

Kuwait: Selected Issues and Statistical Appendix

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KUWAIT

Selected Issues and Statistical Appendix

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Approved by Middle East and Central Asia Department

April 6, 2005

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I. OVERVIEW

1. Kuwait is at an important crossroad. Following a long period of slow economic growth, terms-of-trade loss due to declining oil prices and the insecurity resulting from the invasion of Kuwait by Iraq, the medium-term outlook appears to have improved significantly in recent years. The strong rebound in oil prices, the removal of the security threat from the former regime in Iraq, and the resumption of trade relations with Iraq have created much optimism on the economic front. Large external current account and fiscal surpluses, a rapid build-up of public sector assets, and continued price stability have laid the foundation for a private sector-led nonoil domestic economic recovery. Against this optimistic setting, this Selected Issues paper contains four studies examining the key issues associated with the low real economic growth experienced in recent years, sustainability of the current fiscal policy stance, implications of the lending rate ceilings on small and medium enterprises, and some aspects of the recent stock market developments in the Gulf Cooperation Council (GCC) markets, with emphasis on Kuwait.

2. The first paper (Chapter II) takes a historical approach to Kuwait's economic development strategy and uses a variety of analytical methods to highlight Kuwait's policy challenges and their effectiveness. It finds that Kuwait's economic performance and development strategy has been dominated by weak links between laudable objectives of its five-year development plans and actual policy action/results, adverse effects of the 1990 invasion, a small private sector, and a consensus-building approach to policy reforms. Kuwait's historically low and negative per capita income growth rate is found to be due to, inter alia, its large government size, a poor investment climate, a low investment rate, and low or negative productivity growth. With the change of regime in Iraq, Kuwait is now grappling with a renewed assessment of its long-standing economic challenges and effectiveness of past economic policies within a new economic and political environment. Kuwait needs to improve its investment climate in order to increase its non-oil growth and productivity and should consider expediting the pace of structural reforms taking advantage of the emerging opportunities in the region.

3. The second paper (Chapter III) discusses the issues of fiscal sustainability and options for fiscal adjustment in Kuwait. Kuwait has accumulated large fiscal surpluses, enabling it to build up a sizeable asset position for future generations. The fiscal position is also expected to remain comfortable over the medium term, but the recent rapid increase in expenditures raises doubts about the sustainability of the current fiscal stance over the longer term. The issue of sustainability of the current fiscal stance is further compounded by the fact that more than 90 percent of government revenues are from oil and investment income from external financial assets, both of which are subject to significant global uncertainties. The paper attempts to assess the sustainability of the current fiscal stance based on two different frameworks: the Permanent Income Hypothesis (PIH) of consumption and the standard debt sustainability analysis. It concludes that the unchanged fiscal stance, given the high level of expenditure in relation to non-oil GDP, would not be consistent with the objective of maintaining constant real wealth under the PIH. The fiscal stance would also be inconsistent with debt sustainability in the long run. The paper also identifies some of the options for

fiscal adjustment, which include: rationalization and targeting of subsidies; rationalization of transfers associated with very high social security benefits; increases in infrastructure expenditures; and a widening of the tax base.

4. The third paper (Chapter IV) explores the effects of the lending rate ceilings in Kuwait, with particular attention to their impact on the small and medium enterprises (SMEs). It reviews the literature on the links between financial repression and economic growth, with a focus on the Middle East and North Africa (MENA) region. It finds that the interference with the market's price discovery function seems to be relatively low in Kuwait compared with other MENA countries maintaining interest rate ceilings. The paper concludes that lending rate ceilings in Kuwait do not appear to be a major deterrent in the creation and development of SMEs. This is so because, despite the likely binding effect of the ceilings, the government provides ample financing under concessional terms to all SMEs that meet some predetermined criteria. Furthermore, the Islamic banks, which are not subject to the lending rate ceilings, also provide an effective funding channel which goes well beyond the limitations of the traditional banking in SME financing.

5. The fourth paper (Chapter V) discusses recent developments in the Kuwaiti and other GCC stock markets. The stock markets in the GCC countries performed extremely well in the new millennium and the low correlation with the U.S. stock market offered the regional and global investors an opportunity to diversify their portfolios and reduce risks. The market capitalization and liquidity have risen sharply along with the interest of investors as indicated by the rising turnover ratio. The paper finds that the Kuwait stock exchange (KSE) index is a price index that does not adequately represent changes in the stock market capitalization and therefore, the KSE may consider constructing, publishing and popularizing a more market representative value-weighted index. The study also finds the presence of calendar anomalies in most GCC country stock markets contravening the hypothesis of weak form efficiency. More studies with more detailed data are needed to further explore the efficiency of the GCC stock markets as well as to explain the calendar anomalies found in this study. In this regard, the stock exchanges need to provide more detailed information, including historical information, to investors at minimal costs.

II. GROWTH, PRIVATE SECTOR, AND INVESTMENT CLIMATE: FROM DEVELOPMENT PLANNING, RECONSTRUCTION AND REHABILITATION TO A MARKET-ORIENTED DEVELOPMENT STRATEGY¹

A. Introduction

6. **Two key objectives of Kuwait's economic development strategy have long been acceleration of its non-oil GDP growth and expansion of the role of the private sector.** The growth record over the last two years—the highest pace in the preceding decade and half, except for the strong rebound in the aftermath of the 1990 invasion—could very well set the stage for Kuwait's diversification drive and achievements of its key objectives. The growth, fueled in large part from the reconstruction of Iraq, may merely represent a level effect on income, but it could also constitute a transition to a sustainable growth path provided there are significant changes in policy and pace of structural reforms. Kuwait is well placed to take advantage of its proximity to Iraq and Iran (two populous countries in the region) and its active role in Iraqi reconstruction efforts in order to enhance its non-oil sector performance in a sustainable manner, particularly in sectors such as tourism, transportation and communication, and wholesale and retail trade.²

7. **To understand what policies can be adopted in the future to achieve the stated objectives of the Kuwaiti authorities, it is important to identify what constraints have frustrated achievement of these objectives in the past.** Equally important is the need to understand what can be done realistically in the future and to what extent the future pace of structural reforms needs to be accelerated. This chapter therefore takes a historical approach to Kuwait's economic development strategy by focusing on key objectives of its development and action plans.

8. **The remainder of this chapter is organized as follows.** Section B summarizes the historical background of Kuwait's economic development strategy. Section C examines Kuwait's growth performance since 1980, paying particular attention to oil and non-oil GDP, and contrasts Kuwait's productivity growth performance vis-à-vis other regions and countries using a growth accounting framework. Section D reviews the evolution of the size of public and private sectors in Kuwait which has played an important role in Kuwait's development strategy and has shaped Kuwait's growth and productivity performance. Section E examines investment performance and investment climate issues—from the perspective of both foreign direct investment and domestic investment. Section F investigates the sources of growth in Kuwait from an international and regional perspective. Finally, section G summarizes the main findings of the chapter and policy implications.

¹ Prepared by Hamid R. Davoodi.

² The United Arab Emirates (U.A.E.) has played such a role for quite some time in the region, perhaps for very different reasons, and has provided a gateway to countries in and outside the region, a strategy that has helped its diversification strategy away from oil, boosting its non-oil growth.

B. The Legacy

9. **The current economic structure in Kuwait is, in part, the result of the legacy of the past economic and political events.** The three decades following independence in 1961 were marked by the formation of the National Assembly (the Kuwaiti Parliament) in 1963, which proved to be an important political and economic institution in the post independence era that supported nation building, and the development of the state institutions. The decade of the 1970s witnessed, as in other oil-exporting countries of the region, spending of large oil revenues which accelerated the nation building phase through sizable investments in the physical infrastructure, provision of social services, health care and education, and represented the first large-scale use of Kuwait's oil wealth for its citizens.

10. **A state-led development strategy began with the creation in 1962 of the *Planning Council*.** It was charged with providing a strategic view of Kuwait's economic development, followed by the adoption of the first five-year development plan (1967/68–1971/72). Following two decades of nation building, the decade of the 1980s was marked by fiscal and balance of payments surpluses that allowed the country to achieve two objectives: (i) to accumulate financial assets through the Reserve Fund for Future Generations, a fund established for the purpose of saving and investing excess oil revenues for future generations; and (ii) to establish the General Reserve Fund, a stabilization fund designed to reduce vulnerability of the budget and the economy to adverse developments in international oil markets.

11. **The invasion of Kuwait in August 1990 and the occupation period significantly altered the course of Kuwait's development path, leading to a less diversified economy vis-à-vis its oil rich neighbors, more reliance on expatriate workers, and a larger public sector.** The invasion and the subsequent seven months of occupation were major shocks to an otherwise stable economic system inflicting large physical, human, and financial losses as well as significant damage to many oil wells and oil infrastructure. After the end of the occupation in February 1991, the erosion of government-owned financial assets that were accumulated in the 1980s significantly increased the sensitivity of the budget and the economy to oil price fluctuations in the 1990s, contributing to a pro-cyclical fiscal policy stance.

12. **Budgetary structure became increasingly inflexible.** The high budgetary spending associated with rehabilitation and reconstruction as well as changes in the composition of government spending toward wages, salaries, and transfers created hard-to-reverse expenditure commitments. The disruptions in the labor market, the exodus of large segments of the population (Kuwaitis and expatriates) as well as the unavailability of relevant skills, increased reliance on expatriate workers in the remainder of the 1990s. These developments also led to a larger size of the public sector that has absorbed a large share of oil wealth long after the end of the hostilities and during the reconstruction phase.

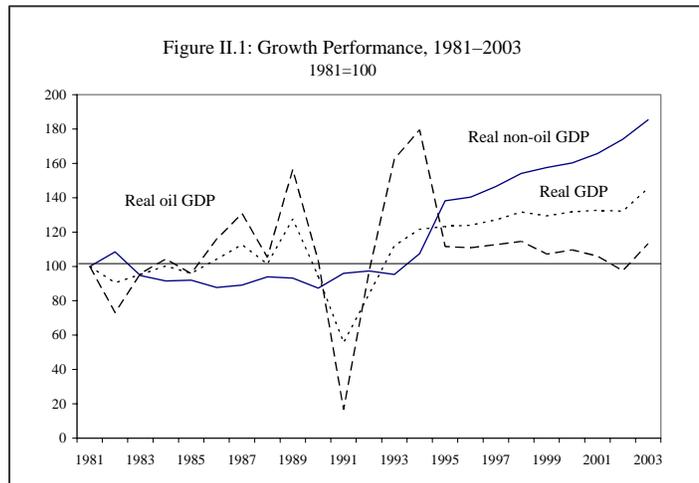
13. **In light of the past slow pace of consensus-building approach to policy reforms, the Kuwaiti government has embarked on a transitional action plan to take advantage**

of the emerging economic opportunities in the region. The process of consensus building for policy reforms between the National Assembly and the government has its roots in the 1960s. The consensus on the direction and pace of reforms has varied over the years and heightened perhaps in the aftermath of the 1990 invasion. However, following the change of regime in Iraq in 2003, and a significant drop in Kuwait's perceived country risk, Kuwaiti policymakers are now determined to put in place reforms that would allow the economy to take advantage of the opportunities offered by the new economic and political environment in the region. In the process of taking a more pro-active stance in policy reforms in its transitional plan, the government intends to accelerate non-oil growth in order to absorb the growing labor force by diversifying the economy; reduce the role of the government and expand that of the private sector; and improve the investment climate. To this end, the government's three-year action plan over the 2005–07 period includes concrete policy actions.

C. Growth Performance

14. Real non-oil GDP has been stagnant for most of the 1980s, but accelerated significantly since mid-1990s

(Figure II.1). Following the 1990 invasion of Kuwait, real non-oil GDP recovered from its pre-invasion level. Real non-oil GDP grew at an annual rate of about 7 percent since mid-1990s, almost twice that of the 1982–2003 period. Excluding a large upward revision in value added from electricity, gas, and water sectors in 1995, real non-oil GDP grew at a slower rate of 3½ percent.³



15. Growth in real GDP has slowed down relative to non-oil GDP since the mid-1990s, primarily on account of a declining oil GDP. Real GDP grew at 3 percent a year over the past two decades and at 2 percent since the mid-1990s. Real oil-GDP is more volatile and has been falling since mid-1990s, but rebounded in 2003 following record levels of oil production. The decline in oil-GDP has been due to lower oil production under OPEC-mandated cutbacks, lower production of refined petroleum products, and the fact that damages to Kuwaiti oil fields were largely overcome only in 1993.

16. Kuwait has become more diversified over time, as judged by the rising importance of non-oil GDP, though it is lagging behind the U.A.E., the most diversified

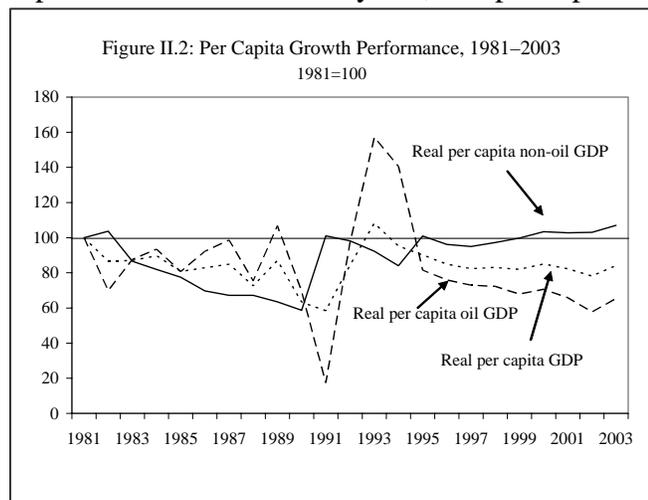
³ The primary reason for the upward revision is changes in the methodology for calculating the value added from these sectors.

member of the GCC. In the period before the 1990 invasion, real non-oil GDP accounted for, on average, 45 percent of real GDP, but has risen to 60 percent since mid-1990s. The highest ratio (of 65 percent) was recorded in 2002 owing to a historically low level of oil production. By contrast, ratio of real non-oil GDP to real GDP for the U.A.E. stood at 70 percent since the mid-1990s, with 76 percent being the highest recorded in 2002.

17. Kuwait’s petrochemical industry has grown substantially since mid-1990s and remains a potential source for future growth. The industry, referred to as “petroleum and refining industry” in Kuwait’s national accounts statistics, grew at 9 percent over the 1982–89 period and the pace of growth accelerated to 45 percent since the mid-1990s. Accordingly, its share in GDP increased from 1 percent of GDP in 1982 to 5 percent of GDP in 2003. Although the industry’s growth was constrained by oil and gas production, it has grown faster than oil production since the mid-1990s, illustrating the importance of value added from further processing of crude oil and the industry’s potential role for boosting Kuwait’s overall growth.

18. Real per capita GDP has remained stagnant over the past two decades through 2001 in marked contrast to growing real per capita non-oil GDP (Figure II.2). Despite the record-breaking real growth rate of 8½ percent over the last two years, real per capita GDP level in 2003 was some 7 percent below the level in the early 1980s.

However, real per capita non-oil GDP grew at 1½ percent per annum over the past two decades and at 3 percent per annum since the mid-1990s, respectively. The combined impact of a changing population dynamics and the changing importance of the non-oil sector accounted for the relative stagnation of growth in real per capita GDP. In the 1980s, real per capita GDP declined on account of a high population growth rate and declining non-oil GDP, even though growth in the oil sector exceeded the population growth rate. In the 1990s, despite the slowing down of the population growth and the positive trend increase in real per capita non-oil GDP, it was the decline in oil GDP that accounted for the negative trend growth in real per capita GDP.



19. Kuwait’s future growth performance therefore hinges on a combination of maintaining a robust non-oil GDP growth and arresting the decline in oil GDP. The lesson from both the empirical growth literature and economic theory highlights the need to adopt policies that accelerate total factor productivity growth. Equally important is investment in oil and gas sector which has been lagging. In this regard, the government plans to invest some \$30–40 billion over the next 15 years to rehabilitate oil refineries, add a new

refinery, and increase oil production capacity to 4 million barrels a day by 2020 from the current level of about 2.5 million barrels per day.

20. **The main sectoral sources of non-oil growth have varied over time.** While the electricity, gas, and water sectors recorded the highest growth on average over the past ten years, the communication and agriculture sectors achieved the highest growth rate (at 14 percent per annum) since the year 2000, followed by the financial sector (10 percent) and food industry (5 percent). Growth in population and subsidies for electricity, water, and gas have been the major factors contributing to the high growth of these sectors. In 2003, the transport and storage sector received a boost from the reconstruction of Iraq, and is likely to be a source of growth in the future as Kuwait strives to be a trade hub in the Northern Gulf region.

21. **A pronounced secular decline has occurred in all standard measures of productivity for Kuwait over the last two decades (Table II.1).** Growth in factors of production have been the main sources of growth in Kuwait. Productivity increases have not accounted for the resulting output growth. In fact, all three measures of productivity—labor, capital, and total factor productivity (TFP),⁴ the latter being the efficiency with which the combined capital, labor, and educational know-how are used in the production process—have been declining since 1980.⁵ On all three measures, Kuwait has underperformed relative to other GCC countries, other oil-producing countries in the MENA region, and developing countries as a whole. Kuwait has a low investment rate relative to all international benchmarks, in spite of its high per capita income. Although higher investment in principle can increase Kuwait's output growth, the findings in Table II.1 indicate that a mere increase in its scale will not lead to sustained positive growth unless accompanied by sustained productivity gains.

⁴ Due to unavailability of data, TFP analysis could not be carried out separately for oil and non-oil sector.

⁵ Results are the same for the post-1990 period, apart from a short-lived productivity rebound immediately after the war.

Table II.1. International Comparison of Kuwait's Productivity Growth, 1980–2002

	Average Annual Rates of Change					Capital-Output Ratio		Investment-GDP Ratio
	Output	Per Worker	Per Worker Contribution of			1980	2002	
			Capital	Education	TFP			
Kuwait	0.9	-2.4	0.5	0.4	-3.3	2.1	2.5	16.6
MENA (19)	3.8	0.5	0.5	0.4	-0.4	2.5	2.6	16.8
Oil exporters	3.3	-0.1	0.5	0.5	-1.0	2.3	2.4	17.4
Non-oil exporters	4.4	1.3	0.4	0.4	0.4	2.8	2.7	17.5
GCC	3.6	0.2	0.6	0.3	-0.7	2.4	2.4	21.2
Developing countries (excluding East Asia and MENA) (44)	3.4	1.0	0.7	0.3	-0.1	2.7	2.2	17.9
East Asia (7)	6.3	3.9	2.0	0.4	1.5	2.1	2.7	28.5
Industrialized countries (21)	2.6	1.6	0.6	0.3	0.7	2.6	2.6	20.6
Latin America (22)	2.4	-0.4	-0.2	0.3	-0.5	2.4	2.3	19.3
South Asia (4)	4.9	2.7	1.3	0.3	1.0	1.9	2.1	20.2

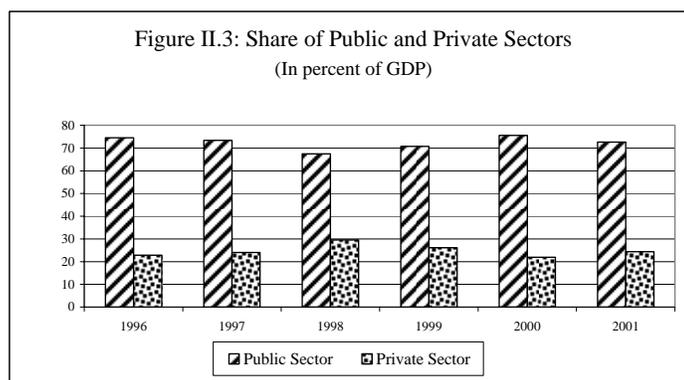
Sources: Adapted from Abed and Davoodi (2004).

Notes: Numbers in parenthesis denote number of countries. Entries for contribution to output per worker do not add up due to rounding. TFP stands for total factor productivity. All entries refer to constant currency real estimates.

22. **One factor that may account for Kuwait's poor productivity record is its relatively small size of private sector and the dominant public sector.** Public sector investment in Kuwait was one and one-half to twice the size of private investment in the 1980s, but this ratio has been declining to about one-half to one-third since mid-1990s. It is commonly accepted that private investment is guided by profit considerations and its productivity may in fact be higher than that of public investment. However, investment is only one aspect of growth, and certainly because of its very low level, Kuwait's rising share of private investment to total investment since the mid-1990s could not reverse the observed decline in productivity. Other factors are obviously at work as well.

D. Relative Size of Kuwait's Private Sector

23. **The size of Kuwait's private sector, as measured by its share in GDP, is about one-third of the public sector and has not been increasing over time.** Over the 1996–2001 period, the most recent period for which data are available from the Ministry of Planning, the private sector accounted for 25 percent of GDP (Figure II.3), as compared with 42 percent for Saudi Arabia (Table II.2). Kuwait's share of the private sector in non-oil GDP, which abstracts from developments in the oil sector and direct



contribution of the public sector to GDP, stood at 43 percent over the same period, and has declined steadily during this timeframe. By contrast, Saudi Arabia's private sector accounts for 65 percent of non-oil GDP (Table II.2). Taking a longer term view, Kuwait's private sector was more dominant in the past than today. In the years preceding Iraq's invasion of Kuwait in 1990, the share of private sector was higher whether measured in terms of GDP or non-oil GDP (Table II.2).

Table II.2. Share of Private Sector in GDP: Kuwait and Saudi Arabia 1/

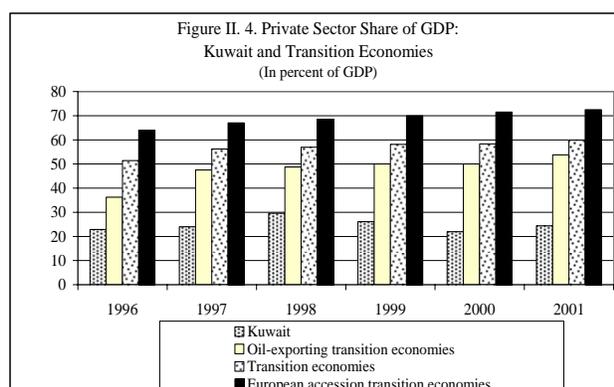
(Selected years)

	1989	1996	1997	1998	1999	2000	2001	Average 1996–2001
(In percent of non-oil GDP)								
Kuwait	54	46	45	43	42	43	42	43
Saudi Arabia	61	67	63	64	65	65	65	65
(In percent of GDP)								
Kuwait	27	23	24	30	26	22	24	25
Saudi Arabia	44	42	41	47	44	39	41	42

Sources: National authorities; and Fund staff estimates.

1/ Entries show value added GDP by the private sector as percent of non-oil GDP and GDP.

24. The private sector accounts for a smaller share of GDP in Kuwait than transition economies of the former Soviet Union and the Baltic countries although these economies adopted market-oriented development strategies at much later years. The share of the private sector in GDP in a group of 27 transition economies rose from 50 percent of GDP in 1996 to 60 percent in 2001 and accounted on average for 57 percent of GDP, almost two and one-half times that of Kuwait over the same period



(Figure II.4).⁶ The private sector in oil-exporting transition economies, though representing a smaller share in GDP than non-oil transition economies, is larger than Kuwait and rising over time.⁷

25. **The Kuwaiti government has always been the employer of last resort and has gone beyond merely setting appropriate rules and regulations for the well-functioning of private markets.** The lessons of transition economies with a longer legacy of development planning than Kuwait and Kuwait's larger private sector before the 1990 invasion suggest that the private sector can become larger again in Kuwait.

E. Investment Performance and Investment Climate

26. **Kuwait has a sizable foreign direct investment (FDI) potential, according to the latest report by United Nations Conference on Trade and Development which ranks Kuwait as the 28th most suitable country for FDI among 140 countries (Table II.3).** Kuwait's high rank is due to many factors that are conducive to a good investment climate. These include its high per capita income, modern infrastructure, low country risk, stable political environment, and large proven reserves of crude oil. In comparison with other GCC countries, Kuwait is behind Qatar and the U.A.E, which are ranked 8th and 17th, respectively, and ahead of Bahrain, Saudi Arabia, and Oman which are ranked 29th, 31st and 53rd, respectively. All GCC countries have a higher FDI potential than many other oil-producing countries in the Middle East and Central Asia.

27. **Despite its high FDI potential, Kuwait lags behind many countries in actual FDI performance, with only four countries having a worse record than Kuwait out of 140 countries (Table II.3).** The index of actual FDI performance ranks countries by the amount of foreign direct investment they received relative to their economic size, calculated as the ratio of a country's share in global FDI inflows to its share in global GDP.⁸ Measured by this index, Kuwait is slightly ahead of Saudi Arabia, but is significantly behind Bahrain and Qatar which are ranked 72 and 81, respectively. The newly oil-producing countries of Brunei Darussalam, Kazakhstan and Azerbaijan are ahead of all GCC countries, ranked 4th, 12th and 13th, respectively, because of their aggressive strategy to seek foreign investment for development of their largely untapped oil and gas reserves.

⁶ The 27 transition economies are those tracked by the European Bank for Reconstruction and Development.

⁷ Part of the increase in the private sector in oil-exporting transition economies has to do with the early privatization of the oil sector, particularly in Russia.

⁸ Although many factors besides economic size affect a country's foreign direct investment, the index merely captures an outcome and does not reflect what factors account for the observed outcome or their quantitative significance.

Table II.3. Inward FDI Potential and Actual Indices, 2000–02

(Out of 140 countries)

Country	Potential 1/		Actual 2/	
	Rank	Index	Rank	Index
Top 10				
United States	1	0.659	92	0.589
Norway	2	0.471	93	0.555
United Kingdom	3	0.467	38	1.499
Singapore	4	0.465	6	4.755
Canada	5	0.459	32	1.771
Belgium and Luxembourg	6	0.446	1	13.531
Ireland	7	0.433	3	6.265
Qatar	8	0.433	81	0.752
Germany	9	0.432	40	1.491
Sweden	10	0.427	23	2.233
United Arab Emirates	17	0.388	120	0.238
Kuwait	28	0.305	136	-0.039
Bahrain	29	0.304	72	0.91
Saudi Arabia	31	0.298	138	-0.148
Selective oil producing countries				
Russian Federation	33	0.291	111	0.317
Brunei Darussalam	35	0.287	4	5.531
Libyan Arab Jamahiriya	46	0.254	137	-0.137
Oman	53	0.221	130	0.068
Iran, Islamic Rep.	61	0.199	135	0.037
Venezuela	73	0.177	74	0.896
Kazakhstan	78	0.175	12	3.456
Yemen	87	0.161	115	0.28
Azerbaijan	96	0.151	13	3.371
Nigeria	98	0.148	79	0.784
Bottom 10				
Kenya	131	0.100	126	0.141
Benin	132	0.090	88	0.628
Nepal	133	0.088	134	0.044
Zambia	134	0.081	76	0.864
Rwanda	135	0.081	127	0.123
Tajikistan	136	0.074	83	0.718
Haiti	137	0.072	129	0.07
Zimbabwe	138	0.064	133	0.05
Sierra Leone	139	0.053	123	0.17
Congo, Dem. Rep.	140	0.042	98	0.495

Source: UNCTAD (2004).

1/ The index is bounded between 0 and 1, with higher values denoting higher potential for FDI, based on 12 economic and political factors. Each country's rank is based on the rank of its potential index.

2/ The index is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. A value greater (less) than 1 indicates a country attracts more (less) FDI in proportion to its economic size. A negative value indicates that foreign investors disinvested in that country in the period.

28. **Kuwait's low FDI performance and high FDI potential is not a recent phenomenon, but has been a constant feature of its economic development over the last 15 years.** Because of year-to-year volatility of FDI flows, FDI performance can change over time, but FDI potential is remarkably stable and driven by structural factors that change infrequently. Nevertheless, UNCTAD's data show that Kuwait's position as a low-FDI-performance country and a high-FDI-potential country has not changed over the past 15 years. This fact suggests that Kuwait has to overcome some structural factors in order to fully realize its FDI potential. This observation also applies to other GCC countries since despite the diversity in their relative position, they fall in the same category of low FDI performance but high FDI potential.

29. **The large disparity between Kuwait's FDI potential and its actual FDI performance results from a number of factors.** One reason for the large disparity for Kuwait and other GCC countries could be the state control of investment in upstream oil and gas production. Another explanation could be that, foreigners do not see the non-oil sector an attractive sector for investment, owing to the sector's poor investment climate. This manifests itself as lack of investment opportunities although causality is far from clear. Although a common explanation may fit the experience of all GCC countries since they are all mature oil-producing countries relative to the Central Asian oil-producing countries, more country-specific explanations are needed, particularly in the case of Kuwait as it has the largest disparity among the GCC countries between its FDI potential and actual FDI performance.⁹ The presence of an external threat throughout the 1990s is certainly one potential explanation.

