

REFORMING
WEALTH
DISTRIBUTION
IN KUWAIT

ESTIMATING
COSTS AND
IMPACTS

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Reforming Wealth Distribution in Kuwait: Estimating Costs and Impacts

Steffen Hertog

About the Author

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Abstract

Like other Gulf Cooperation Council countries, Kuwait shares its wealth generously with its population. Yet the way in which it does so is inefficient, inequitable and economically distortive. This is true both for the country's conventional social safety mechanisms and for two large-scale 'quasi-welfare' policies: the provision of cheap or free energy and large-scale public sector employment for citizens. Current wealth sharing policies are fiscally unsustainable given current demographic trends, disproportionately benefit richer households and deeply distort markets for energy and labour.

Against this background, this paper analyses a number of alternative mechanisms of social safety and wealth sharing that could be less distortionary and more conducive to private job generation for nationals. It focuses in particular on the idea of a 'resource dividend': an unconditional cash grant for adult nationals that could be provided in lieu of other, more unequal, discretionary and distortive forms of subsidies and rent sharing.

While the case for a resource dividend has been made in previous research, this paper goes beyond conceptual discussion and illustrates in detail how such a dividend could be financed, what its distributional consequences would be and how it should be combined with other welfare policies to minimise distortions and maximise political feasibility. The paper develops concrete scenarios illustrating how different types of households and businesses would be impacted and discusses the administrative arrangements likely to be required by resource dividend and social safety reform.

Introduction

A state with a high per capita hydrocarbon income like Kuwait faces inevitable political pressures to distribute its hydrocarbon rents among the citizen population. In fact, given the size of Kuwait's natural endowment, sharing wealth is arguably a moral and political imperative. Yet the way in which the Kuwaiti government currently distributes rents is very inefficient, inequitable and economically distortive.

The country's social safety mechanisms are generous, but also regressive, disproportionately benefiting richer households. More importantly, Kuwait uses two key channels outside of conventional welfare policies to share wealth with its citizens on an even larger scale: provision of cheap or free energy and large-scale public sector employment for citizens. Both of these policies are fiscally unsustainable given current demographic trends. They also deeply distort markets of energy and labour, incentivising over-consumption and keeping nationals out of private employment; they have regressive distributional consequences and they undermine the efficiency of both private industrial production and the public sector.

Against this background, this paper analyses a number of alternative mechanisms of social safety and wealth sharing that could be less distortionary and more conducive to private job generation for nationals. It will focus in particular on the idea of a 'resource dividend': an unconditional cash grant for adult nationals that could be provided in lieu of other, more unequal, discretionary and distortive forms of subsidies and rent sharing. It will explain how the introduction of such a dividend would make it politically easier to adjust energy prices, would allow for gradual shrinkage of the size of the public sector, and would give citizens incentives to become employees or entrepreneurs in the private sector. A resource dividend would also facilitate the reform of existing social safety policies to become more targeted and outcome-oriented.

While the case for a resource dividend (RD) has been made in previous research, this paper goes beyond conceptual discussion and illustrates in some detail how an RD could be financed, what its distributional consequences would be and how it should be combined with other welfare policies. The paper develops concrete scenarios illustrating how different types of households and businesses would be impacted and discusses the administrative arrangements likely to be required by RD and social safety reform.

The paper builds on existing research about wealth distribution and social safety net (SSN) reform in Kuwait, notably the 2015 World Bank report on modernising Kuwaiti social safety policies. This paper does take a more holistic view of Kuwait's welfare policies and the underlying political economy, however. It is a key assumption of the paper that it is difficult to reform individual components of Kuwait's wealth sharing regime without taking the larger political economy context into account. It is, for example, hard to introduce means-testing and clearer targeting of SSN policies without a quid pro quo that allows the government to build a broader reform coalition among Kuwaiti households. Simply reducing entitlements is unlikely to work – but reforming them in a way that

means a majority of citizens gains should be possible.

It should be noted that this paper only deals with welfare and rent sharing policies that involve direct material transfers and are clearly distortive and regressive. It does not discuss the free provision of public goods like health and education to Kuwaiti citizens. There are large efficiencies to be gained in reforming these services too, but the challenges involved are quite different and best analysed separately in their own right.

The paper starts with a detailed overview of current wealth sharing policies in Kuwait and their distortive economic consequences and unsustainable fiscal costs. It specifically covers the provision of cheap energy, government employment and conventional social safety mechanisms and transfers, including employment subsidies currently available for Kuwaitis in the private sector. The following section presents alternative wealth sharing and social safety mechanisms, including the RD idea and means-tested social safety policies tied to more active labour market policies. It discusses these issues both conceptually and in terms of the available international experience, suggesting cash grants that are differentiated by employment status, with citizens outside of the public sector receiving higher grants.

This is followed by a detailed section modelling the potential scale of an RD for Kuwaitis that could be financed out of domestic energy price reforms. The paper focuses on the welfare consequences for Kuwaiti households on different income levels, and the consequences for the operating costs of local businesses relying on energy inputs. It also discusses the option of providing additional cash grants financed through expected savings from lower public employment. These savings could be realised through a freeze on public employment and the probable exit of a share of public employees who want to receive the higher cash grants available to individuals outside of the government sector. The paper's final section discusses various institutional and policy design questions that would need to be addressed in the implementation of the RD and accompanying social safety reforms.

Objectives of Welfare and Wealth Distribution Policies

Before analysing the status quo of wealth distribution in Kuwait, we need to define which long-term objectives welfare and wealth distribution should serve. This will allow us to evaluate both current practices and potential future reforms.

Large-scale distribution of hydrocarbon rents among the Kuwaiti population cannot and arguably should not be abandoned. But which principles should guide rent distribution? The following four objectives are generally agreed in principle but often lost from sight in practice:

1. **Long-run fiscal sustainability:** Rent distribution should not threaten the fiscal health of government in either the short or the long run. The empirical 'ratchet effect' of rent distribution – in which new distributional entitlements are quickly created but very hard to dismantle – makes sustainability a particularly pressing concern. The finite

nature of rents and uncertain expectations on future hydrocarbons prices need to be factored into the distributional regime.

