of the amended banking law (see below). The current absence of these four Principles has so far not raised any issues about the health of the financial sector.

[3] The UN compensation fund is made up of proceeds from the sale of Iraqi oil, which are to be used to compensate Kuwait's government and private sector entities for losses incurred as a result of the 1990/91 invasion and occupation. In FY 2001/02, the government received KD 267 million while the private sector received approximately KD 561 million. Future transfers will be determined by several factors including the value of Iraqi oil sales and the requirements of UN humanitarian goods purchases for Iraq.

[4] The preparation and implementation of the structural reform package is being managed by the Higher Committee for Development and Economic Reform, which was reorganized in

(continued…)

has become subject to a regulatory authority to ensure appropriate pricing and private sector participation. Over the past five years, the KIA has divested shares valued at KD 1.7 billion (equivalent to 12 percent of GDP in 2001) in 26 companies. Meanwhile, a number of laws are currently being considered to facilitate private sector investment.[5] Prices of some publicly supplied goods and services have also been adjusted upwards in the past to reduce subsidies. Domestic petroleum product prices were increased by 30–50 percent in 1999. Health insurance and related charges have been levied on expatriate workers to reduce burden on the budget.

7. In a bid to encourage Kuwaiti nationals to seek employment in the private sector, the authorities have recently extended the social allowance to Kuwaitis in the private sector. They have also initiated several steps in the area of training, including a 2.5 percent tax on companies listed on the KSE to fund this effort. While Kuwaitization has so far been applied flexibly, effective September 2002, the government has established mandatory limits for the employment of nationals in the private sector.[6]

2001; it has worked with the World Bank on reform initiatives, as well as steps to energize the private sector, including privatization and labor market reform.

[5] The plan to involve international oil companies in the upstream oil sector on a service contract basis (Project Kuwait) is still awaiting approval by the National Assembly.

[6] The Kuwaitization program under the Labor Market Law stipulates the proportion of Kuwaitis that private sector companies must have in their workforce. This varies from sector to sector, and also within sectors depending on the size and nature of their operations. Effective September 2002, such limits range from 1 percent in agriculture to 38 and 39 percent in telecommunication companies and banks, respectively. For most of the private sector activities, such limits are below 10 percent of total employment in each sector. The government is prohibited from directly hiring services from, or awarding tenders to the private entities that did not meet these requirements.

Box 1. Developments in Banking Supervision and Regulation

Kuwait's financial system consists of the Central Bank of Kuwait (CBK); 7 commercial banks; 2 specialized banks (the Industrial Bank and the Real Estate Bank); the Kuwait Finance House, which operates on Islamic principles; about 38 investment companies (for portfolio management, including international placements, and securities underwriting); 29 moneychangers/exchange houses; about 25 insurance and reinsurance companies; and the stock exchange.

Banks have been effectively supervised in line with international standards and practices. International Accounting Standards (IAS) have been applied since 1991 and 21 of the 25 Basel Core Principles (BCP) implemented, including the latest addition of market risk analysis to the computation of capital adequacy (March 2001) as a step toward the adoption of the proposed new Basel capital standards. Bank supervision is fully consolidated and is effected through regular onsite inspections, offsite monitoring, and special onsite inspections, and is supported by an early warning system. A credit bureau would be operational by end-2002.

To deepen the well-functioning and well-capitalized banking sector, an Amended Banking Law (ABL) is expected to be approved by the National Assembly by end-2002. The ABL would include the following main measures: (a) opening the market to foreign banks; (b) strengthening the prudential regulatory environment by authorizing the disclosure of confidential information to home and host country supervisors (BCP 1.6, 24, 25); granting the CBK the authority to approve changes in bank ownership (BCP4), and establishing stiff financial penalties for noncompliance; and (c) bringing Islamic banks fully under the CBK's supervision. These measures should complete the observance of all the BCP. A limited deposit insurance scheme is being considered to protect small depositors and replace the current blanket guarantee of all bank deposits.

A regulatory and supervisory framework has been developed and has recently been strengthened for AML activities. Legal measures include: adoption of AML guidelines (1997), and enactment of a law criminalizing money laundering activities (March 2002) in accordance with the 40+ 8 Financial Action Task Force (FATF) recommendations. This law requires financial institutions to freeze assets of suspicious parties and not to open accounts or effect international fund transfers for charitable organizations that are not licensed to collect and transfer funds abroad. Administrative measures include: upgrading of the AML unit in CBK to a full division in May 2002, and the establishment of the National Committee for Combating the Financing of Terrorism in 2001.
The banking sector's financial soundness indicators are summarized below:

Kuwait: Financial Soundness Indicators, 1997–2001
(In percent)

	1997	1998	1999	2000	2001
Banks' capital-asset ratio	11.1	11.4	11.6	11.5	11.2
Banks' risk-weighted capital-asset ratio	22.4	22.5	23.7	22.2	22.0
Nonperforming to total loans ratio: post-invasion	2.0	3.0	6.0	6.4	5.2
Loan provisions as a proportion of total nonperforming loans	65.2	68.2	53.2	50.1	53.4
Banks' interest rate spread	2.9	2.6	2.8	3.0	3.4
Return on assets	1.7	1.6	1.8	2.0	2.0
Return on equity	15.7	13.8	15.3	17.6	18.2
Liquid assets-total assets ratio	16.2	15.5	17.6	16.3	14.8

Source: Central Bank of Kuwait.

Box 2. Capital Market Developments

The authorities have recently stepped up their efforts to develop the capital market. It is mainly limited to the stock market and the primary market for government securities, which are traded principally between the CBK and the commercial banks. Secondary trading in government securities is minimal. Market for corporate bonds is also limited.

The stock market, which has expanded considerably over the past decade, still lacks depth and liquidity due mainly to the relatively few listings. Foreign participation has been liberalized over time. Under the September 2000 portfolio Foreign Investment Law, foreigners are now allowed to own and trade shares of joint-stock companies listed on the KSE, except that no single individual or group of foreign investors may own more than 5 percent of the capital of a Kuwaiti bank unless approved by the CBK. As a group, foreigners may not own more than 49 percent of the capital of a particular bank, unless recommended by the CBK and approved by the Council of Ministers. Under the April 2001 FDI Law, foreigners may own 100 percent of Kuwaiti companies subject to conditions, which are being finalized.

The overall stock market index increased by 26.7 percent in 2001, reversing the downward trend from its record peak in October 1997. It gained another 22 percent in January–mid-September 2002. Owing to this performance, market capitalization increased to KD 10 billion (almost 100 percent of GDP) by end-June 2002. The strength of the market reflected mainly the high level of liquidity, generated in part by UN compensation, weakening of stock markets abroad, the generous tax treatment under the 2001 FDI Law, good corporate profitability, especially in the banking sector, and the sale of a large proportion of government shares in telecommunications and the remaining shares in the banking sector.

The authorities have adopted or envisaged to adopt several measures to deepen the stock market. The adopted measures include: expansion of the primary market through the opening of a parallel stock exchange to which were admitted 3 new companies; bilateral agreements with Bahrain, Lebanon, Egypt; and cross-listing agreements with other GCC stock exchanges. The planned measures include: introduction of bond trading, new products such as derivatives or convertible bonds, and further liberalization of nonresidents' participation in the capital market. Furthermore, to facilitate stock transactions and settlements, the current electronic trading system would be upgraded for real time transactions.

The debt market consists mainly of the primary market for government securities, having maturities ranging from 3 months to 5 years held predominantly by commercial banks. The trading in the secondary market is minimal.

Box 3. Institutional and Structural Reforms

A series of structural reforms have been introduced in Kuwait since 2000 aimed primarily at encouraging foreign investment, promoting the role of the private sector, providing employment opportunities for Kuwaiti nationals, and reducing government ownership and its role in the economy. These include:

- 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, subject to the limits indicated in Box 2.

- In 2001, a new **Higher Committee for Development and Economic Reform** was appointed to facilitate the reform process.

- In April 2001, the **Foreign Direct Investment (FDI) Law** was passed which allows foreigners to own **100 percent of Kuwaiti companies** subject to conditions to be determined by the Council of Ministers. According to the new law, corporate taxes would be reduced from 55 percent to 25 percent. Further, 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. A Foreign Investment Capital Office was established to process FDI applications. The implementation is awaiting approval of bylaws including specification of the negative list.

- The **Labor Market Law** (National Labor Support and Encouragement to Work in NonGovernment Sectors) was approved by the National Assembly on May 10, 2000, and is designed to encourage Kuwaitis to seek employment in the private sector. The Manpower and Government Restructuring Program (MGRP) was established in July 2001 to implement the Labor Law, provide unemployment benefits to unemployed Kuwaiti nationals, and provide training and facilitate employment of Kuwaiti nationals in the private sector.

- In September 2002, the government approved **quotas for** the proportion of Kuwaitis that private companies must employ; companies that fail to meet this target would be subject to a fine and sanctions such as exclusion from bidding for government contracts.

- The **Privatization Law has been approved by the Finance Committee of the National Assembly**, and is currently awaiting approval by the Assembly.

- Kuwait amended its **Copyrights Law** in 2000 and the **Patent Law** in January 2001, in line with WTO requirements.

- **Other measures under consideration include:**

  a. Review of Company Law and Competition Law to make them more effective.
  b. Increases in fees and charges on government provided services (especially on electricity and water).

II. Report on Discussions

8. The staff reports over the past few years have encouraged the authorities to accelerate the implementation of their structural reform program including a structural strengthening of the budget. Improvement in the quality and timeliness of data provision has also been recommended. While political consensus is being developed to facilitate implementation of structural reforms, the authorities have initiated steps, with the support of Fund technical assistance, to strengthen budget expenditure management and to explore options for mobilizing non-oil revenues as recommended by the staff. Steps have also been taken in line with the recommendations of the past Fund technical assistance missions, to improve the database for the balance of payments, the national accounts, and prices. The dissemination of information has also been improved through the adoption of the GDDS. The authorities have implemented staff advice on strengthening bank supervision and the development of monetary policy instruments. Recommendations on the introduction of a targeted bank deposit insurance scheme are awaiting implementation.

9. **The macroeconomic position is expected to soften further during 2002 due to reduced oil export receipts, but remain comfortable (Table 1).** Staff estimates of the 2002/03 budget, based on WEO-consistent oil price prevailing at the time of the consultation discussions and including investment income, indicate a fiscal surplus of about 15 percent of GDP (Table 2).[7] The external current account surplus is also expected to moderate to about 21 percent of GDP and CBK's official foreign assets would rise modestly to the equivalent of about 11 months of prospective imports of goods and services. While oil output will be lower than in 2001, real non-oil GDP is estimated to recover somewhat in 2002 under noninflationary conditions.

10. **Under an unchanged policy stance, and with the present oil price outlook, it is projected that over the medium term (2003–07) there will be some improvement in real growth, with non-oil GDP registering an average growth of about 2.5 percent but below the projected rate of population growth which could increase unemployment pressures (Table 5).** The macroeconomic position, however, is projected to remain comfortable over this period despite the likely decline in the external current account and fiscal surpluses to an average 12 percent and 7 percent of GDP, respectively. Moreover, the non-oil fiscal deficit, though on a rising trend—reflecting increasing total expenditure and lower non-oil revenue—

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[7] Since the mission visited Kuwait in September 2002, a new WEO oil price baseline has been released. Based on this price revision, the fiscal and external current account surpluses in 2002/03 and 2002, respectively, are estimated to improve somewhat over these projections. The revised WEO oil price baseline also implies that the fiscal and external current account surpluses in percent of GDP would be higher than projected for 2003–04 by an average of about 0.7 percentage points; forecasts remain unchanged for 2005–07.

would under current assumed oil prices and expected rates of return be well below the permanent income from oil wealth over the foreseeable period.[8] While there would be no pressing reason for intensifying adjustment in the near term, over the longer term, under unchanged policies and the current population dynamics, the maintenance of intergenerational equity would call for a strengthened fiscal position, which should also contribute to improved resource allocation and growth. Moreover, the economy would remain susceptible to downside oil price risks.

11. **The authorities are fully aware of the medium-term challenges, and have signaled their determination to implement steadfastly their reform program.** The policy discussions, therefore, focused on steps for accelerating structural reforms to promote non-oil growth, strengthen further macroeconomic balances in order to ensure longer-term intergenerational equity, and reduce the vulnerability of the economy to fluctuations in oil prices. The mission also discussed steps to strengthen the country's economic database and dissemination of information. The authorities have expressed their willingness to publish the staff report, and a PIN will be issued at the conclusion of the consultation process.

A. Structural Reforms

12. **The pace of structural reforms has so far been constrained by the need to establish a solid national consensus for such reforms, limited administrative capacity, and to avoid exacerbating short-term unemployment pressures.** The strategy is aimed at developing the institutional and legal foundations to reduce the role of the public sector, and encourage private sector activity under market-based prices. It calls for a deepening and widening of the financial sector to facilitate private sector investment, including foreign direct investment (FDI), and to compete in a globalized financial market. Concurrently, the labor market reforms are to be undertaken in order to develop skills needed by the private sector.

Privatization and private sector investment

13. **The authorities are pursuing a privatization strategy that includes, in a sequential fashion, autonomization, commercialization, and finally privatization of state**

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[8] On the basis of the current oil production rate—given that the known oil reserves are estimated to be equal to about 90 years of this rate—current WEO oil price forecasts, and assumed rates of return and discount of 5 percent, permanent income from oil wealth would be US$19.4 billion per year. This compares with projected average non-oil deficit during 2003–07 of about US$10.5 billion. Oil prices will have to fall below US$13 per barrel on a durable basis as compared with the present average of about US$20 per barrel for the permanent income to fall below the projected non-oil deficit during the 2003–07 period.

enterprises while market-based prices are introduced and regulatory authorities are established to ensure protection against monopolies.[9] The Privatization Law, presently under discussion at the National Assembly and targeted for approval in 2003, will establish a comprehensive framework for large-scale privatization, identify areas and modes of privatization, and establish a pricing mechanism and safeguards against job losses. Pending enactment of the law, the authorities intend to identify activities that do not require explicit legislative approval for divestiture, and prepare them for marketing and eventual privatization. Concurrently, the authorities intend to gradually rationalize prices of utilities and of other publicly supplied goods and services in line with market conditions, which should also reduce implicit subsidies. In addition, procedures for the use of "build-operate-transfer" (BOT) mode have been approved as an alternative to public sector activity. Areas for early use of BOT include electricity, water desalination, and sewerage.[10] Going forward, the KIA plans to offer more of the 62 public sector entities still under its control for sale to the private sector as part of the overall privatization strategy. The staff underscored the need to accelerate the privatization process by an early enactment of the Privatization Law.