30. **The passage of the FDI law and its by-laws is expected to narrow the gap between Kuwait's high potential inward FDI and its actual FDI performance.** The FDI law enacted in April of 2001, required two resolutions to be operational both of which were passed in 2003. The first resolution (known as No. 1006/1) identified a list of sectors approved for FDI while the second one (known as No. 1006/2) specified a set of requirements for the investors before they are issued a license to operate as a 100 percent foreign-owned entity in Kuwait. The first resolution provides a list of 11 sectors (see Box II.1) that are open to FDI, known as a positive list. Best international practices in promoting FDI, however, suggest the use of a negative list (namely, a list of activities subject to regulation) which is simple, specific, and transparent (see Box II.2). The second resolution provides some standard requirements for approval of a license, such as a company's paid-in capital, job creation, and expansion of the private sector and some other procedures set forth in Law No. 15/1960. Under the FDI law and its various resolutions, some \$2.1 billion foreign investment was approved as of end-November 2004. Of these, \$1.6 billion was for the petrochemical sector, and the remainder for an electricity plant and communication networks. Currently, several projects amounting to \$1.85 billion are under review by the investment committee of the Ministry of Economy and Commerce of which \$1.2 billion is for industrial

⁹ Saudi Arabia has the second largest disparity, followed by the U.A.E, Oman, Qatar, and Bahrain.

purposes (electricity generation, and a nitrogen production plant), \$0.6 billion for services (information technology and communication) and \$50 million for banking.

Box II.1. Kuwait's Positive List for FDI and the Approval Process

Under resolution No. 1006/1, a license is issued by the Minister of Commerce and Industry upon the recommendation of the Investment Committee and in accordance with competency requirements set forth in FDI Law No. 8/2001, a foreign investor may invest in the following activities:

1. Industries except for those related to oil or gas exploration or production.
2. Construction, operation and management of infrastructure enterprises in the field of water, power, drainage and communication.
3. Banks, investment corporations and foreign exchange companies which the Central Bank of Kuwait agrees to consider incorporating.
4. Insurance companies which the Ministry of Commerce and Industry agree to incorporate.
5. Information Technology and software development.
6. Hospitals and pharmaceutical industry.
7. Land, sea and air transport.
8. Tourism, hotels, and entertainment.
9. Culture, information, and marketing except for issuance of newspapers and magazines and opening of publishing houses.
10. Integrated housing projects and zone developments except for real estate speculation.
11. Real estate investment through foreign investor subscription to the Kuwaiti shareholding companies as per the provision of Law No. 20/2002.

Box II.2. Use of “Negative Lists” in Promotion of FDI: Best Practices

A negative list is the basic mantra of how to screen projects, and has two essential elements. The first is the idea of specifying just what is regulated, with the explicit statement in the law that anything not on the list is permitted—essentially, this is choosing negative as opposed to positive lists. This is the market paradigm, as contrasted to the command economy paradigm. The second basic element of the negative list approach is that it should be as specific as possible. It should avoid vague formulations such as "sensitive industries" or "industries of national importance." The introduction of a negative list should be accompanied by a provision in the relevant law or laws that states clearly that no licenses or other permission will be required for foreigners, distinct from own nationals, to invest in activities that are not on the list.

Issuing such a list provides maximum transparency by eliminating discretion over which types of investments will be screened. This gives potential investors a clear sense of where they stand. Increasingly, governments around the world are adopting these negative lists that specify exactly the types of activities subject to screening, and are allowing all others to proceed.

A country may wish to have as many as three different kinds of negative lists, although this practice has to be avoided. Starting with the most restrictive, one list may be of activities in which FDI is prohibited. A second kind may consist of activities subject to certain restrictions, such as percentage foreign ownership, or export-only. Yet a third may simply be activities that are permitted without restriction but only after a case-by-case screening and licensing. It is not recommended to publish dozens of items in such a list. If it is decided to have many lists, it is good practice to make these lists as clear, explicit, and automatic as possible, and to publish them in easily accessible ways so that the rules are known to all.

Where screening of project proposals is required by the negative list, specific criteria for approval and the methodology for reaching a decision should be spelled out in regulatory guidelines. The screening decision should be made on tightly defined grounds relevant to the precise economic or political reasons for placing the activity on the negative list. Superfluous factors should be excluded. In particular, the screening process should not involve second-guessing investors on their assessments of the viability of projects. Requirements for the investors to present feasibility studies to prove the economic and/or financial viability of their proposed investment should be eliminated, along with having government officials investigating the technical and economic feasibility of potential investments.

Once an investment project has been screened and granted a license, it should be free to operate as a normal company. A company should not have to return to the screening authority to receive subsequent permission for carrying out its business. Expansions should not require approval, since a company has already been licensed to perform its activity. The company should be free to sell shares. Also, it should be able to engage in variants of its approved activity, such as undertaking the processing of tailings for an approved mining project or changing the design specifications for licensed military production. An approved company should not be encumbered by time limits on its investment schedule, which need to be left flexible to fit with changing market conditions. Requirements for discretionary annual renewal of licenses, not common any more, should also be avoided.

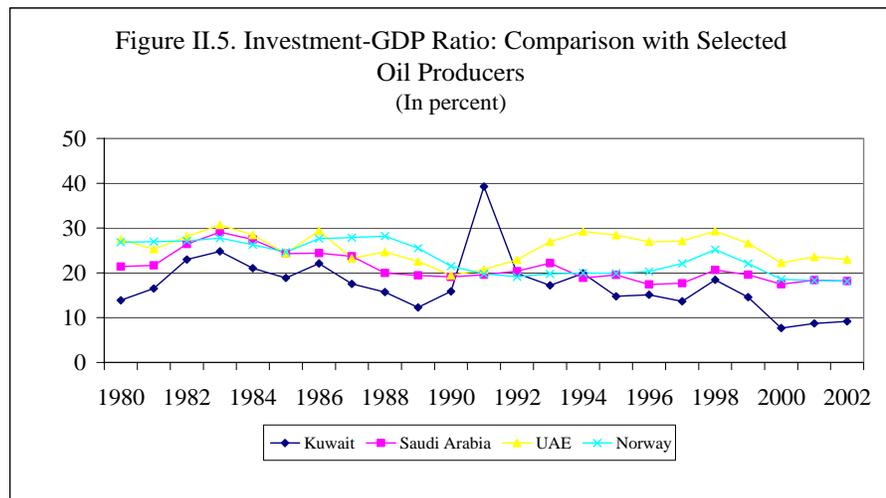
Source: Adapted from International Finance Corporation's website
<http://www.fias.net/html/intro#intro> IFC (FIAS).

31. Kuwait's investment climate is poor in some areas, better than some of its neighbors in other areas, but not as favorable as the high-income OECD countries.

According to World Bank's statistics (World Bank, 2005), in 2004 it took 75 days to register a property in Kuwait as compared with only 4 and 9 days in Saudi Arabia and the U.A.E, respectively. In contrast, it took 29 and 19 fewer days in Kuwait to start a business than it did in Saudi Arabia and the U.A.E, respectively. In Kuwait, it took 35 days and 13 number of procedures to start a business whereas it took 10 fewer days and half as many procedures to do the same in high-income OECD countries. Although the average cost of a business start-up in high-income OECD countries was four times as high as Kuwait's, the minimum capital requirement to start a business in Kuwait was three and a half times as large. For many activities in Kuwait that are not subject to FDI laws, cost of doing business is lower if non-Kuwaitis set up a joint venture with Kuwaitis and abide by an equity share of 49 percent. Similar joint ventures exist in other GCC countries.

32. In part due to the poor investment climate and limited investment opportunities, Kuwait's domestic investment has been low relative to other countries in the region and has been declining since mid-1990s (Figure II.5).

Kuwait's gross domestic investment is now close to all time historical lows of the early 1980s. Although private investment has been increasing relative to public investment, the increase has been well below GDP



growth. Clearly, much more needs to be done in improving the investment climate in order to spur growth. Trade with neighboring populous countries (Iraq and Iran) as well as further opening of the economy with the introduction of the GCC common external tariff and the initiatives under the Greater Arab Free Trade Area could boost Kuwait's investment levels in the coming years. In addition, the large scale projects such as the construction of a deep sea port on Boubiyah island (likely to be operational by end-2008) and a North-South GCC train line will also increase investment levels. In addition to passing various FDI law and bylaws, the authorities have begun to improve other aspects of the investment climate by reviewing all outdated laws with a view to adapt them to a more market-friendly environment.

F. Sources of Kuwait's Growth: An International Comparison

33. During the 1980–2002 period, Kuwait registered an annual per capita real GDP growth rate of -0.6 percent, some 0.8 percentage point below the marginally positive growth rate for the MENA region and 4 percentage point below East Asia's per capita

growth rate. What accounts for this poor growth performance? While growth accounting, as presented in Section B, provides a convenient framework for decomposing GDP growth into accumulation in factors of production and efficiency gains in use of these factors, it alone cannot determine the causes of factor accumulation, efficiency gains, GDP growth or causality among these three variables. Cross-country growth regressions provide an avenue to address this issue, identify sources of growth and present various benchmarks for comparison.¹⁰

34. **A widely used econometric specification of growth regression is used to account for Kuwait's growth performance.** It expresses growth in real per capita GDP as a function of initial real per capita GDP (in 1980), a measure of human capital, an infrastructure measure, a measure of quality of institutions (commonly used as a proxy for investment climate, quality of workings of public regulations, red tape and other aspects of public institutions), a measure of financial depth, a demographic variable, a measure of the size of government (proxied by the ratio of government consumption to GDP), and the ratio of investment to GDP.¹¹

35. **The results show that, in large part, Kuwait's high government consumption and low investment rate account for its poor growth performance (Table II.4).** These two factors account for one-third of Kuwait's growth differential with East Asia, two-thirds of its growth differential with the MENA region and offset the positive growth effects of Kuwait's high human capital.¹² These two factors also account for Kuwait's poor growth performance relative to other GCC countries (Table II.4, column 2). In fact, these two are the only factors that pull down Kuwait's growth rate vis-à-vis other GCC countries. For Kuwait to improve its growth performance, it needs to improve its institutions and investment climate, increase the depth of its financial markets, as well as reduce its government consumption and increase its investment rate.¹³

¹⁰ An alternative cross-country approach is to present regressions with accumulation in factors of production and TFP growth as dependent variables. When interpreted appropriately, these two approaches are comparable; see Bosworth and Collins (2003).

¹¹ This specification and the results reported in this section draw on Abed and Davoodi (2004), which also reports on other specifications.

¹² The latter finding is obtained by comparing the contribution of government consumption and investment with secondary enrollment rate in column (1) of Table 4.

¹³ The real effective appreciation of the Kuwaiti dinar during the 1995-2002 period, though reversed since 2002, may have affected its external competitiveness and growth. However, no evidence of a Dutch Disease effect was found in the empirical growth regression.

Table II.4: International Comparisons of Kuwait's Sources of Per Capita GDP Growth, 1980–2002

	Kuwait vs. Its Past History (1)	Kuwait vs. Other GCC (2)	Kuwait vs. MENA (3)	Kuwait vs. East Asia (4)	GCC vs. East Asia (5)	Oil MENA vs. East Asia (6)
Actual growth differential 1/	-0.61	0.40	-0.80	-4.19	-4.53	-3.99
Explained growth differential 2/ due to	-0.55	0.92	-0.61	-3.96	-4.73	-4.27
Log (real per capita GDP in 1980)	-17.15	0.23	-2.11	-2.47	-2.67	-1.11
Secondary school enrolment rate in 1980	0.58	0.26	0.28	0.20	-0.02	-0.04
Log (mainland phone lines per 1000 population)	2.37	0.14	0.69	0.39	0.28	-0.13
Institutions	0.41	-0.01	0.70	-0.12	-0.12	-0.87
Ratio of credit to private sector to GDP	1.42	0.57	0.44	-0.48	-0.96	-1.21
Growth in working age population less growth in total population	0.25	0.08	-0.02	-0.09	-0.16	-0.07
Ratio of government consumption to GDP	-1.36	-0.18	-0.43	-0.87	-0.72	-0.48
Ratio of investment to GDP	0.75	-0.17	-0.17	-0.51	-0.37	-0.36
Unexplained growth differential 3/	-0.06	-0.51	-0.19	-0.23	0.20	0.27

Source and notes: Based on Abed and Davoodi (2004).

The estimated regression includes all the explanatory variables listed in the Table and consists of 111 countries.

MENA consists of 20 countries in the Middle East and North Africa.

East Asia consists of seven countries (Thailand, Singapore, the Philippines, Malaysia, South Korea, Indonesia, and Hong Kong) GCC consist of Saudi Arabia, United Arab Emirates, Qatar, Bahrain, Oman and Kuwait.

1/ Defined as Kuwait's growth or a country grouping's growth minus East Asia's growth, except for column (1) which is based on predicted growth using actual values for Kuwait.

2/ Defined as above but based on the estimated regression as reported in Abed and Davoodi (2004). For column (1), the intercept is included as well.

3/ Defined as actual growth differential minus predicted growth differential, except for column (1) which is the difference between Kuwait's actual growth and predicted growth.

36. **Increasing Kuwait's investment rate alone, however, is not the key to higher growth rate if not accompanied by higher productivity.** A main message of growth accounting of Section B is that Kuwait has continuously registered a negative productivity growth rate. The same scale of investment can therefore boost growth rate if productivity of existing investment can be enhanced. Studies that investigate the determinants of TFP growth consistently point out the importance of, among other things, improving the investment climate and institutions, adopting outward-oriented policies, enhancing human capital, and avoiding an excessively large public sector (Bosworth and Collins 2003; Hakura 2004). These are invariably the same factors that also increase per capita GDP growth rate. Therefore, work on both fronts can be win-win policies: boosting the TFP growth rate should be combined with the fostering of a policy environment that provides the right incentives for encouraging investment in physical and human capital.

G. Conclusion

37. **This chapter used a variety of analytical methods to review Kuwait's development strategy, comparing fulfillment of some of the objectives of this strategy with the track record over the last two decades.** It found that Kuwait's focus on its long-standing policy challenges—namely, accelerating non-oil growth in order to absorb the growing labor force, diversifying the economy, reducing the role of the government and expanding that of the private sector; and improving the investment climate—is well-placed.

38. **It also found that the link between objectives of development plans and the track record—particularly on growth, size of the private sector, the investment climate and diversification—was weak.** Growth has been negative either on a per capita basis or in terms of productivity for the last two decades; the size of Kuwait's private sector is small in a regional and international comparison and has been falling over time. Investment climate is generally unfavorable although this was in part due to the regional security situation. Some diversification has been achieved, as measured by the higher ratio of non-oil GDP to total GDP, but diversification away from oil has been largely limited to the growth of the petrochemical industry.

39. **At present Kuwait is one of the least diversified economies among the GCC countries.** There is no doubt that petrochemical industry is a high-value added industry but it is limited in its potential for job creation and its fortunes are highly linked to volatility in the oil markets. Potential for diversification exists in transportation, wholesale and retail trade, storage, communication and perhaps tourism. In most of these areas, Kuwait is likely to face competition from other countries in the region, but is well placed to serve the Northern Gulf region, particularly if its trade expands significantly with Iran and Iraq and peace and stability gain a stronger footing in the region.

40. **Kuwait's policies of high government consumption and low investment rate have had adverse effects on growth and urgent policy reforms are needed.** The paper finds that the combined impact of high government consumption and low investment rate has offset the positive growth effects of Kuwait's high human capital. The challenge of reducing

the size of the public sector is not easy, given some of the rigidities in the labor market, and a budget structure that has become more inflexible over time. The authorities should begin to find more efficient ways of transferring oil wealth than the current method of being employer of last resort and guaranteed provider of a range of subsidies and transfers. The heavy reliance on a large public sector will not aid development of a vibrant indigenous private sector and will undermine the authorities' diversification strategy.

41. **Kuwait also needs to improve further its investment climate in order to increase its non-oil growth and productivity and should consider expediting the pace of structural reforms to take advantage of the emerging opportunities in the region.** The paper shows that increasing the scale of investment may not be as important as increasing its productivity as all three measures of productivity for Kuwait have shown a secular decline over the last two decades. Without an increase in productivity, it will be difficult for Kuwait to absorb its fast growing labor force and increase the standard of living of its population.

42. **The Kuwaiti authorities are well aware of the weaknesses in the current investment climate and have taken a number of measures.** These includes: passage of the FDI law, with a positive list of 11 sectors open to 100 percent foreign ownership, and establishment of a one-stop shop to attract foreign investment. Also, the authorities' decision to open up the economy to foreign bank competition should direct capital towards its most efficient use, boost investment productivity and increase the depth of Kuwait's financial markets which the empirical results in this chapter have shown to have large growth payoff. Improving trade prospects within the Greater Arab Free Trade Area and with Iran and Iraq, and the move toward the GCC monetary union may also result in productivity gains and boost non-oil growth.

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III. FISCAL SUSTAINABILITY AND OPTIONS FOR FISCAL ADJUSTMENT¹⁴

A. Introduction

43. **Large hydrocarbon revenues in Kuwait have led to sizable fiscal surpluses and accumulation of sizable financial assets.** Kuwait receives substantial earnings from the export of its hydrocarbon resources most of which are oil-related (henceforth referred to as oil). Oil resources, however, are non-renewable, and one can naturally expect that at the national level Kuwait will realize savings out of its oil export receipts to smooth out the consumption path somewhat along the lines implied by the Permanent Income Hypothesis (PIH) of consumption. Kuwait has indeed made large savings over the years and accumulated considerable external financial assets. Oil export receipts accrue exclusively to the government,¹⁵ and sizable fiscal surpluses accumulated over the years have contributed to Kuwait's large savings in the Reserve Fund for Future Generations (RFFG).

44. **Excessive dependence of the budget on oil revenues and investment income, together with a very high and growing share of recurrent expenditures in the budget, raises questions about Kuwait's long-term fiscal sustainability.** More than 90 percent of government revenues are estimated to have been oil export receipts and investment income from external financial assets¹⁶ in recent years. Both revenue items are subject to a large degree of uncertainty compared with tax revenues. On the expenditure side, recurrent expenditures have been growing at a fast pace and reached a record high level in relation to GDP. The share of capital expenditures that can support growth of the non-oil economy, however, increased only marginally.

45. **This chapter assesses Kuwait's long-term fiscal sustainability and discusses options for fiscal adjustment to address the challenge.** It first describes the developments in consumption and savings, which led to the accumulation of large external financial assets. It then turns to the assessment of fiscal sustainability in Section C. As a first step, the PIH rule is applied to check for a specific form of fiscal sustainability. The analysis concludes that an unchanged Kuwaiti fiscal policy is not consistent with the PIH. A standard debt sustainability analysis also reaffirms that an unchanged Kuwaiti fiscal policy would be unsustainable in the sense that it would lead to a rapid depletion of the accumulated assets and thereafter to a buildup of debt at an unsustainable pace. The final Section (Section D) discusses ways to strengthen the budget structure and options for fiscal adjustment. The options include the following: (i) rationalization and targeting of subsidies; (ii) rationalization of transfers associated with very high social security benefits;

¹⁴ Prepared by Hajime Takizawa.

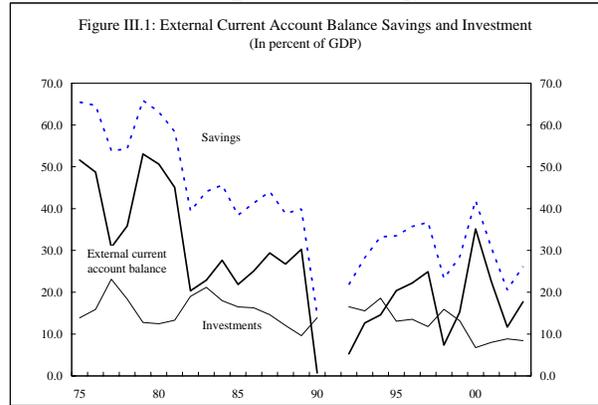
¹⁵ The upstream oil sector is not open to foreign oil companies in Kuwait.

¹⁶ These figures include the transfer of profits of state-owned Kuwaiti Petroleum Corporation.

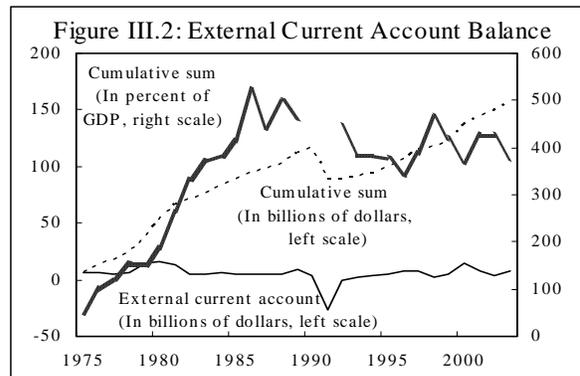
(iii) increases in capital expenditures in areas which would engender private sector investment; and (iv) an expansion of the tax base.

B. Savings-Investment Balance, 1975–2004

46. **Kuwait has saved considerable portions of its gross national disposable income (GNDI), as reflected in its large external current account surpluses during the last three decades** (Figure III.1).¹⁷ The external current account balances have recorded large surpluses in most years except for a few years following the Iraqi invasion. Kuwait has also built up a good quality infrastructure by investing a part of gross national disposable income in the form of physical capital. A close inspection of the data reveals that physical capital accumulation was intensive during certain periods: before 1980, which corresponds to the period when the country started to transform its infrastructure following the oil boom of 1970s; and again in early 1990s after the end of the Iraqi invasion, which significantly damaged the nation’s physical infrastructures.



47. **Reflecting the large external current account surpluses, Kuwait is estimated to have built up substantial gross external financial assets over the last several decades.** While the data on gross external financial assets are not available, a very rough estimate can be made by calculating the cumulative sum of Kuwait’s external current account balances over the last three decades.¹⁸ A simple cumulative sum for the period 1975–2003 amounts to



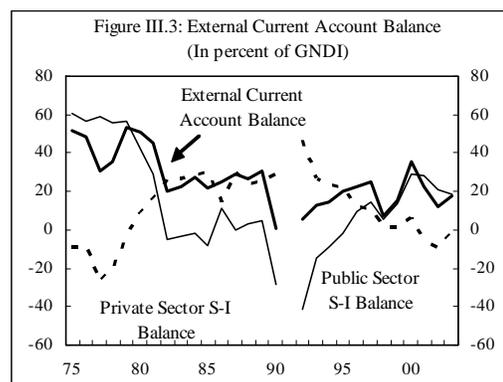
¹⁷ Gross national disposable income (GNDI) is defined as gross domestic product (GDP) plus net factor income from abroad (NFI) and net transfers (NT). Given the definitions of GNDI and the external current account balance (CAB), gross national savings, which is defined as GNDI minus consumption (C), is equal to gross domestic investment (I) plus external current account balance:

$$S = GNDI - C = I + CAB.$$

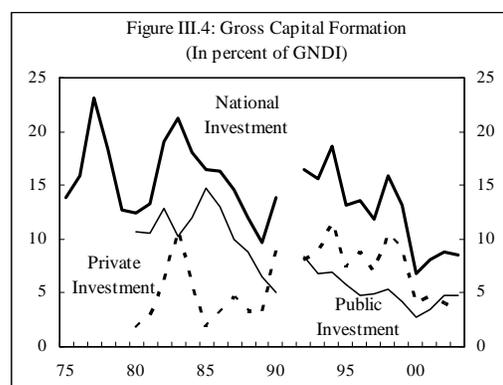
¹⁸ The data on external current account balance are available for 1975 and thereafter in the Fund’s *International Financial Statistics*.

\$156.8 billion (Figure III.2). Based on an assumption of nominal annual return of 4 percent, the cumulative savings would amount to \$306.7 billion. A rough breakdown of the cumulative sum into public and private sector parts can also be calculated from the national accounts data.

48. **The large external current account surpluses, particularly those during the oil boom in the 1970s and the post-reconstruction period of the 1990s, were attributable to large fiscal surpluses and declining national investment** (Figures III.3 and III.4). The fiscal position, however, remained relatively weak during most of the 1980s due to the secular decline in oil prices in real terms, followed by a marked deterioration in the fiscal position in early 1990s due to the liberation efforts and subsequent reconstruction. The lower level of domestic investment in the 1980s and in the second half of 1990s reflected the limited investment opportunities in the non-oil economy. The relatively high level of investment in the 1970s reflected the developmental needs of the economy, and the temporary surge in investment during the post-liberation period was associated with the reconstruction and rehabilitation of the damaged infrastructure.



The lower level of domestic investment in



49. **Kuwait lags behind other oil-exporting countries in domestic investment despite the very high level of domestic savings.** Among selected oil-exporting countries, Kuwait has the lowest gross fixed capital formation in relation to GDP (Table III.1). In particular, the pace of gross fixed capital formation markedly slowed down in the post-reconstruction period (1997–2003).

50. **The private sector savings-investment balance has offset to some extent the impact of changes in fiscal balance on the external current account balance** (Figure III.3). In the pre-Iraqi invasion period, private sector savings increased above the level of private investment to offset the declining fiscal surpluses. After the Iraqi reconstruction period, however, the trend was reversed as the private sector reduced its net savings amid rising fiscal surpluses. The observation suggests that households partially substituted consumption of publicly provided goods and services and public investment for consumption of privately purchased goods and services and private investment. The negative correlation between the fiscal balance and the private sector saving-investment balance might not necessarily be the sole outcome of an accounting identity. Even when the private sector

savings-investment balances were not to develop in such a way to offset the changes in the fiscal balances, the accounting identity would hold.¹⁹

Table III.1: Gross Fixed Capital Formation

(In percent of GDP)

	1992–96	1997–2003
Kuwait	17.4	11.5
Bahrain	18.9	14.2
Oman	15.7	15.7
Qatar	24.3	23.7
Saudi Arabia	19.7	20.0
U.A.E.	26.9	24.7
Venezuela	18.3	15.9
Trinidad and Tobago	17.7	23.3

Source: World Economic Outlook.

51. **During the period 2003–04, the central government budgetary position has been strong due to higher oil prices, but the stance of fiscal policy was expansionary, since the government spent a large part of the oil revenue on various expenditure programs.** Specifically, expenditures grew by 24 percent in real terms during 2003–04. While a part of the increase in expenditure was attributable to security-related outlays and to a one-time transfer of higher oil revenues to the citizens, other recurrent expenditures including wages and salaries and subsidies and transfers also increased significantly and are estimated to have accounted for almost 70 percent of current expenditures. As a result, non-oil primary deficit as a percent of non-oil GDP increased by more than 8 percentage points (to 61 percent) during the two-year period ending 2004.

52. **The recent sharp increase in recurrent expenditures calls for a fiscal sustainability analysis.** A large part of the increase in expenditure was financed by higher oil revenues, while domestic tax revenue effort remains low at less than 2 percent of total

¹⁹ For the discussion of fiscal neutrality, see Barro (1974). Subsequent research indicates that fiscal neutrality holds under limited conditions (Aiyagari, 1987). Empirical research for the U.S. economy indicates that the households partially offset the change in the government savings-investment balance (Aschauer, 1985; Campbell and Mankiw, 1990; Graham, 1993; and Kormendi, 1983).

revenue. Thus, the vulnerability of the budget to uncertainties in oil and investment income receipts has accentuated. The following section analyzes in greater detail the sustainability of Kuwait's current fiscal stance over the longer term.

C. Fiscal Sustainability

53. **Kuwait's fiscal sustainability has been assessed using two different types of frameworks, both based on an exogenous extraction rate for hydrocarbon resources.** The first framework is the PIH of consumption. The second framework is a standard debt sustainability analysis. Under both frameworks, the current Kuwaiti fiscal policy stance is not sustainable.

54. **The PIH framework.** This framework provides an approach to assess fiscal sustainability. The PIH framework aims at maintaining the government total net wealth, defined as the sum of gross financial and hydrocarbon wealth net of gross financial debt, by limiting the government spending to the annuity value of total net wealth (Box 1). Since hydrocarbon reserves will be eventually converted into financial assets, the path of fiscal position that is determined by the PIH is by construction sustainable.²⁰ One desirable property of the PIH is the recognition of exhaustible nature of hydrocarbon resources. The PIH outlines a specific path of fiscal positions consistent with the objective of ensuring a constant total real net wealth. It also ensures that the fiscal policy stance is sustainable beyond the point hydrocarbon resources are completely depleted. Thus, comparing the current stance of fiscal policy with this path helps determine whether current fiscal policy is consistent with the maintenance of total net wealth and thus satisfies a sufficient condition for fiscal sustainability.

55. **While the PIH provides a check for one form of fiscal sustainability, it has its limitations.** The path of fiscal position that is implied by the PIH is indeed one of many that ensure fiscal sustainability. In other words, the PIH-based fiscal policy is a sufficient condition for fiscal sustainability and not a necessary condition. For a particular level of gross financial assets net of gross financial debt (in relation to GDP), there are, in general, many fiscal paths that could be consistent with fiscal sustainability after oil is depleted.

²⁰ Fiscal sustainability (i.e., public debt sustainability) can be defined as "...a situation in which a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditures" (www.imf.org "Assessing Sustainability").

Box III.1: Permanent Income Hypothesis (PIH)²¹

The PIH rule targets a constant total net wealth in real terms. Total net wealth is defined as the sum of the value of hydrocarbon reserve under the ground and gross financial asset net of gross financial debt. Thus, the PIH rule essentially means pursuing fiscal policy under which total net wealth grows at the rate of inflation. Such fiscal policy implies a path of net primary balance and, taking into account the exogenously given hydrocarbon revenues, a path of non-hydrocarbon net primary balance.