2. **Autonomous growth path:** All of the world's major resource-dependent economies have adopted long-term objectives to become independent of rents in their long-run growth and diversification path. This requires technological progress, a move into sectors of production with reduced (direct or indirect) rent-dependence, and in the Gulf Cooperation Council (GCC) cases at least, reduced reliance on low-skilled migrant labour that serves mostly factor-intensive, low-tech production. There is much talk in the GCC about transitioning to a new 'knowledge economy', but the constraints that current rent distribution and labour market structures exert in this context are seldom analysed.
3. **A productive role for nationals in their own economy:** Distribution should be structured so as to minimise work disincentives for nationals, should not dissuade them from acquiring skills relevant for productive employment and should allow them to join the private sector as entrepreneurs or employees.
4. **High and continued citizen welfare:** Wealth distribution should be continuous, efficient and equal; that is, it should be independent of oil price fluctuations, maximise the 'bang for the buck' and provide equal access to all citizens in a fair and transparent manner.

In practice, the distribution regime in Kuwait (as in the rest of the GCC) has grown in a haphazard and path-dependent manner, with the result that such criteria have rarely been taken into account systematically.

The above criteria would appear to be uncontroversial, yet distributional regimes in most resource-rich countries deviate far from them in practice.¹ Kuwait is no exception. This paper aims to identify 'first best' policies that are politically feasible and attain the above four objectives.

Sources and Data

This paper relies on a wide range of qualitative and quantitative data. This includes household, labour and establishment survey data from Kuwait's Central Bureau of Statistics; fiscal data from the Ministry of Finance and the International Monetary Fund (IMF); electricity, water and fuel consumption, revenue and production data from the Ministry of

¹ One could make an academic argument for eschewing economic diversification and relying purely on rent income that gradually transitions from oil rents to investment revenue on growing government-held overseas financial assets; see e.g. Giacomo Luciani, 'Allocation vs. Production States', in Hazem Beblawi and Giacomo Luciani (eds), *The Rentier State* (London: Croom Helm, 1987). In practice, all GCC governments aspire to local diversification, an objective that they are very unlikely to abandon. At a minimum, governments should groom more sophisticated service sectors that generate more value added on the basis of oil rents and local state spending, similar to the Norwegian economy (which continues to export mostly hydrocarbons yet has a mature service economy). Such an objective is complementary rather than rival to the strategy of gradually transitioning from oil rents to overseas investment rents, which is discussed below in this paper.

Electricity and Water (MoEW); and demographic and administrative employment and demographic data from the Public Authority for Civil Information (PACI). It builds on a number of existing studies about wealth distribution and SSN reform in Kuwait. It also relies on a daily survey of the Kuwaiti press over the last decade, as well as a number of qualitative interviews with policy-makers, citizens and private sector stakeholders undertaken during a field mission in February 2019.

I have not enjoyed access to raw survey data, which means that some of the quantitative estimates in this paper are preliminary (and identified as such). I hope that future versions of this research can build on such data to allow for more precise scenario-building.

I would like to express special gratitude to the Kuwait Foundation for the Advancement of Sciences (KFAS) and the Kuwait Public Policy Center (KPPC) for supporting the grant that has enabled this project and for critical support on the ground in Kuwait. I would furthermore like to thank the General Secretariat of the Supreme Council for Planning and the staff at the KPPC at the Secretariat for excellent support in setting up key interviews and acquiring local data.

Context: Wealth Distribution in Kuwait

This paper is not the first to point out that existing policies of wealth sharing in Kuwait and the GCC, although successful in terms of creating a broad middle class of citizens, are fiscally costly and economically distortive.² Among GCC states, Kuwait is one of the most generous, to the extent that spending on citizen benefits crowds out other forms of economic development spending. This is partially because of the strong influence of Kuwait's parliament, which valiantly defends the entitlements of its citizens.³ It is also rooted in Kuwait's constitutional framework. Article 11 of the 1962 constitution states that 'The State ensures aid for citizens in old age, sickness, or inability to work. It also provides them with services of social security, social aid, and medical care.' This paper provides an update on Kuwait's energy subsidy policies, public sector employment practices, social safety and security policies and other transfers.

Energy and Water Prices

The availability of cheap energy is a key channel of wealth distribution across most of the

² Laura El-Katiri, Bassam Fattouh and Paul Segal, 'Anatomy of an Oil-Based Welfare State: Rent Distribution in Kuwait', *LSE Kuwait Programme Research Papers* 13 (London, 2011); Michael Herb, 'A Nation of Bureaucrats: Political Participation and Economic Diversification in Kuwait and the United Arab Emirates', *International Journal of Middle East Studies* 41/3 (2009), pp. 375–95; Steffen Hertog, 'Rent Distribution, Labour Markets and Development in High-Rent Countries', *LSE Kuwait Programme Research Papers* 40 (London, 2016); 'Labor Market Reforms to Boost Employment and Productivity in the GCC', *IMF* (Washington, DC, October 2013); 'Energy Subsidy Reform: Lessons and Implications', *IMF* (Washington, DC, January 2013).

³ Michael Herb, *The Wages of Oil: Parliaments and Economic Development in Kuwait and the UAE* (Ithaca, NY: Cornell University Press, 2014).

Middle East and North Africa (MENA) region,⁴ but it is practised with particular generosity in Kuwait.