14. **Private sector investment will also be encouraged through the implementation of the Foreign Investment Law in 2003 and reform of the labor market (see below), in conjunction with an early expansion in the domain of the private sector**. The Foreign Investment Law intends to, in principle, open all sectors to foreign investment except crude oil production.[11] Priority would be accorded to investment in the petrochemicals sector, oil exploration, health, manufacturing, infrastructure, and construction. Once the by-laws are clarified, the Foreign Investment Law would: (a) allow up to 100 percent foreign ownership as against 49 percent at present; and (b) lower the corporate income tax to 25 percent from the present 55 percent along with a selective tax holiday for 10 years (Box 3).[12] Corporations

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[9] The World Bank has provided technical assistance including improving the regulatory structure to facilitate privatization.

[10] In January 2001, the first BOT contract was awarded to an international company for a water and sewerage treatment plant. Foreign bids were also invited for two independent power plants in 2001.

[11] Under plans currently being considered, international oil companies could be brought into the upstream oil sector on the basis of service contract arrangements.

[12] Under the law, foreign investment activity will be overseen by the Foreign Capital Investment Committee, which will be composed of the Minister of Commerce and Industry, representatives of the private sector, as well as members of the Kuwait Chamber of Commerce and Industry. The Foreign Investment Capital Office (FICO) will execute the decision of the Committee. The FICO will: (a) inform international investors about

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from Kuwait and member countries of the Cooperation Council of the Arab States of the Gulf (GCC) will continue to be exempt from such taxation. The mission encouraged the authorities to ensure that the application of the law did not discriminate against foreign investors, and allowed market forces to determine sectoral allocation of FDI, and that the "negative list" was kept narrow and clearly defined. The authorities are of the view that the planned tax holidays would help avoid the discriminatory effects of unequal tax treatment of foreign investors.

15. **The authorities recognize the importance of eliminating price distortions and the development of market-based institutions in the promotion of the private sector-led growth.** In this context, the authorities are planning, as a first step, to establish free trade zones to promote private sector investment in high technology activities. The KIA expects to help establish the Technology City for computer-related investments and to provide financial support for the development of small projects. The mission felt that an early movement toward market-based pricing of publicly supplied goods and services, particularly for electricity and water, which involve implicit subsidies, would be crucial in ensuring efficient and sustainable private sector investment. In the same vein, establishment of market-based wages would improve competitiveness and facilitate growth.

Financial sector

16. The financial sector has continued to perform well. However, the narrowness of the capital market and concentration of bank lending on consumer finance and real estate appear to have constrained private sector investment. The authorities are aware that a deepening and widening of the financial sector is needed to accelerate private sector investment. Building upon the existing sound banking system, the authorities intend to pursue a three-pronged strategy aimed at increasing competition, strengthening enforcement of regulation and supervision, and developing new lending instruments to facilitate private sector activity. In this regard, an amended Banking Law is expected to be approved by the National Assembly by end-2002. The law will encompass:

- Opening of the domestic market to foreign banks, in line with the ongoing harmonization of bank rules and regulations within the GCC, resulting in increased competition and efficiency gains;

- Strengthening of the regulation and licensing powers of the CBK including extension of the role of external auditors, authorization for the disclosure of confidential information for supervisory purposes, CBK's approval for change in bank ownership,

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investment opportunities in Kuwait; (b) facilitate foreign investment through streamlining execution of licensed investment, and (c) coordinate with other Kuwaiti authorities.

and enforcement of stiffer financial penalties for noncompliance with laws and regulations; and

- Bringing Islamic banking operations fully under the CBK's supervision and such banking would be promoted through licensing the existing commercial banks to compete with the Kuwait Finance House (presently the only Islamic banking institution) under rules in conformity with standards to be recommended by the Islamic Financial Services Board (IFSB).

17. **In addition, the amended Banking Law will help introduce new financial instruments including mortgage financing and shariah-compatible bonds**, which would be tradable and could be used in open-market operations.[13] Such bonds could be introduced before the approval of the planned law. The authorities recognize that the current implicit government blanket guarantee of bank deposits is counterproductive, since it would increase moral hazard, reduce market discipline, and could prove costly to the government. However, to protect small depositors—who constitute a large majority of depositors but account for a fraction of total deposits—the authorities intend to introduce a deposit insurance scheme which would cover deposits up to KD 10,000.[14] The mission encouraged the authorities to move apace on this front and agreed that the optimal approach would be to supplement it by maintaining tight bank supervision in order to prevent the emergence of any financial difficulties. The authorities have expressed interest in holding an early FSAP exercise.

18. **The expansion of a well-functioning capital market to complement the banking sector would encourage private sector investment.** In this context, the authorities are working toward the development of an appropriate institutional and legal framework to enable market forces function more effectively, thereby promoting private sector investment. A number of steps have been taken or are being implemented to help mitigate any shocks, including:

- Enlargement of the primary market through the opening of a parallel stock exchange for smaller companies, and cross-listing with other GCC and regional stock exchanges;

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[13] Shariah-compatible bonds would be structured similar to leasing contracts consistent with the profit and loss-sharing principles in order to observe the shariah constraint against pre-determined interest rates. An indicator based on profit and loss-sharing mechanism would also be available to facilitate trading.

[14] Technical assistance to introduce a deposit insurance scheme was provided by the Fund in 1999. Much of the technical preparation has been completed and its introduction is awaiting government approval.

- Strengthening rules and regulations governing corporate accounting and disclosure requirements resulting in greater transparency;

- Close monitoring to ensure that the prudential limit on bank lending for stock trading has been observed; and

- Strengthening supervision by the Stock Market Commission (SMC).

19. The authorities also stressed that market participants are fully aware that, as in 1997, the government will not bail out investors in the event of a downturn. The mission was of the view that the effectiveness of the SMC could be enhanced by changing it into an independent regulatory body and taking further steps to widen and deepen the stock market including an accelerated privatization of public companies. The authorities intend to proceed in this direction by encouraging bond trading to complement share trading and new products such as derivatives or convertible bonds. Consideration is also being given to liberalizing rules governing nonresident participation in the capital market.

20. **A new Anti-money Laundering Law was passed in 2002, which is fully consistent with the 40+8 FATF recommendations.** Indeed, the CBK has had an anti-money laundering unit since 1994, which was upgraded to a full division in May 2002, in line with recent international developments. The law considers money-laundering activities criminal acts, with provision for freezing and confiscating assets associated with such activities. In this regard, the CBK has instructed all financial institutions under its supervision to be vigilant, and to conform to the requirements of the UN Security Council resolutions.[15]

Labor market

21. **The authorities are following a two-pronged strategy to address the challenges of a rapidly growing—though still relatively small, at 20 percent of the total—Kuwaiti labor force.**[16] In the near term, Kuwaitization will be used to increase employment opportunities in the private sector. This process would be implemented in conjunction with the ongoing job search plan under which jobseekers are matched with job opportunities in the

[15] Furthermore, financial institutions will not open accounts or effect international fund transfers for charitable organizations unless these are licensed to collect such funds and transfer them abroad.

[16] In 2001, the Kuwaiti population grew by an estimated 3.4 percent, while Kuwaiti labor force grew by 7.1 percent. The rate of growth of the Kuwaiti labor force is expected to accelerate in the periods ahead and exceed the current capacity of the economy—both public and private sectors—to generate employment opportunities. The unemployment rate of Kuwaitis in 2001 was officially reported at about 2 percent.

public and private sectors. In this context, the mission noted that the maintenance of strict sectoral quotas for Kuwaiti workers would, in light of relatively high wages and allowances in the public sector and the lack of adequate indigenous skills, be inimical to competitiveness. The mission therefore stressed that Kuwaitization should be implemented flexibly. Moreover, mechanisms should be established in the private sector for financing allowances and benefits so that the burden on the budget could be minimized.

22. **Over the long term, the strategy aims at developing skills required by the private sector, improving incentives for work in the private sector**, establishing institutional structures to train manpower, and taking steps toward integrating the labor market through reduction in cost differentials between the public and private sectors and between expatriate and Kuwaiti workers.[17]

23. The development of domestic supply of skills needed by the private sector is being pursued under the supervision of the Higher Education Council through the establishment of new training institutions and rigorous training standards and systems with World Bank technical assistance, which, it is expected, will pave the way for labor market integration. The government will meet 75 percent of the cost of training Kuwaitis, with the remainder being met by the private sector. The training initiative is being financed by a dedicated 2.5 percent tax on the profits of companies traded on the stock exchange.[18]

B. Fiscal Policy

24. **The fiscal position is deemed to remain manageable for the medium term.** The likely fiscal surpluses, though declining, should be sufficient during the 2003–07 period to ensure some increase in wealth per capita (Table 2 and Table 5). However, over the longer term, given the anticipated population and employment pressures, steps would need to be initiated now to ensure a stronger fiscal position beyond the medium term with the aim of ensuring intergenerational equity. Moreover, unless reversed, the evolving expenditure pattern—that has recently seen an increase in the share of current outlays to an estimated 44 percent of GDP in 2002/03, including wages and salaries, and subsidies and transfers—could weaken growth impulses stemming from the budget. In addition, reduction in vulnerability to oil price fluctuations will call for measures to curtail dependence on oil revenue. Fiscal policy would also need to more fully support structural reforms by improving

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[17] The Labor Market Law allows extension of allowances/benefits provided by the government in the public sector to Kuwaitis employed in the private sector. Although the law envisages a special fund to pay for allowances to Kuwaitis in the private sector and to pay unemployment benefits, the cost is presently being borne by the budget.

[18] The tax is expected to be extended to all companies in the near future.

resource allocation. Therefore, a strengthening of the structure of the budget would be necessary primarily through greater efforts to improve expenditure management and reduce current expenditures, especially wages and subsidies. Mobilization of non-oil revenue could also play a role in the period ahead.

25. **The authorities reaffirmed their determination to follow a restrained fiscal policy supported by tighter budget management in 2002/03.** The budget for 2002/03, which is based on a highly conservative oil price assumption (US$15 per barrel) and does not include investment income, calls for a deficit equivalent to 19 percent of GDP. Total expenditure is budgeted to increase by 12 percent including a 4 percent increase in current outlays. Given the rebound in oil prices in 2002 and including investment income, total revenue is estimated to be almost twice the budgeted amount. The authorities intend to limit expenditures on subsidies and transfers to about 95 percent of the budgeted amount, which, combined with the slower-than-planned implementation of capital projects, would contain the increase in total expenditures to the equivalent of about 2 percent of GDP in 2002/03 as compared with 6 percent of GDP in 2001/02.

26. In the medium term, the authorities plan to move to a system of a three-year rolling budget as a way of setting fiscal policy in a medium-term framework. In response to the mission's inquiry about plans to contain expenditure growth, the authorities cautioned that significant expenditure cuts in the short term would be politically difficult to implement, and would require a prior acceleration of private sector growth and generation of employment opportunities.

27. Meanwhile, a number of steps have been initiated to strengthen budget management. These include efforts to increase the efficiency of revenue collection through engaging private companies to collect outstanding utility charges and fees, and making a number of government services subject to fees. Expenditure management will be strengthened further through improved coordination of expenditure processes under the Ministry of Finance with stricter enforcement of controls on maintenance and procurement including privatization of government maintenance services. The authorities indicated their intention to expeditiously introduce BOT operations, which should improve expenditure efficiency.[19]

28. **The mission expressed the view that while strengthened budget management and expenditure controls would be crucial, the authorities could introduce additional**

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[19] Other measures include a new policy of leasing rather than purchasing government vehicles; introducing a limit on the amount of fuel that a government vehicle is allowed to consume in a given period in order to minimize the use of official vehicles for nongovernment purposes; and introducing a ceiling on the amount allowed for furnishing government offices.

non-oil revenue measures to support their fiscal efforts in a longer-term context. These could include an income tax applicable to all residents, a general sales tax (as a precursor to a VAT), and a revamped corporate tax applicable to both foreign and Kuwaiti companies. In this context, continuation of Fund technical assistance, which was initiated in 2002 on expenditure management and on revenue measures, including possible adoption of a VAT, would be particularly beneficial.[20] The staff was of the view that these measures and stricter fiscal rules on expenditure would enhance the resilience of the budget, and obviate the need for large and prolonged financing operations through the General Reserve Fund (GRF), especially in light of uncertain oil price developments.[21] However, any temporary sharp fall in oil revenues can be addressed by drawing on these resources rather than cutbacks in capital outlays.

C. Monetary Policy and the Exchange System

29. **The focus of monetary policy has been mainly to ensure the stability of the exchange rate under an open and free exchange and trade system.** The mission praised the authorities' intention to continue to pursue prudent monetary and bank supervisory policies to maintain confidence in the exchange rate in an environment of low inflation, and to facilitate private sector investment. Reflecting continued strong credit expansion to the private sector, broad money is expected to grow at about the same rate in 2002 as in 2001. Given its comfortable liquidity position, the banking system should be able to meet the anticipated private sector credit demand. The mission agreed that the open market operations policy and the use of direct bank deposits with CBK have been effective in managing

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[20] The ongoing technical assistance on public expenditure management (PEM) aims at establishing a macro-fiscal coordination unit and a new system of budget classification. It will include amending the budget preparation process, program budgeting including change in budget classification, and developing a program structure, establishing a treasury single account for effective cash management, revamping the accounting system, and developing a new information system consistent with the Government Finance Statistics (GFS).