Under the PIH rule, non-hydrocarbon net primary deficit should be equal to the real return on total net wealth discounted by a period nominal interest rate. That is,

$$PD_t = \frac{(i_t - p_t)(FA_t - FD_t + OW_t)}{1 + i_t}$$

where PD_t is the non-oil net primary deficit; i_t is the nominal interest rate; p_t is inflation rate; FA_t is the beginning-of-the-period gross financial asset; FD_t is the beginning-of-the-period gross financial debt; and OW_t is the present value of exogenously given hydrocarbon revenues which are assumed to be depleted at some time in future.

The PIH rule in principle sets the consumption level equal to the real return out of the total net wealth regardless of the form of the wealth. Underlying this result is a supposition that the government finances its non-hydrocarbon deficits from hydrocarbon revenues. Hydrocarbon revenues can be used either to finance the government spending (consumption) or to accumulate net financial assets (savings). The unused part of hydrocarbon revenues is accumulated in such a way to ensure that total net wealth remains constant in real terms.

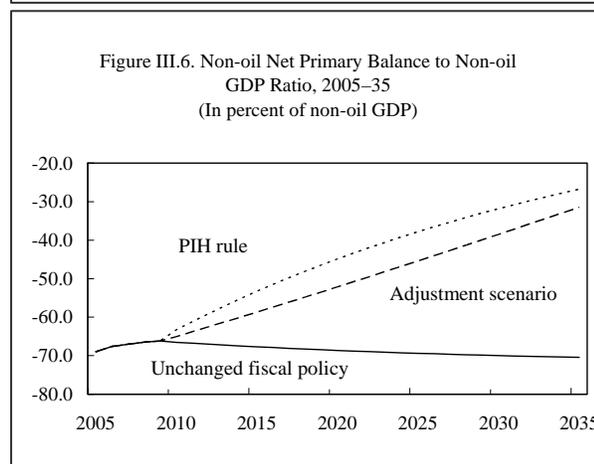
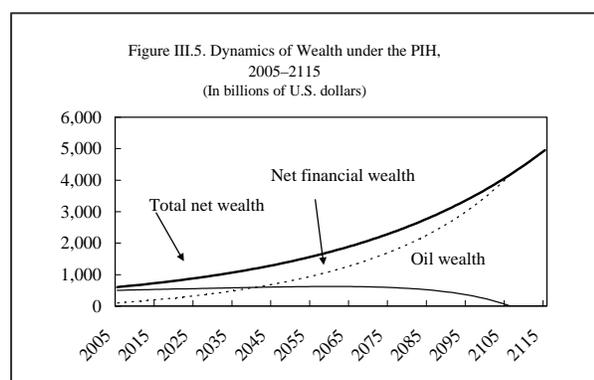
56. **The PIH framework is best used to provide a normative assessment based on certain criteria.**²² The path of fiscal position guided by the PIH ensures one form of intergenerational equity on the assumption that the discount rate used in the PIH framework is equal to the time preference of households who benefit from the government spending. Since the spending is equal to the annuity value of total net public wealth that will be constant in real terms, each generation as a whole enjoys the same level of government services out of the petroleum resources under the rule. The PIH rule, however, is somewhat arbitrary in the sense that the targeted level of total real net public wealth is what an economy happens to own at a particular time. Furthermore, total real net public wealth is held constant regardless of the level of net wealth held by the households. If future generations are projected to be wealthier and earn higher income, holding government spendings constant in real terms might not be compatible with the objective of intergenerational equity.

²¹ A detailed discussion of the PIH can be found in Davoodi (2002).

²² Aside from the limitation in the analysis of fiscal sustainability, the PIH rule has serious problems if it were to be made operational. For example, the rule requires notional long-term price as an input, and revising the price could impart significant procyclicality.

57. **A standard debt sustainability analysis.** In order to assess the implications of deviations of the fiscal stance from the implied PIH-based path, it is necessary to conduct a standard debt sustainability analysis.²³ A simple comparison of a fiscal stance with the PIH-based fiscal policy stance by itself does not provide the basis for assessing the sustainability of the fiscal policy. A debt sustainability analysis helps assess the likely debt path under the unchanged Kuwaiti fiscal stance and enables quantifying the fiscal adjustment needed to achieve fiscal sustainability. While standard debt sustainability analyses are usually conducted for a medium-term time horizon, a long-term analysis is relevant in the present context to reflect the implications of the exhaustible nature of hydrocarbon resources on debt sustainability. Thus, the simulations in this section cover the period after which oil is depleted. The results of both frameworks are reported below.

58. Given Kuwait's large size of hydrocarbon reserves, the PIH framework implies that large non-oil fiscal deficits are permissible under the assumptions summarized in (Box III.2). The simulation targets maintaining the projected total public sector net wealth in the beginning of 2010 that is implied by the medium-term macroeconomic framework outlined in the accompanying staff report. The dynamics of the components of total net wealth is shown in Figure III.5. The value of hydrocarbon reserves declines as the reserves are extracted and a part of the resulting oil revenue is converted into financial assets. The ratio of non-oil net primary deficit to non-oil GDP that is permissible under the PIH in 2010 amounts to 63 percent. The deficit ratio steadily declines thereafter as non-oil GDP grows over time (Figure III.6).



²³ See www.imf.org for a standard debt sustainability analysis. Several papers have fine-tuned the framework in order for the framework to be applied to various economies. See IMF (2003).

Box III.2. Assumptions underlying the PIH Simulation for Kuwait

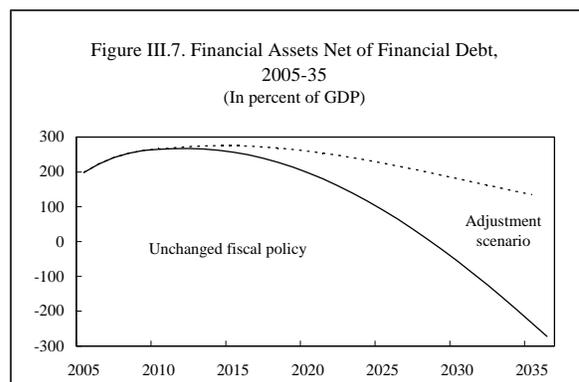
A PIH simulation has been performed under the following assumptions:

- The simulation targets maintaining the projected total public sector net wealth beginning 2010 that is implied by the medium-term macroeconomic framework outlined in the 2005 staff report;
- The long-term Kuwaiti crude export price is projected to increase by 0.6 percent per annum starting from \$28 per barrel, which is the projected Kuwaiti crude export price for 2010.
- Crude oil production is virtually flat at the projected 2009 production level of 2.5 million barrels per day;
- Given the estimated 95 billion barrels oil reserves as of end-2004, oil reserves are projected to be depleted in 112 years;
- Real non-oil GDP is projected to grow at 3.5 percent;
- The inflation rate is projected to be 1.9 percent; and
- The average nominal rate of return on financial assets is assumed to be 3.5 percent.

59. **The unchanged Kuwaiti fiscal policy stance is projected to become inconsistent with the maintenance of total net wealth** (Figure III.6). The unchanged fiscal policy stance assumes that neither new revenue measures nor new expenditure restraints will be introduced in future. Specifically, the stance of the fiscal policy until 2009 is assumed to be the fiscal policy stance in the medium-term macroeconomic framework of the staff report.²⁴ For 2010 onwards, it assumes that: (a) the ratio of non-oil tax and non-tax revenues (except investment income and profit transfers from state-owned Kuwait Petroleum Corporation) in relation to non-oil GDP will remain constant at the projected 2009 level; (b) oil export receipts and profit transfers from Kuwait Petroleum Corporation will move in step with crude oil production and export prices; and (c) the ratio of primary expenditures to non-oil GDP will remain constant at the projected 2009 level. The simulation indicates that non-oil net primary deficit under the unchanged policy will exceed the permissible level because of projected continued growth of expenditures, while oil revenues decline in relation to GDP.

²⁴ Despite no new significant measures, the ratio of primary expenditures to non-oil GDP is projected to decline gradually until 2009, reflecting the changes in fuel cost subsidies for electricity and water in response to the projected oil market developments.

60. **A standard debt sustainability analysis also reaffirms that the unchanged fiscal policy stance is not sustainable.** For the first 20 years of the simulation, gross financial assets net of gross financial debts are positive (Figure III.7). However, the net financial asset position deteriorates rapidly and turns into net debt position as the increase in primary expenditure starts dominating the modest increase in revenues. The modest increase in revenues is attributable to a projected rather flat profile for oil export receipts and to the low ratio of non-oil domestic revenues to non-oil GDP.



61. **Although both the PIH and long-term debt sustainability analysis are sensitive to changes in the key assumptions, the current fiscal stance remains unsustainable even if allowance is made for oil prices being higher than envisaged in the simulation.** In the simulation, long-term Kuwaiti crude export price is assumed to increase by 0.6 percent per annum from 2010. Even, if crude oil prices are assumed to increase by 2 percent instead, in line with the projected inflation rate for advanced economies over the long term, the net financial asset position will turn negative in 2029 (rather than in 2026).

62. **The unchanged fiscal policy stance cannot be sustained indefinitely no matter how large the accumulated net financial asset is prior to the depletion of oil unless the rate of return on assets exceeds the nominal growth rate of non-oil GDP.** After the depletion of oil, net primary deficit is assumed to increase at the rate of nominal GDP growth while the return of gross financial asset and gross financial debt is lower than the rate of nominal GDP growth. Thus, no matter how large is the accumulated net financial wealth prior to the depletion of oil, the increases in debt resulting from the growing fiscal deficits will eventually dominate the increases in gross financial assets, leading to unsustainable government debt levels.

63. **Only under unrealistic assumptions for the projected crude oil export prices can net financial wealth be maintained above the current level in real terms for a certain period after the depletion of oil.** It is theoretically possible to find a rate of increase in crude export price that ensures that the net financial wealth remains above current levels in real terms under the unchanged fiscal policy for at least, say, 30 years after the depletion of oil. A simulation indicates that an annual rate of increase in crude export price of at least 6.3 percent will be required to achieve such an objective. This required rate of increase is more than three times the assumed long-term rate of inflation for the major industrial countries (2 percent). Furthermore, even under this scenario, gross financial debt will quickly grow and start exceeding gross financial assets 30 years after the depletion of oil. Thereafter, government debt would soon reach unsustainable levels in relation to GDP.

64. **To ensure fiscal sustainability, expenditure restraints, preferably combined with non-oil revenue mobilization will be necessary.** A hypothetical adjustment path has been generated so as to illustrate the magnitude of fiscal adjustment that would be necessary to ensure fiscal sustainability. For simplicity, we assume a combination of expenditure containment of one percentage point of non-oil GDP a year and non-oil revenue mobilization of half a percentage point of non-oil GDP a year²⁵ (i.e., one and a half percentage points of discretionary fiscal adjustment) is maintained for a period that would be necessary to ensure fiscal sustainability (Table III.2). The result shows that fiscal adjustments would need to be sustained for about 50 years to ensure fiscal sustainability, taking into account the exhaustible nature of hydrocarbon revenues.

Table III.2: A Comparison of the Unchanged Fiscal Policy Stance with the Illustrative Adjustment Scenario

	Unchanged Fiscal Policy Stance	Adjustment Scenario
Annual reduction in non-oil deficit-to-non-oil GDP ratio (In percentage points)	0.0	1.5
Non-oil net primary balance (In percent of non-oil GDP)		
In 2025	-72.2	-48.2
In 2050	-72.2	-10.7
Net government assets/debt (In percent of GDP) 1/		
End-2025	91	225.3
End-2050	-862.5	61.7

Source: IMF staff estimates.

1/ Defined as gross government financial assets net of gross financial debts.

65. **The financial assets already built up by the government and the hydrocarbon wealth remaining in the ground can be used to undertake a smooth fiscal adjustment.** In the adjustment scenario presented above, fiscal sustainability is ensured because net financial assets and hydrocarbon revenues are used to finance the non-oil primary fiscal deficits along the transition path to the steady state. Although financial assets of the public sector will be

²⁵ The revenue mobilization does not take into account the indirect effect of improvement in primary fiscal balance on reduction of (increase in) interest payment (investment income).

exhausted by the time fiscal sustainability is achieved, Kuwait's needs for such assets will also largely disappear. While there is some flexibility in terms of timing and phasing of the required adjustment measures, front loading will provide additional flexibility in the event of adverse shocks along the way.

D. The Budget Structure in Kuwait and Options for Fiscal Adjustments

Structure of the budget

66. **A significant part of Kuwait's fiscal operations is related to transferring oil earnings to its citizens.** In Kuwait, all oil export receipts accrue to the government, and oil export receipts and investment income from the assets held abroad account for the vast share of the government revenues (Table III.3). Tax revenues are only a small fraction of the total revenue (2 percent in FY 2003/04). On the expenditure side, subsidies and transfers account for about a quarter of total expenditures. Furthermore, the government has remained in its role as the employer of last resort over the years by absorbing most of the rapidly growing labor force in the public sector. A large part of the fast-growing wage bill, which accounts for more than one-third of the total expenditures, is also *de facto* transfers to the Kuwaiti citizens.

67. **Subsidies are not targeted in Kuwait.** A lion's share of the subsidies is for electricity and water (Table III.4). Since charges for these services are very low, revenues from these services are small and are well short of the operating costs associated with the provision of these services. This policy is contributing to misallocation of resources and is also regressive to the extent that the wealthier households tend to consume much more than the less wealthy households.

68. **Transfers to the Public Authority for Social Security (PASS) account for a large share of transfers, followed by housing subsidies** (transfers to individuals). The PASS pays pension benefits to both private and public employees. Reflecting a very high replacement ratio by international standards,²⁶ the budget makes large transfers to the PASS to supplement the contributions of employers and employees, as well as investment income. While liquidity problem of the PASS will not likely arise for some time because of the demographic composition of the Kuwaiti citizens, growth of the number of the beneficiaries will eventually call for either a fundamental rationalization of the benefits, a move toward a fully funded system by raising the rate of contribution, or a combination of both.

²⁶ Percentage of benefits accounting for more than 80 percent of the salary/income of the contributors.

Table III.3: Summary of Fiscal Operations

	2000/01	2002/02	2003/04
	(In percent of total revenue)		
Total revenue	100.0	100.0	100.0
<i>Of which</i>			
Oil	69.2	68.3	75.8
Investment income and transfer of profits of public entities	25.3	20.9	16.0
Taxes	1.1	1.7	1.9
	(In percent of total expenditures)		
Total expenditure	100.0	100.0	100.0
<i>Of which</i>			
Wages and salaries	36.7	34.1	35.0
Subsidies and transfers	24.2	26.9	24.7
Goods and services	23.1	22.1	24.5
	(In percent change)		
Total expenditure	12.0	2.0	11.5
<i>Of which</i>			
Wages and salaries	5.0	4.0	4.4
Subsidies and transfers	8.2	24.7	-6.3
Goods and services	5.0	7.7	12.7

Sources: Ministry of Finance; and Fund staff estimates.

Options for fiscal adjustment

69. **Fiscal adjustment can be gradual.** One possible fiscal adjustment scenario to ensure fiscal sustainability is to follow the fiscal policy that is anchored by the PIH. The literature suggests that oil economies that are already on a balanced growth path tend to benefit by following PIH-type fiscal rules given households' consumption smoothing motives.²⁷ In Kuwait, however, non-oil economy appears to have room for development. If investment in capital (both physical and human) is to change the growth path of the non-oil economy, investing in capital (both physical and human) rather than accumulating external financial

²⁷ For details of the argument, see Takizawa et al. (2004).

assets can be welfare improving.²⁸ Thus, fiscal adjustment can be slower than what the PIH rule suggests in order to accommodate expenditures aimed at enhancing growth of the non-oil economy. As already discussed, financial assets of the public sector can be used to smoothen the adjustment path. The growth of non-oil economy would also reduce Kuwait's needs for financial assets of the public sector. Furthermore, the decline in the public sector financial assets could well be accompanied by an increase in private sector savings-investment balance, consistent with the behavior observed in the past in Kuwait. Such household behavior can mitigate the possible effect of fiscal adjustment on the domestic economy.

Table III.4: Subsidies and Transfers

(In millions of Kuwaiti dinars; unless otherwise indicated)

	2001/02	2002/03	2003/04
Total current subsidies	341	337	439
<i>Of which</i>			
Petroleum product subsidies	6	7	7
Electricity, water, and housing authority	329	323	424
Total transfers	951	873	929
Social Security Institute	489	510	558
Other public entities	33	51	54
Individuals	362	207	200
Private domestic institutions	10	11	12
Other public entities	57	94	105
Total current subsidies and transfers	1,292	1,210	1,368
Memorandum items			
Subsidies and transfers			
In percent of GDP	12.3	10.9	10.4
In percent of total expenditures	26.9	24.7	25.1

Source: Ministry of Finance.

70. Fiscal adjustment should be undertaken through both expenditure rationalization and revenue mobilization over the medium term. Simulations in the previous subsection make it clear that large non-oil primary deficit in relation to non-oil GDP, together with increases in the size of non-oil economy relative to oil economy, is a

²⁸ Takizawa, et al. (2004) demonstrate that accumulation of physical capital can yield higher welfare than that achievable from accumulation of external financial assets if the level of initial physical capital is significantly lower than the steady state balanced growth level.

primary source of fiscal unsustainability under the unchanged policy. Thus, any fiscal adjustment would need to address the high level of primary expenditures and the low level of non-oil revenue in relation to non-oil GDP. Sustained expansion of the non-oil economy will also create greater potentials for expanding the tax base.

71. **Various options for expenditure rationalization and reallocation should be considered.** Primary areas that could be subject to expenditure rationalizations are subsidies and transfers. Raising water and electricity fees at least to cost recovery levels would help reduce budgetary outlays and reduce misallocation of resources. Regarding transfers, maintaining the very high replacement ratio over the long term is not desirable as such a policy would require large increases in contributions over time as the demographic composition tilts more towards the elder population. Hence, future benefits rationalization should be considered. The ongoing efforts to gradually build a funded supplementary system will also help create the basis for future benefit rationalization. Expenditure reallocations will also indirectly facilitate fiscal adjustment. Capital expenditures and expenditures on education can enhance growth of the non-oil economy and employment generation over the medium to long term. Growth of the non-oil economy would also facilitate the reallocation of the Kuwaiti labor force from the government to the private sector, easing the pressure on wages and salaries.

72. **Additional revenue mobilization will help the fiscal adjustment over the long-term.** Given the low level of the ratio of non-oil noninvestment revenues to non-oil GDP, increasing the tax incidence on the domestic economy is a natural option. The proposed simplification of corporate income tax rates and extension of its coverage to domestic companies, together with efforts to revitalize the non-oil economy, would help broaden the domestic tax base. The authorities should also consider implementation of a broad-based general sales tax (GST), preferably in collaboration with the other GCC members, over the medium term. Initially the basic GST rate could be relatively low, with the option to increase it over the long term, as needed.

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IV. ARE LENDING RATE CEILINGS HAMPERING THE DEVELOPMENT OF SMALL- AND MEDIUM-SIZED ENTERPRISES IN KUWAIT?²⁹

A. Introduction

73. **The Kuwaiti banking sector shows adequate levels of capitalization, asset quality, and profitability.** Overall soundness is supported by a comprehensive prudential regulation and supervisory framework that conforms in most respects to international standards. As concluded by the recent FSAP (IMF, 2004), it could withstand significant shocks to interest rates, exchange rate, liquidity, and asset quality. It has played a dynamic role in promoting private sector development and contributed to the country's impressive recovery from the economic damage caused by the 1990–91 war. Kuwait remains, nonetheless, highly dependent on oil, and its economic diversification has advanced at a somewhat slow pace, with reversals caused by oil market developments.

74. **The purpose of this paper is to analyze whether the existence of lending interest rate ceilings is hampering the development of a vibrant small- and medium-size enterprises (SMEs) sector** which may help invigorate non-oil economic growth and employment. We conclude that, given the data available, lending rate ceilings in Kuwait do not appear to be a major deterrent in the creation and development of SMEs. This is so because, despite the likely binding effect of the ceilings, the public sector provides ample financing under concessional conditions to all SMEs that meet some predetermined criteria. Furthermore, despite the virtual nonexistence of financial products targeted to the SMEs in the traditional banking sector, Islamic banks provide an effective funding channel which goes well beyond the traditional limitations of the banking system in SME financing. Nonetheless, the removal of the remaining ceilings may contribute at the margin to the development of SMEs and provide additional flexibility to the product development and pricing practices of banks.

75. **This paper does not analyze the broader impact of lending rate ceilings on economic growth.** The authorities report that the vast majority of corporate loans are extended at rates below the ceilings, which supports the hypothesis that, as they stand, lending rate ceilings in Kuwait are not generally binding. It follows that their impact on overall economic growth has to be relatively small, except for credit to customers which traditionally are priced above market average. Thus, this section focuses on whether lending rate ceilings affect the SME sector, which is one of the more relevant groups of customers generally priced above corporate lending average rates, and one of the main drivers for job creation.³⁰

²⁹ Prepared by Fernando L. Delgado.

³⁰ Consumer lending and other micro and retail credit may also be affected by lending rate ceilings, as analyzed below. However, the analysis of the availability of credit to these sectors falls beyond the scope of this paper.

76. **The remainder of the chapter is organized as follows.** Section B summarizes the theoretical background explaining the relationship between financial repression and economic growth. Section C reviews the current status of interest rate ceilings in the MENA region. Section D discusses the recent structure of interest rate ceilings in Kuwait and their impact on SMEs' access to financing. The conclusions of the study and policy recommendations are presented in section E.

B. Theoretical Background

77. **Lending rate ceilings, as an instrument of financial repression, have been found to have a negative effect on economic growth,** both through its credit rationing effect and the distortion in the allocation of financial resources (Box IV.1). Applying the analytical framework used in the empirical financial repression literature to assess the specific impact of lending rate ceilings on SMEs has proved elusive so far. Only partial and descriptive papers have been produced, since econometric analysis is hampered by the difficulty in separating the effects of the ceilings from the effects of other administrative measures that are usually present simultaneously in financially repressed environments, and by the lack of financial information on the SMEs and/or disaggregated banks' loan portfolio.

78. **Lending rate ceilings make harder access to credit for riskier and smaller customers/sectors.** Since credit is not a homogeneous product, credit extended at any particular point in time in a particular market is priced differently according to its term, amount, and credit risk of the borrower, among other factors. It follows that, under lending rate ceilings, riskier projects requiring higher interest rates will be affected first by the rationing effect of the ceiling. Similarly, micro and retail credit entail large unit operating costs, which are partially compensated through higher interest rates. Thus, access to credit by companies and/or economic sectors with higher credit risk (as measured by the statistical probability of default), such as agriculture, and by retail or micro borrowers, is more likely to be hampered by the existence of lending rate ceilings, unless specific administrative mechanisms are put in place to meet for their financial needs.³¹ Since SMEs are the engine of job creation in most countries,³² lending rate ceilings may constitute a serious handicap for promoting employment in the private sector.

³¹ The links between administrative restrictions and difficulties faced by the SMEs in accessing bank finance are well documented in Beck, Demirgunc-Kunt, and Maksimovic (2003, and 2005), and Beck, Demirgunc-Kunt, Laeven, and Levine (2004). Rajan and Zingales (1998) in their analysis of data for 41 industrial and developing countries, find that financial liberalization is more beneficial for the rise of new firms than for the growth of existing firms. For an analysis of lending rate ceilings on micro enterprises, see CGAP (2004).

³² The link between SME development, economic growth and job creation is well documented. See, for instance, Kirby, and Watson (2003).

Box IV.1. Financial Repression and Economic Growth: Theoretical Background

The existence of interest rate ceilings is usually associated with financial repression, leading to financial underdevelopment and lower economic growth.³³ In the McKinnon/Shaw framework, interest rate ceilings inhibit financial development mainly through keeping real interest rates below their market level. This, in turn, leads to the rationing of credit that affects negatively economic growth. Also, growth is hampered by the sub-optimal allocation of financial resources caused by the elimination of the price discrimination system that allows financial markets to allocate financial resources to those investment projects with the highest returns.

Financial repression, defined as the set of policies, laws, regulations, taxes, qualitative and quantitative restrictions and controls imposed by the government which directly interferes with the allocation of financial resources and the price discovery function of financial markets, was common prior to the 1970s. According to Roubini and Sala-i-Martin (1995, p. 276) financial repression was favored on the basis that (i) anti-usury laws were needed for social reasons; (ii) tight control and regulation of the banking system was considered necessary to ensure banking soundness and proper monetary policy transmission mechanism; (iii) determining the allocation of financial resources to certain sectors or projects was a policy issue to be decided according to the government's notion of socially "strategic" sectors or projects; and (iv) maintaining interest rates below market rates reduced the cost of servicing government debts.

Empirical research (Roubini and Sala-i-Martin, 1992 and 1995) suggests three main channels through which financial repression impacts negatively on economic growth: (i) productivity of investments is negatively affected; (ii) the overall level of investment and savings in the economy is reduced; and (iii) intermediation costs are increased. Recent research has found that the relationship between financial liberalization and economic growth is more relevant via the effect of liberalization on the efficiency of the financial system to allocate financial resources than via its effect on financial deepening. Increased financial system efficiency has been measured through higher access to external finance (Demigurc-Kunt and Maksimovic, 1996, and Rajan and Zingales, 1998), lower default rates (Jayaratne and Strahan, 1996), enhanced total factor productivity (Beck, Levine and Loayza, 2000), and lower variation in expected returns to investment (Abiad, Oomes and Ueda, 2004).

79. **Other negative effects of interest rate ceilings include competitive disadvantages for some intermediaries, regulatory arbitrage, and fraud.** Since interest rate ceilings seldom affect all financial intermediaries and products (assets), they usually result in an unlevelled playing field. Financial institutions are particularly creative in developing alternative ways of financing their customers and attract deposits which circumvent interest rate ceilings. The opacity of this type of arrangements and their frequently unregulated nature increase the chances for fraud.³⁴

³³ McKinnon (1973) and Shaw (1973) laid the basis for the current literature on financial development and growth. Levine (1997, and 2004) and Wachtel (2001) provide comprehensive surveys of the main contributions.

³⁴ Policis (2004) analyzes the effect of lending rate ceilings on credit availability and cost in the U.S.A., the U.K., France, and Germany. The paper finds that the primary effect of the ceilings is to restrict product diversity and, when regulations do not allow lenders to accommodate ceilings with product innovation, to create credit

(continued)

80. **As a monetary policy tool, interest rate ceilings and other direct instruments have been phased out by most industrial countries since the 1970s.** In progressively liberalized economies with full convertibility and capital mobility, direct instruments became increasingly ineffective, leading to inefficiencies and disintermediation.³⁵ Careful sequencing of the financial liberalization process and the adoption of accompanying reforms, including institutional strengthening in the financial supervisory and monetary authorities, are critical elements for a successful elimination of interest rate ceilings and other financial repression measures (Alexander, Baliño and Enoch, 1995). Financial liberalization without proper sequencing and concomitant reforms may easily result in financial instability.

C. Interest Rate Ceilings: Selected Cases

Interest rate ceilings in the MENA region

81. **Liberalization of financial systems, including removal of interest rate ceilings, has progressed in the MENA region during the last decade, albeit at a slower pace than in other parts of the world.** The current status of interest rate ceilings in the region is summarized in Table IV.1. Out of the 20 countries considered in the MENA region, 10 had completely liberalized interest rates *de facto*, while the remaining 10 still present a number of limits to the free market determination of interest rates, ranging from certain degrees of institutionalized collusion (mainly among large public sector banks) to the administrative determination of lending and deposit interest rates.

82. **There is a wide dispersion in the way the interest rate ceilings are calculated, the scope of the banking system affected by the rates, and the resulting maximum marginal intermediation spreads (Table IV.2).**³⁶ Out of the eight countries with formal ceilings in the MENA region, Tunisia, Yemen, and Kuwait present relatively low distortions through interest rate ceilings, while Libya, Syria, and Iran's ceilings introduce a substantial degree of financial repression. Although Kuwait's maximum marginal intermediation spread is smaller than in some other countries (such as Mauritania), its lower inflation results in a higher spread in real terms.

exclusion. Also, when regulations are so stringent that they cannot be accommodated by either product innovation or non-bank lenders, they create the conditions for illegal lending, such as in France and Germany.

³⁵ As mentioned in Alexander, Baliño, and Enoch (1995), interest rate ceilings may present some advantages in cases where entry barriers prevent competitive pricing of financial intermediation, where adverse selection is present (for instance, when information on borrowers is scarce or banking supervision is weak), or when market conditions prevent the authorities from achieving monetary policy goals through indirect instruments. Disadvantages of interest rate ceilings vis-à-vis indirect monetary policy instruments include distortions in the allocation of financial resources, administrative rationing of credit, and financial disintermediation.

³⁶ Maximum marginal intermediation spreads are defined as the difference between the maximum lending rates (ceilings) and the marginal cost of funds for banks (discount rate or equivalent).

Table IV.1. Interest Rate Ceilings in the MENA Region

Country	Are Interest Rates Liberalized? Status
Algeria	Yes, <i>de jure</i> . Public banks convene to discuss interest rates.
Bahrain	Yes
Djibouti	Yes
Egypt	Yes, <i>de jure</i> . Social considerations by public banks result in downward rigidity of deposit rates.
Iran, Islamic Rep. of	No
Jordan	Yes
Kuwait	Partially. Ceilings on bank lending rates remain, tied to discount rate.
Lebanon	Yes
Libya	No. Interest rates on deposits and loans unchanged since 1994.
Mauritania	Partially. Floor is set on some savings rates and legal ceiling on lending rates.
Morocco	Yes
Oman	Partially. Interest rates on personal loans capped at 12 percent.
Pakistan	Yes
Qatar	Yes
Saudi Arabia	Yes
Sudan	Yes
Syrian Arab Republic	No. Interest rates unchanged since 1984.
Tunisia	Partial. Some deposits remain regulated.
United Arab Emirates	Yes
Yemen, Rep.	Partial. A minimum benchmark rate for savings deposits is set administratively.