Facing a strong decrease in oil revenues, the government increased gasoline and diesel prices in September 2016 to between 85 and 165 fils per litre of gasoline (depending on quality) and 115 fils per litre of gas oil. This was equivalent to an average raise of 70 percent for gasoline and 100% for diesel (although with some exemptions for large consumers), thereby bringing fuel prices close to their value on international spot markets. At the same time, efforts to generally increase tariffs for electricity and (desalinated) water have failed. The partial tariff increases that happened in 2017 have mostly affected customers in the public sector, where water and electricity prices are now close to the cost of production (see Tables 1 and 2) – but where fiscal savings are limited, as one part of government transfers funds to another one. Kuwait has largely lagged behind the rest of the GCC in its energy subsidy reforms, arguably due to its more complex political economy and better collective organisation of vested distributional interests through parliament and civil society⁵ – highlighting the need for creative solutions that minimise the number of losers from any reform.

Both water and electricity services are still provided almost for free for Kuwaiti citizens, who predominantly live in private houses. The electricity tariff structure for such houses has remained unchanged since 1966. In practice, the collection of electricity and water bills is not systematically enforced.

Table 1: Current Kuwaiti Water Tariffs (KD)

Sector	Price per 1,000 Imperial Gallons
Government	4.00
Investment and commercial	2.00
Others (except residential)	2.00
Industrial and agriculture	1.25
Agricultural and industrial (producers) ⁶	0.75
Water filling station	0.50
Reference: average OECD price level	4.50

Source: MoEW

⁴ Laura El-Katiri and Bassam Fattouh, 'A Brief Political Economy of Energy Subsidies in the Middle East and North Africa', *International Development Policy* 7 (2017). Available at <http://poldev.revues.org/bcrfj.revues.org/2267> (accessed 21 February 2020); 'Energy Subsidy Reform', *IMF*.

⁵ Tom Moerenhout, 'Energy Pricing Reforms in the Gulf: A Trend but Not (Yet) a Norm', *International Institute for Sustainable Development* (Winnipeg, 2018).

⁶ Here and in all following tables, 'producers' are firms that have proved to authorities that they are actually producing goods and services; those without such proof are considered inactive and subject to a somewhat higher tariff.

Table 2: Current Kuwaiti Electricity Tariffs (KD)

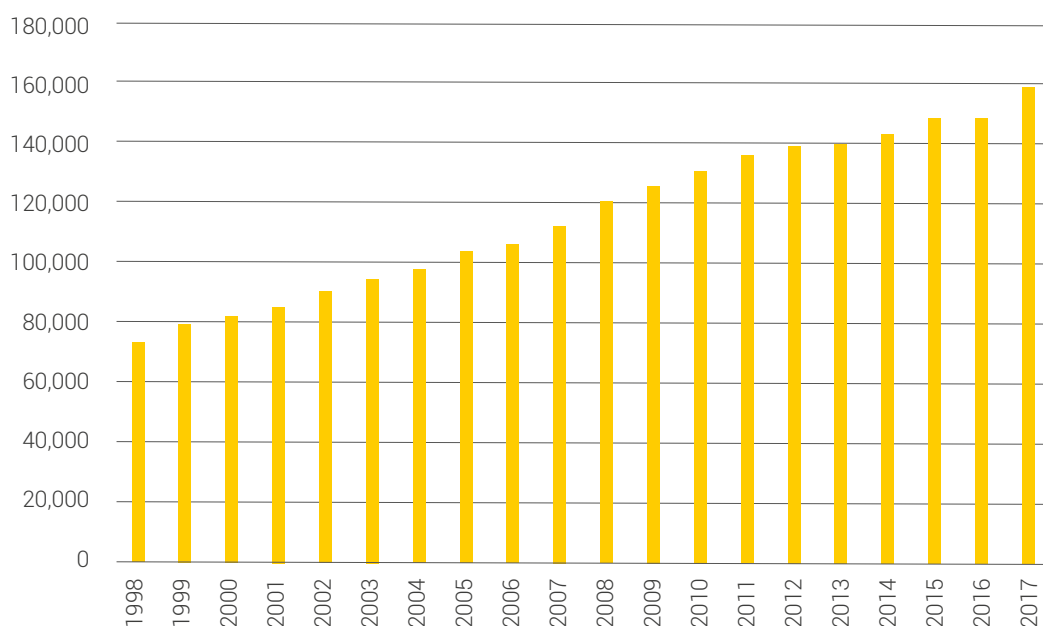
Sector	Price per kWh
Government	0.025
Investment and commercial	0.005
Industrial and agriculture	0.005
Agricultural and industrial (producers)	0.003
Others (except residential)	0.012
Houses (Kuwaiti citizens)	0.002
Reference: average US price	0.040

Source: MoEW

As Figure 1 shows, low water costs for consumers have led to rapid consumption growth, with total distilled water production in Kuwait doubling in less than two decades. As desalination is energy intensive and requires large infrastructure, this creates a significant fiscal burden. In 2017, 62 percent of water consumption was residential, making households the most important target category for bringing escalating water consumption under control.

Total revenue from fresh water sales in 2017 was KD 82 million (MoEW). If water was generally charged at OECD price levels of around KD 4.5 per 1,000 imperial gallons, and bills fully collected, the government would collect more than KD 700 million.