[21] Deficits are usually financed through the GRF, which serves as a stabilization fund to mitigate against the impact of fluctuations in oil prices on budgetary revenue through transfers to and from the budget. As a rule, budget surpluses are used to replenish the GRF and add to the pool of assets accumulated in the RFFG. During the Gulf war and the recovery period, the GRF resources were depleted owing to extraordinary budgetary needs, and the GRF was allowed to borrow from the RFFG. Following recovery, both funds are being replenished and the GRF is in the process of paying back the RFFG. Both funds are managed by KIA whose independence from the government is guaranteed by law. Any GRF borrowing from the RFFG and any other borrowing as well as amendments to the rules governing the operations of those funds require an act of the National Assembly.

liquidity consistent with market conditions and prudential regulations, and supported the authorities' intention to continue following this policy in the period ahead. While the authorities have also been appropriately adjusting the CBK discount rate in line with developments in the U.S. interest rates, the mission suggested the ending of the lending rate ceilings, which could facilitate increased lending to small- and medium-sized enterprises, better price risks, and thus support efficient private sector growth.

30. **The mission agreed with the authorities that the peg of the Kuwaiti dinar to a basket of currencies in which the U.S. dollar has a predominant weight has been appropriate and has served Kuwait well.** It further endorsed the plan to move to a full U.S. dollar peg from the beginning of 2003, in line with the decision of the GCC Heads of States. The real effective appreciation of the dinar in the past two to three years has not affected the competitiveness of non-oil exports. The volume of such exports grew at an annual average rate of 6 percent over 1999–2001. The authorities stated that the current exchange rate stance will be maintained pending the establishment of necessary institutions for the GCC monetary union by 2010. Kuwait maintains an exchange rate system free of restrictions in making payments and transfers for current international transactions. In addition, capital flows are unrestricted and will further benefit from the expected implementation of the Foreign Investment Law.[22]

D. Regional Integration and Trade Policy

31. **Important progress has been made in the economic integration of the economies of the GCC countries.** The adoption of a common external tariff (CET) has been advanced to the beginning of 2003 from the originally planned date of 2005.[23] In the context of the Arab Free Trade Agreement, Kuwait reduced by 40 percent the import tariff on goods originating from Arab countries during 1999–2000. Similarly, the currencies of the GCC group will all move to a full U.S. dollar peg from January 2003, while the adoption of a common currency is planned by 2010. In order to facilitate progress toward the monetary union, the legal and institutional arrangements, including performance criteria for policy

[22] Portfolio capital inflows are regulated by the Portfolio Investment Law to avoid speculative pressures.

[23] The CET will harmonize GCC import duties at a rate of 5 percent, with limited number of imports subject to higher rates for protection and health reasons. At present, Kuwait's tariff structure ranges between 4 and 12 percent. Goods originating in GCC countries have duty-free access in member countries. Imports of a few items are prohibited for religious and security considerations. The implementation of the Foreign Investment Law will eliminate apparent discrimination between domestic and foreign companies with respect to rules governing imports.

convergence, are presently being developed and are expected to be ready no later than 2005. Kuwait has taken several steps to prepare for these changes, and is on target to meet these milestones. Other areas include free movement of labor and capital within the region, provision for commercial banks to open branches in other GCC countries, and cross listing of stocks in the national bourses. Further, citizens are allowed to own real estate in any GCC country, while the interlinking of the electricity grids of member countries has reached an advanced stage with the establishment of a GCC Electricity Grid Authority in Riyadh.

E. Statistical Issues

32. **There has been significant improvement in Kuwait's economic database since the last Article IV consultation, particularly in national accounts and balance of payments data, and their reporting.** The authorities' participation in the GDDS and the ongoing efforts to update their statistical database are commendable. Kuwait has benefited from technical assistance cooperation with the Fund in the area of national accounts, with a resident Fund advisor during 2001/02. There is a need for further improvement in statistics, particularly in the areas of aggregate expenditure, nonfinancial sector private capital flows, FDI, and the national accounts' consistency with the balance of payments data. Similarly, collection and sharing of data on the private sector external debt will be useful, and better labor market data will help improve the formulation of policies to address potential unemployment pressures. Furthermore, improvement in the currentness of fiscal data submitted for publication in the Fund GFS would be helpful, as would the publication of the newly rebased consumer price index (CPI) data.[24] The authorities reiterated their commitment to continue with efforts to improve further the availability, currentness, transparency, and publication of relevant data, which they considered as critical in their policymaking process. The authorities noted that given the openness of the economy and the lack of administrative capacity, they were not able to collect information on the private sector's international investment position (IIP).

III. Staff Appraisal

33. **Over the past several years, the Kuwaiti authorities have pursued prudent fiscal and monetary policies, which, together with an open and free exchange and trade system, have allowed the maintenance of a strong macroeconomic position in a noninflationary environment despite the wide fluctuations in global oil prices.** The macroeconomic position in 2002/03 is estimated to remain comfortable despite lower oil export receipts, and there will be a modest recovery in non-oil economic activity. The

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[24] A new expenditure survey was conducted in 2000, aimed at providing a more accurate picture of sectoral developments, household income and expenditure, demographic and labor force developments, and to construct a new consumer price index.

medium-term outlook, under current policies and expected oil prices, is for a gradual decline in fiscal and external current account surpluses. Non-oil growth is likely to remain subdued and the rapidly growing indigenous population could generate unemployment pressures. While fiscal sustainability is not in doubt in the medium term, there could be difficulties in sustaining inter-generational equity in the long run under unchanged policies. The economy would also remain vulnerable to any significant and sustained weakening of oil prices.

34. **The authorities are fully cognizant of these challenges and intend to speed up the implementation of their reform program.** Their strategy is appropriately centered on structural reforms in order to accelerate non-oil growth through increase in the role of the private sector, including foreign direct investment, privatization of government-owned assets, deepening and widening of the financial sector, and labor market reforms. These efforts will be supported by a strengthening of the budget structure in order to reduce vulnerability to oil price fluctuations and facilitate continued growth in per capita wealth.

35. **The staff considers the planned institutional and legal changes as appropriate. However, the authorities are encouraged to accelerate the implementation of their structural reforms program, which, if fully implemented, should generate the needed increase in private investment and non-oil growth.** An early enactment and implementation of the Privatization Law and of the Foreign Investment Law would help provide a clearer statement of the privatization strategy to the market. In particular, private sector investment would benefit from several factors: (a) streamlining of rules and regulations and a shift away from sector-specific interventions; (b) accelerated privatization of government-owned assets including utilities under market-based tariff rates and effective regulatory systems; and (c) the establishment of a narrow "negative list" for foreign direct investment. Moreover, reduction in subsidies and a shift toward targeted and time-specific subsidies under hard budget constraints would facilitate better allocation of resources. Introduction of a nondiscriminatory, broad-based income tax on both domestic and foreign corporations, combined with liberalization of rules governing access to the domestic capital market would also facilitate FDI inflows.

36. **The staff agrees that a further deepening of the financial market combined with the maintenance of effective supervision of the banking sector would be crucial for a sustained increase in private sector investment.** An early approval and implementation of the amended Banking Law and the enforcement of the credit risk analysis would allow adaptation of regulations to ensure financial stability under shifting credit demand and expanding global competition. The staff welcomes steps to continue increasing conformity of bank regulation and supervision to the Basel Core Principles, and hopes that the planned deposit insurance scheme will be introduced soon. In the same vein, improvements in the regulation of the stock market through the introduction of stricter accounting standards, intensification of corporate audit procedures, and disclosure requirements, are welcome developments. Consideration could be given to transforming the Stock Market Commission into an independent regulatory body in order to further strengthen its effectiveness. Liberalization of rules governing nonresident participation in the capital market, with

appropriate safeguards against speculative activities, would be beneficial to the deepening of the capital market and facilitating privatization. Steps should also be considered to introduce bond trading and other products to complement stock market operations. The staff supports an early FSAP exercise that would help identify vulnerabilities, if any, in the financial sector and help formulate policies to address them. The staff also welcomes the recent strengthening of control on money-laundering activities.

37. **The staff considers as appropriate the authorities' strategy to address the emerging unemployment pressures mainly through steps in the longer-term context, by developing the skills that are likely to be needed by the private sector as non-oil growth increases.** However, it is important that quotas under the Kuwaitization policy be applied flexibly so that the competitiveness of the private sector is not adversely affected. Concerted attempts at an early integration of the segmented labor market with market-determined wages would be crucial. This process would be facilitated by steps for rationalizing government sector employment and wages under a well-defined civil service reform.

38. **The staff welcomes the authorities' intention to restrain current outlays in 2002/03 and encourages a strengthening of fiscal policy in the medium term in order to support the needed structural reforms.** The staff would recommend accelerating reduction in current expenditure, particularly through cuts in the wage bill and curtailment of subsidies through a gradual upward adjustment in utility charges toward market levels, and redirection of expenditure toward capital outlays. An early strengthening of non-oil revenue generation through improved revenue collection would be crucial. Over the period ahead, new tax measures including VAT should further strengthen the fiscal position. The staff supports the planned introduction of the three-year rolling budget as a mechanism for formulating fiscal policy in a medium-term framework under conservative oil price assumptions and well-defined fiscal rules. Streamlining of the state welfare system by better targeting social benefits expenditures will also help sustain the desired fiscal position. Continued Fund technical assistance to support the strengthening of expenditure management and revenue mobilization would be helpful. The authorities are to be commended for maintaining a generous foreign assistance program despite rising domestic needs and terms of trade shocks.

39. **The staff welcomes the authorities' determination to continue pursuing prudent monetary policy to ensure the stability of the pegged exchange rate arrangement and to facilitate private sector investment under a noninflationary environment.** The staff considers appropriate the authorities' decision to peg the Kuwaiti dinar to the U.S. dollar effective 2003 as a first step toward the GCC monetary integration by 2010. The maintenance of stability in the interbank market and an effective management of liquidity through the use of direct deposits with the CBK should be commended. At the same time, the staff encourages the authorities to ensure continued convergence of interest rates with the U.S. dollar deposit rate by more timely adjustments in the CBK's discount rate. Consideration should also be given to eliminating the lending rate ceilings, which could be negatively impacting lending to small- and medium-scale private enterprises.

40. **Kuwait's participation in the GDDS and the ongoing progress in the development and dissemination of economic data are commendable.** There have been welcome improvements in national accounts and balance of payments data, and their reporting. With regard to the balance of payments, analysis of developments is complicated by large errors and omissions, which are mainly attributed to the unavailability of data on capital flows of the nonfinancial private sector. It is to be hoped that accelerated efforts will be continued to further improve national accounts data on aggregate expenditure, nonfinancial private capital flows, foreign direct investment, and to improve the consistency of national accounts with the balance of payment data. In addition, the staff believes that collection and sharing of more comprehensive data on the labor market will help improve the formulation of policies to address the unemployment pressures. The staff recognizes technical difficulties, which do not permit Kuwait to collect and share information on the private sector's IIP.

41. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Kuwait: Selected Economic Indicators, 1997–2002

	1997	1998	1999	2000	2001	Est. 2002
Nominal GDP (market prices, millions of U.S. dollars)	29,865	25,123	29,140	35,824	32,807	32,487
Crude oil production (millions of barrels per day)	2.01	2.05	1.87	1.98	1.95	1.81
Kuwait crude export price (U.S. dollars per barrel)	16.8	10.3	15.5	25.7	22.3	22.4
			(Percentage change)			
Production and prices						
Nominal GDP	-2.6	-15.5	16.0	23.7	-8.5	-1.1
Nominal non-oil GDP	3.3	3.8	3.4	2.0	3.0	2.3
Real GDP	2.3	2.4	-2.5	1.4	-1.1	-0.9
Real oil GDP	1.6	1.8	-6.5	2.2	-3.2	-7.3
Real non-oil GDP	4.1	3.1	1.0	1.1	0.5	1.1
Consumer price index	0.7	0.1	3.0	1.8	1.7	2.0
Public finance 1/	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03
			(In percent of GDP)			
Total revenue	64.0	47.9	71.0	80.8	69.5	64.2
Of which						
Oil and gas revenue	38.4	27.3	48.3	57.4	45.1	42.4
Investment income 2/	22.6	17.2	19.9	18.9	17.5	16.5
Total expenditures	48.6	50.3	40.8	40.7	46.8	49.3
Current	42.6	44.5	37.2	37.4	42.6	44.3
Capital	6.1	5.8	3.6	3.3	4.2	5.0
Fiscal balance (deficit -)	15.4	-2.4	30.2	40.2	22.7	14.9
Fiscal balance excluding investment income (deficit -)	-7.2	-19.5	10.3	21.2	5.3	-1.6
	1997	1998	1999	2000	2001	2002
			(Changes in percent of broad money stock)			
Money and credit						
Foreign assets (net)	-7.2	-1.9	1.5	11.4	6.5	2.7
Domestic assets (net)	11.1	1.1	0.1	-5.1	6.3	9.7
Claims on government (net)	-2.7	-1.4	-2.7	-7.3	-4.1	-1.5
Claims on nongovernment sector	16.9	7.3	3.6	3.9	12.0	11.3
Broad money	3.9	-0.8	1.6	6.3	12.8	12.4
			(Percent per year)			
Interest rates 3/						
Kuwaiti dinar three-month deposits	6.0	5.9	5.3	5.4	3.7	2.1
U.S. dollar three-month deposits	5.3	5.1	4.9	6.0	3.3	1.4
			(In millions of U.S. dollars, unless otherwise indicated)			
External sector						
Exports	14,279	9,616	12,277	19,477	16,173	15,366
Of which: oil and refined products	13,467	8,470	11,027	18,162	14,976	14,138
Imports	-7,747	-7,715	-6,708	-6,451	-6,932	-7,091
Current account	7,930	2,213	5,062	14,672	8,566	6,711
In percent of GDP	26.6	8.8	17.3	41.0	26.1	20.7
Overall balance	-65	496	876	2,259	2,815	980
In percent of GDP	-0.2	2.0	3.0	6.3	8.6	3.0
International reserve assets	3,556	4,052	4,928	7,187	10,002	10,981
In months of imports of goods and services	3.3	4.1	5.0	7.4	10.1	10.7
Total external debt (including private sector)	4,848	9,938	10,057	10,426	11,599	11,053
In percent of GDP	16.2	39.6	34.5	29.1	35.4	34.0
			(Percentage change)			
Exchange rates 3/						
Exchange rates (US$ per KD, period average)	3.30	3.28	3.28	3.26	3.26	3.28
Nominal effective exchange rate	7.2	5.5	-0.6	4.4	6.0	0.2
Real effective exchange rate	4.9	3.1	1.0	4.0	5.0	0.4

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

1/ The fiscal year was changed from July–June to April–March effective 2001/02.