Source: Creane, Goyal, Mobarak, and Sab (2004), pp. 42–43.

83. **Jbili, Kramarenko, and Bailén (2005) show evidence on the impact of financial repression on the financial intermediation function of banks in Iran.** The authors do not find evidence of causality between financial repression and economic growth in Iran, and hypothesize that the inefficiencies in the financial sector may be masking this relationship. However, they find indirect evidence of the negative effects of interest ceiling on the development of public banks. The four private commercial banks in the country, which are not subject to controls on rates of return and do not benefit from the implicit guarantee of deposits affecting public banks, show higher costs of funds, including deposit and lending rates, as expected. However, despite these pricing and guarantee disadvantages, private banks have increased their market share, due in part to the credit rationing resulting from ceilings imposed on state-owned banks.

Table IV.2. MENA: Explicit Interest Rate Ceilings

(In annual percent, as of end-December 2004) 1/

	Iran 5/	Kuwait	Libya 11/	Mauritania	Oman 18/	Syria	Tunisia	Yemen
Discount rate 2/	14.0	4.75 9/	4.0	11.0 15/	1.25 - 7.5 19/	n.a.	5.0 26/	n.a.
Maximum lending rate	13.5 - 18.0 6/	4.75 - 8.75 10/	2.0 - 6.5 12/	21.0 16/	11.0 20/	4.0 - 9.5 23/	free 27/	free
Average lending rate	16.7 7/	6.74	n.a.	15.0	7.8	n.a.	n.a.	15.0
T-bill auction rate 3/	17.0	0.85	5.5 13/	7.2	0.5 21/	n.a.	5.2	14.4
Minimum deposits rate	7.0 - 17.0 8/	free	0.0 - 5.0 14/	8.0 17/	n.a.	2.0 - 6.5 24/	2.0 - 5.25 28/	13.0 29/
Average deposit rate	n.a.	3.26	n.a.	5.5	1.1	n.a.	n.a.	n.a.
Spread between average lending and deposit rates	n.a.	3.48	n.a.	9.5	6.7	n.a.	n.a.	n.a.
Maximum marginal intermediation spread 4/	-0.5 - 4.0	0 - 4	-2 - 2.5	10.0	3.5 - 9.75 22/	-2.5 - 7.5 25/	free	n.a.
Memorandum items								
CPI growth (2004 average)	15.0	1.8	-1.0	16.2	1.6	3.5	3.6	12.5

Sources: National authorities and Fund staff estimates.

1/ All rates for local currency.

2/ Alternatively, Interest rate at which banks could obtain liquidity from the central bank on a daily basis.

3/ Shorter maturity being offered at the end-2004.

4/ Difference between the maximum lending rates and the marginal cost of funds for banks (discount rate or equivalent).

5/ Rates correspond to annual rates of return, since ex-ante pre-set interest rates are prohibited by the Islamic finance principles.

6/ Maximum lending rates for public banks range from 13.5 for agriculture to 18 percent for housing. There is a minimum lending rate of 21 percent for trade and services loans. Rates of return for private banks are free.

7/ Data for 2003.

8/ Fixed deposit rates for public banks range from 7 percent (short term) to 17 percent (over 2 years). Private banks do not have ceilings on rates of return. loans, facilities and overdrafts: 6.5 percent.

9/ Raised to 5 percent in February 2005.

10/ Ceilings set at 0-4 percentage points above the discount rate (see Table 3). Increased to 5-9 percent on February 2005.

11/ Data as of May 2004.

12/ Real estate loans: 2 percent. Agricultural, industrial, occupational, loans on employees' shift to production: 5 percent. Secured loans and facilities: 6 percent. Other loans, facilities and overdrafts: 6.5 percent.

- 13/ Rate is set administratively.
- 14/ Maximum rates on deposits. Range according to type of deposit, maturity and amount.
- 15/ Raised to 13 percent in January 2005.
- 16/ Set at 10 percentage points above the discount rate. Increased to 23 percent in January 2005.
- 17/ Constant since 2001. Affects savings and term deposits (not sight deposits).
- 18/ As of September 2004.
- 19/ Depending on the underlying security, ranges from 1 percent above the T-bill rate for T-bill with a remaining maturity of 91 days or less, to 7.5 percent for some commercial paper.
- 20/ Only for personal loans (about 40 percent of total credit to the private sector), excluding debt related to international credit cards. Reduced from 12 percent on April 2003.
- 21/ As of March 2004.
- 22/ Affecting only personal loans (rest are free).
- 23/ Interest rates are set administratively for each public bank, sector and type of credit. Ceilings range from 4 percent (Agricultural Cooperative Bank) to 9.5 percent (Real Estate Bank). Maximum rates may be reduced by up to 1 percentage points. For private banks, lending rates are indicative since January 2004.
- 24/ Minimum rates range from 2 percent (sight deposits) to 6.5 percent (investment certificates). Minimum rates may be increased by up to 1 percentage points.
- 25/ Assuming marginal funding cost of banks equal to minimum deposit rates.
- 26/ Money market monthly average rate.
- 27/ There are maximum and minimum ceilings for lending rates applied by the Tunisian Solidarity Bank, fixed at 11 and 13 percent, respectively. Also, a ceiling of 6.75 percent applies for house finance loans by the Housing Bank to housing saving passbook holders.
- 28/ Minimum interest rates are set for sight accounts and term deposits up to 3 months (2 percent), special savings accounts at the Tunisian National Savings Fund and deposits in convertible dinars for emigrants (money market monthly average less two percentage points, currently 3 percent), and housing savings passbooks at the Housing Bank (5.25 percent). Rest of deposit rates are liberalized.
- 29/ Only for savings deposits.

Other country case studies

84. **Evidence on the impact of financial liberalization on economic growth is mixed.** The effect of interest rate ceilings on economic growth is normally measured together with that of the whole set of financial repression measures. Most country case studies focus on the effect of eliminating financial repression measures (i.e., financial liberalization) on economic growth. Frequent episodes of financial crisis followed the liberalization of the financial system, making it clear that financial liberalization introduced risks for financial stability. Thus, earlier positive assessments of the impact of financial liberalization on economic growth were later tuned down or even completely reversed after economic growth was severely affected by financial instability. This was the case, for instance, for South East Asian countries after 1997. However, the evidence tends to point that financial instability could be prevented through an appropriate sequencing of the liberalization and parallel institutional strengthening measures (Box IV.2).

D. Interest Rate Ceilings in Kuwait

Current structure of interest rate ceilings

85. **The Kuwaiti authorities are engaged in a process of financial sector liberalization** and have already eliminated most of the rigid interest rate structure that characterized the Kuwaiti market of the 1970s and 1980s, including administrative ceilings and floors on various categories of deposits and loans.³⁷ As discussed in the staff report for the 2004 Article IV consultation, the latest steps in this process include the elimination of restrictions to the opening of foreign banks' branches and regulatory improvements equalizing the prudential oversight of local commercial and Islamic banks. As part of this process, mandatory minimum interest rates for time and saving deposits were eliminated by the decision of the Central Bank of Kuwait (CBK) issued in January 1995. Also, charges and commissions collected by banks against rendering banking services (henceforth banking fees) were also liberalized by the CBK decision issued in January 1995.

³⁷ For a brief description of the policy evolution in Kuwait in the 1970s, 1980s, and the first-half of the 1990s, see Chalk, El-Erian, Fennell, Kireyev, and Wilson (1997).

Box IV.2. Selected Country Case Studies: The Impact of Financial Liberalization

Greece. Voridis (1993) estimates the effect of interest rate ceilings on private sector investment in Greece from 1960 to 1985. He concludes that the availability of bank credit to the private sector has a significant positive effect on private sector investment. The negative correlation between lending rates and the level of private sector investment led to the conclusion that credit rationing, imposed through interest rate ceilings, had a lagged negative effect on investment.

India. Imam (1984) estimates the welfare cost of interest rate ceilings in India through an intertemporal general equilibrium model. The results of the numerical exercise show that national income and consumption could be increased by about 10 percent by the removal of the ceilings. Kunal Sen and Vaidya (1998) positively assess the experience of financial liberalization in India, and attribute its success to the adequate sequencing of measures within a gradualist approach to liberalization, and to adequate concomitant reforms including previous real sector reforms.

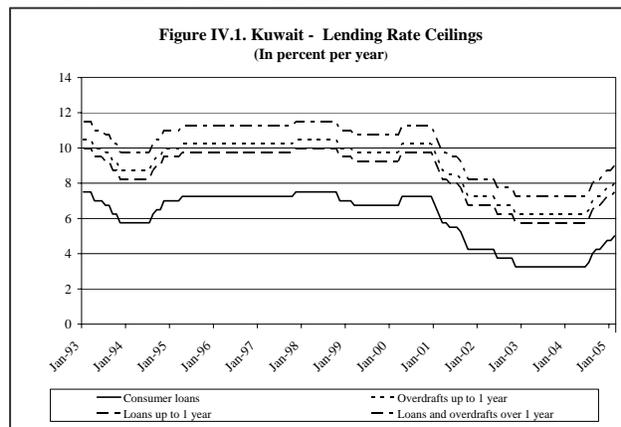
The United States of America (U.S.A.) Jayaratne and Strahan (1996) test the effects of the deregulation of intrastate branching restrictions in the U.S. between 1972 and 1993 on economic growth. Restricting banks' branch network expansion has negative effects on the efficiency of financial intermediation through market segmentation and reduced competition. Although the credit rationing effects of interest rate ceilings are not produced by restrictions on branching, both financial repression measures share their negative impact on intermediation costs, the level of savings and investments, and the effective management of risks. The paper finds evidence that banks improved their credit risk screening and monitoring practices after removal of the branching restrictions. This increased efficiency is deemed to be the channel explaining the acceleration of economic growth following intrastate branching reform.

Other. Alexander, Baliño and Enoch (1995) provide statistical evidence on the positive effects of phasing out direct monetary policy instruments, including interest rate ceilings, on the efficiency in the financial sector and on the degree of monetary control, for 14 countries. In addition, they provide a detailed account of the policy measures undertaken, the concomitant reforms, and the sequencing of the changes for eight countries, including **Chile, Egypt, Ghana, Indonesia, Mexico, New Zealand, and Poland**. In all but three countries the efficiency of financial intermediation increased after phasing out of direct monetary policy instruments, as proxied by the narrowing of intermediation spreads. Also, the variability of the money multiplier fell substantially between the transition period and after completing the phasing out of direct instruments. Some 70 percent of the countries in the sample experienced lower interest rate volatility, implying a potential improvement in monetary control.

Alawode (2003) extensive survey concludes that the results of financial liberalization have been mixed in developing countries. While negative effects seem to be the norm in African countries (**Senegal, Nigeria, and Uganda**), mixed results are reported in the Middle East and Asian regions, where increases in financial instability were predominant in **Turkey** and the **Philippines**, while successful experiences were reported in **Malaysia, Korea, Sri Lanka and Indonesia**. The assessment of the effects of financial liberalization on Asian countries, however, changed radically after 1997. In Latin America, **Argentina, Uruguay and Colombia** were among the cases in which financial liberalization led to instability, while in **Mexico** positive effects on intermediation efficiency were assessed. In **Chile**, while initially contributing to financial instability, financial liberalization is deemed to have had a long-term positive effect on economic growth. It is worth mentioning that in most cases where financial liberalization led to instability, the studies link this failure with either the inadequate sequencing of the liberalization process, the inconsistent implementation of the reforms, frequent policy reversals, and a lack of concomitant measures (mainly the strengthening of prudential regulation and supervision).

86. Interest rate ceilings on lending rates are still in effect in Kuwait. Maximum

limits on interest rates on Kuwaiti dinars (KD) lending are linked to the CBK-fixed discount rate within specific spreads, which have remained unchanged since their application on April 25, 1993. The maximum marginal intermediation spread ranges from slightly above zero³⁸ (for consumer loans) to 4 percent (loans and overdrafts with over one-year maturity). The ceilings are expressed in nominal rates and do not include banking fees and commissions (Figure IV.1 and Table IV.3).



87. Interest rate ceilings do not apply to Islamic financial institutions. According to the Islamic finance principles, the return on financial instruments of Islamic financial institutions must be linked to purchase and resale of goods (and provision of services) or to profit and loss sharing on investments. Since Islamic financial institutions do not charge ex-ante pre-set interest rates, the interest rate ceilings as defined in Kuwait do not apply to the return obtained in their financial intermediation operations.

88. Although the monetary authorities agree that lending rate ceilings are no longer needed, their elimination has proven not feasible so far. The 2004 Financial Sector Stability Assessment Report for Kuwait (FSSA), recommended easing or removing the lending rate ceilings in order to enable lenders to better price the risks of lending, including to SMEs in particular for two reasons: (i) to better support private sector growth; and (ii) to further strengthen its otherwise effective monetary operations.³⁹ The authorities agree with this recommendation. However, since the ceiling on lending rates remains a legal requirement under Article 111 of the Commercial Law, its removal will require a legal amendment entailing a delicate political process.

89. After several reported incidents of charges of bank fees considered to be abusive, the CBK decided to introduce a pre-approval requirement for bank fees in 2002. This has resulted, *de facto*, on a ceiling for bank fees, since the maximum amount of the fee for each specific bank service in all banks within the system approved by CBK is the same. In practice, therefore, banks cannot charge fees freely in order to achieve the all-in yield of lending operations required for servicing the SMEs or other high risk or high cost customers.

³⁸ The effective rate of consumer loans is marginally higher than the discount rate, since banks charge the interest on the loan principal upfront.

³⁹ IMF (2004), p. 5, 6, 17, and 18.

Table IV.3. Kuwait: Interest Rate Ceilings, 1993–2005

(In percent per annum)

Valid Since		Discount rate	Maximum lending rates						Lending margin over discount rate			
Year	Month		Consumer loans	Credit one year or less		Credit more than one year		Credit one year or less		Credit more than one year		
				Overdraft	Loans	Overdraft	Loans	Overdraft	Loans	Overdraft	Loans	
1993	4	7.00	7.00	10.00	9.50	11.00	11.00	3.00	2.50	4.00	4.00	
1993	7	6.75	6.75	9.75	9.25	10.75	10.75	3.00	2.50	4.00	4.00	
1993	9	6.25	6.25	9.25	8.75	10.25	10.25	3.00	2.50	4.00	4.00	
1993	11	5.75	5.75	8.75	8.25	9.75	9.75	3.00	2.50	4.00	4.00	
1994	8	6.25	6.25	9.25	8.75	10.25	10.25	3.00	2.50	4.00	4.00	
1994	9	6.50	6.50	9.50	9.00	10.50	10.50	3.00	2.50	4.00	4.00	
1994	11	7.00	7.00	10.00	9.50	11.00	11.00	3.00	2.50	4.00	4.00	
1995	4	7.25	7.25	10.25	9.75	11.25	11.25	3.00	2.50	4.00	4.00	
1997	11	7.50	7.50	10.50	10.00	11.50	11.50	3.00	2.50	4.00	4.00	
1998	11	7.00	7.00	10.00	9.50	11.00	11.00	3.00	2.50	4.00	4.00	
1999	3	6.75	6.75	9.75	9.25	10.75	10.75	3.00	2.50	4.00	4.00	
2000	5	7.25	7.25	10.25	9.75	11.25	11.25	3.00	2.50	4.00	4.00	
2001	1	6.75	6.75	9.75	9.25	10.75	10.75	3.00	2.50	4.00	4.00	
2001	2	6.25	6.25	9.25	8.75	10.25	10.25	3.00	2.50	4.00	4.00	
2001	3	5.75	5.75	8.75	8.25	9.75	9.75	3.00	2.50	4.00	4.00	
2001	5	5.50	5.50	8.50	8.00	9.50	9.50	3.00	2.50	4.00	4.00	
2001	8	5.25	5.25	8.25	7.75	9.25	9.25	3.00	2.50	4.00	4.00	
2001	9	4.75	4.75	7.75	7.25	8.75	8.75	3.00	2.50	4.00	4.00	
2001	10	4.25	4.25	7.25	6.75	8.25	8.25	3.00	2.50	4.00	4.00	
2002	6	3.75	3.75	6.75	6.25	7.75	7.75	3.00	2.50	4.00	4.00	
2002	11	3.25	3.25	6.25	5.75	7.25	7.25	3.00	2.50	4.00	4.00	
2004	7	3.50	3.50	6.50	6.00	7.50	7.50	3.00	2.50	4.00	4.00	
2004	8	4.00	4.00	7.00	6.50	8.00	8.00	3.00	2.50	4.00	4.00	
2004	9	4.25	4.25	7.25	6.75	8.25	8.25	3.00	2.50	4.00	4.00	
2004	11	4.50	4.50	7.50	7.00	8.50	8.50	3.00	2.50	4.00	4.00	
2004	12	4.75	4.75	7.75	7.25	8.75	8.75	3.00	2.50	4.00	4.00	
2005	2	5.00	5.00	8.00	7.50	9.00	9.00	3.00	2.50	4.00	4.00	

Source: Central Bank of Kuwait.

90. **A number of measures taken primarily for prudential purposes, and certain administrative instruments of monetary policy, also introduce additional rigidities in the market allocation of financial resources.** Specifically, the CBK imposes several

quantitative ceilings to specific types of credit (consumer and installment)⁴⁰ and, although no reserve requirements are imposed, a liquidity requirement and a maturity ladder are used to regulate bank liquidity.⁴¹ Mainly for prudential reasons, in July 2004 the CBK introduced a ceiling of 80 percent on the ratio of credit (net of provisions) to total deposits, which Kuwaiti banks are required to meet by June 2005. Although the average value of the ratio as of end-September 2004 was 78.6 percent, all but three banks in the system had ratios above the 80 percent ceiling. The existence of these administrative measures does not appear to have had a significant impact on bank profitability, which has been growing continuously during the last decade.⁴²

Are lending rate ceilings binding?

91. **In a liberalized financial system, banks price their loans individually, factoring in several critical elements.** Considering a stylized model of bank credit pricing policies, lending rates for a particular bank are based on the cost of funds, operating expenses, and risk of the operation.⁴³ Interest rates applied to a particular operation also depend on the cross-subsidization policies that the bank may consider and, finally, on the specific competitive conditions of the market, which will determine the profit margin for the bank.

92. **Financial liberalization and competition are critical to the price discovery function of financial markets.** At any given point in time, in a competitive, liberalized financial market, the cost of funds relevant for all operations of the same maturity is identical and equal to the average cost of funds of the bank for that particular maturity.⁴⁴ Operating expenses, however, vary according to the nature of the operation and the customer. Also, the

⁴⁰ In addition to capital-linked risk concentration ratios, consumer lending is restricted to 10 percent of customer deposits; the principal amount of personal or installment loans available to Kuwaiti individuals has a ceiling of KD 70,000; consumer loans cannot exceed the lesser of KD 10,000 or 10 times the monthly salary of the borrower; and total repayment burden of individual borrowers cannot exceed 50 percent of the borrower's monthly salary. Total aggregate consumer and installment loans extended by a bank may not exceed a certain multiple of some funding sources (12 percent of total private sector deposits plus 30 percent of bonds issued and interbank loans received with a one-year maturity or longer).

⁴¹ The liquidity requirement varies according to the maturity of the bank's liabilities, with an aggregated minimum liquidity requirement, to be invested in Treasury bills and bonds, of 20 percent of private sector KD deposits.

⁴² Except for a slight decrease in 1998, related to a severe correction in stock prices, the return on equity and the return on assets of Kuwaiti banks has increased steadily since 1995 to reach 20.4 percent and 2.3 percent, respectively, by September 2004. However, it is not possible to ascertain whether banks' profits (if not profitability ratios) could have been even larger without these restrictions.

⁴³ The risk of a particular operation will depend on the customer and the type of operation, including its maturity, collateral, and other characteristics.

⁴⁴ Assuming that the rate differentials within the yield curve price maturity mismatch risk.

volume of operations may affect operating expenses when economy of scale is present. In addition to the maturity, type of operation and customer, the risk of the operation also varies according to a number of institutional factors including quality of financial statements, existence and quality of property registries, contract enforcement and foreclosure procedures. Finally, although cross-subsidization policies may be present for cultural or historical reasons,⁴⁵ they tend to be less relevant in liberalized financial systems where banks are forced to compete in every line of products.

93. Lending ceilings will be binding when the lending rates resulting from applying a bank's credit pricing policies are higher than the maximum rates allowed. When, as in the case of Kuwait, lending ceilings are differentiated by types of lending products, the ceilings will be binding if the bank rate for a particular type of product is higher than the ceiling.⁴⁶ Since this rate is determined also by factors other than the type of product and the cost of funds,⁴⁷ it may well happen that the ceilings may be binding for products and customers with higher operating costs and risk, while, at the same time, the pricing for operations and customers with lower operating costs and risk may not be affected.

94. Indirect indicators are needed to assess whether lending rate ceilings are binding for certain operations and customers, since it is impossible in practice to know the theoretical prices for each operation and customer of the banks. Interest rate spreads and the distribution of loans according to interest rate are the two indirect measures available in Kuwait. In addition, further information is obtained from the actual banking practices reported by senior bank officers and by recent regulatory changes.

⁴⁵ This is the case, for instance, in countries where interest rates were controlled for a long time. In many cases, the interest income implicit in the mandatory interest rate ceilings and floors ensured the average bank profitability without the need to charge fees for most of its lending and deposit-related services. Long after interest rates were liberalized, customers still are inclined to reject paying for certain bank services, a factor which often leads banks to cross-subsidize these services by increasing the price in associated products or services.

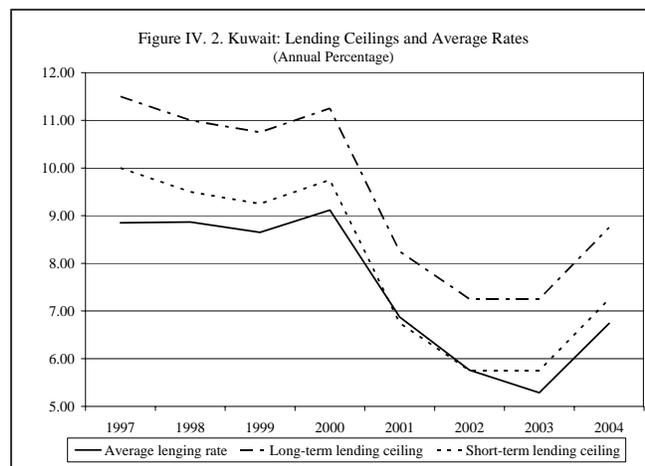
⁴⁶ This provides partial relief for the differences in operating costs and risk associated to different products, but it fails to ensure the flexibility to accommodate differences in the elements affecting pricing within each type of product.

⁴⁷ If Kuwait's financial market was efficient and liberalized, the cost of funds relevant for all operations of the same maturity would be identical, as discussed above. Since the confluence of the lending rate ceilings with the newly introduced ceiling on the net lending to the private sector to total deposits ratio has resulted in a segmentation of the market, this is no longer the case. For instance, since July 2004 the cost of funding for interbank loans is substantially lower than the cost for non-financial private sector loans. As a result, the ceiling may not be binding for interbank loans and still be binding for non-financial private sector operations.

Interest rate spreads

95. Available data suggests that lending rate ceilings have not been binding for the average corporate loan.

The average intermediation spread in the Kuwaiti banking sector fluctuates around 3 percent. The marginal cost of funds (the CBK discount rate) has been traditionally between 0.5 and 1.5 percentage points above the average deposit rate, which could be used as a proxy for the average cost of funds.⁴⁸ Since the maximum marginal intermediation spread is fixed between 2.5 and 4 percentage points, depending on the maturity of the operation (other than consumer credit), average lending rates have been traditionally below the lending rate ceilings (Figure IV.2). Thus, it is possible to conclude that, unless a disproportionate amount of operations had maturities of one year or less, the ceilings have not been binding for the average operation, maturity, amount and customer.



96. However, the ceilings seem to be binding for the SMEs. The ceilings are very close to the average rate effectively used by banks, with only 1.5 to 2 percentage points of spread in the best of the cases to deal with operations priced above the average. The average interest rates charged to the SME sector in some European markets ranges from 1 to 3 percentage points above the average lending rates of the banking sector.⁴⁹ This spread is substantially higher in less matured financial markets, where the institutional factors mentioned above would increase the risk of the operation. Thus, the average spread in the lending rate of small enterprises is of about 5 percentage points in Chile, 6.5 percentage points in El Salvador, and 16 percentage points in Peru.⁵⁰ Furthermore, SMEs start-ups are usually charged a

⁴⁸ However, the average deposit rate does not include the operating expenses linked to the deposit activity of the banks and, therefore, the difference between the average and the marginal cost of funds would be somewhat lower.

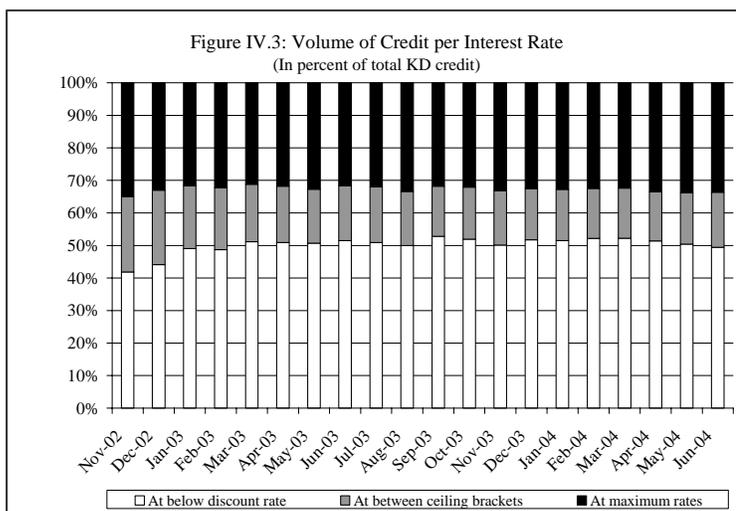
⁴⁹ There is little information on the interest rates effectively applied by size of the borrowing company. This estimate is based on the historical series of financial costs by size of company compiled by the Bank of Spain (2004), based on a sample of 8,000 Spanish companies. However, the under-representation of small (and micro) companies in the sample may result in underestimating the premium on SME financing, since, in principle, a correlation may be expected between size of the firm and risk premium.

⁵⁰ The data for Chile corresponds to the Superintendency of Banks and Financial Institutions of Chile in 2000, the data for El Salvador and Chile was estimated by Grupo DFC (2002), p. 32. The spreads are substantially higher for the very small companies (micro enterprises), ranging from 3 to 50 percentage points in a sample of 6 Asian countries (CGAP, 2004, p.4).

particularly high risk premium, since there is no previous information on which to base the assessment of the financial flows of the company and no track record of management quality, competitive position, and other key indicators.⁵¹ Therefore, it is likely that the lending ceilings in Kuwait are binding at least for those SMEs (and other customers and types of operations) with relatively high risk.⁵²

Interest rate distribution of loans

97. **The hypothesis that lending ceilings are binding for the SMEs is reinforced by the analysis of the limited data available on the distribution of total KD loans per clusters of interest rates.**⁵³ About one-third of total loans were granted at the maximum lending rate, at least for the period June 2002– July 2004. During the period December 2001– December 2004, an average of between 45 and 50 percent of total KD loans carried interest rates below the short-term lending ceiling (Figure IV.3).



This could be interpreted as a rough indicator that lending rate ceilings have been binding for about 30 to 50 percent of total loans. Including consumer loans (all of them granted at the maximum ceiling equal to the discount rate),⁵⁴ these percentages increase to about 40 to 60 percent of total loans. Bank

⁵¹ This is reflected in the wide range of lending rates applied to SME. These ranged between 14 and 21 percent in El Salvador, and 24 to 30 percent in Peru, According to Grupo DFC (2002), pp. 51 and 65.

⁵² This could be interpreted as a prudential strength, since higher risk customers and operations are thus excluded from the formal market. However, dealing with high risk customers is possible with adequate risk assessment and management systems, together with flexible pricing policies, as demonstrated by hundreds of banks around the world. Furthermore, precluding some of these high risk customers from receiving bank finance, such as SME start-ups, may have a negative impact on the development of the private sector.

⁵³ Data on the percentage of loans granted at the maximum lending rates in each one of the five lending ceilings' categories, and the average lending rate per category, might have offered further insight.

⁵⁴ Since all consumer loans are granted at the maximum lending rate, there is little doubt that the ceiling is binding for this type of product. Furthermore, since CBK's discount rate is effectively the marginal cost of funds for Kuwaiti banks, in the margin, the ceiling on consumer loans (which is set equal to the discount rate) will not allow banks to cover operating costs and risks associated with consumer lending on the margin. In practice, consumer lending may be profitable for some banks because of the large amount of low-cost deposits (as of end-December 2004, 22 percent of total deposits were unremunerated, and 25 percent had interest rates below 2 percent) and the special collateral regulations that allow banks to deduct payment for consumer loans

(continued)

practitioners report that the rate applied for personal loans⁵⁵ cluster at about the maximum lending rates. Since about 40 percent of the total amount of KD loans correspond to personal loans, it is possible to conclude that about 20 percent of total credit (representing about one-third of total credit to the corporate sector) is granted to enterprises at the maximum lending rate.