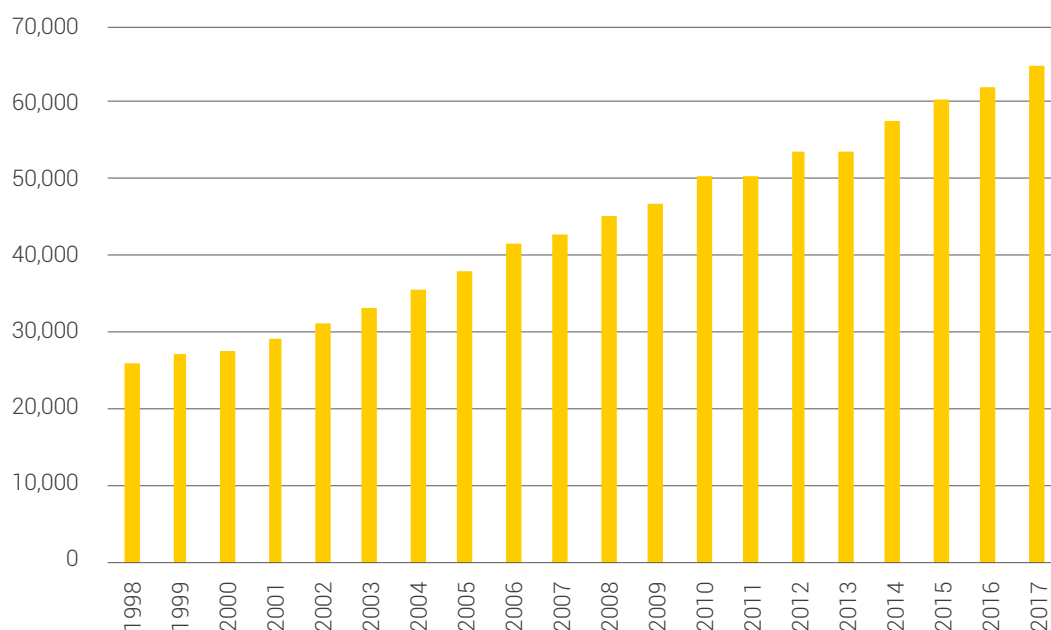
Figure 1: Total Production of Distilled Water, 1998–2017 (million imperial gallons)



Source: MoEW

Figure 2 shows a similar escalation in the consumption of electricity, which has doubled in about 15 years. The rapid growth in electricity consumption has led to brownouts and blackouts for Kuwaiti consumers.

Figure 2: Electricity Produced by Kuwaiti Power Stations under the MoEW, 1998–2017 (million kWh)



Source: MoEW

Just as for water, most electricity consumption is residential (see Table 3): private residences, investment buildings (with apartments, predominantly inhabited by foreigners) and public housing together account for 68 percent of the available electricity load – a high share by international comparison.

Table 3: Distribution of Electricity Loads across Sectors, 2017

	KW	Percentage
Private residential	483206	50.5
Government	77873	8.1
Investment buildings	117727	12.3
Commercial	149822	15.7
Industrial	48399	5.1
Agricultural	29730	3.1
Public housing	50373	5.3

Source: MoEW

The combined electricity load of producing sectors is only 23.8 percent of the total, which is low: internationally, industry consumes closer to 50% of total energy.⁷ This means that if escalating consumption is to be tackled, residential electricity should be the prime target.

As in the water sector, total government revenue in the electricity sector is very low, reaching only KD 109 million in 2017 (MoEW). At average US prices of 13 cents per kWh (a low price in comparison with other developed countries), fully collected revenue would amount to KD 2.57 billion or about 6 percent of GDP.

A popular counter-argument to criticisms of low energy prices in the GCC is that energy is cheap and plentiful in the region. Economically speaking, this is misleading: power and desalination plants in Kuwait are powered either with fuel oil that could be sold at high prices internationally, or by gas that at least in part needs to be imported at high prices from abroad. The country consumes more than 450,000 barrels' worth of its own energy per day and derives almost no revenue from this. If the same amount of crude was sold internationally at oil prices of \$65/barrel, the revenue from this would be KD 3.25 billion or almost 8 percent of GDP. This implies a large fiscal 'opportunity cost' in terms of foregone revenue that could be used for other purposes, including welfare provision for citizens.

There are other reasons why sharing wealth through cheap energy is a bad idea, which have come to be well documented in the international literature.⁸ Notably, low-price energy is also an unfair way of providing welfare as the benefits of cheap electricity, water and fuel accrue disproportionately to wealthy households with higher levels of consumption and are hence equivalent to a regressive tax.

It is doubtful that the utility that consumers derive from cheap energy is anywhere near its opportunity cost and a good deal of the nearly cost-free consumption of energy in Kuwaiti households is frivolous as low costs incentivise over-consumption. There are no incentives for buying more fuel-efficient cars and appliances, insulating houses or turning off the lights – all of which would only modestly inconvenience most consumers, but could significantly improve the long-term fiscal position of the government and liberate funds for more productive uses.

In the private sector, cheap energy can also distort investment decisions, leading to declining

⁷ See 'BP Energy Outlook', *BP*. Available at <https://www.bp.com/en/global/corporate/energy-economics/energy-outlook/demand-by-sector.html> (accessed 21 February 2020).

⁸ Taimur Baig, Amine Mati, David Coady and Joseph Ntamatunigiro, 'Domestic Petroleum Product Prices and Subsidies: Recent Developments and Reform Strategies', *IMF* (Washington, DC, March 2007). Available at <https://www.imf.org/external/pubs/ft/wp/2007/wp0771.pdf> (accessed 21 February 2020); Joshua Charap, Arthur Ribeiro da Silva and Pedro Rodriguez, 'Energy Subsidies and Energy Consumption: A Cross-Country Analysis', *IMF* (Washington, DC, May 2013). Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2276347 (accessed 21 February 2020); 'Case Studies on Energy Subsidy Reform: Lessons and Implications', *IMF* (Washington, DC, January 2013); Paul Stevens and Glada Lahn, 'Burning Oil to Keep Cool: The Hidden Energy Crisis in Saudi Arabia', *Chatham House* (London, December 2011). Available at <http://www.chathamhouse.org/publications/papers/view/180825> (accessed 21 February 2020).

energy efficiency and reliance on resource-intensive rather than efficient technology.⁹ Different from subsidised public services like health and education, energy consumption also entails negative environmental externalities in terms of local pollution and a large contribution to global warming. Very low consumer and industrial energy prices also make the transition towards more sustainable forms of energy difficult – despite the advantageous geography of Kuwait, which enjoys abundant, almost continuous sunshine. It is clear that sharing wealth by providing cheap energy is costly, regressive and deeply distortive.