2/ Includes profit of public enterprises.

3/ In 2002, up to end of August.

Table 2. Kuwait: Summary of Government Finance, Medium-Term Projections, 1999/2000–2006/07 1/

			Prel.	Budget	Est.	Projections			
	1999/2000	2000/01	2001/02	2002/03	2002/03	2003/04	2004/05	2005/06	2006/07
	(In millions of Kuwaiti dinars)								
Total revenue	7,053	8,505	6,976	3,371	6,440	6,398	6,135	6,085	5,968
Oil and gas	4,795	6,037	4,525	2,969	4,252	4,202	3,948	3,886	3,771
Investment income and transfer of profits of public entities 2/	1,976	1,991	1,751	...	1,654	1,644	1,616	1,626	1,624
Other 3/	282	476	699	368	533	551	569	570	572
Capital	0	0	1	34	2	0	0	0	0
Total expenditure	4,050	4,279	4,697	5,277	4,944	5,111	5,250	5,403	5,563
Current	3,694	3,935	4,271	4,446	4,446	4,602	4,731	4,874	5,023
Wages and salaries	1,498	1,573	1,636	1,789	1,718	1,804	1,894	1,989	2,088
Goods and services	938	985	1,059	1,176	1,176	1,211	1,248	1,285	1,324
Interest on domestic debt 4/	216	249	221	79	216	214	211	209	207
Interest on foreign debt 2/	0	0	0	...	0	0	0	0	0
Transfers abroad	84	91	95	83	83	83	75	75	75
Subsidies and transfers	958	1,036	1,260	1,319	1,253	1,291	1,304	1,317	1,330
Capital	356	344	426	831	499	509	519	529	540
Overall balance	3,003	4,226	2,279	-1,906	1,496	1,288	885	682	406
Financing	-3,003	-4,226	-2,279	...	-1,496	-1,288	-885	-682	-406
Domestic (net)	-457	-1,035	-135	...	-77	-61	-32	-17	4
Banks	-534	-1,170	-169	...	-111	-95	-66	-51	-30
Nonbanks	77	135	34	...	34	34	34	34	34
External	0	0	0	...	0	0	0	0	0
Reserve funds	-2,546	-3,191	-2,144	...	-1,419	-1226	-853	-665	-410
	(In percent of GDP)								
Revenue	71.0	80.8	69.5	33.6	64.2	62.6	60.1	58.2	55.2
Oil and gas	48.3	57.4	45.1	29.6	42.4	41.1	38.7	37.1	34.9
Investment income	19.9	18.9	17.5	0.0	16.5	16.1	15.8	15.5	15.0
Other	2.8	4.5	7.0	4.0	5.3	5.4	5.6	5.5	5.3
Expenditure	40.8	40.7	46.8	52.6	49.3	50.0	51.4	51.6	51.5
Current	37.2	37.4	42.6	44.3	44.3	45.0	46.3	46.6	46.5
Wages and salaries	15.1	15.0	16.3	17.8	17.1	17.6	18.5	19.0	19.3
Goods and non-interest services	9.4	9.4	10.6	11.7	11.7	11.8	12.2	12.3	12.2
Interest on domestic and foreign debt	2.2	2.4	2.2	0.8	2.2	2.1	2.1	2.0	1.9
Subsidies and transfers	9.6	9.8	12.6	13.2	12.5	12.6	12.8	12.6	12.3
Capital	3.6	3.3	4.2	8.3	5.0	5.0	5.1	5.1	5.0
Overall balance	30.2	40.2	22.7	-19.0	14.9	12.6	8.7	6.5	3.8

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

1/ Fiscal year has been changed to April–March effective 2001/02. The 2000/01 data were obtained by grossing up the 2000/01 (9-month fiscal data).

2/ Excluded from national budget presentation.

3/ Excludes revenues from utility tariffs (included in the national budget presentation), but includes UN (Iraq) compensations.

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: Summary Balance of Payments Medium-Term Projections, 1999–2007

(In millions of U.S. dollars)

	1999	2000	2001	Est. 2002	Projections 2003	2004	2005	2006	2007
Current account	5,062	14,672	8,566	6,711	6,137	4,661	3,953	2,966	2,557
Goods (trade balance)	5,569	13,026	9,241	8,275	7,942	6,707	6,369	5,593	5,399
Exports	12,277	19,477	16,173	15,366	15,595	14,720	14,732	14,362	14,585
Oil and oil products	11,027	18,162	14,976	14,138	14,284	13,319	13,234	12,757	12,866
Non-oil	1,250	1,315	1,197	1,228	1,310	1,401	1,499	1,605	1,719
Imports	-6,708	-6,451	-6,932	-7,091	-7,653	-8,014	-8,363	-8,769	-9,186
Services	-3,612	-3,097	-3,552	-3,392	-3,661	-3,833	-4,001	-4,195	-4,394
Transportation	-378	-153	-228	-218	-235	-246	-257	-270	-282
Travel	-2,178	-2,396	-3,081	-2,942	-3,175	-3,325	-3,470	-3,638	-3,811
Other services	-1,056	-548	-243	-232	-251	-262	-274	-287	-301
Investment income	5,109	6,698	4,959	3,918	3,988	3,962	3,802	3,830	3,860
Receipts	6,095	7,314	5,484	4,864	4,973	4,985	4,861	4,926	4,994
General government 1/	4,212	4,951	3,967	3,064	3,121	3,179	3,240	3,305	3,373
Other 2/	1,883	2,363	1,517	1,800	1,852	1,806	1,620	1,620	1,620
Payments	-986	-616	-525	-946	-984	-1,023	-1,058	-1,096	-1,134
General government	-227	-16	-52	-248	-258	-268	-277	-287	-297
Other	-759	-600	-473	-698	-726	-755	-781	-808	-837
Current transfers	-2,004	-1,956	-2,082	-2,090	-2,132	-2,174	-2,218	-2,262	-2,308
Capital and financial account	-5,002	-11,089	-3,105	-4,637	-5,259	-4,391	-3,853	-2,917	-2,623
Capital account (official grants)	703	2,217	2,933	1,606	950	800	500	300	200
Financial account	-5,705	-13,306	-6,038	-6,243	-6,209	-5,191	-4,353	-3,217	-2,823
Direct investment	49	319	-362	-653	-649	-543	-455	-337	-295
Abroad	-23	303	-323	-582	-749	-743	-755	-637	-595
In reporting country	72	16	-39	-71	100	200	300	300	300
Portfolio investment	-2,558	-12,667	-7,453	-5,551	-4,616	-3,469	-2,962	-2,206	-1,917
Assets	-2,637	-12,921	-7,375	-5,851	-4,851	-3,684	-3,125	-2,344	-2,021
Liabilities	79	254	-78	300	235	215	163	138	104
Other investment	-3,196	-958	1,778	-39	-944	-1,179	-936	-675	-610
Trade credits	-841	-274	470	-11	-270	-337	-267	-193	-174
Loans	-283	-23	356	-1	-22	-28	-22	-16	-15
Currency and deposits	-1,849	-1,040	1,791	-42	-1,024	-1,279	-1,016	-733	-662
Other	-223	378	-838	15	372	465	369	266	241
Net errors and omissions 3/	816	-1,325	-2,647	-1,094	0	0	0	0	0
Overall balance	876	2,259	2,815	980	878	270	101	48	-66
International reserve assets (-increase)	-876	-2,259	-2,815	-980	-878	-270	-101	-48	-66
Memorandum items:									
Current account/GDP	17.3	41.0	26.1	20.7	18.3	14.1	11.7	8.5	7.1
Overall balance/GDP	3.0	6.3	8.6	3.0	2.6	0.8	0.3	0.1	-0.2
International reserve assets (in millions of U.S. dollars) 4/	4,928	7,187	10,002	10,981	11,859	12,129	12,229	12,278	12,212
Total reserves minus gold	4,824	7,082	9,897	10,877	11,755	12,025	12,125	12,173	12,107
Gold (national valuation)	104	104.2	104.2	104.2	104.2	104.2	104.2	104.2	104.2
In months of imports of goods and services	5.0	7.4	10.1	10.7	11.1	11.4	11.1	11.1	11.1

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

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/ Central Bank of Kuwait, local banks, investment, insurance companies, and nonfinancial private sector.

3/ Includes other unclassified private sector flows.

4/ As reported in *International Financial Statistics.*

Table 4. Kuwait: Monetary Survey, 1997–2003

End of Period	1997	1998	1999	2000	2001	June 1/ 2002	Est. 2002	Proj. 2003
	(End-period stocks in millions of Kuwaiti dinars)							
Foreign assets (net)	1,929	1,784	1,899	2,778	3,307	3,356	3,556	3,792
Central bank	1,034	1,080	1,320	2,005	2,850	3,121	3,118	...
Local banks	895	704	579	773	457	235	437	...
Domestic assets (net)	5,687	5,773	5,780	5,386	5,902	6,336	6,798	7,277
Claims on government (net)	3,782	3,678	3,475	2,911	2,573	2,464	2,433	2,287
Central bank (net)	-237	-205	-392	-532	-598	-561	-668	...
Claims	39	0	45	0	0	...	0	...
Deposits	276	205	437	532	598	561	668	...
Local banks (net)	4,019	3,883	3,867	3,443	3,171	3,026	3,101	3,033
Claims	4,363	4,140	4,062	3,628	3,402	3,305	3,332	...
Government debt bonds	2,389	2,246	1,931	1,491	1,294	1,190	1,259	...
Public debt instruments	1,974	1,895	2,132	2,137	2,108	2,115	2,073	...
Other claims	0	0	0	0	0	0	0	...
Deposits	344	257	195	185	231	280	231	...
Claims on nongovernment sector	4,745	5,303	5,572	5,871	6,851	7,130	7,887	8,512
Credit facilities	4,324	4,802	5,015	5,252	6,125	6,344	6,493	...
Local investments	420	501	557	619	726	786	1,395	...
Other items (net)	-2,840	-3,209	-3,268	-3,396	-3,522	-3,259	-3,522	-3,522
Broad money	7,616	7,557	7,678	8,163	9,209	9,692	10,354	11,068
Money	1,248	1,143	1,371	1,468	1,641	2,156	1,655	...
Currency in circulation	345	349	443	417	401	427	386	...
Demand deposits	902	795	929	1,051	1,240	1,728	1,269	...
Quasi money	6,368	6,413	6,307	6,695	7,567	7,536	8,700	...
Of which: foreign currency deposits	1,154	1,037	881	895	892	950	912	...
	(Annual percentage change)							
Foreign assets (net)	-21.4	-7.5	6.4	46.3	19.0	4.9	7.5	6.6
Central bank	-1.4	4.5	22.2	51.9	42.2	21.6	9.4	...
Local banks	-36.4	-21.4	-17.7	33.5	-40.9	-62.7	-4.2	...
Domestic assets (net)	16.7	1.5	0.1	-6.8	9.6	18.9	15.2	7.0
Claims on government (net)	-5.0	-2.7	-5.5	-16.2	-11.6	-1.7	-5.4	-6.0
Central bank (net)	8.4	-13.5	91.3	35.6	12.3	-26.0	11.7	...
Local banks (net)	-4.3	-3.4	-0.4	-11.0	-7.9	-7.3	-2.2	...
Claims on nongovernment sector	35.5	11.8	5.1	5.4	16.7	16.2	15.1	7.9
Other items (net)	-8.9	-13.0	-1.8	-3.9	-3.7	1.7	0.0	0.0
Broad money	3.9	-0.8	1.6	6.3	12.8	13.7	12.4	6.9
Money	0.4	-8.3	19.9	7.0	11.8	28.0	0.8	...
Quasi money	4.6	0.7	-1.7	6.2	13.0	10.1	15.0	...
Of which: foreign currency deposits	-8.2	-10.1	-15.1	1.6	-0.3	13.8	2.3	...
	(Change in percent of broad money stock a year earlier)							
Foreign assets (net)	-7.2	-1.9	1.5	11.4	6.5	1.9	2.7	2.3
Central bank	-0.2	0.6	3.2	8.9	10.4	6.5	2.9	...
Local banks	-7.0	-2.5	-1.7	2.5	-3.9	-4.6	-0.2	...
Domestic assets (net)	11.1	1.1	0.1	-5.1	6.3	11.8	9.7	4.6
Claims on government (net)	-2.7	-1.4	-2.7	-7.3	-4.1	-0.5	-1.5	-1.4
Central bank (net)	-0.2	0.4	-2.5	-1.8	-0.8	2.3	-0.8	...
Local banks (net)	-2.5	-1.8	-0.2	-5.5	-3.3	-2.8	-0.8	...
Claims on nongovernment sector	16.9	7.3	3.6	3.9	12.0	11.7	11.3	6.0
Other items (net)	-3.2	-4.8	-0.8	-1.7	-1.5	0.7	0.0	0.0
Broad money	3.9	-0.8	1.6	6.3	12.8	13.7	12.4	6.9
Money	0.1	-1.4	3.0	1.3	2.1	5.5	0.1	...
Quasi money	3.8	0.6	-1.4	5.1	10.7	8.1	12.3	...
Of which: foreign currency deposits	-1.5	-2.1	0.2	0.0	0.2	0.1	0.2	...