Bank practices and regulatory changes

98. **SMEs have limited access to commercial banks in Kuwait.** Several commercial bank officers reported to the 2004 Article IV mission that their institutions did not engage in simple (“plain-vanilla”) credit relationships with SMEs, and rarely maintain simple credit relationships with large enterprises. Only those companies which demanded a comprehensive set of financial products and services from the banks, allowing the possibility to cross-subsidize loans with income from services, off-balance sheet products, and off-shore financing, were considered as profitable customers, thus excluding most SMEs.

99. **The findings of a survey of 483 SMEs conducted in 2000 by Kuwait University and the World Bank provide further evidence of SME difficulties in accessing to commercial banks credit.** “Kuwaiti banks are not prepared to extend term loans to SMEs in significant volumes. This seems to be due to interest rate caps that prevent banks from pricing loans to cover actual risk and to a prevailing culture of lending mainly for trade and for personal consumption” (Webster, 2002, p.4).

100. **The introduction of the 80 percent ceiling on the net credit to the nongovernmental sector to total deposits has increased the chances that lending rate ceilings are binding for a larger number of operations.** This is due to the market segmentation caused by this measure.⁵⁶ Due to the increased competition for large, long-term deposits, the marginal deposit rate has been pushed well above the CBK’s discount rate.⁵⁷

directly from the borrower’s payroll. This may explain why consumer loans represented about 7.5 percent of total nongovernment credit as of end-September 2004, despite the quantitative ceilings imposed on this type of product.

⁵⁵ These include consumer loans, installment loans, loans for the purchase of securities, and other personal loans.

⁵⁶ The segmentation in the Kuwaiti financial market appears because the ceiling in the credit to loan ratio has made non-fungible the alternative funding sources for banks. Thus, a bank may be very liquid but, if its ratio of net loans to total deposits is close or above the ceiling, it may have to compete by raising customer deposit interest rates to maintain or by expanding its credit to the private sector. At the same time, since other profitable alternatives for placing its excess liquidity in KD are very limited, the banks are willing to lend it to other banks in the interbank market at very low rates. Therefore, the interbank and customer deposit rates become disconnected, leading to market segmentation.

⁵⁷ From June to October, 2004, weighted average interest rates for 1-year term deposits of over KD 1 million increased by 1.4 percentage points, to 4.72 percent. Marginal rates for 6-month and 1-year term deposits of over KD 1 million in October 2004 were of 5.04 percent and 5.13 percent, respectively.

Therefore, the marginal cost of funds qualifying to be onlent to the private sector, is no longer the CBK's rediscount rate, but the marginal deposit rate. Since, according to the latest data available, the marginal deposit rate was over 0.75 percentage point of the discount rate for some banks, the effective maximum marginal intermediation spread for Kuwaiti banks could have been reduced from zero to about -0.75 percent for consumer loans, at the bottom of the range, and from 4 to 3.25 percent for loans over one year, at the top of the ceiling range. The authorities are considering exempting some large investment operations considered strategic for the country from the ceiling on the ratio of net loans to total deposits, but this will likely not affect financing to SMEs. As a result, the probability has increased that market-determined pricing for corporate customers (and particularly for SMEs) would result in interest rates above the lending rate ceilings.

101. **However, since the authorities consider the ceiling on the ratio of net loans to total deposits as temporary**, and intend to remove it once domestic credit expansion is in line with the expansion of the domestic deposit base, its effect on the relevance of lending rate ceilings is only transitory. Furthermore, the rapid increase of the CBK's discount rate since the introduction of the ceiling on the ratio of net loans to total deposits will also alleviate the problem by containing demand for credit at the higher interest rates.

Alternative sources of financing for SMEs

102. **Despite the likely binding effect of the lending rate ceilings on SME financing by Kuwaiti commercial banks, there is little evidence of shortage of funding for Kuwaiti's SMEs.** Furthermore, access to finance and to venture capital for most SMEs appear to be easier in Kuwait than in many industrial and developing countries. This is due mainly to the existence of two alternative sources of finance for SMEs: government-subsidized lines of credit and capital, and Islamic financial products.

Subsidized credit and capital for SMEs

103. **Most subsidized credit and capital for SMEs are channeled through the Industrial Bank of Kuwait (IBK).**⁵⁸ The IBK obtains long-term finance from the government⁵⁹ at a negotiated rate and uses it to provide credit to medium and small companies (total investment valued ranging typically between KD 1 million and KD 7 million) at a fixed rate below the CBK rediscount rate.⁶⁰ Loans could have a grace period of up to two years, and a maturity of up to six years thereafter. IBK may finance up to 50 or 65 percent of the total cost of the investment, depending on whether the project cost is

⁵⁸ The IBK was established in 1973 as a joint venture between several government agencies and the private sector, with majority control by the former.

⁵⁹ A revolving facility for KD 200 million has been extended to IBK through KIA. Funds are remunerated at KIBOR if on lent to final borrowers, and a 0.5 percent fee is applied to disbursed funds not yet on lent.

⁶⁰ Rates were reduced to 3.5 percent in November, 2003.

up to KD 1 million or above. Financial conditions could be further improved if the project so deserves. Funding is available for start-ups, expansion of capacity, and a broad range of needs including financial restructuring. Collateral includes first mortgages on the project's material and intangible assets. Other collateral may be required, depending on the case. As of end-2003, cumulative lending granted by IBK under its main industrial loans program reached KD 544.3 million, while the average loan amount was KD 0.8 million corresponding, on average, to 50.6 percent of the total investment.

104. **There seems to be no rationing of IBK subsidized funds for SMEs.** As of October 2004, the government revolving line was disbursed up to about 70 percent; that is, total outstanding credit to SMEs was about KD 140 million. According to IBK officers, they do not foresee major problems to obtain the necessary approval for additional funding in the event the SME demand for funds exceeds the current amount of the government line of credit.

105. **In addition to the industrial loans program, IBK has two additional programs available for small enterprises and professionals.** The program for small enterprises (handicraft and small enterprise financing portfolio) was established in 2000, and provides finance through Islamic instruments. Loans are substantially smaller than in the industrial loans program (average of KD 70,000 per operation), but represent a larger amount of the total investment by small enterprises (68.1 percent on average). The professionals program (portfolio for financing the professional activity and small projects) started in 1999. The IBK administers an endowment of KD 50 million, for 20 years, provided by the Industrial Investment Public Authority, to be invested in accordance with Islamic Sharia provisions. The program provides short-, medium-, and long-term financing for an amount ranging between 65 and 80 percent of the total investment (of no more than KD 500,000), under very favorable financial conditions (rate of return of 2.5 percent, and up to a 3-year grace period). Finally, IBK also contributes to the development of Agricultural SMEs with a specific loan program, and provides limited capital to industrial SMEs through its direct investments and promotion department.

106. **In addition to the IBK, the Kuwait Small Projects Development Company (KSPDC), established in 1997, has an endowment of KD 100 million from the Kuwait Investment Authority (KIA) to help in the development of SMEs in Kuwait.**⁶¹ KSPDC provides technical, legal and financial support to SMEs. KSPDC finances up to 100 percent of the establishment fees for SMEs start-ups, including due diligence, legal documents, and employment needs, plus up to 50 percent of the capital needed for the projects. KSPDC funds are in the form of venture capital and, therefore, no collateral is required.⁶² However,

⁶¹ Qualifying SMEs could operate in any economic sector but real estate, financial brokerage, agriculture and agro-industry, and public transportation. Also, the size of the investment could not be more than KD 500,000 and not less than KD 50,000.

⁶² Alternatively, KSPDC may participate in projects with third-party financing. In this case, it could finance up to one third of the total investment and collateral is required.

restrictions on management are imposed by contract, as well as a 5-year schedule for the repurchase of KSPDC shares at pre-agreed prices. In part, because KSPDC finance is relatively expensive (up to 74 percent accumulated financial cost over a 5-year period), it is considered to be the “last resource” for the SMEs unable to obtain financing through IBK or other channels. Up to end-2003, KSPDC had provided some KD 24 million in venture capital to 42 SMEs. An additional endowment of KD 100 million has been planned in the Kuwait National Technologies equity fund.

107. Access to finance by SMEs seems to be guaranteed within certain limitations.

The major limitations of the subsidized finance channels to SMEs appear to be that financing: (i) is directed to certain economic sectors and types of projects, (ii) is restricted to Kuwaiti nationals; and (iii) must be provided to activities that are the full-time activity of the owner and/or CEO of the SMEs, thus making it incompatible with employment by the public sector. Other than these restrictions, there appear to be no major limitations for the SMEs to access subsidized financing in Kuwait.

108. Although Kuwait’s subsidized credit framework seems to overcome some of the traditional problems associated with credit ceilings, it has some drawbacks. Available information seems to confirm that traditional problems of subsidized interest rate lending schemes such as rationing are not present in Kuwait. However, ample availability of subsidized funds may be aggravating the problem of inefficient allocation of resources which also traditionally affects such schemes. The scheme also entails fiscal cost, although its magnitude does not seem to be significant.⁶³

Islamic financing for SMEs

109. The Kuwait Finance House (KFH) provides a wide range of Islamic financial products for SMEs. KFH, established in 1977 and 49 percent state-owned, is the largest Islamic financial institution in Kuwait, and the second largest bank in the country with KD 2.3 billion deposits by end-2003, about 20 percent of total deposits. It provides a wide range of Islamic finance products for enterprises, including discount of effects, deferred sales, leasing, factoring, and venture capital. The KFH has a large base of over 500 SME customers, and has developed specific products for them, including cooperatives’ financing. Since KFH rates of return are not subject to lending rate ceilings, KFH is able to price products according to their risk and cost, reaching borrowers which are otherwise subject to the rationing imposed on commercial banks. KFH finance is particularly attractive to enterprises, vis-à-vis subsidized public finance, due to the larger percentage of financing provided in relation to the total investment needed (up to 100 percent).

⁶³ A rough estimate of the fiscal cost of the main IBK line during 2004 would reach some KD 3.5 million (about 0.02 percent of GDP), although it does not include the cost of write-offs (which is traditionally large in this type of programs) as there is no available information.

110. **In addition to KFH, a number of nonbank Islamic financial institutions and investment funds provide financial services for SMEs**, some of them concentrating in the smaller companies. Also, a second Islamic bank (Bubyan Bank) was licensed in October, 2004, adding to the abundant supply of Islamic financial services for SMEs in Kuwait.

111. **The drawback of Islamic financing to SMEs is an unlevelled playing field with traditional commercial banks.** Since yield of financial products for SMEs in Islamic institutions is not subject to the interest rate ceilings affecting commercial banks, there is a regulation-induced competitive disadvantage for the latter which may further affect the problem of inefficient allocation of financial resources mentioned in the previous subsections.

Obstacles to the development of SMEs in Kuwait

112. **As discussed, lending rate ceilings affecting finance from commercial banks do not seem to be a major obstacle for Kuwaiti SMEs' access to financing in sufficient quantity from government-subsidized sources and Islamic financial institutions.** Therefore, the reason for the unsatisfactory development of the private sector and, in particular, the SMEs in Kuwait, lies mainly in nonfinancial obstacles.

113. **A survey by the Kuwait University and the World Bank identified the dominant role of the public sector as the main obstacle to SME development.** As reported by Webster (2002), the main problems in the business environment explaining the difficulties found for SME development are: (i) government subsidies on selected products and services exclude the possibility for private sector competition in their production; (ii) an inordinate amount of business opportunities depend on government contracts; (iii) high salaries, better working conditions and social status, and full employment policy in the public sector discourage Kuwaiti nationals to undertake SME operations (iv) due mainly to the higher labor cost, Kuwaiti production costs are not competitive with largely liberalized imports; and (v) over-regulation further raises the cost of doing business.

E. Conclusions and Policy Recommendations

114. **Kuwait has followed a gradual approach to the liberalization of the financial system in the 1990s.** As assessed by the IMF and World bank (IMF, 2004), the CBK has established a comprehensive system for banking regulation and supervision that conforms in most respects to international standards. The strong regulatory and supervisory framework has contributed to maintaining financial stability during the liberalization of the system, unlike some developing countries in Asia and Latin America. Furthermore, careful oversight has succeeded in preventing further financial crisis after the Suq al-manakh stock market crisis of 1982.

115. **While monetary and supervisory policies have been effective in achieving their objectives, their efficiency could be enhanced by the gradual removal of the few still-existing administrative instruments.** Specifically, lending rate ceilings are likely to have a

negative effect on financial development and the efficient allocation of financial resources. In this particular aspect, Kuwait seems to be lagging behind since most countries within the GCC and the MENA regions have already completed the liberalization of their interest rates. Despite the fact that Kuwait's lending rate ceilings do not seem to be affecting the average borrower of commercial banks, they seem to be binding on personal loans and on a significant share of corporate customers, particularly on the SME sector.

116. The obstacles on commercial bank financing to SMEs introduced by the lending rate ceilings are deemed to be largely offset by the existence of abundant financing at subsidized rates provided through several public-sector sponsored channels, and by the active involvement of Islamic financial institutions in the financing of SMEs. Non-financial obstacles seem to be more relevant in explaining the sluggish growth of SMEs in Kuwait. This notwithstanding, the removal of the remaining ceilings may have a positive effect on the development of SMEs and provide additional flexibility to the product development and pricing practices of banks. Also, it will enhance the efficiency of the allocation of financial resources and contribute to the price discovery function of the market. If the authorities were to discontinue or substantially reduce their financial support to the SMEs, removal of the lending rate ceilings should be considered so as to not to impact negatively the availability of credit for the sector.

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V. KUWAIT AND OTHER GCC STOCK MARKETS: RECENT DEVELOPMENTS AND SOME EFFICIENCY ISSUES⁶⁴

A. Introduction

117. **The stock markets in Kuwait and the other GCC⁶⁵ countries have witnessed large increases in stock price indices, market capitalizations, and trading volumes in recent years.** New stocks have been continually listed on the Kuwait Stock Exchange (KSE) and the number of listed companies has risen from 86 at end-2000 to 125 by end-2004. Foreigners have been allowed to invest on the KSE-listed firms since 2000. As the GCC stock markets are becoming larger, they are witnessing larger capital inflows from investors seeking higher returns and a diversified global portfolio.

118. **Given the importance of increasing non-oil private sector growth in the GCC countries, it is important that stock markets are well developed, efficient, and properly regulated for efficient mobilization and allocation of resources.** A vibrant and efficient stock market would help in channeling saving to domestic investment, price discovery, privatization efforts, and providing opportunities to investing in the region.

119. **In this paper we study the recent developments and the existence of calendar anomalies on the GCC stock markets.** The stock market returns correlations among the GCC countries and the U.S. equity market (S&P 500 index) are also examined. Section B analyzes and presents data on stock market returns, market capitalization, and turnover in the GCC countries in recent years. The statistical properties of the stock market index returns in the GCC countries are examined and reported in Section C. Section D investigates the existence of calendar anomalies such as the day of the week effect and the month effect on the GCC stock markets to ascertain whether the markets are weak form efficient. This form of efficient markets implies that knowledge of the past price trends of stocks cannot be used to generate extraordinarily high returns. The existence of calendar anomalies would contradict the weak form efficient market hypothesis since predictable returns based on historical prices would provide opportunities for investors to generate abnormal returns. The conclusions of the paper are presented in Section E.

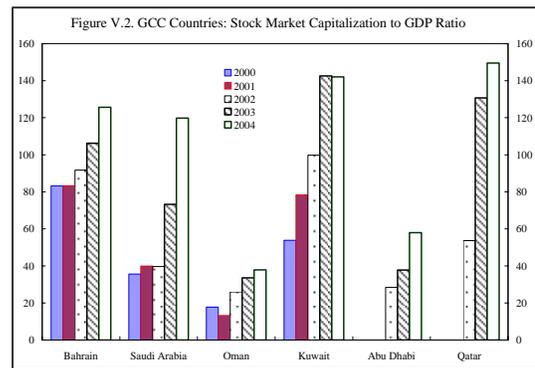
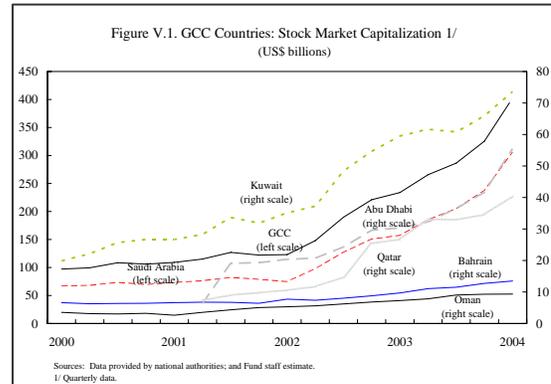
⁶⁴ Prepared by Rajan Govil.

⁶⁵ The GCC member countries are: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (U.A.E).

B. Stock Market Developments in the GCC Countries

120. **Stock market capitalization in the GCC countries has almost quadrupled** from a total of \$129 billion at the end of March 2002 to \$499 billion at the end of December 2004.⁶⁶ This is a remarkable pace of growth. Consequently, stock market capitalization to GDP ratio has increased significantly over this period in all the GCC countries. This growth has been supported by sharply higher international oil prices (all GCC countries are oil exporters), improved corporate profitability, lower interest rates and comfortable liquidity in these economies as well as the relative reluctance of the GCC nationals to invest in overseas markets after the September 11 incident. The Average Oil Spot Price Index (APSPI)⁶⁷ has more than doubled since 1995, and in fact, has almost quadrupled since its low reached in late 1998. This improvement in terms of trade has led to a sharp increase in nominal GDP in the GCC countries and has further spurred real economic activity in the oil and non-oil sectors. Because the GCC currencies are pegged to the U.S. dollar, interest rates have declined and remained low in recent years in line with U.S. interest rate developments.

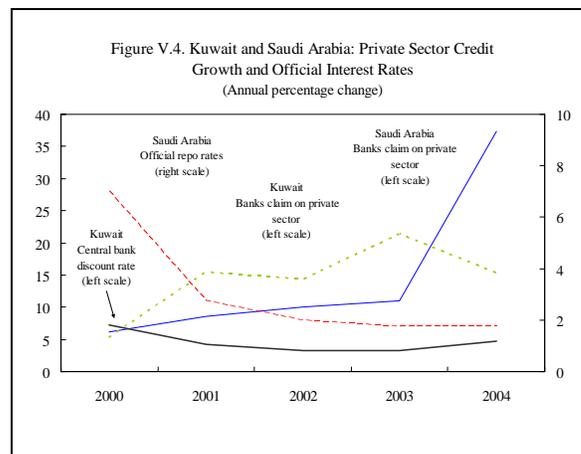
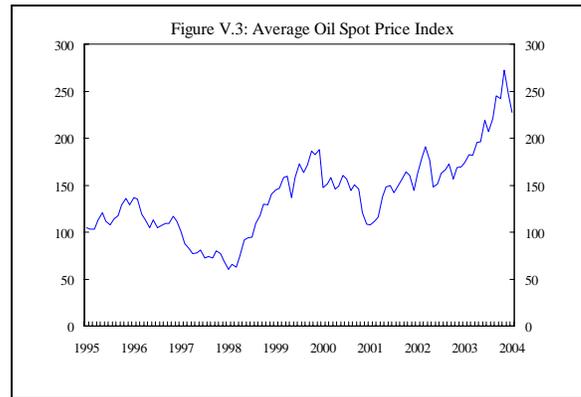
Meanwhile, credit to the private sector has shown a sharp rise in recent years, particularly in Saudi Arabia and Kuwait that boast the largest stock markets in the region in recent years. Further, Kuwait has also benefited from the change in the regime in neighboring Iraq that has reduced uncertainty of doing business in Kuwait, renewed trade relations with Iraq as well as generated a ‘feel-good factor’ in the domestic economy.



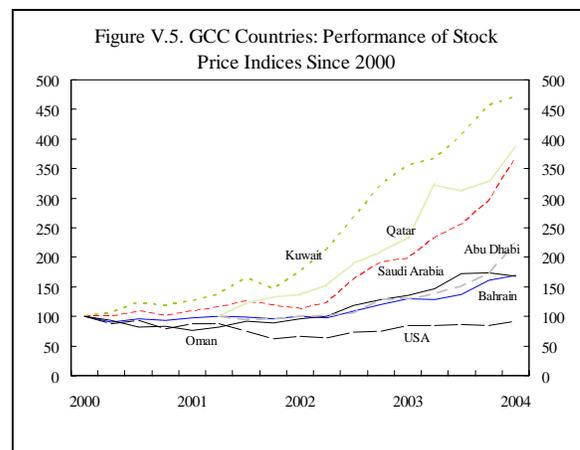
⁶⁶ In this study, data on the following local stock markets were used: Bahrain Stock Exchange, Kuwait Stock Exchange, Muscat Securities Market for Oman, Doha Securities Market for Qatar, Saudi Stock Market, and Abu Dhabi Securities Market for the U.A.E. In addition, data on the S&P 500 index are used as a proxy for stock market developments in the United States Data for the study were obtained from Bloomberg, AMDB Bulletins of the Arab Monetary Fund, and the Muscat Securities Market.

⁶⁷ This is an average of U.K. Brent, Dubai and West Texas Intermediate crude oil spot prices.

121. **The sharp rise in market capitalization in the GCC countries in the new millennium reflects the growth in the stock market price indices.** Except Kuwait, in all other GCC countries the increase in the stock price index is less than the increase in the market capitalization. In the case of Kuwait, while the Kuwait Stock Exchange (KSE) index increased by about 371 percent from end-2000 to end-2004, the market capitalization grew by 270 percent despite the increase in listed companies from 86 to 110 over the same period. The current KSE index is therefore showing larger gains in the value of the market than has been the actual increase in the value of the stocks. This is probably related to the fact that the KSE index is a price index and not a value-weighted index. In a price index, equal weight is given to the change in price of an individual stock of a firm included in the index irrespective of the firm's market capitalization. The KSE may wish to consider constructing and publishing a more representative value-weighted stock market price index that would better reflect the gains on a buy and hold portfolio strategy for an investor.

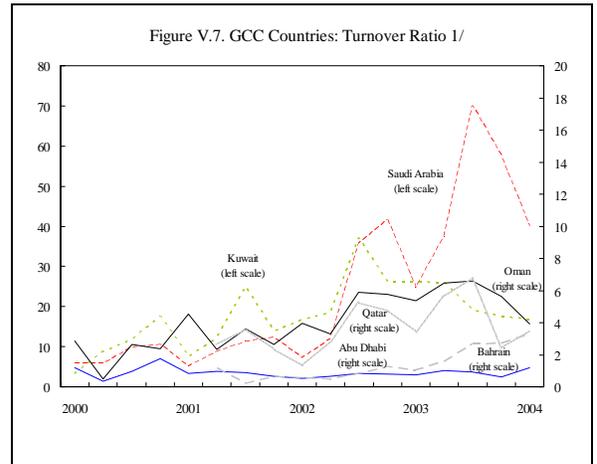
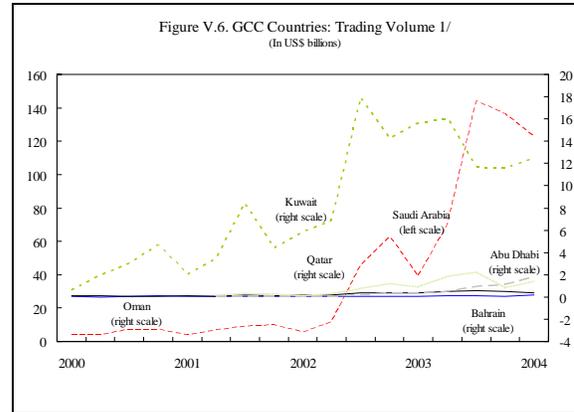


122. **The trading volumes in the GCC markets have also seen a surge since end-2000 with the turnover ratio (the ratio of value of stocks traded to market capitalization) rising significantly in all GCC stock markets during this period.** The increase in turnover ratio in the GCC markets (particularly noticeable in the larger markets in Saudi Arabia and Kuwait) is a very welcome development since it is indicative of the increasing liquidity and rising investor interest in these markets. The increased stock market liquidity is important for the markets to channel savings for the development and growth of the non-oil private sector as well as for price discovery.



C. Descriptive Statistics of Stock Returns in the GCC Markets and their Correlation with the U.S. Market

123. The GCC daily and monthly stock market returns have a positive mean reflecting the increase in the stock prices during 1996–2004 while the variability of these returns, measured by the coefficient of variation, are relatively lower in the larger markets of Kuwait and Saudi Arabia (Tables V.1 and V.2).^{68, 69} Mean daily and monthly returns on the Kuwait and Saudi Arabia markets were much higher than those experienced on the stock markets in Oman and Bahrain over the 1996–2004 period. For the period, 2002–04, the mean stock market returns were very high in Qatar and the U.A.E., and their variability was also lower. Mean monthly returns on the stock markets in the other GCC countries during this sub-period (2002–04) were positive and much higher than over the entire 1996–2004 period, with the larger markets in Kuwait and Saudi Arabia experiencing mean monthly returns of 3.6 percent and 3.8 percent, respectively.



⁶⁸ The monthly return for stock market price index i in month t , R_{it} , was calculated as follows:

$$R_{it} = \frac{P_{it} - P_{i, t-1}}{P_{i, t-1}}$$

where P_{it} is the stock market price index in month t and $P_{i,t-1}$ is the stock market price index in month $t-1$. Daily stock returns were computed in a similar manner for each day. However, daily returns were excluded from the analysis on the days on which the relevant stock market was closed.

⁶⁹ Daily stock price index data were available on Bloomberg from 1996 to 2004 for only four countries—Bahrain, Kuwait, Oman, and Saudi Arabia. Monthly returns for the U.A.E. and Qatar are available from 2002 to 2004 only.

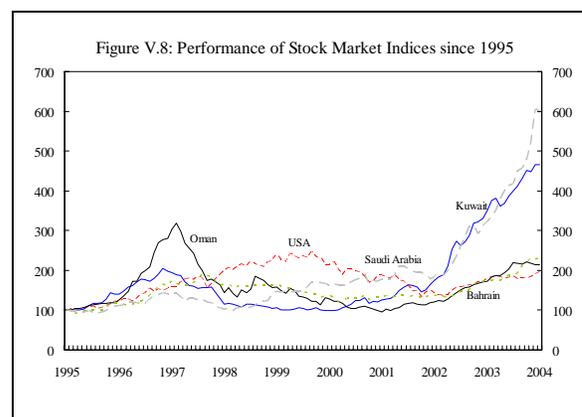
Table V.1: Selected GCC Stock Markets:¹
Descriptive Statistics of Daily Returns on Stock Market Indices
(1996–2004)

	Bahrain	Kuwait	Oman	Saudi Arabia
Number of observations	2080	2179	2209	1785
Mean	0.0416	0.0741	0.0395	0.1062
Standard Deviation	0.5512	0.8320	1.0235	1.0905
Coefficient of variation	13.2435	11.2321	25.8997	10.2639
Minimum	-4.4783	-5.3907	-12.6810	-8.2821
Maximum	3.4850	4.1546	16.4422	9.1980

1/ Daily returns are measured in percent.

124. The stock markets in the GCC countries provide immense opportunities for global investors to benefit from the low correlation with the U.S. stock market.

When the U.S. stock markets performed well from end-1995 to 2000, the stock market performance in GCC countries was relatively lackluster. Later on, when the U.S. stock market (as measured by the S&P 500 index) stagnated in the new millennium, the stock markets in the GCC countries witnessed extremely high returns. This view is further



corroborated by looking at the correlations of monthly stock returns on the indices for some of the GCC markets (for which data are available from end-June 1995) and the S&P 500 index. While the GCC markets have a strong positive correlation among themselves the correlation with the S&P 500 index is low for most GCC countries. With a market capitalization of close to \$500 billion, GCC markets provide an opportunity to investors for benefiting through portfolio diversification.

Table V.2. GCC Stock Markets: Descriptive Statistics of Monthly Returns on Stock Market Indices, (1996–2004)^{1, 2}

	Kuwait	Oman	Bahrain	Saudi Arabia	U.A.E.	Qatar
Number of observations	108	108	108	108	36	36
Mean	1.55	0.88	0.85	1.78	2.59	3.99
Standard Deviation	4.96	6.11	3.85	4.78	4.66	6.20
Coefficient of variation	3.19	6.90	4.54	2.68	1.80	1.56
Minimum	-10.94	-12.59	-8.77	-12.53	-5.40	-8.30
Maximum	20.25	20.27	13.29	15.35	16.51	16.34

1/ Monthly returns are measured in percent.

2/ Data for U.A.E. and Qatar are from 2002–04.

Table V.3: Correlation of Monthly Stock Market Returns among GCC Countries and the U.S. Stock Market Indices, (1996–2004)

	Bahrain	Kuwait	Oman	Saudi Arabia	U.S.
Bahrain	1.00				
Kuwait	0.39	1.00			
Oman	0.28	0.34	1.00		
Saudi Arabia	0.31	0.33	0.22	1.00	
U.S.	0.18	0.04	0.02	0.07	1.00

D. Calendar Anomalies⁷⁰

125. **Many seasonals or anomalies have been reported in the literature for the U.S. and other stock markets.** Cross (1973) and French (1980), using U.S. data, found that returns on Mondays were, on average, lower than returns on other days of the week. Jaffe and Westerfield (1985) found a day of the week effect on several foreign stock markets.