Other Subsidised Goods

In addition to cheap energy, the Kuwaiti government also provides food subsidies on certain basic items, such as rice, sugar and cooking oil, through the use of ration cards for Kuwaitis, administered through the Ministry of Commerce and Industry (MoCI). According to a recent MoCI statement, around KD 238 million were spent on various kinds of subsidised food supplies and construction material in 2018, including KD 108 million for basic food supplies and KD 4.5 million for various types of baby formula and nutrients. The estimated number of beneficiaries from food supplies (primarily Kuwaitis) totalled 2 million.¹⁰

While the use of food subsidies in a rich country like Kuwait is unusual, the cost incurred is orders of magnitude below that created by cheap energy, and incentives are likely to be less distortive, as it is easier to over-consume energy than to over-consume food items.

Government Employment

The most important channel of wealth distribution in Kuwait, however, is not energy subsidies but rather public employment of citizens, which is far larger in scale than the actual administrative needs of government would require. Kuwait has for decades provided a de facto employment guarantee for its citizens in government agencies. Overall recruitment planning has generally been driven not by administrative needs but by the anticipated annual supply of new Kuwaiti job-seekers.¹¹

As a result, 335,000 Kuwaitis worked in the public sector in 2018, compared to only 64,000 in the private sector and a total citizen population of 1.33 million citizens. Government salaries accounted for 41 percent of total government expenditure in 2018/19, considerably above the international norm of 20–30% and more than twice the country's investment expenditure. Kuwait's government wage bill as a percentage of GDP is 1.5 times larger than that of other GCC countries.¹²

⁹ Steffen Hertog, 'Making Wealth Sharing More Efficient in High-Rent Countries: The Citizens' Income', *Energy Transitions* 1/2 (2017), art. 7.

¹⁰ A. Saleh and Meshaal Al-Enezi, 'Rights Watch Team "Pleased" with Kuwait', *Kuwait Times*, 13 February 2019 (citing the MoCI). Available at <https://news.kuwaittimes.net/website/rights-watch-team-pleased-with-developments-in-kuwait> (accessed 21 February 2020).

¹¹ Herb, *The Wages of Oil*.

¹² 'Kuwait: 2019 Article IV Consultation – Staff Report', *IMF* (Washington, DC, 2019), p. 11.

Evidence of overstaffing is pervasive. About 85 percent of Kuwaitis in employment work in the public sector, compared to an international average of 10–30%. Senior administrators in many agencies informally concede that a large share of their staff is inactive for much of the time. One senior technocrat told us that he might actually need about 150 of the 800 employees in his agency. One striking indicator of overstaffing is that the salary expenditure of the Ministry of Social Affairs and Labor (MOSAL) in 2013 was larger than the total volume of social transfers the ministry provided.¹³

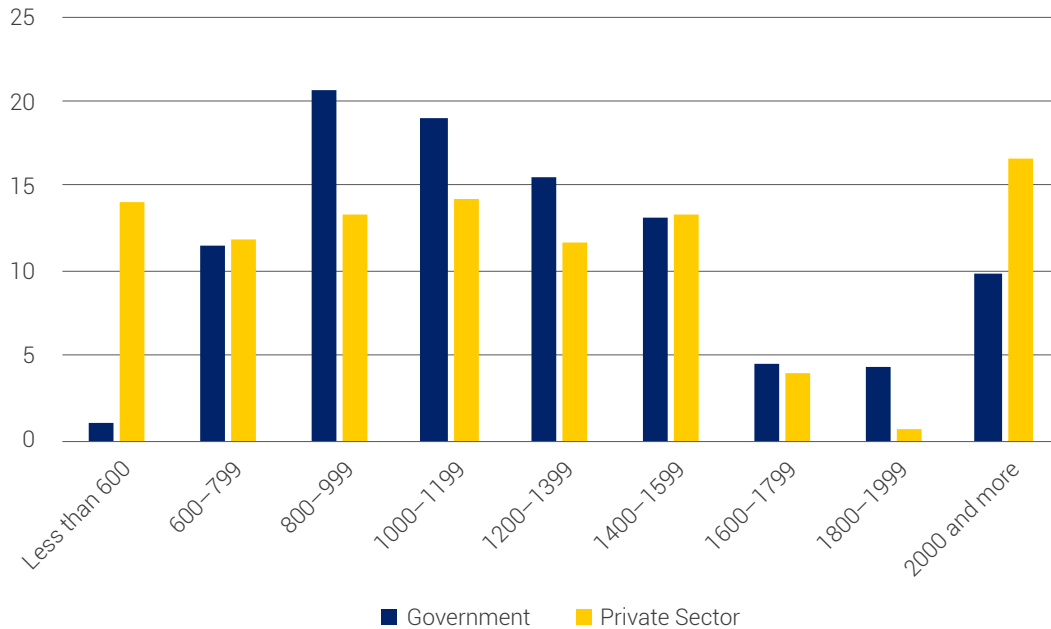
Excess public sector employment creates not only direct salary costs but also overhead costs in terms of building, infrastructure and utility use and commuting-induced traffic jams. Moreover, it reduces the overall efficiency and responsiveness of the bureaucracy, as staff are often not recruited in line with needs and qualifications, and responsibility and accountability become diffuse.¹⁴ This is reflected in Kuwait's middling (and declining) World Bank Governance Indicator score for 'government effectiveness', which has recently dropped below the global average, much below that of OECD countries and also discernibly below that of Kuwait's GCC neighbours.

The easy availability of government employment distorts labour market incentives for citizens. Although the private sector has more well-paid jobs to offer at the top of the wage distribution, on average Kuwaiti citizens are paid better in government jobs than in private sector positions (Figure 3).

¹³ 'Developing a Strategic Social Safety Net Framework for Kuwait', *World Bank*, unpublished report (Washington, DC, 2015).