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

1/ Growth is calculated on annual basis (June 2001 to June 2002).

Table 5. Kuwait: Illustrative Baseline Scenario, 1997–2007

(Percent of GDP; unless otherwise specified)

	1997	1998	1999	2000	2001	Est. 2002	Baseline Scenario 2003	2004	2005	2006	2007
Production and prices											
Nominal GDP (millions of Kuwaiti dinars)	9,059	7,656	8,884	10,991	10,057	9,950	10,250	10,157	10,377	10,719	11,067
Nominal GDP (percent change)	-2.6	-15.5	16.0	23.7	-8.5	-1.1	3.0	-0.9	2.2	3.3	3.2
Nominal non-oil GDP (percent change)	3.3	3.8	3.4	2.0	3.0	2.3	3.9	4.7	4.4	4.9	4.8
Real GDP (percent change)	2.3	2.4	-2.5	1.4	-1.1	-0.9	2.0	2.1	2.0	2.3	2.3
Real oil GDP (percent change)	1.6	1.8	-6.5	2.2	-3.2	-7.3	1.9	1.4	1.2	1.2	1.2
Real non-oil GDP (percent change)	4.1	3.1	1.0	1.1	0.5	1.1	2.0	2.5	2.5	3.0	3.0
Kuwait crude export price (U.S. dollars per barrel)	16.8	10.3	15.5	25.7	22.3	22.4	22.2	20.4	20.0	19.0	19.0
Crude oil output (millions of barrels per day)	2.01	2.05	1.87	1.98	1.95	1.81	1.84	1.86	1.89	1.91	1.93
Public finance 1/											
Revenue	64.0	47.9	71.0	80.8	69.5	64.2	62.6	60.1	58.2	55.2	54.5
Of which											
Oil and gas	38.4	27.3	48.3	57.4	45.1	42.4	41.1	38.7	37.1	34.9	34.5
Investment income 2/	22.6	17.2	19.9	18.9	17.5	16.5	16.1	15.8	15.5	15.0	14.9
Expenditure	48.6	50.3	40.8	40.7	46.8	49.3	50.0	51.4	51.6	51.5	51.3
Current	42.6	44.5	37.2	37.4	42.6	44.3	45.0	46.3	46.6	46.5	46.4
Capital	6.1	5.8	3.6	3.3	4.2	5.0	5.0	5.1	5.1	5.0	4.9
Fiscal balance	15.4	-2.4	30.2	40.2	22.7	14.9	12.6	8.7	6.5	3.8	3.2
Fiscal balance excluding investment income (deficit -)	-7.2	-19.5	10.3	21.2	5.3	-1.6	-3.5	-7.2	-9.0	-11.3	-11.7
Balance of payments											
Exports	47.6	38.0	42.4	54.4	49.3	47.3	46.6	44.4	43.5	41.0	40.4
Of which: oil and refined products	44.5	33.7	38.1	50.7	45.6	43.5	42.7	40.2	39.1	36.5	35.6
Imports	-25.9	-30.7	-23.2	-18.0	-21.1	-21.8	-22.9	-24.2	-24.7	-25.1	-25.4
Investment income (net)	21.0	23.4	17.6	18.7	15.1	12.1	11.9	11.9	11.2	10.9	10.7
Current account	26.6	8.8	17.3	41.0	26.1	20.7	18.3	14.1	11.7	8.5	7.1
Saving-investment balance											
Final consumption	72.7	88.4	78.3	64.8	74.0	75.4	75.4	79.0	80.6	83.4	84.6
Government	27.1	31.5	27.7	22.6	26.3	28.1	28.4	29.8	30.4	30.6	30.7
Private	45.6	56.9	50.5	42.2	47.7	47.3	47.1	49.1	50.3	52.8	53.8
Gross domestic investment	13.9	19.1	15.0	7.5	8.6	9.6	11.8	12.4	12.4	12.6	12.6
Government	5.4	5.5	3.9	3.5	4.4	5.0	5.0	5.1	5.1	5.1	5.0
Private	8.4	13.6	11.1	4.0	4.2	4.5	6.8	7.3	7.3	7.5	7.6
Saving	43.3	27.9	32.5	48.5	34.7	30.2	30.1	26.4	24.0	21.1	19.7

Sources: Kuwaiti authorities; IMF, *World Economic Outlook;* and Fund staff estimates and projections.

1/ On a fiscal year basis (July–June); since 2001/02 the fiscal year was changed to April–March. FY 2001/02 was obtained by grossing up the 2001/02 fiscal data.

2/ Included profits of public enterprises.

Table 6. Kuwait: Vulnerability Indicators, 1997–2001

	1997	1998	1999	2000	2001
	(In percent; unless otherwise indicated)				
External solvency indicators					
REER (CPI based, period average)	7.2	5.5	-0.6	4.4	6.0
External debt including private sector (in millions of U.S. dollars) 1/	4,848	9,938	10,057	10,426	11,599
Short-term debt (original maturity) 1/	1,500	2,600	2,000	2,000	2,000
Medium- and long-term debt 1/	3,348	7,338	8,057	8,426	9,599
External debt/GDP	16.2	39.6	34.5	29.1	35.4
External debt/total exports of goods and services	30.2	87.3	72.5	48.8	57.6
Short-term debt/total exports of goods and services	9.4	22.8	14.4	9.4	9.9
External debt service/total exports of goods and services	9.1	11.4	7.1	2.9	3.0
Public sector solvency indicators					
General government domestic debt/GDP (TBs and bonds)	24.7	26.2	25.8	21.2	24.5
Interest payments/total revenue	5.5	7.0	3.1	2.9	3.2
Distribution of the public domestic debt by holders					
Local commercial banks	88.3	93.5	91.2	89.0	85.6
Other (including nongovernment public institutions)	11.7	6.5	8.8	11.0	14.4
Oil revenue/total revenue	60.0	56.9	73.0	73.0	74.0
External liquidity indicators					
CBK net foreign assets (in millions of U.S. dollars)	3,409	3,545	4,336	6,535	9,297
CBK gross foreign assets (in millions of U.S. dollars) 2/	3,428	3,552	4,344	6,547	9,308
In months of imports of goods and services	3.2	3.2	4.4	6.8	8.7
Relative to short-term external debt	228.5	136.6	217.2	327.4	465.4
Relative to M0	243.6	241.4	226.8	375.2	547.3
Relative to M1	83.4	94.7	96.4	136.9	136.9
Total official net foreign assets/M3	13.6	14.3	17.2	24.6	30.9
Local banks' net foreign assets (in millions of U.S. dollars)	2,951	2,308	1,901	2,519	1,489
Foreign assets	6,981	5,866	5,869	6,415	6,612
Foreign liabilities	4,030	3,558	3,968	3,896	5,123
Oil exports/total exports	94.7	88.7	89.8	93.2	92.6
Financial sector indicators					
Increase in net bank profits 3/	34.8	-8.2	13.7	20.9	9.9
Ratio of net profits to total bank assets	1.7	1.6	1.8	2.0	2.0
Ratio of net profits to total shareholders' equity	15.7	13.8	15.3	17.6	18.2
Banks' capital-asset ratio	11.1	11.4	11.6	11.5	11.2
Banks' risk-weighted capital-asset ratio	22.4	22.5	23.7	22.2	22.0
Banks' leverage 4/	9.0	8.8	8.6	8.7	...

Table 6. Kuwait: Vulnerability Indicators, 1997–2001

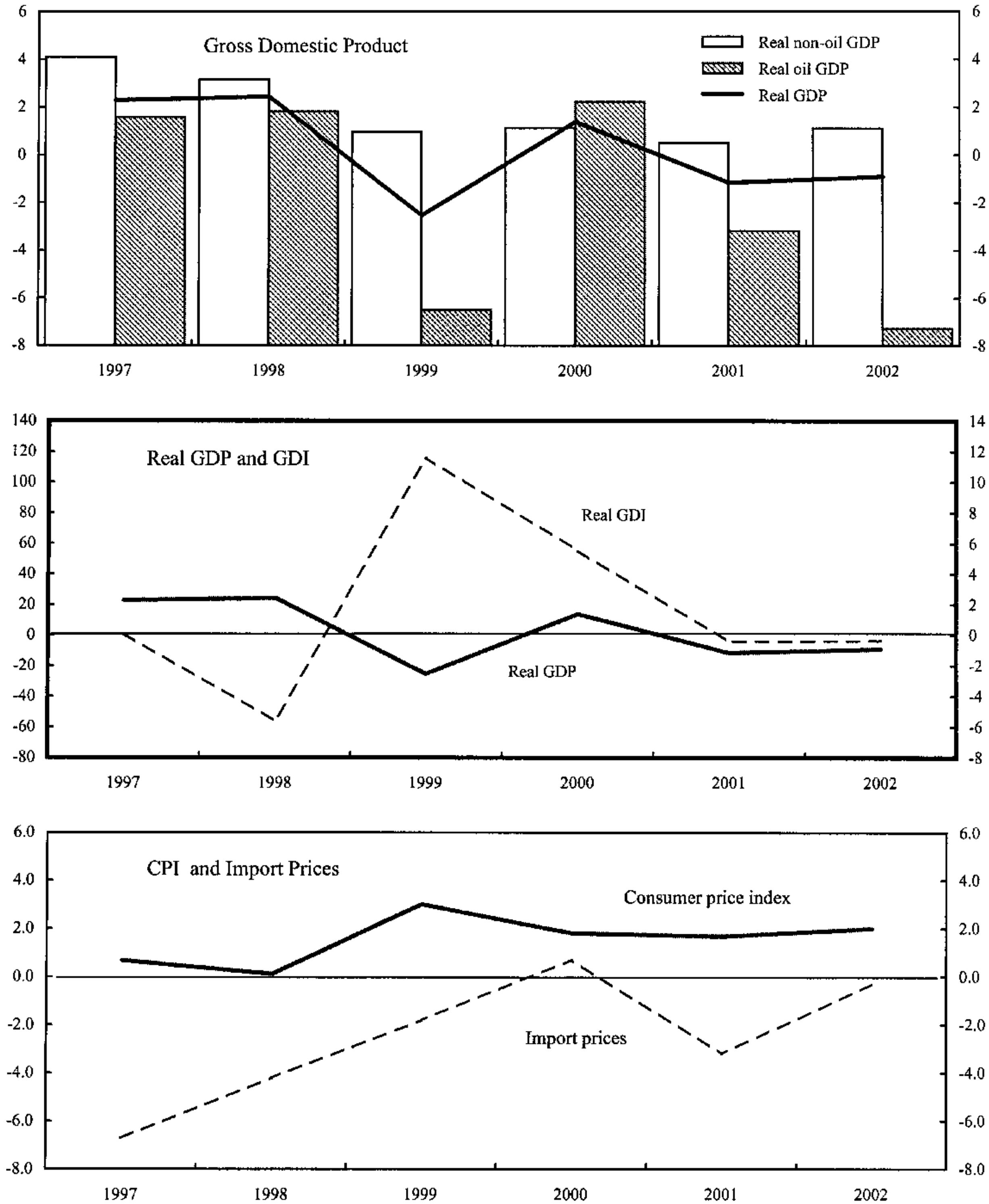
	1997	1998	1999	2000	2001
	(In percent; unless otherwise indicated)				
Financial sector indicators					
Banks' liquidity ratio 5/	45.0	44.2	44.5	50.5	47.7
Ratio of banks' nonperforming loans to total loans	10.2	10.3	12.8	19.2	10.3
Nonperforming loans from before invasion	8.2	7.3	6.8	12.8	5.1
Nonperforming loans since liberation	2.0	3.0	6.0	6.4	5.2
Loan provisions as a proportion of nonperforming loans	65.2	68.2	53.2	50.1	53.4
Ratio of bank lending to total domestic credit facilities					
Stock market-related	7.7	6.1	4.3	4.7	6.3
Real estate 6/	15.6	17.5	19.9	16.3	19.0
Total (stock market, real estate)	23.3	23.6	24.2	21.0	25.3
Ratio of bank lending to banks' own funds					
Stock market-related	23.7	19.9	14.4	15.7	22.9
Real estate	47.9	57.3	66.5	53.9	69.3
Total (stock market, real estate)	71.6	77.2	80.9	69.6	92.2
Banks' interest rate spread 7/	0.7	0.8	0.4	-0.6	0.4
Investment companies' capital and reserve/total assets	40.2	38.6	39.5	37.8	33.6
	(In millions of Kuwaiti dinars)				
Net foreign assets of local banks	895.2	703.5	578.7	772.8	456.5
Net foreign assets of investment companies 8/	635.6	601.3	705.5	794.3	667.1
Open foreign exchange position of banks 9/	-4.6	26.0	19.4	6.8	-13.5

Sources: 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/ Ratio of total liabilities to banks' own funds.
5/ 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).
6/ Ratios may be overestimated due to loan classification problems by the local banks.
7/ Calculated as the difference between 3-month deposits rates in KD relative to the 3-month deposit rates in U.S. dollars.
8/ Equals nonresident assets minus nonresident liabilities, excluding own funds.
9/ A (-) sign indicates a short position.