⁷⁰ Data used are for the stock markets in Bahrain, Kuwait, Oman, and Saudi Arabia from end-1995 to end-2004. Data for Qatar and U.A.E. were not available for this period.

Condoyianni *et al.* (1988) found that returns were negative on Mondays as well as Tuesdays for Australia, Japan, and Singapore. The Tuesday effect was stronger in these markets. This may have been because these markets tended to be strongly correlated with the U.S. market of the previous day. When the U.S. market opened, these markets were already closed for the day.

126. **Keim (1983) found that stock returns, especially returns on small stocks, were on average higher in January than in other months in the U.S. market.** This anomaly of higher returns in January is known as the January effect. Gultekin and Gultekin (1983) also found the evidence of the January effect in other major international stock markets. The hypothesis of tax-loss based selling is often advocated to explain the January effect.

127. **We find evidence of the day of the week effect in the stock market returns for Kuwait, Oman, Bahrain, and Saudi Arabia (Table V.4).** In Kuwait, the stock returns are positive and statistically significant on Mondays, Tuesdays and Saturdays. In Oman, the returns are positive and statistically significant on Saturdays during the period January 1996 to June 2000, when the stock market was closed on Thursdays and Fridays. For the period July 2000 to December 2004, when the stock markets were closed on Fridays and Saturdays, the returns are positive and statistically significant on Thursdays. In Bahrain, the daily returns are found to be positive and statistically significant on Wednesdays and Thursdays. In Saudi Arabia, stock returns are statistically significant and positive on Wednesday, Thursdays and Saturdays. The following regression was estimated to test for the day of the week effect:

$$R_{it} = \gamma_1 d_{1t} + \gamma_2 d_{2t} + \dots + \gamma_6 d_{6t} + \varepsilon_t,$$

where R_{it} is the return on index i , and d 's represent dummy variables for each day of the week. In the event of the stock market being closed on a particular day (except over the weekend) in the period under consideration, the observation for the subsequent day is dropped from the sample.

128. **We find evidence of the month of the year effect in the stock market returns for Kuwait, Bahrain and Saudi Arabia (Table V.5).** In Kuwait, the stock returns are strongly positive and statistically significant in the months of April and May. The Oman stock market does not show any statistically significant abnormal returns in any particular month. In Bahrain, the monthly returns are found to be statistically significant and positive in the month of August and negative in the month of February. In Saudi Arabia, stock returns are statistically significant and positive in the months of April, July, and August. The following regression was estimated to test for the month of the year effect:

$$R_{it} = \gamma_1 d_{1t} + \gamma_2 d_{2t} + \dots + \gamma_{12} d_{12t} + \varepsilon_t,$$

where R_{it} is the return on the index i , and d 's represent dummy variables for each month of the year.

Table V.4: Selected GCC Countries:
Regression Results for Day of the Week Effect 1/

	Observations	Mon.	Tue.	Wed.	Thurs.	Sat.	Sun.
Kuwait	2137	0.08* (1.98)	0.10* (2.42)	0.05 (1.20)		0.19* (4.90)	-0.08 (-1.92)
Oman 2/	1083	-0.07 (-0.73)	0.10 (1.12)	0.13 (1.39)		0.18* (2.02)	-0.17 (-1.82)
Oman 3/	1079	-0.02 (-0.43)	0.00 (0.07)	0.06 (1.60)	0.09* (2.39)		0.04 (1.18)
Bahrain	2010	0.03 (1.10)	0.04 (1.35)	0.07* (2.60)	0.06* (2.18)		0.00 (-0.14)
Saudi Arabia	1736	0.08 (1.44)	0.06 (1.07)	0.11* (2.20)	0.15* (2.90)	0.27* (2.11)	0.22 (1.76)

1/ t-Statistics are in parenthesis.

2/ Data used are from January 1996 to June 2000 when the Muscat Securities Market (MSM) was closed on Thursdays and Fridays.

3/ Data used are for July 2000 to December 2004 when the MSM was closed on Fridays and Saturdays.

* Coefficients marked with an asterisk are statistically significant at the 5 percent level.

129. **The presence of calendar anomalies on the GCC stock markets is indicative that these markets may not be weak form efficient.** Further information and analysis is required to ascertain the reasons for the presence of these calendar anomalies. The study did not investigate the presence of a ‘Ramadan effect’ in these markets, since Ramadan does not coincide with any of the calendar months every year. The calendar effect in these countries is also unlikely to be explained by tax calendar issues (like the ‘January effect’ in industrial countries) since there is no personal income tax in the GCC countries.

E. Conclusions

130. **The stock markets in GCC countries performed extremely well in the new millennium and the low correlation with the U.S. stock market offered global investors an opportunity to diversify their portfolio and reduce risks.** The market capitalization and liquidity have risen sharply as also the interest of investors as indicated by the rising turnover ratio. The KSE may wish to consider constructing and publishing a more representative value-weighted stock market price index that would better reflect the gains on a buy and hold portfolio strategy for an investor.

131. **The authorities need to continue to provide the necessary environment to develop the stock markets.** Such support would help channel savings for the development of the non-oil private sector to create much needed growth and job opportunities. Efficient stock markets will also serve as institutions for price discovery to enable privatization of state enterprises at appropriate prices.

Table V.5: Selected GCC Countries:
Regression Results for Month of the Year Effect 1/

	Kuwait	Oman	Bahrain	Saudi Arabia
Observations	108	108	108	108
January	1.54 (0.93)	3.02 (1.44)	-1.23 (-1.02)	1.29 (0.80)
February	1.78 (1.07)	-0.94 (-0.45)	-3.77* (-3.12)	-0.56 (-0.35)
March	0.67 (0.41)	1.48 (0.70)	0.74 (0.61)	2.04 (1.27)
April	3.92* (2.36)	1.43 (0.68)	2.27 (1.88)	3.20* (1.99)
May	4.99* (3.00)	1.11 (0.53)	1.07 (0.89)	1.78 (1.11)
June	0.91 (0.55)	1.73 (0.82)	1.42 (1.18)	1.32 (0.82)
July	0.08 (0.05)	2.60 (1.24)	2.31 (1.91)	3.54* (2.20)
August	2.47 (1.48)	-0.39 (-0.18)	2.62* (2.17)	4.05* (2.52)
September	1.09 (0.66)	1.20 (0.57)	0.70 (0.58)	-0.19 (-0.12)
October	1.37 (0.83)	-1.62 (-0.77)	2.22 (1.84)	0.42 (0.26)
November	-0.69 (-0.41)	0.94 (0.45)	0.24 (0.20)	3.01 (1.87)
December	0.52 (0.31)	0.07 (0.03)	1.57 (1.30)	1.50 (0.93)

1/ t-Statistics are in parenthesis.

2/ Data used are from 1996–2004.

.... * Coefficients marked with an asterisk are statistically significant at the 5 percent level.

132. **This study finds the presence of calendar anomalies on most GCC country stock markets that contravene the hypothesis of weak form efficiency.** Further studies with more detailed data are needed to further explore the efficiency of the GCC stock markets as well as to explain the calendar anomalies found in this study. In this regard, the stock exchanges need to provide more detailed information to investors at minimal costs, including historical information. It is important that regulators ensure that the stock markets are efficient and if any inefficiency is reported, they should investigate the factors contributing to it. Greater awareness of the efficiency and regulation would enhance investor interest and further the development of these markets.

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Kuwait: Basic Data
(Quota: SDR 1,381.10 million)

I. Social and Demographic Indicators, 2003

Area (sq. km.)	17,820
Population	
Total (in millions): <i>Of which</i>	2.55
Kuwaiti nationals (in millions)	0.93
Annual rate of growth (in percent)	5.24
Density (estimated numbers of inhabitants per sq. km.)	142.91
GDP per capita (US\$)	16,394
Population characteristics	
Life expectancy at birth (in years)	
Overall	76.90
Female	79.00
Infant mortality (per thousand live births)	9.00
Child death rate, under 5 years (per thousand live births)	10.00
Education	
Literacy rate (percent of population aged 15 and over)	82.93
Male (percent of population aged 15 and over)	84.65
Female (percent of population aged 15 and over)	80.97

II. Selected Economic Indicators, 1999–2004

	1999	2000	2001	2002	2003	<u>Est.</u> 2004
Oil and gas sector						
Total oil and gas exports (in billions of U.S. dollars)	11.0	18.2	15.0	14.1	19.0	26.0
Average oil export price (in U.S. dollar/barrel)	16.1	25.0	21.2	22.9	25.5	31.8
Crude oil production (in millions of barrels/day)	1.87	1.98	1.95	1.75	2.11	2.30
Share of oil GDP in total GDP (in percent)	44.0	53.4	47.5	45.2	51.2	55.7
	(Annual percentage change, unless otherwise indicated)					
National accounts and prices						
Nominal GDP (market prices, in billions of Kuwaiti dinar)	9.2	11.3	10.4	10.7	12.4	15.3
Nominal GDP (market prices, in billions of U.S. dollars)	30.1	36.9	34.1	35.2	41.7	51.8
Real GDP	-1.8	1.9	0.7	-0.5	9.7	7.2
Real oil GDP	-6.5	2.2	-3.3	-7.9	19.8	9.5
Real non-oil GDP	2.1	1.9	3.6	4.3	4.8	5.5

II. Selected Economic Indicators, 1999–2004

	1999	2000	2001	2002	2003	Est. 2004
(Annual percentage change, unless otherwise indicated)						
Real Gross Disposable Income (GDI)	14.1	19.4	-4.5	2.1	11.8	14.1
CPI inflation (average)	3.1	1.6	1.4	0.8	1.0	1.8
Unemployment rate (Kuwaiti nationals)	0.0	1.0	2.5	3.6	3.4	...
(In percent of GDP at market prices)						
Investment and savings						
Investment	14.6	7.7	8.7	9.2	8.7	11.2
Public	3.9	1.8	2.2	3.0	2.8	4.5
Private	10.7	5.9	6.6	6.2	5.8	6.7
Gross national savings	31.4	47.1	33.2	21.2	26.8	40.4
Public	36.5	43.2	24.1	27.5	26.6	29.0
Private	-5.1	3.9	9.1	-6.3	0.2	11.3
Savings/investment balance 1/	16.8	39.4	24.4	12.1	18.1	29.1
(In percent of GDP at market prices)						
Budgetary operations 2/						
Revenue	68.9	80.2	63.1	65.2	60.6	61.9
Oil	46.8	55.5	43.1	49.4	46.8	49.0
Non-oil, <i>of which</i>	22.0	24.7	20.0	15.8	13.8	12.9
Investment income	19.3	20.3	13.2	10.5	8.8	9.4
Expenditures and net lending	39.9	39.4	45.6	43.9	41.5	39.8
<i>Of which:</i> current	36.4	36.2	40.8	38.8	36.3	34.4
capital	3.5	3.2	4.0	4.7	4.8	4.5
Balance	29.0	40.8	17.5	21.3	19.1	22.1
Domestic financing	-4.2	-2.8	-1.3	-3.2	-0.9	-5.2
External financing	-1.0	0.0	0.0	0.0	0.0	0.0
Non-oil primary balance (in percent of non-oil GDP)	-29.3	-25.0	-44.6	-51.0	-56.9	-59.3
Total gross debt (calendar year-end)	46.5	35.0	36.0	32.5	26.4	19.5
(Changes in percent of beginning broad money stock)						
Money and credit						
Net foreign assets	1.5	11.5	6.5	-4.1	-4.8	10.9
Net domestic assets	0.1	-5.1	6.3	8.8	12.6	-0.1
Claims on government (net)	-2.7	-7.3	-4.1	0.2	-2.8	-7.8
Claims on nongovernment sector	3.3	3.9	11.1	10.5	17.2	13.8

II. Selected Economic Indicators, 1999–2004

	1999	2000	2001	2002	2003	Est. 2004
(Changes in percent of beginning broad money stock)						
Broad money	1.6	6.3	12.8	4.8	7.8	10.8
Velocity of broad money	1.2	1.4	1.1	1.1	1.2	1.3
Kuwaiti dinar 3-month deposit rate (average in percent)	5.3	5.4	3.7	2.2	1.5	2.0
U.S. dollar 3-month deposit rate (average in percent)	4.9	6.0	3.3	1.3	0.7	1.3
Stock market index (annual percent change)	-8.9	-6.5	26.8	39.0	101.7	33.8
(In millions of U.S. dollars, unless otherwise indicated)						
External sector						
Exports of goods and services	12,225	21,298	17,910	17,012	22,611	30,352
<i>Of which:</i> Oil and refined products	11,029	18,182	14,977	14,057	19,004	25,951
Annual percentage change in volume	-14.3	9.0	-0.3	-12.1	20.0	8.2
Imports of goods and services	-11,880	-11,369	-12,406	-13,959	-16,239	-17,328
Annual percentage change in volume	-9.1	-4.1	7.0	6.9	11.4	5.5
Current account	5,010	14,671	8,328	4,250	7,318	15,098
In percent of GDP 1/	16.6	39.8	24.5	12.1	17.5	29.1
External public and publicly guaranteed debt	1.3	0.4	0.4	0.6	0.5	...
International reserve assets, <i>of which:</i>	4,928	7,186	10,000	9,314	7,685	8,359
Central Bank of Kuwait	4,347	6,577	9,268	8,455	6,744	7,451
In months of imports of goods and services	5.0	7.6	9.7	8.0	5.7	5.8
(Percentage change; unless otherwise noted)						
Memorandum items:						
Exchange rate (US\$ per KD, period average) 3/	3.28	3.26	3.26	3.29	3.36	3.39
Nominal effective exchange rate 4/	-0.6	4.7	5.8	-0.7	-6.9	-6.9
Real effective exchange rate 4/	0.9	4.2	5.1	-0.9	-7.7	-5.4
Credit rating (S&P)		...	...	...	...	A+

Sources: Data provided by the authorities; World Bank Social Indicators of Development; and Fund staff estimates.

1/ For 2003, the discrepancy between the savings/investment balance and the current account balance is possibly due to the data being preliminary and may be resolved when the authorities revise the data.

2/ Kuwaiti fiscal year ending March 31. The 2000/01 fiscal year was only 9-month, and the data were obtained by grossing up the 9-month data.

3/ Since January 5, 2003, the exchange rate of the Kuwaiti dinar has been officially pegged to the U.S. dollar at 0.29963 KD/US\$ (3.33745US\$/KD) within a margin not exceeding 3.5 percent on both sides of this parity exchange rate.

4/ For 2004, average for January to October.

Table 1. Kuwait: Sectoral Origin of Gross Domestic Product at Current Prices, 1998–2003

(In millions of Kuwaiti dinars)

	1998	1999	Rev.			Prel.
			2000	2001	2002	2003
Oil sector (crude oil, gas, and refining)	2,965	4,036	6,046	4,961	4,836	6,367
Crude oil and gas	2,355	3,328	5,544	4,587	4,406	5,794
Petroleum and refining	610	708	502	374	431	573
Non-oil sector	5,241	5,495	5,665	5,890	6,249	6,530
Agriculture and fisheries	35	39	41	48	60	66
Mining (non-oil) and quarrying	1	1	1	1	0	0
Manufacturing	315	307	299	304	313	324
Food, beverage and tobacco	64	65	66	70	72	74
Textile, clothing and leather products	39	35	34	36	37	38
Wood and wood products	15	15	14	16	17	18
Paper, printing, and publishing	29	29	30	31	31	32
Chemicals, fertilizers, and plastic	42	39	39	38	40	41
Non-metallic minerals	47	47	45	42	43	43
Basic metals	4	5	4	4	4	4
Fabricated metal products	71	68	61	62	64	67
Other manufacturing	4	4	5	5	6	6
Electricity, gas and water	230	237	246	253	275	301
Construction	231	240	255	263	271	285
Hotels and restaurants	81	83	92	97	100	103
Whole sale and retail trade	587	609	604	636	664	689
Transport, storage and communications	433	487	552	598	616	633
Financial institutions and insurance	503	573	617	693	723	760
Real estate and business services	652	672	666	670	678	685
Community, social and personal services	2,173	2,247	2,293	2,328	2,549	2,685
Public administration and defense	959	993	1,008	1,008	1,127	1,186
Personal and household services	232	233	238	249	262	280
Other	982	1,021	1,047	1,072	1,160	1,219
Imputed bank service charges	-385	-442	-476	-489	-490	-545
GDP at factor cost	7,821	9,089	11,235	10,362	10,595	12,353
Import duties	84	80	77	84	97	88
GDP at current market prices	7,905	9,169	11,312	10,446	10,691	12,441

Source: Ministry of Planning, Central Statistical Office.

Table 2. Kuwait: Sectoral Origin of Gross Domestic Product at Constant 1995 Prices,
1998–2003

(In million of Kuwaiti dinars)

	1998	Rev.				Prel.
		1999	2000	2001	2002	2003
Oil sector (crude oil, gas, and refining)	3,820	3,571	3,651	3,530	3,250	3,893
Crude oil and gas	3,188	2,927	3,112	3,042	2,729	3,291
Petroleum and refining	632	644	539	488	521	602
Non-oil sector	5,015	5,118	5,214	5,402	5,636	5,906
Agriculture and fisheries	33	36	36	43	51	55
Mining (non-oil) and quarrying	1	1	1	0	0	0
Manufacturing	321	308	300	299	307	323
Food, beverage and tobacco	60	59	60	65	68	72
Textile, clothing and leather products	41	35	34	32	29	31
Wood and wood products	12	12	11	13	14	14
Paper, printing, and publishing	34	33	34	36	37	40
Chemicals, fertilizers, and plastic	42	40	41	40	42	43
Non-metallic minerals	48	49	49	45	40	39
Basic metals	7	7	6	5	6	6
Fabricated metal products	72	69	60	58	66	72
Other manufacturing	4	4	5	5	5	6
Electricity, gas and water	230	252	288	316	349	382
Construction	227	234	248	246	258	261
Hotels and restaurants	60	64	65	64	67	59
Whole sale and retail trade	566	577	564	584	598	612
Transport, storage and communications	487	557	620	665	675	697
Financial institutions and insurance	321	332	349	394	420	479
Real estate and business services	621	627	611	609	609	605
Community, social and personal services	2,148	2,129	2,132	2,182	2,303	2,432
Public administration and defense	1,013	1,003	1,001	1,019	1,062	1,124
Personal and household services	235	220	221	255	271	286
Other	900	906	911	908	970	1,022
Imputed bank service charges	-246	-252	-261	-272	-279	-337
GDP at factor cost	8,589	8,437	8,604	8,660	8,607	9,462
Import duties	83	80	76	82	90	80
GDP at constant prices	8,672	8,517	8,680	8,742	8,697	9,542

Source: Ministry of Planning, Central Statistical Office.

Table 3. Kuwait: Gross Domestic Expenditure at Current Market Prices, 1998–2003

	1998	1999	2000	2001	2002	<u>Prel.</u> 2003
(In millions of Kuwaiti dinars)						
Final consumption	7,020	7,239	7,443	7,849	8,784	9,392
Government	2,412	2,463	2,485	2,529	2,929	3,224
Private 1/	4,608	4,776	4,958	5,320	5,855	6,169
Gross domestic investment	1,459	1,335	868	910	979	1,077
Government	371	357	202	225	320	352
Private	1,088	978	666	685	659	725
Net exports of goods and nonfactor services	-572	596	3,046	1,687	928	1,973
Exports of goods and services 2/	3,468	4,212	6,534	5,490	5,171	6,817
Imports of goods and services 2/	4,040	3,616	3,488	3,803	4,243	4,844
Gross domestic product	7,906	9,170	11,357	10,446	10,691	12,442
Net factor income from abroad	1,788	1,555	2,055	1,504	1,016	991
Gross national income	9,694	10,725	13,412	11,949	11,707	13,433
Net transfers	-541	-610	-600	-637	-652	-709
Gross national disposable income	9,153	10,115	12,812	11,312	11,055	12,724
Gross saving	2,134	2,876	5,369	3,463	2,271	3,332
S-I=CAB	675	1,541	4,501	2,553	1,292	2,255
Current account 3/	657	1,525	4,500	2,554	1,292	2,181
(In percent of GDP)						
Memorandum items:						
Final consumption	88.8	78.9	65.5	75.1	82.2	75.5
Government	30.5	26.9	21.9	24.2	27.4	25.9
Private 1/	58.3	52.1	43.7	50.9	54.8	49.6
Gross domestic investment	18.5	14.6	7.6	8.7	9.2	8.7
Government	4.7	3.9	1.8	2.2	3.0	2.8
Private	13.8	10.7	5.9	6.6	6.2	5.8
Saving	27.0	31.4	47.3	33.2	21.2	26.8
Current account	8.3	16.6	39.8	24.5	12.1	17.5

Source: Ministry of Planning, Central Statistical Office.

1/ Includes government-owned enterprises.

2/ Including re-exports.

3/ Discrepancy between current account and S-I balance is due to differences in the compilation of national accounts and balance of payment statistics.

Table 4. Kuwait: Gross Domestic Expenditure at Constant 1995 Prices, 1998–2003

(In millions of Kuwaiti dinars)

	1998	1999	Revised			Prel.
			2000	2001	2002	2003
Final consumption	6,792	6,793	6,808	7,139	7,790	8,149
Government	2,378	2,350	2,252	2,359	2,599	2,742
Private 1/	4,414	4,443	4,556	4,780	5,191	5,407
Gross domestic investment	1,497	1,398	904	908	952	1,021
<i>Of which:</i>						
Government	371	357	277	225	311	334
Private	1,077	943	570	684	641	687
Net exports of goods and nonfactor services	397	133	616	360	-386	-122
Exports of goods and services	4,354	3,731	4,066	4,052	3,561	4,274
Imports of goods and services	3,957	3,598	3,450	3,692	3,947	4,396
Statistical discrepancy	-15	194	353	335	341	493
GDP at constant prices	8,672	8,517	8,680	8,742	8,697	9,542

Sources: Ministry of Planning, Central Statistical Office; and Fund staff estimates.

1/ Includes government-owned enterprises.

Table 5. Kuwait: Production and Disposal of Crude Oil and LPG, 1998–2003

	1998	1999	2000	2001	2002	2003
	(In thousands of barrels per day)					
Crude oil output	2,052	1,873	1,984	1,947	1,746	2,107
	(In millions of barrels per annum)					
Crude and LPG output	785	721	761	746	670	806
Crude oil output	749	684	726	711	637	769
<i>Of which: Refined locally 1/</i>	312	330	270	239	261	303
LPG	36	38	35	35	33	37
Crude and LPG disposal	782	714	748	728	652	794
Domestic consumption	58	60	56	51	53	75
Refined products	57	59	56	50	52	74
LPG	1	1	1	1	1	1
Exports	725	653	691	677	597	716
Crude oil	434	346	444	454	358	453
Refined products (including bunker oil)	254	271	214	188	209	228
LPG	36	36	33	35	31	35
Stocks 2/	-0.4	0.4	0.5	-0.5	1.1	3.4
Refinery loss & reinjection	3	8	13	18	19	11
Memorandum items						
Export value (US\$ millions)	8,443	11,105	18,234	14,940	14,074	19,114
Oil production value (KD)	2,582	3,356	5,578	4,591	4,273	5,664
Export price (US\$/barrel) 3/	11.65	16.99	26.24	22.08	23.56	26.68
Crude price (US\$/barrel)	10.3	16.1	25.0	21.2	22.9	25.5
LPG price (US\$/barrel)	12.0	16.7	25.5	22.6	21.1	25.7
Refined products prices (US\$/barrel)	13.9	18.2	29.5	24.2	25.1	29.1

Sources: Ministry of Energy, Kuwait Petroleum Corporation, Central Bank of Kuwait, and Fund staff estimates.

1/ Excludes bunkers and stocks.

2/ Includes statistical discrepancy.

3/ Average price of crude, LPG, and refined products.

Table 6. Kuwait: Consumer Price Index, 1998–2003

	Relative Weight	1998	1999	2000	2001	2002	2003
(Annual averages)							
(2000=100)							
Overall index	1,000.0	95.4	98.4	99.9	101.4	102.2	103.2
Food	182.9	94.9	99.2	99.8	103.1	104.5	106.6
Beverages and tobacco	6.6	89.1	98.1	100.1	101.5	105.8	107.4
Clothing and footwear	88.6	100.0	101.7	100.0	103.2	105.9	108.0
Housing	267.5	96.2	98.1	100.0	101.1	102.1	103.8
Household goods and services	147.1	97.6	101.4	99.6	96.9	99.1	100.2
Transport and communications	161.4	93.7	93.3	99.9	99.1	95.0	93.8
Education and medical care	46.8	93.9	96.1	100.1	103.9	106.6	112.4
Other goods and services	99.1	90.8	99.3	100.1	106.2	108.5	105.8
(Annual percentage changes)							
Overall index		0.1	3.1	1.6	1.4	0.8	1.0
Food		0.2	4.6	0.6	3.3	1.4	2.0
Beverages and tobacco		16.4	10.1	2.1	1.4	4.2	1.5
Clothing and footwear		0.7	1.7	-1.6	3.2	2.6	2.0
Housing		1.7	1.9	1.9	1.1	1.0	1.7
Household goods and services		2.3	3.9	-1.8	-2.7	2.3	1.1
Transport and communications		-5.8	-0.4	7.1	-0.8	-4.1	-1.3
Education and medical care		2.4	2.4	4.1	3.8	2.6	5.4
Other goods and services		5.4	9.4	0.8	6.1	2.2	-2.5

Source: Ministry of Planning, Central Statistical Office.

Table 7. Kuwait: Wholesale Price Index, 1998–2003
(1980=100)

	Relative Weights			1998	1999	2000	2001	2002	2003
	Imported	Locally Produced	All Items						
All groups	769.2	230.8	1,000.0	164.4	162.4	163.1	166.3	171.8	175.1
Agriculture, livestock, and fishing	47.4	6.1	53.4	124.3	121.5	124.8	120.0	127.0	132.8
Agriculture	30.0	1.9	31.9	124.4	117.9	120.8	121.4	128.1	132.3
Livestock	17.3	2.1	19.5	112.1	116.6	116.6	106.7	111.5	121.3
Fishing	0.0	2.1	2.1	234.4	219.1	263.8	219.7	255.7	246.6
Mining (non-oil) and quarrying	0.0	7.8	7.8	103.5	102.8	110.4	155.0	155.0	161.8
Manufacturing	721.8	216.9	938.8	167.1	165.2	165.7	169.0	174.5	177.7
Food, beverages, and tobacco	79.8	51.0	130.9	161.1	165.9	165.7	166.5	167.5	168.9
Textiles	125.9	0.0	125.9	256.7	246.7	246.1	246.7	263.9	278.9
Wood and wood products	9.9	20.4	30.2	171.9	168.5	164.5	163.3	162.7	166.4
Paper and paper products	14.2	2.0	16.1	143.5	144.6	151.0	151.7	151.4	130.6
Chemicals and chemical products	49.7	43.2	92.9	156.2	154.8	154.5	154.0	153.0	151.6
Nonmetallic mineral products	43.7	51.2	94.9	143.2	146.3	146.9	153.4	162.9	165.6
Basic metal products	61.6	2.4	64.0	120.0	118.9	117.0	114.0	101.2	119.2
Fabricated metal products	327.8	46.8	374.6	156.5	153.3	155.1	162.0	169.6	159.2
Other	9.4	0.0	9.4	174.6	172.7	173.2	173.4	170.8	171.5

Source: Ministry of Planning, Central Statistics Office.

Table 8. Kuwait: Output of Major Industrial Products, 1997–2002

Product	Unit	1997	1998	1999	2000	2001	2002
Brakish water	Billion gallons	24.0	26.1	26.1	28.2	30.1	31.0
Potable water	Billion gallons	73.3	78.4	84.2	88.5	85.0	91.3
Electric energy	bn kwh	26.7	30.0	31.6	32.3	34.5	36.4
Sand lime bricks	Thousand metric me	505.7	505.2	302.8	272.0	256.0	338.0
Cement	Thousand tons	1,370.0	2,309.9	947.3	1,187.4	920.7	1,584.4
Bran and flour	thousand tons	196.3	195.7	202.2	210.0	211.2	225.1
Urea	Thousand metric ton	757.5	785.5	719.4	625.3	682.4	555.0
Chlorine	Thousand tons	18.3	19.4	18.3	14.8	17.7	19.0
Caustic soda	Thousand tons	20.1	21.8	20.6	18.5	20.0	56.6
Salt	Thousand tons	42.8	41.0	38.7	36.8	37.5	42.5
Hydrochloric acid	Million gallons	2.7	2.6	2.1	1.3	2.1	2.5
Sodium hypochlorite	Thousand cubic met	9.2	10.9	11.6	11.7	12.7	12.7
Hydrogen gas	Thousand cubic met	49.8	54.5	52.7	52.3	71.9	68.0

Source: Ministry of Planning, Central Statistical Office.