¹⁴ Ugo Fasano and Rishi Goyal, 'Emerging Strains in GCC Labor Markets', *IMF Middle East and Central Asia Department* (Washington, DC, 2004); Ingo Forstenlechner and Emilie Rutledge, 'Unemployment in the Gulf: Time to Update the "Social Contract"', *Middle East Policy* 17/2 (1 June 2010), pp. 38–51; Steffen Hertog, 'A Comparative Assessment of Labor Market Nationalization Policies in the GCC', in Steffen Hertog (ed.), *Labour Market, Unemployment, and Migration in the GCC* (Geneva: Gulf Research Center, 2011); Richard Shediak and Hatem Samman, 'Meeting the Employment Challenge in the GCC', *Booz & Co* (Dubai, 2010).

Figure 3: Percentage Distribution of Monthly Wages Paid to Kuwaitis by Sector, 2015 (KD)



Source: Central Statistical Bureau (CSB) labour force survey

As importantly, government jobs are highly secure and come with short working hours. Given minimal education requirements, new job-seekers are in practice assured of a government job if they want one, although there can be waiting times until an appointment which differ somewhat by education level and gender. The waiting time until a job is provided can be bridged with generous social benefits provided by the MoSAL as well as other government agencies (see below).

As a result, few nationals of working age are available for private employment. The dominant share of potentially productive national manpower is ‘parked’ in jobs whose economic contribution is in many cases questionable. Public sector employment policies give questionable education incentives, leading to an undersupply of national skills relevant in the private market and an overproduction of graduates in disciplines with limited practical use.¹⁵

Even when citizens join the private sector, this is often only a waystation en route to eventual public employment. Recent statistics show that 11,443 citizens resigned from their private sector jobs between 2015 and 2017 and joined the government.¹⁶ While we lack

¹⁵ Hertog, ‘Comparative Assessment’; ‘Developing a Strategic Social Safety Net Framework for Kuwait’.

¹⁶ A. Saleh, ‘11,443 Nationals Moved from Private to Public Sector Jobs in Three Years’, *Kuwait Times*, 25 November 2018. Available at <https://news.kuwaittimes.net/website/11443-nationals-moved-from-private-to-public-sector-jobs-in-three-years> (accessed 21 February 2020).

statistics about movements in the other direction, interviews indicate that almost no one moves from government to the private sector. While government employment of Kuwaitis has been growing consistently, private job creation for citizens has stalled. In fact, while the number of Kuwaiti government employees grew by about 64,000 from 2009 to 2018, the number of Kuwaitis in the private sector dropped slightly, from 67,000 to 64,000, in the same period. In other words, in just nine recent years, government employment of citizens grew by as much as the total current stock of privately employed Kuwaitis.

The weak presence of national employees in private employment reduces their interest in a thriving and diversified private sector and often leads to a zero-sum conflict between citizens and business when it comes to fiscal and economic policy decisions: while business prefers development-oriented government spending and the opening of new sectors to private investment, citizens prefer social spending and state provision of goods and services. This tension is particularly acute in Kuwait, where citizen interests are powerfully organised through parliament.¹⁷

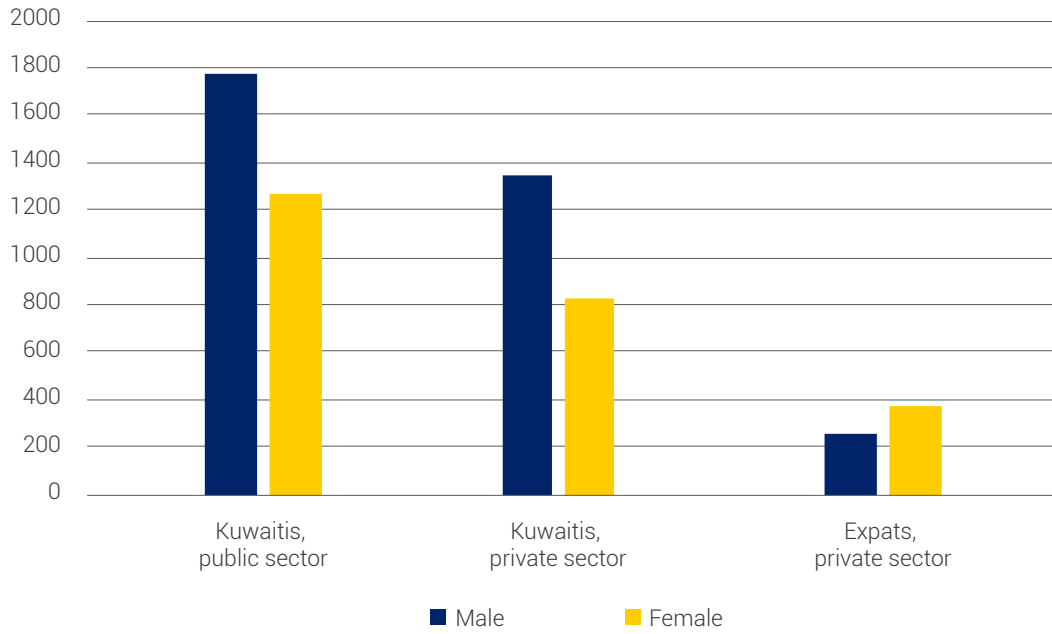
While excessive employment in the public sector is often decried by local economists and technocrats, it has become such a core plank of the local social contract that it has become impossible to slow down or reverse – at least as long as there is no material ‘quid pro quo’ that would make it politically acceptable for citizens to reduce government hiring.

A further key factor that makes citizens uncompetitive in the private sector – and allows private business to get by without employing citizens – is the availability of low-cost foreign labour in Kuwait. As Figure 4 shows, while Kuwaitis in the private sector earn less on average than in government, privately employed expatriates are drastically cheaper.

The large wage gap is not just a function of Kuwaitis’ higher education: while Kuwaitis on average are better educated than foreign workers, the absolute gap in earnings between the two is high (and roughly similar) within all education categories (see Figure 5). In terms of the relative ratio, the gap between low-skilled Kuwaitis and foreigners is the largest, with Kuwaitis being paid about 8 times more than foreigners. From an employer’s perspective, foreigners have the largest cost advantage in the low- to medium-skilled labour market segments.