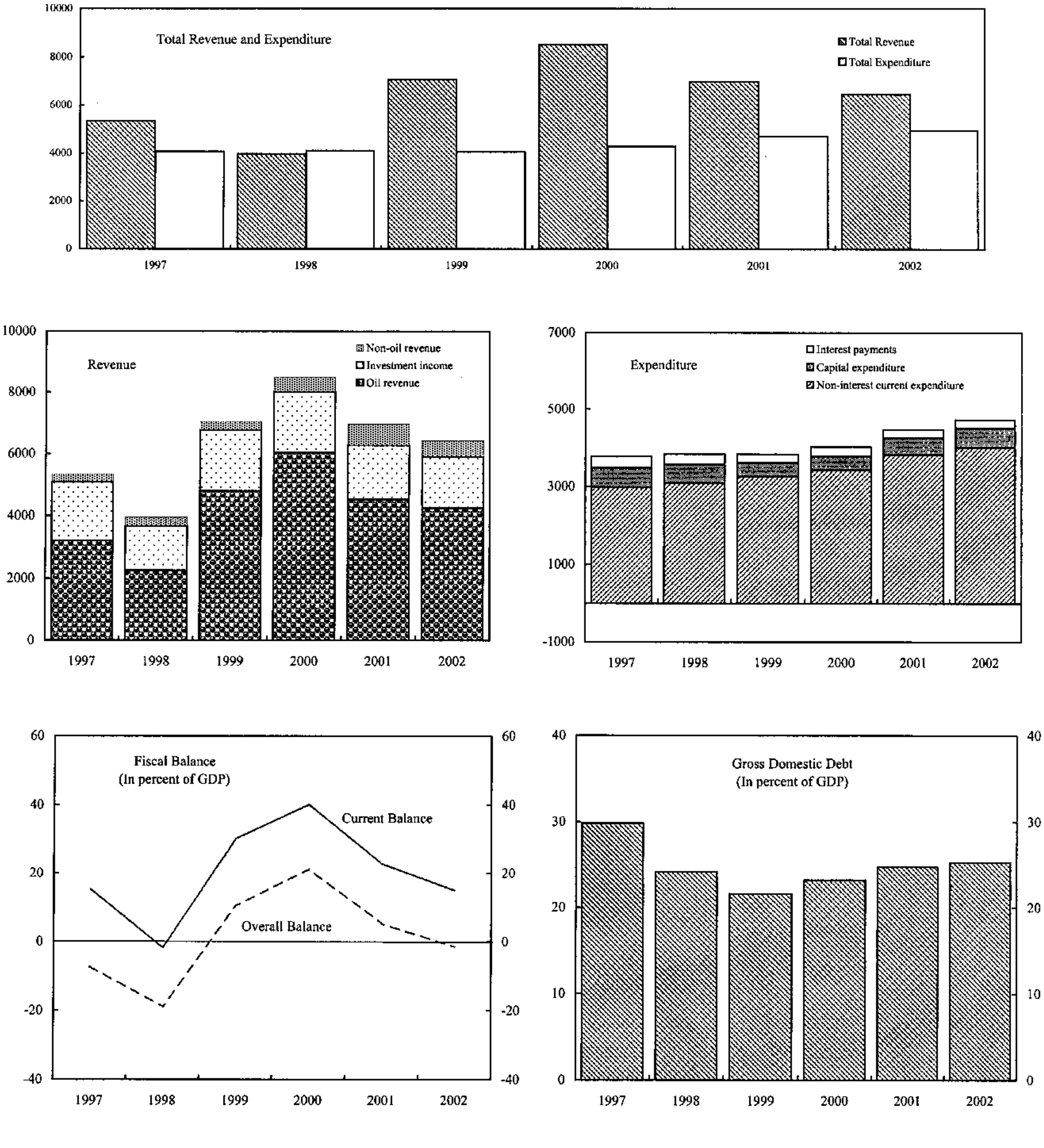
Figure 1. Kuwait: Selected Real Sector Indicators, 1997–2002

(Annual percentage change)



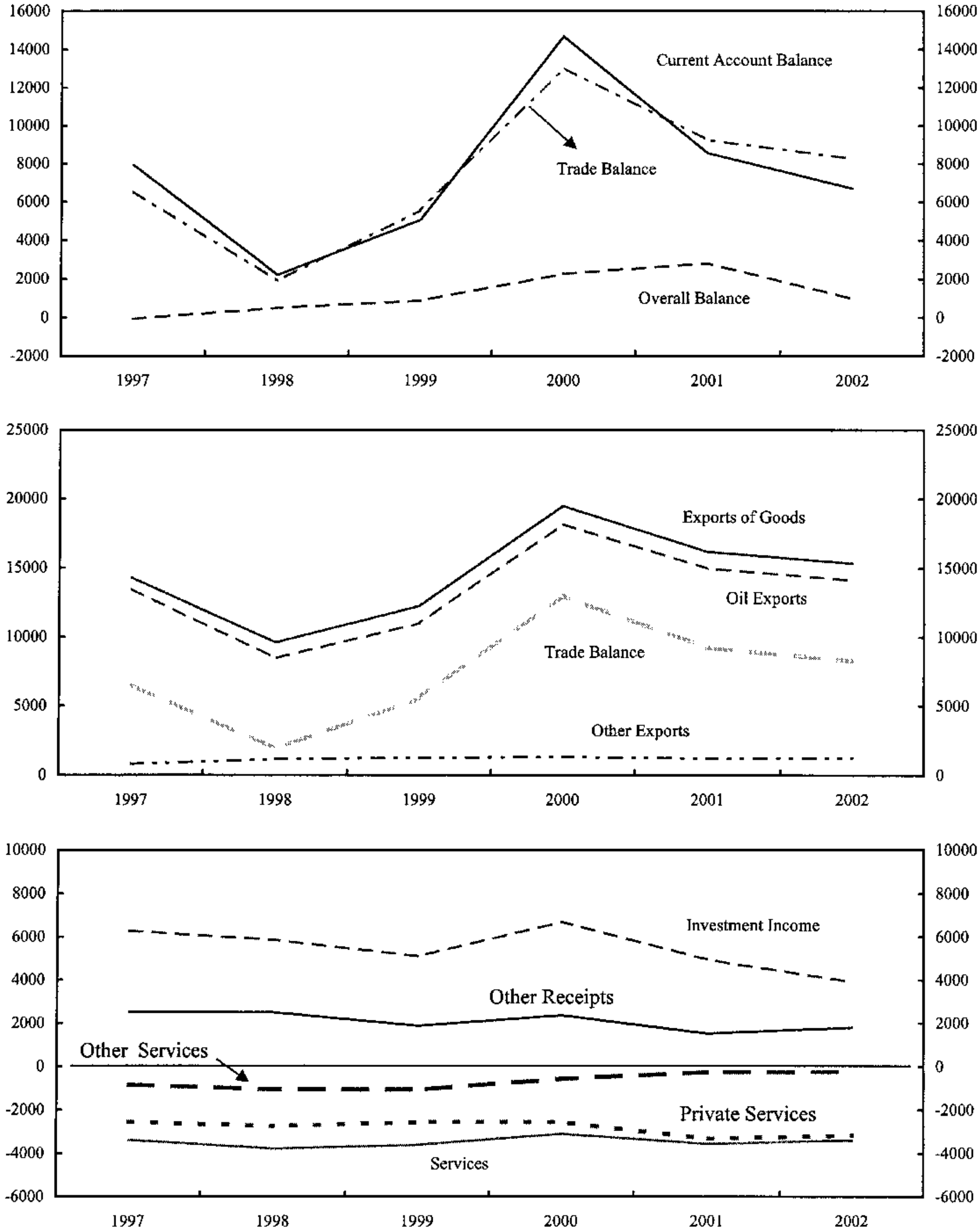
Sources: Data provided by the Kuwaiti authorities; and Fund staff estimtaes.

Figure 2. Kuwait: Central Government Fiscal Indicators, 1997–2002
(In millions of Kuwaiti Dinars, unless otherwise indicated)



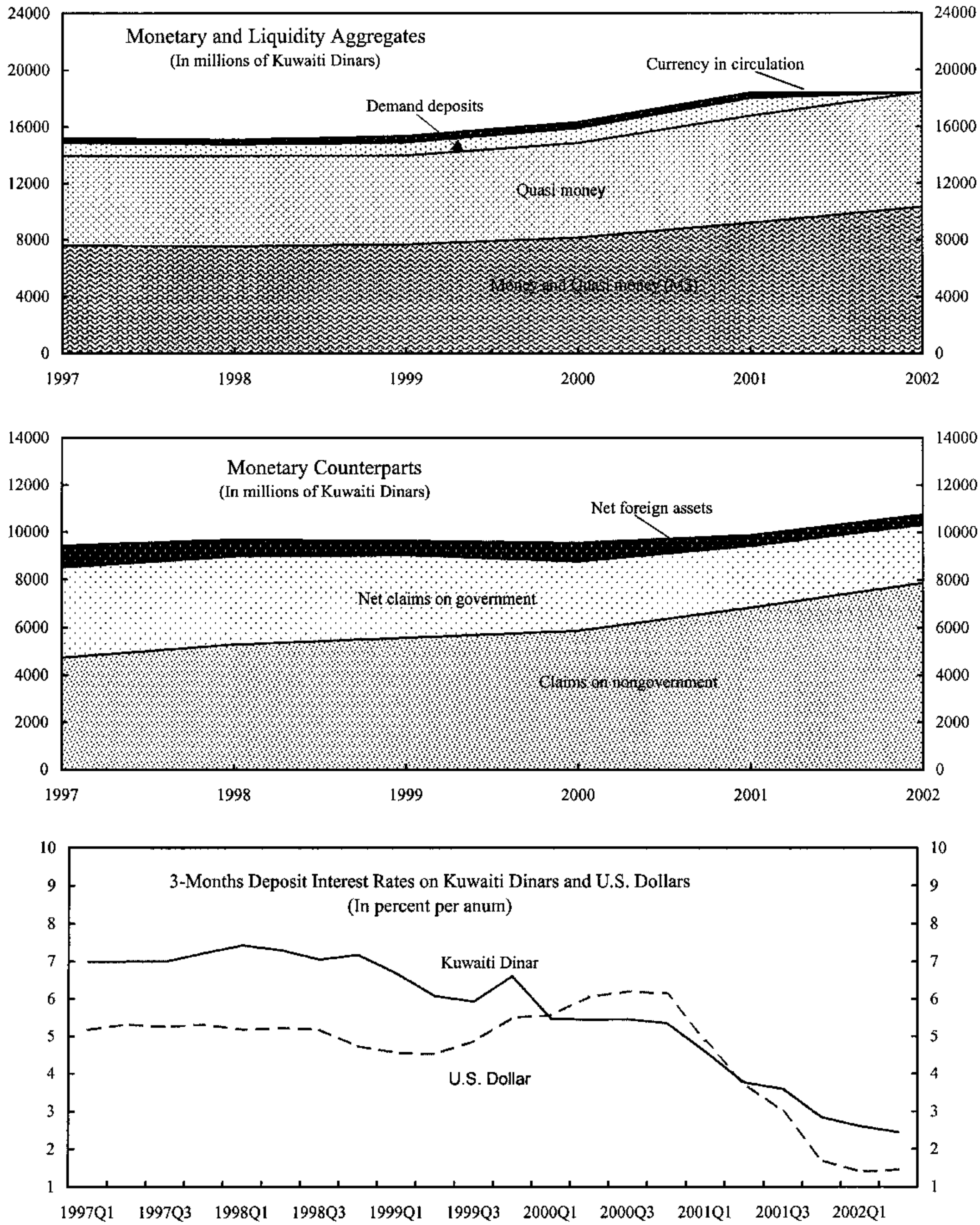
Sources: Data provided by the Kuwaiti Authorities; and Fund staff estimates and projections.

Figure 3. Kuwait: External Sector Developments, 1997–2002
(In millions of U.S. dollars)



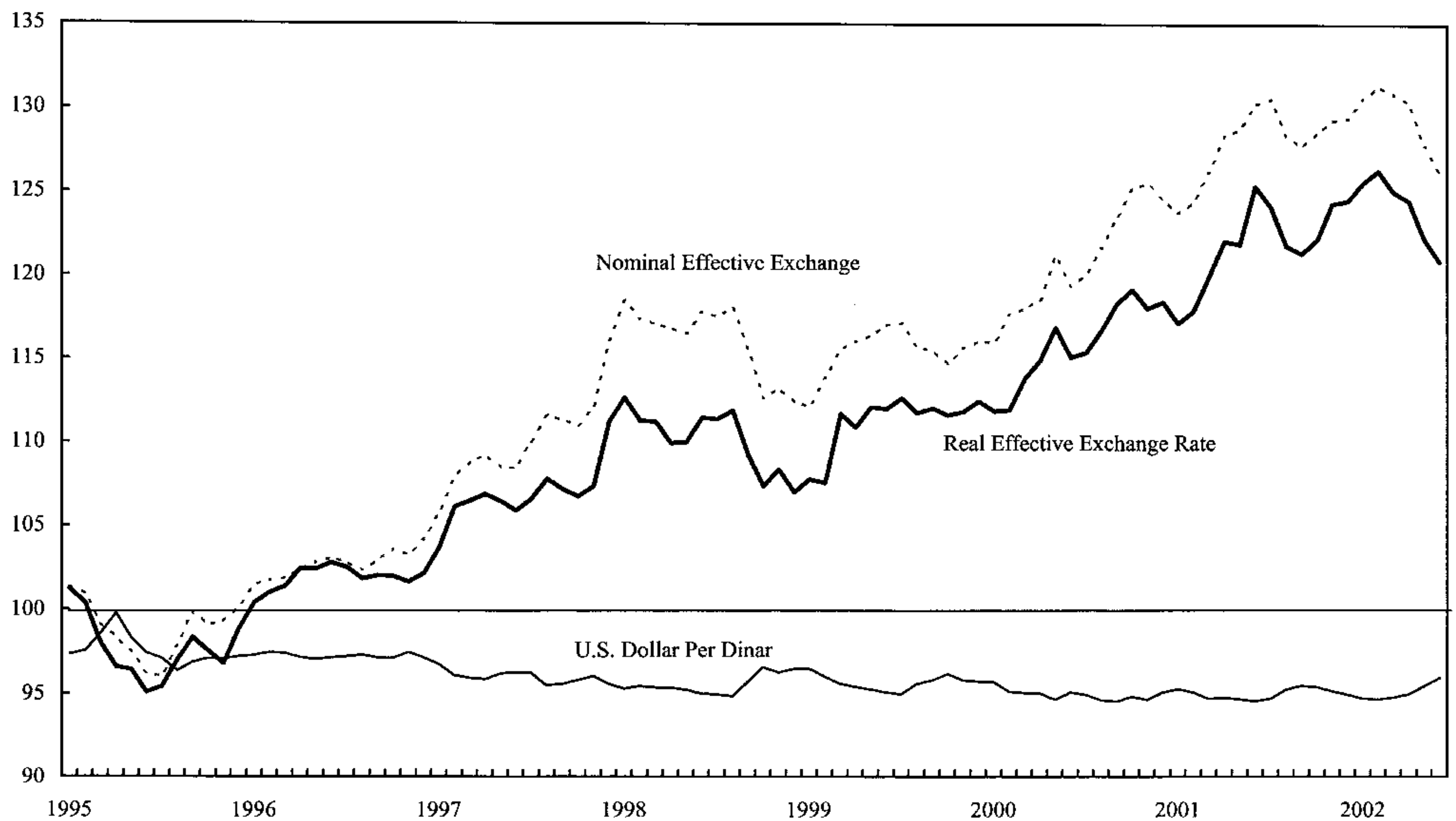
Sources: Data provided by the Kuwaiti authorities; and Fund staff estimates and projections.