Table 9. Kuwait: Agricultural and Fisheries Production, 1997/98–2002/03

(In thousands of metric tons)

	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03
Vegetable and field crop	340.90	370.10	403.30	407.80	498.10	529.61
Wool	283.00	343.00	417.00	390.00	356.00	369.00
Meat	39.90	42.89	37.78	33.95	41.26	41.59
Milk	34.95	37.77	34.81	33.24	36.72	42.92
Eggs (millions)	235.50	293.10	343.50	314.60	273.00	329.40
Fish	7.80	7.30	6.90	5.90	5.90	5.90

Sources: Ministry of Planning, Central Statistical Office; and the Public Authority for Agriculture.

Table 10. Kuwait: Population and Employment, 1999–2004

(In thousands)

	Kuwaiti			Non-Kuwaiti			Total		
	Female	Male	Total	Female	Male	Total	Female	Male	Total
1999									
Employed	75.7	143.4	219.1	210.2	787.2	997.3	285.9	930.6	1,216.5
Total labor force 1/	76.2	145.1	221.4	211.5	793.2	1,004.7	287.8	938.4	1,226.1
Population	410.8	401.4	812.3	471.8	970.9	1,442.7	882.7	1,372.3	2,255.0
Participation ratio (in percent)	18.6	36.2	27.3	44.8	81.7	69.6	32.6	68.4	54.4
2000									
Employed	81.7	149.1	230.8	202.3	753.9	956.2	284.1	902.9	1,187.0
Total labor force 1/	82.3	150.9	233.3	203.6	759.4	963.0	285.9	910.4	1,196.3
Population	426.2	415.6	841.8	448.4	927.0	1,375.5	874.6	1,342.6	2,217.3
Participation ratio (in percent)	19.3	36.3	27.7	45.4	81.9	70.0	32.7	67.8	54.0
2001									
Employed	88.3	155.3	243.6	228.8	785.0	1,013.8	317.1	940.2	1,257.4
Total labor force 1/	91.3	158.5	249.8	230.5	790.9	1,021.5	321.9	949.4	1,271.3
Population	441.1	429.2	870.3	478.4	960.4	1,438.8	919.5	1,389.6	2,309.1
Participation ratio (in percent)	20.7	36.9	28.7	48.2	82.4	71.0	35.0	68.3	55.1
2002									
Employed	95.0	160.8	255.8	247.3	843.3	1,090.6	342.3	1,004.2	1,346.5
Total labor force 1/	100.4	165.0	265.5	249.5	849.3	1,098.8	350.0	1,014.3	1,364.3
Population	456.0	442.3	898.3	500.7	1,020.9	1,521.6	956.7	1,463.2	2,419.9
Participation ratio (in percent)	22.0	37.3	29.6	49.8	83.2	72.2	36.6	69.3	56.4
2003									
Employed	102.2	167.5	269.8	260.7	917.8	1,178.5	362.9	1,085.3	1,448.3
Total labor force 1/	107.8	171.5	279.4	263.4	923.4	1,186.7	371.2	1,094.9	1,466.1
Population	471.5	456.2	927.7	520.1	1,098.9	1,619.0	991.6	1,555.1	2,546.7
Participation ratio (in percent)	22.9	37.6	30.1	50.6	84.0	73.3	37.4	70.4	57.6
2004 (end-June)									
Employed	106.0	170.4	276.4	271.8	977.2	1,249.0	377.8	1,147.6	1,525.4
Total labor force 1/	114.4	176.4	290.7	276.6	984.0	1,260.6	391.0	1,160.3	1,551.3
Population	479.5	463.4	942.9	538.8	1,163.1	1,701.9	1,018.3	1,626.5	2,644.8
Participation ratio (in percent)	23.9	38.1	30.8	51.3	84.6	74.1	38.4	71.3	58.7

Sources: Ministry of Planning, Central Statistical Office; and Civil Information Authority.

1/ Labor force includes population 15 years old and over.

Table 11. Kuwait: Distribution of Employees by Economic Activity and Nationality, 2000-04

Economic Sectors	2000			2001			2002			2003			2004 1/		
	Kuwaiti	Non-Kuwaiti	Total	Kuwaiti	Non-Kuwaiti	Total	Kuwaiti	Non-Kuwaiti	Total	Kuwaiti	Non-Kuwaiti	Total	Kuwaiti	Non-Kuwaiti	Total
Agriculture and fisheries	0.2	99.8	100.0	0.2	99.8	100.0	0.2	99.8	100.0	0.3	99.7	100.0	0.4	99.6	100.0
Mining and quarrying	58.8	41.2	100.0	59.9	40.1	100.0	61.3	38.7	100.0	62.3	37.7	100.0	62.7	37.3	100.0
Manufacturing	9.1	90.9	100.0	9.0	91.0	100.0	8.6	91.4	100.0	8.7	91.3	100.0	8.8	91.2	100.0
Construction	0.8	99.2	100.0	0.9	99.1	100.0	0.9	99.1	100.0	1.6	98.4	100.0	1.8	98.2	100.0
Electricity, water, and gas	68.2	31.8	100.0	70.2	29.8	100.0	70.6	29.4	100.0	72.4	27.6	100.0	73.4	26.6	100.0
Wholesale and retail trade	1.5	98.5	100.0	1.4	98.6	100.0	1.5	98.5	100.0	1.8	98.2	100.0	2.0	98.0	100.0
Transportation and communication	15.0	85.0	100.0	14.7	85.3	100.0	14.4	85.6	100.0	14.7	85.3	100.0	14.5	85.5	100.0
Finance and business services	14.0	86.0	100.0	13.7	86.3	100.0	13.7	86.3	100.0	14.4	85.6	100.0	14.3	85.7	100.0
Public administration	31.8	68.2	100.0	31.0	69.0	100.0	30.0	70.0	100.0	29.4	70.6	100.0	28.5	71.5	100.0
Unclassified	7.4	92.6	100.0	12.4	87.6	100.0	13.7	86.3	100.0	10.6	89.4	100.0	11.8	88.2	100.0
Total	19.5	80.5	100.0	19.6	80.4	100.0	19.5	80.5	100.0	19.1	80.9	100.0	18.7	81.3	100.0

(In percent, by nationality)

Sources: Ministry of Planning, Central Statistical Office; and Civil Information Authority.

1/ End-June.

Table 12. Kuwait: Permits for Expatriate Workers, 1988–2004

(In thousands)

Year	Entry Visa for Work 1/	Work Permits Issued First Time	Cancellation of Work Permits	Net Issuance of Work Permits
1988	89.2	61.6	23.1	48.5
1989	43.1	69.9	32.8	37.1
1990	...	...	...	...
1991	...	...	...	...
1992	...	...	...	...
1993 2/	181.4	183.0	11.7	171.3
1994 2/	52.0	78.4	32.2	46.2
1995 2/	63.4	49.3	29.1	20.2
1996 2/	73.7	61.9	24.8	37.1
1997 2/	21.0	17.3	4.7	12.6
1998 2/	91.1	71.4	26.6	44.8
1999 2/	77.5	60.8	22.2	38.6
2000 2/	58.3	40.3	5.9	34.4
2001 2/	83.5	59.7	...	59.7
2002 2/	113.0	155.4	...	155.4
2003 2/	128.4	96.7	...	96.7
2004 2/ 3/	114.3	84.0	...	84.0

Sources: Ministry of Social and Labor Affairs (for 1987–93); and Annual Statistical Abstract (from 1994).

1/ Entry visa must be obtained separately from work permit.

2/ These data were compiled on a different basis than those before 1993.

3/ End-June.

Table 13. Kuwait: Number of Construction Permits Issued,
1989–2002

Year	Residential	Commercial/Industrial	Total
1989	10,544	2,269	12,813
1990	4,192	792	4,984
1991	1,010	132	1,142
1992	6,145	646	6,791
1993	13,338	1,055	14,393
1994	12,955	1,459	14,414
1995	13,172	1,173	14,345
1996	14,297	1,367	15,664
1997	13,700	1,447	15,147
1998	13,249	1,254	14,503
1999	12,145	1,290	13,435
2000	11,608	1,716	13,324
2001	11,183	1,148	12,331
2002	11,097	1,254	12,351

Source: Ministry of Planning, Central Statistical Office.

Table 14. Kuwait: Summary of Government Finance, 1999/2000–2004/05 1/

	1999/2000	2000/01	2001/02	2002/03	Prel. 2003/04	Budget 2004/05
(In millions of Kuwaiti dinars)						
Total revenue	7,053	8,722	6,630	7,256	7,966	3,167
Oil and gas	4,795	6,037	4,525	5,499	6,150	2,735
Investment income and transfer of profits of public entities 2/	1,976	2,208	1,386	1,164	1,161	0
Other 3/	282	477	719	593	655	432
Total expenditure	4,086	4,283	4,796	4,890	5,454	6,145
Current	3,730	3,939	4,290	4,318	4,773	5,150
Wages and salaries	1,498	1,573	1,637	1,709	1,825	1,939
Goods and services	938	985	1,061	1,196	1,436 4/	1,448
Interest on domestic debt 5/	252	254	203	121	81	37
Transfers abroad	84	91	97	82	63	83
Subsidies and transfers	958	1,036	1,292	1,210	1,368	1,644
Capital	356	344	506	572	681	995
Of which: land purchases	1	0	83	49	48	147
Overall balance	2,967	4,439	1,834	2,366	2,512	-2,978
Financing	-2,967	-4,439	-1,834	-2,366	-2,512	2,978
Domestic (net)	-457	-303	-134	-351	-122	...
Banks	-534	-438	-169	-196	-66	...
Nonbanks	77	135	35	-156	-55	...
External	0	0	0	0	0	...
Reserve funds 6/	-2,509	-4,136	-1,700	-2,014	-2,390	...
(In percent of GDP)						
Revenue	68.9	80.2	63.1	65.2	60.6	20.3
Oil and gas	46.8	55.5	43.1	49.4	46.8	17.6
Investment income	19.3	20.3	13.2	10.5	8.8	...
Other 3/	2.8	4.4	6.8	5.3	4.7	2.8
Expenditure	39.9	39.4	45.6	43.9	41.5	39.4
Current	36.4	36.2	40.8	38.8	36.3	33.0
Wages and salaries	14.6	14.5	15.6	15.4	13.9	12.4
Goods and services	9.2	9.1	10.1	10.7	10.9	9.3
Interest on domestic and foreign debt	2.5	2.3	1.9	1.1	0.6	0.2
Subsidies and transfers	9.4	9.5	12.3	10.9	10.4	10.5
Capital	3.5	3.2	4.8	5.1	5.2	6.4
Overall balance	29.0	40.8	17.5	21.3	19.1	-19.1
Memorandum items:						
Overall balance (excluding investment income and profit transfers)	991	2,231	448	1,202	1,351	-2,978
(In percent of GDP)	9.7	20.5	4.3	10.8	10.3	-19.1
Kuwait crude export price (US\$ per barrel)	20.5	23.1	21.6	23.5	27.1	15.0

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

1/ Coverage of budgetary operations includes the operation of the KIA. Data are on an accrual basis.

2/ Excluded from the national budget presentation. Estimated by the Fund staff.

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

4/ Includes the KD 121 million supplementary budget for the emergency spending.

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

6/ The Reserve Fund for Future Generations (RFFG) and the General Reserve Fund (GRF).

Table 15. Kuwait: Government Revenue, 1999/2000–2004/05

	1999/2000	2000/01	2001/02	2002/03	Prel. 2003/04	Budget 2004/05
(In millions of Kuwaiti dinars)						
Total revenue	7,053	8,722	6,630	7,256	7,966	3,167
Current revenue	7,053	8,721	6,629	7,229	7,929	3,142
Oil and gas receipts	4,795	6,037	4,525	5,499	6,150	2,735
Investment income and transfer 1/	1,976	2,208	1,386	1,164	1,161	0
Other current revenue	282	476	718	567	618	407
Tax revenue	97	93	110	135	187	150
Taxes on income and profits of non-oil companies	17	15	18	26	30	29
Taxes on property transfers	4	3	6	8	10	9
Customs duties	76	75	86	101	147	112
Excise taxes						
Nontax revenue	185	383	608	432	431	257
Capital revenue	0	2	1	26	37	25
(In percent of total revenue)						
Oil receipts	68.0	69.2	68.2	75.8	77.2	86.4
Investment income	28.0	25.3	20.9	16.0	14.6	0.0
Tax revenue	1.4	1.1	1.7	1.9	2.3	4.7
<i>Of which</i>						
Customs duties	1.1	0.9	1.3	1.4	1.8	3.5
Nontax revenue	2.6	4.4	9.2	6.0	5.4	8.1

Sources: Ministry of Finance; and Fund staff estimates.

1/ Income from government's external assets; excluded from national budget and ex-post fiscal accounts.

Table 16. Kuwait: Government Current Expenditure, 1999/2000–2004/05

	1999/2000	2000/01	2001/02	2002/03	Prel. 2003/04	Budget 2004/05
(In millions of Kuwaiti dinars)						
Economic classification						
Total current expenditure	3,730	3,939	4,290	4,318	4,773	5,150
Wages and salaries 1/	1,498	1,573	1,637	1,709	1,825	1,939
Goods and non-interest services	938	985	1,061	1,196	1,436	1,448
Interest on domestic debt	252	254	203	121	81	37
Interest on DCP bonds	100	81	51	27	16	37
Interest on treasury bills 2/	36	42	36	32	31	...
Interest on treasury bonds 2/	116	130	116	61	34	...
Interest on foreign debt 2/	0	0	0	0	0	...
Transfers abroad	84	91	97	82	63	83
Subsidies and domestic transfers	958	1,036	1,292	1,210	1,368	1,644
Functional classification						
Total current expenditure	3,730	3,939	4,290	4,318	4,773	5,150
General public service	360	280	355	397	501	428
Defense	710	708	780	879	946	1,051
Public order	385	401	426	450	492	510
Education	579	605	629	649	684	734
Health	266	273	301	315	343	352
Social affairs	758	801	1,001	814	867	905
Social security	456	476	489	304	558	558
Social welfare	303	325	512	510	309	347
Housing and utilities	198	136	123	116	147	164
Economic services	210	283	348	388	511	684
Mining, manufacturing, and construction	12	13	13	18	14	15
Electricity, etc.	142	220	281	329	417	599
Agriculture	17	17	20	23	24	26
Other	39	32	34	18	56	44
Other 3/	264	451	327	310	282	322
(In percent of total)						
Economic classification						
<i>Of which</i>						
Wages and salaries	40.2	39.9	38.2	39.6	38.2	37.7
Goods and services	25.1	25.0	24.7	27.7	30.1	28.1
Transfers abroad	2.3	2.3	2.2	1.9	1.3	1.6
Subsidies and domestic transfers	25.7	26.3	30.1	28.0	28.7	31.9
Functional classification						
<i>Of which</i>						
General public service	9.7	7.1	8.3	9.2	10.5	8.3
Defense	19.0	18.0	18.2	20.4	19.8	20.4
Health	7.1	6.9	7.0	7.3	7.2	6.8
Housing and utilities	5.3	3.5	2.9	2.7	3.1	3.2
Economic services	5.6	7.2	8.1	9.0	10.7	13.3

Sources: Ministry of Finance; and Fund staff estimates.

1/ Excludes military wages and salaries which are included under goods and services.

2/ Excluded from national budget presentation.

3/ Include interest payments on treasury bills and bonds which are excluded from national budget presentation.

Table 17. Kuwait: Government Capital Expenditures and Land Purchases,
1999/2000–2004/05

	1999/2000	2000/01	2001/02	2002/03	<u>Prel.</u> 2003/04	<u>Budget</u> 2004/05
(In millions of Kuwaiti dinars)						
Capital expenditure	356	344	423	523	633	848
General public services	27	33	29	31	34	63
Defense	2	-1	4	3	4	8
Education	34	47	47	61	60	108
Health	13	20	26	23	34	51
Social affairs	5	4	7	11	7	24
Housing	67	63	83	148	189	217
Economic services	161	133	174	201	259	296
<i>Of which</i>						
Electricity and water	147	116	157	184	241	261
Other	14	17	17	17	18	35
Public order	19	32	32	26	24	36
Other 1/	26	15	21	19	22	45
Land purchases	1	0	83	49	48	147
Capital and land, total	356	344	506	572	681	995
(In percent of total)						
Capital expenditure	99.9	100.0	83.6	91.4	93.0	85.2
<i>Of which</i>						
General public services	7.7	9.4	5.7	5.3	5.0	6.3
Education	9.7	13.5	9.3	10.6	8.8	10.9
Health	3.8	5.7	5.1	4.0	5.0	5.1
Housing	18.8	18.3	16.4	25.9	27.8	21.8
Economic services	45.2	38.7	34.4	35.2	38.0	29.7
Land purchases	0.1	0.0	16.4	8.6	7.0	14.8
Total	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes contingency funds not allocated to specific expenditures.

Table 18. Kuwait: Government Domestic Subsidies and Transfers,
1999/2000–2004/05

(In millions of Kuwaiti dinars)

	1999/2000	2000/01	2001/02	2002/03	<u>Prel.</u> 2003/04	<u>Budget</u> 2004/05
Total current subsidies	274	280	341	337	439	673
Food and commodity subsidies	6	5	6	7	8	9
Petroleum product subsidies	6	7	6	7	7	8
Electricity and water	262	268	329	323	424	656
Total transfers	684	756	951	873	929	971
Social Security Institute	442	476	489	510	558	558
Individuals	160	168	362	207	200	200
<i>Of which</i>						
End-of-employment benefits	16	17	4	15	15	14
Cancellation of housing loans	33	35	235	35	35	35
Private domestic institutions	10	9	10	11	12	12
Other public entities	40	43	33	51	54	61
Other	32	60	57	94	105	140
Total current subsidies and transfers	958	1,036	1,292	1,210	1,368	1,644
Memorandum items						
Subsidies and transfers						
As percent of GDP	9.4	9.5	12.3	10.9	10.4	10.5
As percent of government expenditure	23.4	24.2	26.9	24.7	25.1	26.8

Sources: Ministry of Finance; and Fund staff estimates.

Table 19. Kuwait: Monetary Survey, 1998–2004

End of Period	1998	1999	2000	2001	2002	2003	2004
(In millions of Kuwaiti dinars)							
Foreign assets (net)	1,784	1,899	2,778	3,306	2,930	2,467	3,603
Central bank	1,080	1,320	2,005	2,850	2,521	1,966	2,165
Local banks	704	579	773	456	409	500	1,438
Domestic assets (net)	5,773	5,780	5,385	5,902	6,716	7,935	7,919
Claims on government (net)	3,678	3,475	2,911	2,573	2,595	2,323	1,510
Central bank (net)	-205	-392	-532	-598	-354	-413	-662
Claims	0	45	0	0	0	0	0
Deposits (increase -)	205	437	532	598	354	413	662
Local banks (net)	3,883	3,867	3,443	3,171	2,949	2,735	2,172
Claims	4,140	4,062	3,628	3,402	3,248	3,050	2,750
Government debt bonds	2,246	1,931	1,491	1,294	1,006	818	604
Public debt instruments	1,895	2,132	2,137	2,108	2,242	2,232	2,146
Other claims	0	0	0	0	0	0	0
Deposits (increase -)	257	195	185	231	299	315	578
Claims on nongovernment sector	5,303	5,551	5,848	6,753	7,723	9,379	10,814
Credit facilities	4,802	4,993	5,230	6,027	6,854	8,419	9,808
Local investments	501	557	619	726	870	959	1,006
Other items (net)	-3,209	-3,246	-3,375	-3,423	-3,602	-3,767	-4,405
Broad money	7,557	7,678	8,163	9,209	9,646	10,401	11,522
Money	1,143	1,371	1,468	1,641	2,067	2,612	2,983
Quasi money, <i>of which</i> :	6,413	6,307	6,695	7,567	7,580	7,790	8,539
Foreign currency deposits	1,037	881	895	892	904	991	1,169
(Annual percentage change)							
Foreign assets (net)	-7.5	6.4	46.3	19.0	-11.4	-15.8	46.1
Central bank	4.5	22.2	51.9	42.2	-11.6	-22.0	10.1
Local banks	-21.4	-17.8	33.6	-41.0	-10.3	22.3	187.3
Domestic assets (net)	1.5	0.1	-6.8	9.6	13.8	18.1	-0.2
Claims on government (net)	-2.7	-5.5	-16.2	-11.6	0.8	-10.5	-35.0
Central bank (net)	13.5	-91.3	-35.6	-12.3	40.7	-16.5	-60.5
Claims	-99.7	...	-100.0	...	...	...	...
Deposits (increase= +)	-25.8	113.2	21.7	12.3	-40.7	16.5	60.5
Local banks (net)	-3.4	-0.4	-11.0	-7.9	-7.0	-7.2	-20.6
Claims on nongovernment (net)	11.8	4.7	5.4	15.5	14.4	21.4	15.3
Credit facilities	11.0	4.0	4.7	15.2	13.7	22.8	16.5
Local investments	19.3	11.2	11.0	17.3	19.9	10.3	4.8
Other items (net)	-13.0	-1.2	-4.0	-1.4	-5.2	-4.6	-16.9

Table 19. Kuwait: Monetary Survey, 1998–2004

End of Period	1998	1999	2000	2001	2002	2003	2004
	(Annual percentage change)						
Broad money	-0.8	1.6	6.3	12.8	4.8	7.8	10.8
Money	-8.3	19.9	7.0	11.8	25.9	26.4	14.2
Quasi money, <i>of which</i> :	0.7	-1.7	6.2	13.0	0.2	2.8	9.6
Foreign currency deposits	-10.1	-15.1	1.6	-0.3	1.3	9.6	18.1
	(Change in percent of broad money stock a year earlier)						
Foreign assets (net)	-1.9	1.5	11.5	6.5	-4.1	-4.8	10.9
Central bank	0.6	3.2	8.9	10.4	-3.6	-5.7	1.9
Local banks	-2.5	-1.7	2.5	-3.9	-0.5	0.9	9.0
Domestic assets (net)	1.1	0.1	-5.1	6.3	8.8	12.6	-0.1
Claims on government (net)	-1.4	-2.7	-7.3	-4.1	0.2	-2.8	-7.8
Central bank (net)	0.4	-2.5	-1.8	-0.8	2.6	-0.6	-2.4
Local banks (net)	-1.8	-0.2	-5.5	-3.3	-2.4	-2.2	-5.4
Government debt bonds	-1.9	-4.2	-5.7	-2.4	-3.1	-1.9	-2.1
Claims on nongovernment sector	7.3	3.3	3.9	11.1	10.5	17.2	13.8
Other items (net)	-4.8	-0.5	-1.7	-0.6	-1.9	-1.7	-6.1
Broad money	-0.8	1.6	6.3	12.8	4.8	7.8	10.8
Money	-1.4	3.0	1.3	2.1	4.6	5.6	3.6
Quasi money, <i>of which</i> :	0.6	-1.4	5.1	10.7	0.1	2.2	7.2
Foreign currency deposits	-1.5	-2.1	0.2	0.0	0.1	0.9	1.7

Source: Central Bank of Kuwait.

1/ For 2004, year-on-year percentage change for June 2003–June 2004.

Table 20. Kuwait: Monetary Accounts of the Central Bank, 1998–2004

(In millions of Kuwaiti dinars)

End of Period	1998	1999	2000	2001	2002	2003	2004
Foreign assets 1/	1,082	1,322	2,009	2,854	2,533	1,988	2,196
Gold	32	32	32	32	32	32	32
Other foreign assets	1,051	1,291	1,977	2,822	2,501	1,956	2,164
Rediscounted commercial paper	...	...	...	...	...	...	...
Deposits with local banks	...	...	14	...	...	...	...
Claims on government	...	45	...	...	...	...	...
Unclassified assets	17	28	49	66	53	31	25
Total assets = Total liabilities	1,100	1,395	2,071	2,920	2,585	2,019	2,221
Reserve money	448	583	535	521	590	690	782
Currency in circulation	349	443	417	401	442	494	528
Currency with banks	64	94	89	56	82	91	78
Local banks' deposits with CBK	36	46	29	64	66	105	176
Foreign liabilities 2/	2	3	4	4	12	21	31
Government deposits	205	437	532	598	354	413	662
Capital accounts	184	184	184	184	184	197	204
Unclassified liabilities	185	167	161	214	252	350	417
Local banks deposits	75	22	655	1,399	1,193	348	125
Memorandum items							
Net foreign assets	1,080	1,320	2,005	2,850	2,521	1,966	2,165
Currency issued	412	537	506	457	524	585	606

Source: Central Bank of Kuwait.

1/ Excludes SDRs and IMF reserve position.

2/ Accounts of international organizations.

Table 21. Kuwait: Balance Sheet of the Local Banks, 1998–2004 1/

(In millions of Kuwaiti dinars)

End of Period	1998	1999	2000	2001	2002	2003	2004
Reserves	98	141	119	120	144	199	254
Cash	64	94	89	56	82	91	78
Balances with central bank	34	47	31	64	62	108	176
Foreign assets	1,788	1,787	1,969	2,027	2,441	2,425	3,453
Claims on nongovernment sector	5,303	5,551	5,848	6,753	7,723	9,379	10,814
Credit facilities	4,802	4,993	5,230	6,027	6,854	8,419	9,808
Local investments	501	557	619	726	870	959	1,006
Claims on government	4,140	4,062	3,628	3,402	3,248	3,050	2,750
Government debt bonds 2/	2,246	1,931	1,491	1,294	1,006	818	604
Public debt instruments 3/	1,895	2,132	2,137	2,108	2,242	2,232	2,146
Other claims	0	0	0	0	0	0	0
Interbank deposits	1,088	1,010	1,136	988.8	1925.8	2914.3	1109.3
Time deposits with CBK	75	7	655	1,399	1,193	348	125
Other assets	382	359	451	376	389	498	587
Total assets = Total liabilities	12,874	12,916	13,806	15,063	17,064	18,814	19,093
Broad money	7,208	7,235	7,746	8,807	9,204	9,907	10,994
Demand deposits	795	929	1,051	1,240	1,625	2,117	2,455
Quasi-money deposits	6,413	6,307	6,695	7,567	7,580	7,790	8,539
Savings	1,144	1,084	1,257	1,394	1,536	1,573	1,699
Time	4,166	4,261	4,449	5,217	5,139	5,175	5,595
Foreign currency	1,037	881	895	892	904	991	1,169
Certificates of deposit	67	81	95	64	0	52	75
Government deposits	257	195	185	231	299	315	578
Foreign liabilities	1,084	1,208	1,195	1,571	2,032	1,925	2,015
Interbank deposits	1,292	1,249	1,362	1,254	2,218	2,881	1,301
Own funds	1,470	1,504	1,583	1,681	1,770	2,009	2,104
Other liabilities	1,565	1,525	1,734	1,522	1,540	1,778	2,101

Source: Central Bank of Kuwait.

1/ Includes 7 commercial banks, 2 specialized banks, and Kuwait Finance House.

2/ Includes the purchase by the government of the real estate portfolio of the Kuwait Finance House.

3/ Primarily treasury bills and bonds.

Table 22. Kuwait: Distribution of Local Bank Credit Outstanding to the Private Sector, 1998–2004

End of Period	1998	1999	2000	2001	2002	2003	2004
(In millions of Kuwaiti dinars)							
Trade	818	930	784	812	1,022	1,072	1,401
Industry	287	312	318	394	466	442	455
Construction	395	363	423	356	454	633	702
Agriculture and fisheries	9	8	11	14	20	49	30
Financial institutions	281	283	307	613	538	650	641
Personal facilities	1,716	1,602	1,887	2,308	2,628	3,443	4,025
<i>Of which: credit for trading in securities</i>	292	217	249	386	398	755	833
Real estate	843	1,000	854	1,165	1,298	1,434	1,605
Other	454	495	647	365	428	697	949
Total	4,802	4,993	5,230	6,027	6,854	8,419	9,808
(In percent of total)							
Trade	17.0	18.6	15.0	13.5	14.9	12.7	14.3
Industry	6.0	6.3	6.1	6.5	6.8	5.2	4.6
Construction	8.2	7.3	8.1	5.9	6.6	7.5	7.2
Agriculture and fisheries	0.2	0.2	0.2	0.2	0.3	0.6	0.3
Financial institutions	5.8	5.7	5.9	10.2	7.9	7.7	6.5
Personal facilities	35.7	32.1	36.1	38.3	38.3	40.9	41.0
<i>Of which: credit for trading in securities</i>	6.1	4.4	4.8	6.4	5.8	9.0	8.5
Real estate	17.5	20.0	16.3	19.3	18.9	17.0	16.4
Other	9.5	9.9	12.4	6.1	6.2	8.3	9.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100
(Changes in percent)							
Trade	16.0	13.6	-15.7	3.6	25.9	4.9	30.7
Industry	4.2	8.9	1.9	24.0	18.1	-5.1	3.0
Construction	29.6	-7.9	16.4	-15.7	27.4	39.3	10.9
Agriculture and fisheries	-44.7	-4.5	26.2	31.1	44.6	142.3	-39.0
Financial institutions	6.0	0.7	8.6	99.6	-12.1	20.8	-1.4
Personal facilities	-0.3	-6.6	17.8	22.3	13.9	31.0	16.9
<i>Of which: credit for trading in securities</i>	-12.4	-25.6	14.4	55.3	3.2	89.6	10.3
Real estate	25.0	18.7	-14.6	36.5	11.4	10.5	11.9
Other	25.6	8.9	30.7	-43.6	17.1	63.1	36.1
Total	11.1	4.0	4.7	15.2	13.7	22.8	16.5

Source: Central Bank of Kuwait.