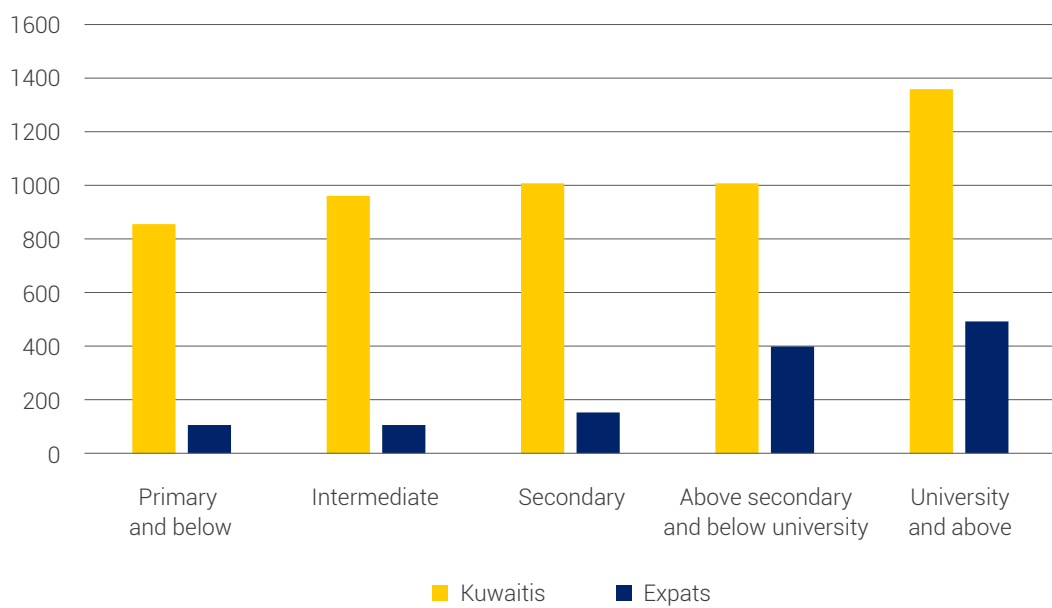
¹⁷ Herb, ‘Nation of Bureaucrats’; Steffen Hertog, ‘The Private Sector and Reform in the Gulf Cooperation Council’, *LSE Kuwait Programme Research Papers* 30 (London, 2013).

Figure 4: Average Monthly Salaries by Sector, Gender and Nationality, Q3/2018 (KD)



Source: CSB Q3/2018 labour force report

Figure 5: Average Monthly Wages by Level of Education and Nationality, all Sectors, 2015 (KD)

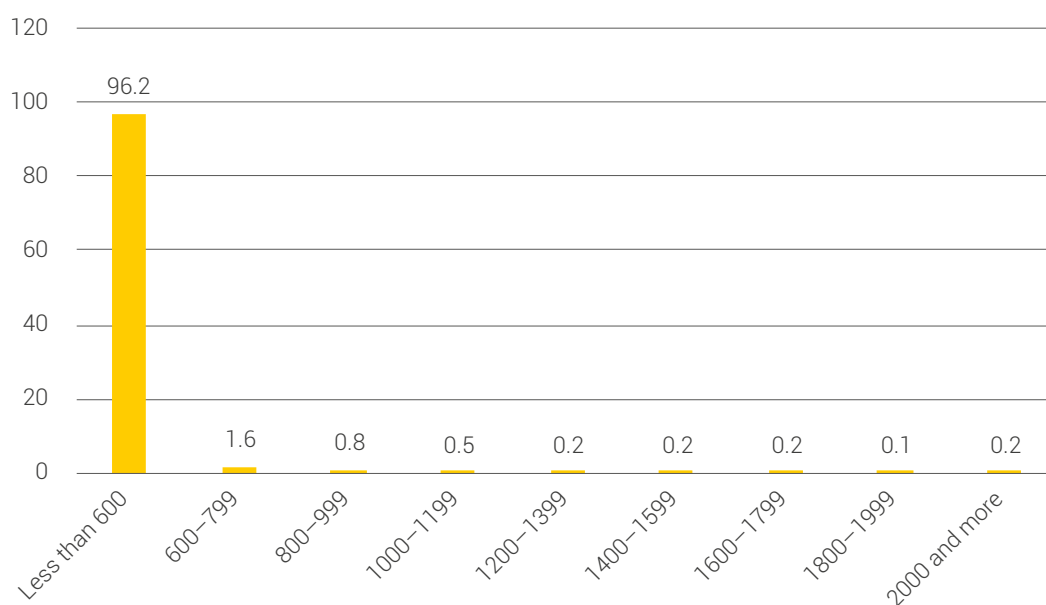


Source: CSB labour force survey

The double wage gap in terms of both sector and nationality drives Kuwaitis to seek government employment and pushes employers to seek foreign workers. Kuwaitis are driven out of the private sector from both sides.

Existing private jobs held by foreigners almost all pay very low wages: only about 60,000 of the 1.61 million foreigners in the private sector in 2015 earned more than KD 600/month (see Figure 6), which some of our interviewees have identified as the minimum socially acceptable monthly wage for citizens. Among these better-paid foreigners, many perform technical roles that will be hard to ‘Kuwaitise’ in the short to medium term.

Figure 6: Percentage Distribution of Monthly Private Sector Wages Paid to Foreigners, 2015 (KD)



Source: CSB labour force survey

The predominant reliance on low-skilled foreigners has helped control cost levels in the private sector, but has also led to stagnant productivity across private sectors in the GCC, where technology use remains relatively limited.¹⁸

The structure of the private labour market means that if the government wants to increase the number of privately employed Kuwaitis:

1. some of this will need to happen in the low- to mid-wage sector; and
2. it is unlikely to happen without further government intervention to improve take-home pay.