Figure 4. Monetary and Financial Developments, 1997–2002
(In millions of Kuwaiti Dinars; unless otherwise indicated)



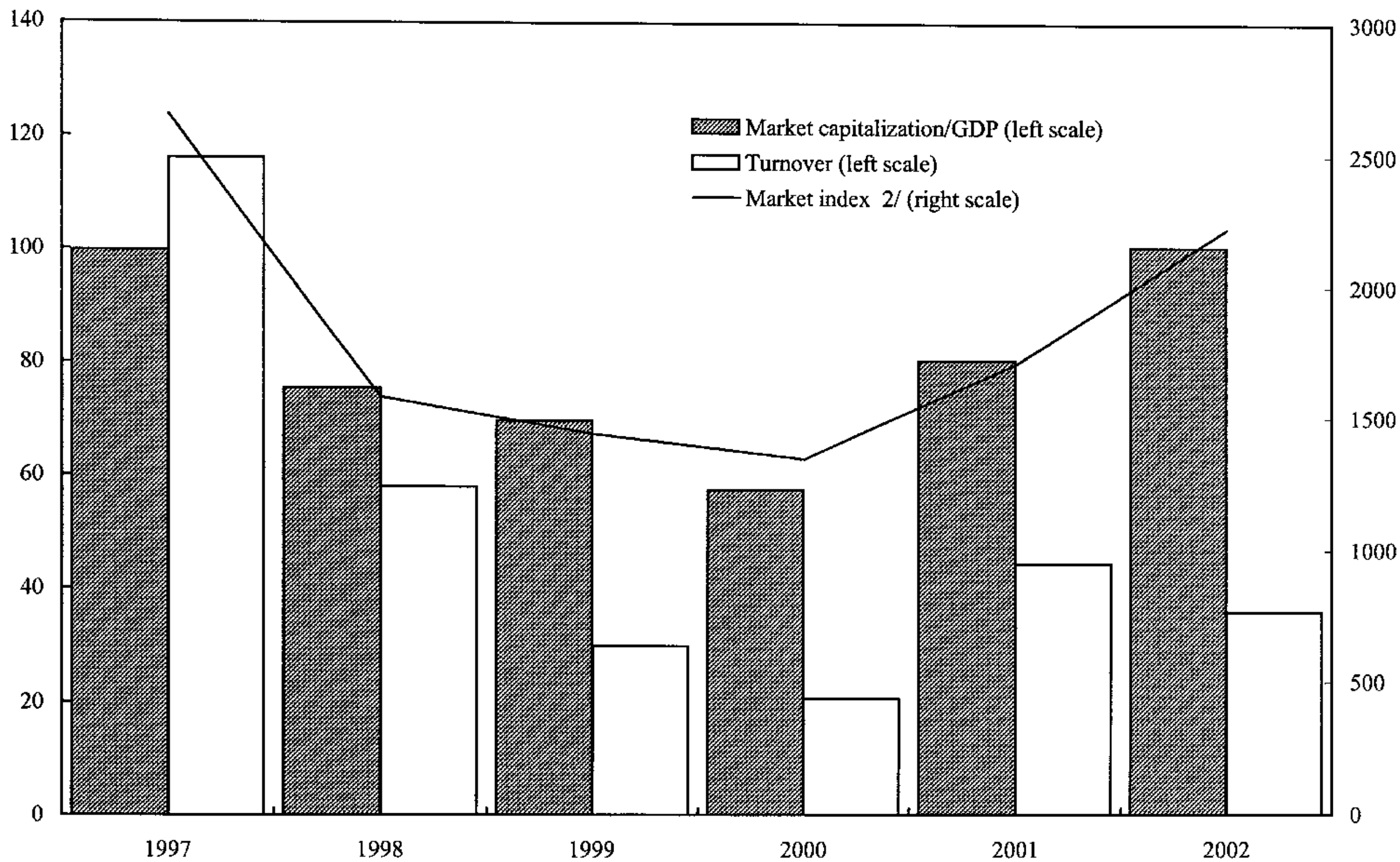
Sources: Data provided by the Kuwaiti authorities; and Fund staff estimates and projections.

Figure 5. Kuwait: Exchange Rate Movements, January 1995–June 2002
(1990 = 100)



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

Figure 6. Kuwait: Stock Market Indicators, 1997–2002 1/
(In Percent)



Source: Central Bank of Kuwait.

1/ 2002 covers January to June.
2/ December 29, 1993 = 1000

KUWAIT

Fund Relations
(As of August 31, 2002)

I. **Membership Status**: Joined September 13, 1962
Article VIII on April 5, 1963

		SDR Million	% Quota
II.	**General Resources Account**:	**SDR Million**	**% Quota**
	Quota	1,381.10	100.00
	Fund holdings of currency	833.41	60.34
	Reserve position in Fund	547.70	39.66
	Operational budget transfers (net)	66.00	

III.	**SDR Department**:	**SDR Million**	**% Allocation**
	Net cumulative allocation	26.74	100.00
	Holdings	94.59	353.67

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 0.3022 as of end-September 2002. On October 13, 2002, the Kuwaiti authorities announced that they will peg the KD to the U.S. dollar effective January 2003 in line with the GCC decision in December 2001.

VIII. **Article IV Consultations**:

The latest Article IV consultation was completed by the Executive Board on June 27, 2001. The staff report was issued in August 2001 (SM/01/167); and the associated Statistical Appendix (SM/01/188).

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
STA	National Accounts and Price Statistics	June 2001–June 2002
FAD	Restructuring Budget Processes	January–February 2002
FAD	Tax Policy and Administration	October 2002

X. **Resident Representative**: None

XI. Kuwait has consented to the quota increase under the Eleventh General Review of Quotas; it has accepted the Fourth Amendment of the Articles of Agreement.

KUWAIT

Relations with the World Bank Group

As of September 30, 2002

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 March 2001 completed a study on "Energizing the Private Sector" in Kuwait. In 2002, the World Bank is conducting various missions in land policy, power sector reform, telecom, transport, and tourism to identify areas where technical assistance might be needed.

- **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 World Bank assistance in implementation of the various reform initiatives, including the institutional set-up for an implementation agency. The Government of Kuwait and the World Bank are currently exploring mechanisms for more World Bank technical assistance involvement in this regard.

- **Investment environment:** The World Bank's recent technical assistance relationship with the Kuwaiti authorities has concentrated on enhancing the investment environment, with work on the FDI law, identification of policy and administrative impediments to investment, and development of a competition law and policy. A presentation was made on investment promotion, investment climate, and FDI regulations in 2002.

Further, the World Bank initiated the FDI Bylaw and provided technical assistance on the negative restricted list.

- **Public awareness:** As a first step to support the Economic Reform Program, the Bank has managed 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.

- **Education expenditure analysis study:** The World Bank has finalized the 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 report was submitted in June 2002 and expected to be finalized shortly to highlight other types of World Bank assistance in the sector.

KUWAIT

Statistical Issues

A. National accounts and production

Improvements have been made in restoring the database after liberation, and the Central Statistical Office (CSO) has now prepared estimates of GDP at current prices through 2001, constant price GDP statistics are also available through 2001, although the 2001 estimates are provisional. The base year for the constant price data has been changed to 1995 and published at the Central Statistical Office website. 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 provided 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 (2000), with new weights, and a revised basket of goods and services for the consumer price index was finalized by 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 about 3 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 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 presentations detailed in the "Code of Good Practices on Fiscal Transparency" and were encouraged to adopt some of the practices recommended in the Code. According to the FAD report entitled "*Restructuring Budget Processes*" which was finalized in March 2002, the weakest part of the Kuwaiti Public Expenditure Management (PEM) system is the accounting system.[2]

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. On an issue noted by that mission it was clarified that the Savings and Credit Bank (SCB) does not accept transferable deposits from the public and, hence, its accounts are rightly not consolidated with the accounts of deposit money banks (consideration should be given to treating the SCB as part of the government sector). 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 STA 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 the beginning of 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

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

[2] The mission was conducted by the FAD in January/February 2002 at the request of H. E. Dr. Yousef Al-Ebraheem.

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 and its GDDS metadata have been posted on the Dissemination Standards Bulletin since May 2000. Kuwait's 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 CBK 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 (monthly); exchange rate (average, monthly); GDP by sector and expenditure at current and constant prices (annually); public finance (selected data are available monthly); CPI and WPI (monthly with about a three-month lag); and securities market indicators (quarterly). The Ministry of Planning constructed a web page corresponding to the CSO, which published their data on national accounts, prices and other related statistics. Further, the Ministry of Finance constructed a web page, which includes elaborated data for the actual and estimated budget. In addition, the KIA 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 September 30, 2002)

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance 2/	GDP/ GNP	External Debt/ Debt Service 7/
Date of latest observation	17/10/02	09/02	09/02	09/02	09/02	09/02	Q202	06/02	2001	FY2000/01	2001	...
Date received	17/10/02	10/02	10/02	10/02	10/02	10/02	9/02	9/02	09/02	09/02	09/02	...
Frequency of data	D	M	M	M	M	M	M	M	A	A 3/	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 4/ MMS 5/	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	...
Confiden-tiality 6/	U	U	U	U	U	U	U	U	U	U	U	...
Frequency of Publication	D	Q	M, Q 5/	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/ Fiscal year data only.
3/ Higher frequency data available only in national format.
4/ *Quarterly Statistical Bulletin.*
5/ *Monthly Monetary Statistics.*
6/ U stands for Unrestricted.
7/ Except for a small volume of trade credits, Kuwait has no public external debt.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/02
FOR IMMEDIATE RELEASE
January 2, 2003

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

IMF Concludes 2002 Article IV Consultation with Kuwait

On December 13, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Kuwait.[1]

Background

In 2001, overall real growth fell slightly as oil output dropped following OPEC-mandated production cuts. The real non-oil GDP growth decelerated to 0.5 percent from 1 percent in 2000 as private sector investment remained broadly unchanged. Inflation remained low at less than 2 percent, reflecting little increase in import prices and a modest nominal effective appreciation of the dinar.

The macroeconomic position continued to be strong despite a decline in oil exports receipts. The overall government budget surplus moderated to about 23 percent of GDP from about 40 percent of GDP in 2000. The reduced fiscal surplus reflected, primarily, the lower oil revenue and an increase in total expenditure, mainly on current outlays. The external position also remained solid. Though smaller than in 2000, the external current account registered a large surplus equivalent to about 26 percent of GDP. There was a sharp drop in portfolio capital outflows, and the Central Bank of Kuwait's (CBK) international reserves increased to the equivalent of about 10 months of prospective imports of goods and services from 7 months in 2000.

[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.

Growth of domestic liquidity accelerated to 13 percent in 2001 from 6 percent in 2000, as credit to the private sector picked up strongly in response to low interest rates. The financial sector continued to perform well and the stock market registered sharp gains. Following trends in global financial markets, the CBK reduced its discount rate seven times in 2001 and another time in 2002, bringing the discount rate down to the present 3.75 percent with the differential of the Kuwaiti dinar deposit rate over the U.S. dollar rate remaining at the broadly historical 75 basis points. Reflecting the appreciation of the U.S. dollar, the Kuwaiti dinar appreciated in real effective terms by 5 percent in 2001.

Some progress was made during 2001 on creating the necessary institutional framework for the implementation of the structural reform package. The reform package includes measures to increase private sector investment, privatize state enterprises and utilities, allow foreigners to own 100 percent equity, open up the upstream oil sector to foreign investment under operating service agreements, reduce implicit subsidies through increases in fees and charges on government-provided services, and reform the labor market. The Kuwait Investment Authority also continued to divest government's equity holdings in telecommunications and the banking sector. Steps have been taken to encourage Kuwaiti nationals to seek employment in the private sector, through extending the social allowance available to government employees to Kuwaitis in the private sector, providing vocational training, and matching jobs with jobseekers.

The macroeconomic position is expected to remain comfortable in 2002 despite reduced oil export receipts and real non-oil GDP growth would pick up somewhat under low inflation. The fiscal and external current account surpluses are estimated to moderate further, and the CBK's net foreign assets are estimated to increase to the equivalent of 11 months of prospective imports. With the expected continued strong credit expansion to the private sector, domestic liquidity is projected to grow at about the same rate in 2002 as in 2001.

Executive Board Assessment

Executive Directors commended the Kuwaiti authorities for their continued pursuit of prudent fiscal monetary policies in an open and free and exchange and trade system. These policies have resulted in a strong macroeconomic position, and characterized by large fiscal and external current account surpluses, a stable financial system, and low inflation, despite wide fluctuations in global oil prices and a difficult external environment. While the medium-term outlook remains favorable, Directors noted that, under current policies, the Kuwaiti economy also faces a number of challenges. The fiscal and current account surpluses, while still sizeable, would likely decline over time and remain vulnerable to oil price fluctuations. The rapidly growing population may generate unemployment pressures, if non-oil growth would remain subdued. And, looking further ahead, sustaining intergenerational equity may become more difficult.