Table 23. Kuwait: Structure of Interest Rates, 1998–2005

(In percent per annum)

Valid Since Year	Month	Discount Rate	Maximum Lending Rates					Lending Margin Over Discount Rate			
			Consumer Loans	Credit One Year or Less		Credit More Than One Year		Credit One Year or Less		Credit More Than One Year	
				Overdraft	Loans	Overdraft	Loans	Overdraft	Loans	Overdraft	Loans
1998	11	7.00	7.00	10.00	9.50	11.00	11.00	3.00	2.50	4.00	4.00
1999	3	6.75	6.75	9.75	9.25	10.75	10.75	3.00	2.50	4.00	4.00
2000	5	7.25	7.25	10.25	9.75	11.25	11.25	3.00	2.50	4.00	4.00
2001	1	6.75	6.75	9.75	9.25	10.75	10.75	3.00	2.50	4.00	4.00
2001	2	6.25	6.25	9.25	8.75	10.25	10.25	3.00	2.50	4.00	4.00
2001	3	5.75	5.75	8.75	8.25	9.75	9.75	3.00	2.50	4.00	4.00
2001	5	5.50	5.50	8.50	8.00	9.50	9.50	3.00	2.50	4.00	4.00
2001	8	5.25	5.25	8.25	7.75	9.25	9.25	3.00	2.50	4.00	4.00
2001	9	4.75	4.75	7.75	7.25	8.75	8.75	3.00	2.50	4.00	4.00
2001	10	4.25	4.25	7.25	6.75	8.25	8.25	3.00	2.50	4.00	4.00
2002	6	3.75	3.75	6.75	6.25	7.75	7.75	3.00	2.50	4.00	4.00
2002	11	3.25	3.25	6.25	5.75	7.25	7.25	3.00	2.50	4.00	4.00
2004	7	3.50	3.50	6.50	6.00	7.50	7.50	3.00	2.50	4.00	4.00
2004	8	4.00	4.00	7.00	6.50	8.00	8.00	3.00	2.50	4.00	4.00
2004	9	4.25	4.25	7.25	6.75	8.25	8.25	3.00	2.50	4.00	4.00
2004	11	4.50	4.50	7.50	7.00	8.50	8.50	3.00	2.50	4.00	4.00
2004	12	4.75	4.75	7.75	7.25	8.75	8.75	3.00	2.50	4.00	4.00
2005	2	5.00	5.00	8.00	7.50	9.00	9.00	3.00	2.50	4.00	4.00

Memorandum items:

Types of Rates

One week REPO rate
Overnight rate
Sales/purchase of treasury bills rate

Rate Formation

Discount rate + 0.50
REPO rate.+ 0.125 percentage point
Variable rate set daily by CBK.

Market Rates

Interbank rate
Savings deposit rate
Time deposit rate
Commercial loans rate
 One year or less
 Ceiling
 More than one year
 Ceiling
Consumer loans rate
Ceiling

One week; one-, three-, six-, nine-, and twelve-month rate.
Variable rate; floor abolished effective February 1995.
Variable rate; floor abolished effective February 1995.
Market Rate
Discount rate +2.5 percentage points
Market Rate
Discount rate +4 percentage points.
Market Rate
Discount rate, but front loaded.

Source: Central Bank of Kuwait.

Table 24. Kuwait: Interest Rates on Kuwaiti Dinar and
U.S. Dollar Deposits with Local Banks, 1998–2004

(In percent per annum, period average)

	Kuwaiti Dinar Deposits		U.S. Dollar Deposits		Interest Differential KD minus U.S. Dollar	
	3 months	6 months	3 months	6 months	3 months	6 months
1998	5.87	6.12	5.08	5.07	0.79	1.05
1999	5.27	5.53	4.86	4.96	0.41	0.58
2000	5.43	5.70	5.99	6.12	-0.57	-0.42
2001	3.70	3.86	3.33	3.28	0.37	0.58
2002	2.21	2.34	1.32	1.40	0.89	0.94
2003	1.51	1.59	0.75	0.78	0.76	0.81
1998						
Q1	5.95	6.14	5.18	5.21	0.77	0.93
Q2	5.90	6.19	5.22	5.27	0.68	0.92
Q3	5.85	6.12	5.18	5.19	0.68	0.94
Q4	5.77	6.03	4.73	4.62	1.04	1.41
1999						
Q1	5.46	5.71	4.56	4.57	0.90	1.14
Q2	5.24	5.50	4.53	4.62	0.72	0.88
Q3	5.06	5.33	4.86	5.12	0.20	0.21
Q4	5.32	5.58	5.50	5.51	-0.18	0.07
2000						
Q1	5.47	5.67	5.56	5.73	-0.09	-0.06
Q2	5.44	5.74	6.06	6.26	-0.62	-0.52
Q3	5.45	5.76	6.20	6.33	-0.75	-0.57
Q4	5.35	5.64	6.15	6.16	-0.80	-0.51
2001						
Q1	4.59	4.80	4.88	4.74	-0.29	0.07
Q2	3.77	3.91	3.73	3.68	0.04	0.23
Q3	3.60	3.74	3.01	3.00	0.59	0.74
Q4	2.85	3.00	1.70	1.72	1.15	1.28
2002						
Q1	2.61	2.76	1.40	1.52	1.20	1.24
Q2	2.46	2.62	1.45	1.59	1.01	1.03
Q3	2.12	2.26	1.37	1.40	0.75	0.86
Q4	1.71	1.75	1.08	1.10	0.63	0.65
2003						
Q1	1.44	1.49	0.86	0.90	0.58	0.60
Q2	1.51	1.58	0.78	0.80	0.73	0.78
Q3	1.50	1.57	0.66	0.69	0.83	0.88
Q4	1.57	1.70	0.71	0.75	0.86	0.95
2004						
Q1	1.57	1.75	0.69	0.73	0.88	1.02
Q2	1.32	1.51	0.74	0.90	0.57	0.61
Q3	1.62	1.86	1.17	1.38	0.45	0.48

Source: Central Bank of Kuwait.

Table 25. Kuwait: Balance Sheet of the Investment Companies, 1998–2003

(In millions of Kuwaiti dinars)

End of Period	1998	1999	2000	2001	2002	2003
Assets	3,458	3,256	3,518	3,418	3,492	3,928
Cash and balances with local banks	259	208	154	168	134	122
Loans and discounts to residents	354	349	346	437	451	559
Local investments	891	588	421	415	519	835
Foreign assets	1,686	1,868	2,249	2,321	2,285	2,287
Cash and balances with foreign banks	142	134	104	147	62	87
Loans and discounts to nonresidents	182	200	168	145	72	64
Foreign investments	1,334	1,495	1,922	1,801	1,964	1,964
Other	28	39	55	228	187	172
Other assets	269	243	349	78	103	125
Liabilities	3,459	3,256	3,518	3,418	3,492	3,928
Resources from residents	622	394	298	454	503	763
From government	85	7	7	7	0	0
From local banks	296	208	240	393	417	582
From others	241	179	51	54	86	181
Foreign liabilities	1,057	1,124	1,400	1,425	1,389	1,511
Other liabilities	426	428	471	305	375	544
Capital and reserves	1,325	1,271	1,296	1,005	1,038	1,236
Other 1/	28	39	55	228	187	-126
Memorandum item:						
Number of companies covered	34	37	36	25	26	27

Source: Central Bank of Kuwait.

1/ From 2001 onward, including only conventional companies.

Table 26. Kuwait: Summary Balance of Payments, 1998–2003

	1998	1999	2000	2001	2002	2003
	(In millions of U.S. dollars)					
Current account	2,215	5,010	14,671	8,328	4,250	7,318
Goods (trade balance)	1,903	5,516	13,025	9,196	7,241	11,012
Exports	9,616	12,225	19,476	16,246	15,363	20,695
Oil and oil products	8,471	11,029	18,182	14,977	14,057	19,004
Non-oil	1,145	1,196	1,294	1,269	1,306	1,691
Imports	-7,713	-6,709	-6,451	-7,050	-8,123	-9,683
Services	-3,780	-3,611	-3,097	-3,693	-4,188	-4,640
Transportation	-427	-378	-153	-372	-618	-634
Travel	-2,310	-2,178	-2,396	-2,740	-2,902	-3,231
Other services	-1,043	-1,055	-548	-581	-668	-775
Investment income	5,866	5,109	6,698	4,903	3,342	3,325
Receipts	7,162	6,094	7,315	5,428	3,708	3,610
General government 1/	4,665	4,061	4,704	3,673	2,780	2,795
Other 2/	2,497	2,034	2,611	1,755	928	815
Payments	-1,296	-986	-616	-525	-365	-285
General government	-492	-227	-16	-52	-13	-10
Other	-804	-759	-600	-473	-352	-275
Current transfers 3/	-1,775	-2,004	-1,956	-2,078	-2,145	-2,379
Capital and financial account	-2,841	-5,004	-11,555	-3,383	-3,490	-9,901
Capital account 4/	79	703	2,217	2,933	1,671	1,429
Financial account	-2,920	-5,707	-13,772	-6,316	-5,162	-11,330
Direct investment	1,926	49	319	-512	161	4,922
Abroad	1,867	-23	303	-365	155	4,989
In reporting country	59	72	16	-147	7	-67
Portfolio investment	-4,767	-2,559	-12,667	-7,448	-3,263	-13,042
Assets	-4,767	-2,638	-12,921	-7,369	-3,425	-13,377
Liabilities	0	79	254	-78	161	336
Other investment (Net)	-79	-3,197	-1,424	1,644	-2,059	-3,211
Trade credits	351	-841	-274	470	-405	-278
Loans	-535	-283	-489	-42	-270	-225
Currency and deposits	269	-1,850	-1,040	2,055	-1,503	-2,355
Other	-164	-223	378	-838	118	-352
Net errors and omissions 5/	1,123	869	-858	-2,131	-1,446	954
Overall balance	496	876	2,258	2,814	-686	-1,629
International reserve assets (-increase) 6/	-496	-876	-2,258	-2,814	686	1,629
	(In percent of GDP)					
Memorandum items						
Current account to GDP	8.5	16.6	39.8	24.5	12.1	17.5
Overall balance to GDP	2.1	2.8	6.1	8.3	-2.0	-3.9
International reserve assets (US\$ millions)	4,052	4,928	7,186	10,000	9,314	7,685
International reserve assets minus gold	3,947	4,824	7,082	9,897	9,208	7,577
Gold	105	104	104	103	106	108
In months of imports of goods and services	3.8	5.0	7.6	9.7	8.0	5.7

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

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

2/ CBK, local banks, Investment companies, exchange companies, insurance companies, and the non-financial private sector.

3/ Primarily expatriate workers' remittances.

4/ Includes UN war compensation.

5/ Includes other unclassified private sector flows.

6/ As reported in Table 31 of the Statistical Appendix.

Table 27. Kuwait: Composition of Exports, 1998–2003

(In millions of U.S. dollars)

	1998	1999	2000	2001	2002	2003
Total f.o.b.	9,616	12,225	19,476	16,246	15,363	20,695
<i>Of which:</i> re-exports	226	212	209	203	216	416
Oil and oil products	8,471	11,027	18,182	14,977	14,057	19,004
Crude oil	4,500	5,442	11,177	9,592	8,143	11,515
Refined products	3,542	4,977	6,132	4,589	5,273	6,606
<i>Of which:</i> Bunker oil	(111)	(85)	(72)	(52)	(72)	(138)
LPG	428	608	875	795	642	882
Non-oil	1,082	1,138	1,253	1,236	1,294	1,681
Plastics in Primary Forms	470	584	698	682	700	754
Road Vehicles	108	57	53	67	68	168
Non-Metallic Mineral Manufactures	30	34	34	35	40	50
Electrical Machinery Apparatus	33	29	28	32	33	30
Papers & Paperboard	25	25	25	30	33	44
Metalliferous & Metal	32	34	37	33	40	57
Manufactures of Metal	37	41	30	29	27	30
Fertilizers, Manufactured	65	57	64	70	51	111
Inorganic Chemicals	33	32	32	19	29	40
Clothing	12	14	11	17	26	27
Fruit & Vegetables	9	11	14	17	19	21
Machinery & Equipment	8	9	18	17	19	38
Textile Yarn & Fabrics Made-up	9	8	22	17	18	24
Plastics in Non-primary Forms	10	11	20	18	18	19
Other	203	193	167	153	174	267
Adjustments for BOP						
Unrecorded exports 1/	63	60	41	33	12	10

Sources: Central Bank of Kuwait, Ministry of Oil, Central Statistical Office.

1/ Exports not reflected in the customs returns.

Table 28. Kuwait: Composition of Imports, 1998–2003

(In millions of U.S. dollars)

	1998	1999	2000	2001	2002	2003
Total, f.o.b.	7,713	6,709	6,451	7,050	8,123	9,683
By SITC category (c.i.f.)	8,616	7,616	7,156	7,873	9,000	10,780
Food and live animals	1,169	1,135	1,138	1,159	1,260	1,486
Beverages and tobacco	87	100	68	66	83	144
Crude materials	154	145	145	171	209	228
Mineral fuels	38	49	43	41	45	60
Other oils and fats	42	43	41	38	40	50
Chemicals	668	660	678	724	785	943
Manufactured materials	1,577	1,243	1,288	1,474	1,680	2,013
Machinery and equipment	3,550	3,024	2,673	2,976	3,584	4,355
Miscellaneous manufactures	1,180	1,107	992	1,138	1,244	1,429
Other commodities	153	111	91	85	71	70
By economic use (c.i.f.)	8,616	7,616	7,156	7,873	9,000	10,780
Capital goods	1,734	1,367	1,093	1,189	1,381	2,172
Intermediate goods	3,032	2,618	2,625	2,847	3,405	3,769
Consumer goods	3,694	3,516	3,345	3,749	4,139	4,764
Other, unspecified	156	115	94	88	75	74
Adjustments for BOP	-903	-908	-705	-823	-878	-1,096
Unrecorded imports 1/	390	235	368	358	472	520
Freight and insurance payments	-1,292	-1,142	-1,073	-1,181	-1,350	-1,617

Source: Ministry of Planning, Central Statistical Office.

1/ Imports not reflected in the customs returns.

Table 29. Kuwait: External Services, Investment Income, and Current Transfers, 1998–2003

(In millions of U.S. dollars)

	1998	1999	2000	2001	2002	2003
Receipts	9,023	7,753	9,221	7,144	5,405	5,593
Transport 1/	1,198	1,120	1,382	1,204	1,128	1,366
Insurance 1/	72	66	72	72	109	84
Travel	207	92	98	104	118	117
Government, n.i.e.	266	263	251	264	276	332
Other services	20	20	20	20	16	17
Investment income	7,162	6,094	7,315	5,428	3,708	3,610
Government 2/	4,833	4,212	4,951	3,967	3,004	2,929
Private	2,329	1,883	2,363	1,461	704	681
Financial institutions 3/	945	628	724	470	273	272
Other	1,385	1,255	1,640	992	431	409
Government transfer receipts	98	99	85	52	49	67
Payments	-8,711	-8,259	-7,575	-8,012	-8,396	-9,287
Transport 1/	-1,624	-1,498	-1,535	-1,576	-1,747	-2,000
Insurance 1/	-69	-62	-59	-62	-72	-87
Travel	-2,516	-2,270	-2,494	-2,845	-3,020	-3,348
Government, n.i.e.	-1,299	-1,304	-805	-835	-957	-1,080
Other services	-33	-36	-26	-39	-39	-40
Investment income	-1,296	-986	-616	-525	-365	-285
Government	-492	-227	-16	-52	-13	-10
Private	-804	-759	-600	-473	-352	-275
Financial institutions	-650	-453	-447	-333	-217	-164
Other	-154	-306	-153	-140	-135	-111
Government transfer payment	-217	-171	-225	-258	-174	-188
Private transfer payments 4/	-1,657	-1,932	-1,816	-1,873	-2,020	-2,258
Total (net)	312	-506	1,646	-868	-2,990	-3,694
Insurance 1/	3	3	13	10	36	-3
Transport 1/	-427	-378	-153	-372	-618	-634
Travel	-2,310	-2,178	-2,396	-2,740	-2,902	-3,231
Government, n.i.e.	-1,033	-1,041	-554	-571	-681	-748
Other services	-13	-16	-7	-20	-23	-23
Investment income	5,866	5,109	6,698	4,903	3,342	3,325
Government	4,341	3,985	4,935	3,915	2,990	2,919
Private	1,526	1,124	1,763	988	352	406
Financial institutions	295	174	277	137	56	107
Other	1,230	949	1,486	851	296	299
Government transfer	-118	-72	-140	-206	-125	-121
Private transfer	-1,657	-1,932	-1,816	-1,873	-2,020	-2,258

Source: Central Bank of Kuwait.

1/ Available data are prepared according to BPM5 which separate transport from insurance.

2/ Income from external assets managed by Central Bank of Kuwait, Kuwait Investment Authority, Kuwait Petroleum Corporation, and Kuwait Airways Corporation.

3/ Income from external assets of local banks and investment companies.

4/ Includes remittances of long-term expatriate workers.

Table 30. Kuwait: Capital and Financial Account, 1998–2003

(In millions of U.S. dollars)

	1998	1999	2000	2001	2002	2003
Capital and Financial Account	-2,841	-5,004	-11,555	-3,383	-3,490	-9,901
Capital account	79	703	2,217	2,933	1,671	1,429
General Government	-210	-13	68	1,207	283	668
Other sectors	289	716	2,148	1,726	1,388	762
Financial Account	-2,920	-5,707	-13,772	-6,316	-5,162	-11,330
Direct investment	1,926	49	319	-512	161	4,922
Direct investment abroad	1,867	-23	303	-365	155	4,989
General government	1,860	-36	297	-362	168	4,986
Other sectors	7	13	7	-3	-13	3
Foreign direct investment in Kuwait	59	72	16	-147	7	-67
Portfolio investment (net)	-4,767	-2,559	-12,667	-7,448	-3,263	-13,042
Assets	-4,767	-2,638	-12,921	-7,369	-3,425	-13,377
General government	-4,045	-2,300	-12,005	-7,882	-1,925	-12,072
Local banks	154	168	411	-434	-763	60
Investment companies	-876	-506	-1,327	946	-737	-1,366
Liabilities	0	79	254	-78	161	336
Local banks	0	105	254	-78	161	191
Investment companies	0	-26	0	0	0	144
Other investment (net)	-79	-3,197	-1,424	1,644	-2,059	-3,211
Assets	646	-3,512	-1,108	506	-3,754	-2,812
Trade credit	538	-736	-130	470	-405	-278
Loans	-289	-463	-313	-13	-86	-500
General government	-39	-493	-535	-476	-125	-342
Local banks	33	89	114	388	-197	-245
Investment companies	-282	-59	108	75	237	87
Currency and deposits	715	-2,152	-711	760	-2,872	-1,822
General government	-236	-1,945	329	1,034	-2,731	-1,923
Local banks	902	-309	-1,115	-130	-408	289
Other sectors	49	102	75	-144	266	-188
Other	-318	-161	46	-711	-391	-211
General government	-272	-115	52	-127	-618	-208
Local banks	-7	59	-3	-16	7	-60
Other sectors	-39	-105	-3	-568	220	57
Liabilities	-725	315	-316	1,139	1,694	-399
Trade credit	-187	-105	-143	0	0	0
Loans	-246	181	-176	-29	-184	275
General government	-1,125	-36	-851	-33	-46	-37
Other sectors	879	217	675	3	-138	312
Currency and deposits	-446	302	-329	1,295	1,369	-533
Other	154	-62	332	-127	510	-141
General government	-3	26	156	0	447	-144
Local banks	-10	0	33	7	-13	-7
Other sectors	167	-89	143	-134	76	10

Source: Central Bank of Kuwait.

Table 31. Kuwait: Reserves and Net Foreign Assets of the Financial Sector, 1998–2003

(In millions of U.S. Dollars)

	1998	1999	2000	2001	2002	2003
Central Bank net foreign assets	4,045	4,920	7,173	9,989	9,274	7,612
International reserve assets	4,052	4,928	7,186	10,000	9,314	7,685
Central Bank foreign assets	3,591	4,349	6,608	9,294	8,463	6,748
Gold 1/	105	104	104	103	106	108
Foreign exchange (as in IFS)	3,486	4,244	6,504	9,191	8,357	6,641
SDRs 2/	116	74	91	108	133	160
IMF reserve position	345	505	487	598	718	777
Central Bank foreign liabilities	7	8	13	12	40	72
Local banks net foreign assets 3/	2,333	1,903	2,530	1,484	1,366	1,698
Foreign assets	5,929	5,874	6,440	6,594	8,145	8,240
Foreign liabilities	3,595	3,971	3,910	5,110	6,779	6,542
Net foreign assets of the banking system	6,379	6,822	9,703	11,473	10,640	9,311
Net Foreign assets of other financial institutions 4/	2,067	2,496	2,687	2,327	2,387	2,427
Foreign assets	5,691	6,272	7,366	7,023	7,203	7,325
Foreign liabilities	3,624	3,777	4,678	4,696	4,816	4,898
<i>Of which: net foreign assets of investment co.</i>	1,994	2,319	2,600	2,209	2,393	3,052
Foreign assets	5,498	6,013	7,179	6,874	7,049	8,235
Foreign liabilities	3,504	3,694	4,578	4,665	4,656	5,183
Net foreign assets of the financial sector	8,445	9,318	12,390	13,800	13,027	11,738
Memorandum item :						
Central bank foreign exchange						
at central bank valuation 5/	3,447	4,240	6,444	9,205	8,228	6,562
Central bank gross foreign assets 5/	3,553	4,346	6,584	9,319	8,344	6,672
Central bank gross foreign exchange 5/	3,449	4,242	6,481	9,216	8,240	6,566
Net foreign assets of non-bank financial institutions,						
exchange insurance companies	2,045	2,494	2,677	2,333	2,353	2,400
Foreign assets	5,631	6,268	7,339	7,042	7,102	7,243
Foreign liabilities	3,586	3,774	4,662	4,709	4,749	4,843

Source: Central Bank of Kuwait.

1/ At notional valuation of KD 12.5 per fine ounce.

2/ Carried as assets of the Ministry of Finance.

3/ Commercial Banks, specialized banks and Kuwait Finance House.

4/ Investment companies, exchange companies, and insurance companies.

5/ At period average exchange rate.

Table 32. Kuwait: Aggregate Banking Soundness Indicators, 1998–2004

(End of period unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	Sept. 2004	Dec. 2004
Capital								
Capital adequacy ratio								
(Percent of risk-weighted assets)	22.5	23.7	22.2	22.0	19.7	18.4	17.3	n.a.
Equity (percent of assets)	11.4	11.6	11.5	11.2	10.4	10.7	11.3	11.0
Investment companies' capital and reserve								
(Percent of assets)	38.6	39.5	37.4	30.9	31.4	30.5	n.a.	n.a.
Liquidity 1/								
(Percent of assets)	15.5	17.6	16.3	14.8	14.0	12.9	12.5	12.6
(Percent of KD private sector deposits)	32.3	35.8	32.9	28.1	28.7	27.3	24.4	24.4
Foreign currency exposure (percent of assets)								
Foreign currency-denominated assets	19.1	19.4	18.8	17.7	20.8	18.4	18.9	n.a.
Foreign currency-denominated liabilities	18.3	18.5	18.5	18.0	20.4	17.9	18.5	n.a.
Net	0.8	0.9	0.3	-0.2	0.4	0.5	0.4	n.a.
(Percent of capital and reserves)	6.9	7.9	2.5	-2.1	4.2	4.2	3.4	n.a.
Foreign assets and liabilities (percent of assets)								
Foreign assets	13.9	13.8	14.3	13.5	14.3	12.9	14.2	18.1
Foreign liabilities	8.4	9.4	8.7	10.4	11.9	10.2	10.7	10.6
Net foreign assets	5.5	4.5	5.6	3.0	2.4	2.7	3.5	7.5
(Percent of GDP)	9.2	6.5	6.8	4.3	3.8	4.0	4.7	9.4
Sectoral credit concentration (percent of total credit)								
Real estate	17.5	20.0	16.3	19.3	18.9	17.0	16.2	16.4
Personal facilities	35.7	32.1	36.1	38.3	38.3	40.9	41.0	41.0
<i>Of which</i> : credit for trading in securities	6.1	4.4	4.8	6.4	5.8	9.0	8.8	8.5
Non banks financial institutions	5.8	5.7	5.9	10.2	7.9	7.7	7.0	6.5
Ratio of bank lending to banks' own funds								
Stock market-related	77.2	80.9	69.6	92.2	95.8	109.0	114.4	115.9
Real estate	19.9	14.4	15.7	22.9	22.5	37.6	40.3	39.6
	57.3	66.5	53.9	69.3	73.3	71.4	74.1	76.3
Nonperforming loans (in percent of total)								
Pre-invasion 2/	10.3	12.8	19.2	10.3	7.8	6.1	5.4	n.a.
Post-invasion	7.3	6.8	12.8	5.1	4.8	3.6	3.1	n.a.
	3.0	6.0	6.4	5.2	3.0	2.5	2.3	n.a.

Table 32. Kuwait: Aggregate Banking Soundness Indicators, 1998–2004

(End of period unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	Sept. 2004	Dec. 2004
Provisions (in percent of nonperforming loan:	68.2	53.2	50.1	53.7	64.3	72.4	72.4	n.a.
Specific provisions	50.2	40.6	37.0	37.6	42.5	45.3	45.3	n.a.
General provisions	17.9	12.5	13.1	16.1	21.8	27.1	27.1	n.a.
Average lending rate 3/	9.0	8.7	8.9	7.9	6.5	5.4	5.8	6.7
Average deposit rate 3/	6.4	5.8	6.0	4.5	3.2	2.4	2.6	3.3
Spread over 3-month deposit rate	2.6	2.8	3.0	3.4	3.3	3.0	3.2	3.5
Profitability								
Return on total assets (in percent)	1.6	1.8	2.0	2.0	1.8	2.0	2.3	n.a.
Return on own funds (in percent)	13.8	15.3	17.6	18.2	17.4	18.6	20.4	n.a.
Changes in net bank profits (in percent)	-8.2	13.7	20.9	9.9	0.6	21.2	16.8	n.a.
Stock price index of bank shares								
(Percent change)	-33.7	-5.2	11.6	49.2	30.2	42.5	10.5	n.a.
(In percent of general index)	100.6	104.7	124.9	147.0	137.7	97.3	83.0	n.a.

Sources: Central Bank of Kuwait; rating agencies; Global Finance House; and Fund staff estimates.

1/ Cash, central bank current deposits, and treasury bills and bonds.

2/ Guaranteed by government.

3/ For local banks.

Table 33. Kuwait: Selected Stock Market Indicators, 1998–2004

	1998	1999	2000	2001	2002	2003	2004 1/
Market index (1993/12=1,000) 1/	1,583	1,442	1,348	1,709	2,375	4,790	6,410
Value of shares traded (In millions of KD)	3,341	1,841	1,290	3,581	6,680	16,250	11,599
Number of shares traded (In millions)	13,917	9,495	6,758	16,300	27,837	49,563	26,591
Number of transactions (In thousands)	350	212	157	354	521	1,082	806
Market capitalization (In millions of KD end-period)	5,802	6,184	6,378	8,300	10,541	18,093	21,690
Memorandum items							
Number of listed companies	78	85	86	88	95	103	125
Market capitalization/GDP	73.4	67.4	56.2	79.5	98.6	145.4	142.1
Turnover 2/	57.6	29.8	20.2	43.1	63.4	89.8	n.a.
Profits of listed companies (Percentage change)	-43.9	27.1	9.3	26.5	13.4	86.0	n.a.
Price/earnings ratio	13.9	13.9	12.7	14.4	22.5	n.a.	n.a.

Source: Central Bank of Kuwait.

1/ January–December 2004, except for value and number of shares traded and number of transactions (January–September 2004).

2/ Value of shares traded divided by market capitalization.

Table 34. Kuwait: External Debt, 1998–2003

(In millions of U.S. dollars)

	1998	1999	2000	2001	2002	2003
Total external debt outstanding 1/	9,938	10,058	9,956	11,094	12,368	12,404
Drawings	1,068	546	1,004	1,301	1,892	316
Repayment of principle	-1,791	-230	-1,328	-166	-200	-750
Total Interest repayments	1,310	986	618	524	370	288
General government external debt 2/	1,419	1,290	443	409	641	510
Drawings	0	26	157	0	454	0
Repayment of principle	-1,330	-141	-998	-33	-47	-183
Interest repayments	497	227	16	52	13	10
Private external debt 3/	8,519	8,768	9,513	10,685	11,727	11,894
Drawings	1,068	519	847	1,301	1,438	316
Repayment of principle	-461	-89	-330	-133	-153	-567
Interest repayments 4/	812	759	602	472	357	278

Source: Central Bank of Kuwait.

1/ Stocks of external debt include changes due to flows (drawings and repayments) as well as revaluation changes.

2/ Includes year-end stocks of loans, repos. and other credit facilities as defined in the BPM5.

3/ Local banks, investment companies, exchange companies, insurance companies, and Equate company.

4/ Partially estimated on the basis of LIBOR plus 0.5 percent and the average stock of the previous and current year, as data on other non-financial private sector external debt are incomplete.