Directors commended the authorities for addressing these emerging challenges by promoting non-oil growth through structural reforms to increase the role of the private sector and foreign direct investment, further deepen and widen the financial sector, and improve labor market performance. Efforts to further strengthen the budget structure will provide welcome support to these reforms, while allowing continued growth in per capita wealth.

Directors noted the progress achieved to date in implementing the reform agenda. They encouraged the authorities to continue their efforts to broaden the consensus in favor of a sustained implementation of reforms that will send a clear signal of their commitment to accelerate the growth of the private non-oil sector. In this context, they looked forward to the early enactment of the Privatization Law and implementation of the Foreign Investment Law. Steps that would facilitate private investment include: measures to streamline rules and regulations and shift away from sector-specific interventions; and the determined implementation of the privatization program under market-based prices and effective regulatory systems. The authorities were also encouraged to consider the introduction of a nondiscriminatory, broad-based income tax on both domestic and foreign corporations.

Directors commended the authorities for their effective supervision of the financial sector, the continued strong progress toward conformity with the Basel Core Principles, and the improvements in stock market regulation. They encouraged further steps to deepen and widen the financial sector. In this regard, Directors looked forward to the early implementation of the amended Banking Law, which will allow adapting regulations to ensure continued financial stability as the economy continues to open up, as well as to the implementation of the planned, more limited deposit insurance scheme. Steps to further strengthen the capital market and improve the investment climate would include transforming the Stock Market Commission into an independent regulatory body, liberalizing the rules governing nonresident participation in the capital market, and introducing bond trading and other similar products to complement stock market operations. Directors welcomed the authorities' decision to undertake an Financial Sector Assessment Program exercise. They commended the authorities for further strengthening the comprehensive framework to combat money laundering and the financing of terrorism.

Directors supported the authorities' strategy to address emerging unemployment pressures through the development of skills that will be needed by the private sector in the period ahead. They called for a flexible application of quotas under the Kuwaitization policy to ensure competitiveness of the private sector. Looking ahead, it will be important to work toward integration of the labor market through a reduction in cost differentials between public and private sector employment, possibly in the context of comprehensive civil service reform.

Directors noted the authorities' determination to restrain government expenditure in 2002/03 and to further strengthen fiscal policy over the medium term. They encouraged continued efforts to reduce current expenditure, especially on wages and subsidies, better target social benefits, and redirect expenditure toward capital outlays. On the revenue side, consideration should be given to strengthening non-oil revenue generation, including through new tax measures such as VAT. Directors endorsed the planned shift toward a three-year rolling budget to formulate fiscal policy in a medium-term framework, and highlighted, in this context, the importance of using prudent oil price assumptions. They supported continued Fund technical assistance to facilitate the strengthening of expenditure management and revenue mobilization in Kuwait.

Directors endorsed the authorities' intention to continue to pursue a cautious monetary policy to keep inflation low and ensure the stability of the pegged exchange rate arrangement. The use of direct deposits with the CBK has helped ensure effective liquidity management, and Directors encouraged continued timely adjustments in the Central Bank's discount rates in line with changes in international rates. Directors also noted that the elimination of lending rate ceilings could facilitate lending to small- and medium-scale private enterprises. Directors generally supported the authorities' decision to peg the Kuwaiti dinar to the U.S. dollar, effective 2003, as a first step toward the Gulf Cooperation Council monetary integration, and as part of a far-reaching regional economic integration effort. They encouraged further analysis of the monetary integration process.

Directors welcomed the significant progress achieved by Kuwait on statistical issues, and encouraged the authorities to continue their efforts to improve the quality, collection, and dissemination of comprehensive data.

It is expected that the next Article IV consultation with Kuwait will take place on the standard 12-month cycle.

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, 1997–2001

	1997	1998	1999	2000	Prel. 2001
	(Percent change)				
Production and prices					
Real GDP	2.3	2.4	-2.5	1.4	-1.1
Real oil GDP	1.6	1.8	-6.5	2.2	-3.2
Real non-oil GDP	4.1	3.1	1.0	1.1	0.5
Consumer price index	0.7	0.1	3.0	1.8	1.7
	(In percent of GDP; unless otherwise indicated)				
Financial variables 1/					
Total revenue, *of which:*	64.0	47.9	71.0	80.8	69.5
Oil and gas 2/	38.4	27.3	48.3	57.4	45.1
Investment income 2/	22.6	17.2	19.9	18.9	17.5
Total expenditure	48.6	49.6	40.8	40.7	46.8
Current	42.6	43.8	37.2	37.4	42.6
Capital	6.1	5.8	3.6	3.3	4.2
Overall fiscal balance (deficit = -)	15.4	-1.7	30.2	40.2	22.7
Change in broad money supply (in percent)	3.9	-0.8	1.6	6.3	12.8
Interest rates (in percent) 3/	6.0	5.9	5.3	5.4	3.7
	(In millions of U.S. dollars; unless otherwise indicated)				
External sector					
Exports, f.o.b. *of which:*	14,279	9,616	12,277	19,477	16,173
Crude oil and refined products	13,467	8,470	11,027	18,162	14,976
Imports, c.i.f.	-7,747	-7,715	-6,708	-6,451	-6,932
Current account balance (deficit = -)	7,930	2,213	5,062	14,672	8,566
In percent of GDP	26.6	8.8	17.3	41.0	26.1
Central Bank of Kuwait's international reserves	3,556	4,052	4,928	7,187	10,002
In months of imports of goods and services	3.3	4.1	5.0	7.4	10.1
Real effective exchange rate (percent change)	4.9	3.1	1.0	4.0	5.4

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

1/ The fiscal year was changed from July–June to April–March effective 2001/02.

2/ Includes profits of public enterprises.

3/ Three-month Kuwaiti dinar deposits.

Statement by A. Shakour Shaalan, Executive Director for Kuwait
December 13, 2002

In the context of a strong macroeconomic position and a comfortable medium-term outlook, the Kuwaiti authorities are focusing their attention on the key long-term challenges facing the economy. While it is recognized that, realistically, the oil sector will continue to be the mainstay of the Kuwaiti economy for some time to come, the authorities attach high importance to accelerating the growth of productive activities in the private non-oil sector. Accordingly, increasing employment opportunities for the growing population and reducing the economy's vulnerability to oil price fluctuations, while preserving the country's wealth for future generations, are key concerns. A comprehensive structural reform strategy to address these long-term challenges has been developed, and implementation is proceeding at a steady pace with emphasis being placed initially on building the institutional and legal framework necessary for the promotion of private sector activity and investment.

Recent developments

The macroeconomic position remained strong in 2001, notwithstanding a slight decline in oil output and subdued non-oil economic growth that was in line with the global slowdown. The fiscal and external current accounts continued to enjoy large surpluses, reaching 23 percent of GDP and 26 percent of GDP, respectively. Central bank international reserves and the stock of foreign assets in the Reserve Fund for Future Generations (RFFG) also rose substantially. Monetary conditions remained stable and inflation remained low. The financial sector also continued to perform well and prudential regulation remained strong, keeping pace with international standards and practices.

Progress has been made in institutional and structural reforms aimed at a number of interrelated goals:

- opening up the economy to foreign investment;
- reducing the role of government in the economy;
- promoting private sector activity; and
- increasing employment opportunities for Kuwaiti nationals.

Building on the reforms initiated in 2000, a new Higher Committee for Development and Economic Reform was appointed in 2001 and a Five-Year Development Plan has been drafted to coordinate and facilitate the reform process. The draft plan emerged from a candid assessment of the ramifications of maintaining the economic strategy pursued since the early 1970s, which focused on the distribution of the country's oil wealth through the provision by the state of a wide array of services and subsidies to the population. The plan emphasizes the need for a fundamental shift to a growth-oriented strategy that relies primarily on the private sector and limits the economic role of the state to one of regulator, as it should be in a free-market economy.

Given the far-reaching nature of the plan and the expected short-term socio-economic consequences of some of its proposed reforms, the authorities are proceeding to build the broad political consensus required to ensure its acceptability and its successful implementation. Even though the plan is still being discussed nationally and has not been finalized, the Higher Committee has already taken steps to implement several of its main themes. Thus various reforms are underway that seek to redefine the roles of the public and private sectors and to create an environment conducive to both foreign and private investment, while promoting the economically justified diversification of the economy. A key element of this effort is the initiation of reforms in education and training to facilitate the absorption of Kuwaiti citizens into the private sector, and building the necessary institutional and legal infrastructure that would promote private sector investment.

Prominent among the steps taken recently in this direction is the passage of the Foreign Direct Investment Law, allowing foreigners to own 100 percent of Kuwaiti companies. The new law grants companies a tax holiday of 10 years, exempts them from customs duties on imports of capital and raw materials, and allows them to bring in necessary foreign labor. A new tax law reducing corporate tax rates is being drafted.

The Manpower and Government Restructuring Program (MGRP) was also established in 2001 to implement the Labor Market Law that was passed in the previous year to encourage Kuwaitis to seek employment in the private sector. The MGRP facilitates the employment of Kuwaiti nationals by providing them with social allowances and training opportunities accorded to government employees and unemployment benefits. The government also promotes Kuwaiti employment by requiring private companies to maintain a certain proportion of nationals in their labor force.

Other steps have been taken recently to promote private sector participation in economic activity. The Privatization Law was recently approved by the Finance Committee of the National Assembly and is awaiting the Assembly's approval. The law would establish a comprehensive framework for large-scale privatization, while identifying the areas and modes of privatization. It would also establish a transparent pricing mechanism and institute safeguards against job losses. Procedures for the use of "build-operate-transfer" (BOT) mode have also been approved for use in the electricity, water desalination, and sewerage sectors. The establishment of a regulatory authority to oversee the public road transportation system to ensure appropriate pricing and private sector participation is under study. The Copyrights and the Patent Laws have also been amended, in line with WTO requirements. A number of other laws aimed at facilitating private sector investment are also currently under consideration.

Looking ahead

On fiscal policy, as part of their comprehensive reform plan, the authorities are determined to contain the growth of government expenditure. This will be done gradually and in conjunction with the planned acceleration of private sector growth and the generation of increased employment opportunities.

For 2002/03, the authorities have initiated a restrained fiscal policy supported by tighter budget management, despite the 2002 rebound in oil revenues. Thus, the 2002/03 budget is based on a very conservative oil price assumption of US$15 per barrel and does not include investment income. However, if account is taken of the relevant WEO oil price estimates and investment income is included, total revenue is projected to reach almost twice the budgeted amount. Nevertheless, the increase in total expenditures will be limited to about 2 percent of GDP as compared with 6 percent of GDP in 2001/02. To this end, expenditures on subsidies and transfers will be contained to about 95 percent of the budgeted amount and capital projects will be implemented at a pace that is slower than planned. Expenditure restraint will be facilitated by a number of steps that have been taken to strengthen budget management. These include the introduction of fees for certain government services, engaging private companies to collect outstanding utility charges and fees, stricter enforcement of controls on maintenance and procurement and the privatization of government maintenance services.

In the medium term, the intention is to set fiscal policy in a medium-term framework by instituting a system of a three-year rolling budget. This will be facilitated by the ongoing technical assistance being provided by the Fund, which aims at establishing a macro-fiscal coordination unit and a new system of budget classification.

Monetary policy in Kuwait has been prudent and continues to be aimed at the stability of the exchange rate under an open and free exchange and trade system. Open market operations and direct bank deposits with the Central Bank of Kuwait (CBK) are being used effectively for liquidity management, and the CBK discount rate is being adjusted in line with developments in interest rates. The authorities intend to move to a full U.S. dollar peg of the Kuwaiti dinar with margins from the beginning of 2003, in line with the GCC decision on this matter, pending the establishment of the planned GCC monetary union by 2010.

Monetary policy has been supported by strong bank supervisory policies that have helped maintain confidence in the exchange rate in an environment of low inflation, while facilitating private sector activity. Banking supervision has kept pace with international standards and practices. To date, 21 of the 25 Basel Core Principles have been implemented, including most recently, the addition of market risk analysis to the computation of capital adequacy as a step toward the adoption of the proposed new Basel capital standards. A credit bureau will also be operational by end-2002 or early 2003.

An amended banking law is also expected to be approved by the National Assembly during its current session. Implementation of the provisions of this law would bring Kuwait to observance of all the Basel Core Principles. Among other provisions, the law would open the market to foreign banks, and bring Islamic banks fully under the CBK's supervision. A limited deposit insurance scheme is also being considered to protect small depositors. The authorities are also looking forward to the conduct of an FSAP in the first half of 2003.

Statistical issues

The Kuwaiti authorities were pleased to note staff's recognition that there had been significant improvement in Kuwait's economic database since the last Article IV consultation. The authorities are committed to continuing to improve their statistical database and are appreciative of the Fund's technical assistance in this area.

With regard to the provision of information to the Fund on the country's International Investment Position (IIP), the authorities intend to remain fully compliant with Article VIII, Section 5, by orally providing to the Board, through their Executive Director, the financial position of the Fund for Future Generations. This information should be considered confidential and should not be made public.

As to the nonfinancial private sector's IIP, the authorities would like to draw the Board's attention to the unavailability of such information in the context of Kuwait's open economy. Information on private capital movements is not available, either directly or indirectly. The authorities, therefore, have serious reservations on the Fund's request for this information. Such information is not available in an open economy with no form of exchange controls. In my view, the Fund would be well advised to exercise more caution in requesting members to provide the International Investment Position of the private sector. Collecting such information would require intensive resources and, in fact, is not doable to any useful degree. In my view, and that of the authorities, there are other more pressing priorities in the area of data provision. I do not support the undue emphasis that has been recently placed on this area.