The government already provides significant wage subsidies for citizens employed in the private sector, which are discussed below. Lower-skilled Kuwaitis especially might need

¹⁸ Hertog, ‘Private Sector and Reform’.

further aid to reach socially acceptable income levels in the private sector, however.

Other Social Safety and Wealth Transfers

In addition to the provision of subsidised energy and government jobs, the Kuwaiti government also shares its wealth through a number of conventional SSN and welfare policies.

Pensions

The pensions system for Kuwaitis is integrated across the public and private sector and is, in principle, financed through contributions. This systems design puts it ahead of the fragmented schemes of many other Arab countries – yet the generosity of the system has created sustainability issues and forces the government to regularly inject new capital.

For both the basic and supplementary pension, contributors pay 5 percent of their salary, while employers and the government pay in 10% each. While these contributions are substantial, the contribution period is short: the pension age in 2019 was 49 for women and 54 for men, to be increased to 50 and 55 respectively in 2020 – far below international standards, despite life expectancy close to OECD levels. Depending on gender and personal circumstances, only 15 or 20 years of contributions are needed for a full pension.

The monthly basic pension (on earnings up to KD 1,500/month) is 65 percent of the insured's last monthly earnings (75% for military personnel), plus 2% for each year of contributions exceeding 15 years, up to 95% of earnings. The supplementary pension (for earnings between KD 1,500 and 2,750 /month) is 25–30% of the insured person's average monthly earnings during the total contribution period, plus additional percentages for each year of contributions.

The average pension in 2016 reached KD 1,264, more than three-quarters of the average government salary,¹⁹ considerably above typical international ratios. In 2018, the Public Institution for Social Security (PIFSS) reported that the total number of retirees receiving KD 2,000 or more in their monthly pension reached 15,275, those receiving KD 1,000–2,000 reached 73,057, while those receiving less than KD 1,000 numbered 34,356.²⁰ Given the short contribution periods, pensions arrangements are very generous – and there is political pressure from parliament to make arrangements even more free-handed.

As a result of this generosity, and despite annual government contributions above KD 2 billion per year (4.6 percent of GDP), the PIFSS has been accumulating a large actuarial deficit in recent years and currently is only about 60–70% funded. This is despite the fact that it has received repeated, large, one-off injections of capital from government beyond the statutory public contributions. The reform of wealth distribution in Kuwait will also

¹⁹ 'Kuwait Has Lowest Retiring Age Among GCC Countries: PIFSS', *Arabic Times*, 5 October 2017. Available at <http://www.arabtimesonline.com/news/kuwait-lowest-retiring-age-among-gcc-countries-pifss> (accessed 21 February 2020).

²⁰ A. Saleh, 'Govt Failed to Implement Replacement Policy for 15 Years: Lawmaker', *Kuwait Times*, 24 November 2018. Available at <https://news.kuwaittimes.net/website/govt-failed-to-implement-replacement-policy-for-15-years-lawmaker> (accessed 21 February 2020).

have to address the sustainability of the public pensions system, which will become more pressing as the national population ages.

Unemployment Insurance

In 2013, Kuwait also introduced a new, compulsory unemployment insurance regime for its citizens. Under the system, Kuwaiti employees and their employers contribute 0.5 percent each to the insurance fund, supplemented by another 0.5% contribution from the public treasury (similar to the above pensions arrangement). Employees who have been employed for at least six months are entitled to 60 percent of their last monthly salary for a period of six months following unemployment, whether in the case of resignation or termination.

The provision of benefits, even in cases of voluntary resignation, is generous. Interviews at the PIFSS indicate, however, that the take-up of insurance payments has been below expectations, probably due to the fairly static nature of the private labour market for Kuwaitis. The insurance system slightly narrows the gap in job security between the government and private sector, but not enough to substantially narrow the attractiveness gap between the two sectors.

Social Safety Net Allowances and Payments

The MoSAL also provides a wide range of social allowances for Kuwaitis falling into a range of categories. The total volume of the allowance disbursements is small compared to the government's expenditure on subsidies, employment or pensions. Perhaps more importantly, it is not fit for purpose in several regards as it is regressive (disproportionately benefiting richer households), is not tied to systematic activation or assistance policies that would help recipients out of welfare dependence and lacks systematic data analysis and follow-up mechanisms to assess its impact.

The 1978 social assistance law makes a range of persons eligible for welfare payments: widows, divorced women, orphans, the sick, the disabled, families of imprisoned persons, financially incapable individuals, the elderly, students, non-working women and unmarried women. The system consists of 15 different allowances, making it fairly complex and difficult to understand. A World Bank survey conducted in 2014 showed that 77 percent of the beneficiaries knew about their social assistance programme through a relative or friend rather than from official sources.²¹

The provision of some of the MoSAL allowances is in principle means-tested, requiring a single-person household to have less than KD 559 of monthly income. In practice, such tests are not well implemented and many higher-income households receive assistance payments. Some of the benefits, like those for single women above 55, are officially categorical and provided to all applicants falling into the category.

²¹ 'Developing a Strategic Social Safety Net Framework for Kuwait', *World Bank*, p. 34.

The family allowance (which in principle is means-tested) varies from KD 255 per month to KD 1,200, depending on family circumstances. The number of households receiving MoSAL allowances increased from 30,000 in 2011 to about 50,000 in 2018.²²

A number of other government agencies also provide allowances to specific categories of citizens: married Kuwaitis who meet certain criteria are entitled to housing subsidies and zero-interest loans which can be used to purchase plots or houses from the National Housing Authority at subsidised prices. While waiting for such plots or houses, Kuwaitis are entitled to rent smaller houses from the Authority at rents far below market rates. The government also subsidises construction material for houses built on lands purchased from the National Housing Authority. Other benefits provided by government include monthly stipends for all Kuwaiti students in higher education, financial assistance for disabled adults and children and zero-interest loans to finance marriages.

Finally, the government and leadership provide occasional ad hoc transfers, such as Amiri grants that can be paid at times of high oil revenue or political crises (such as the KD 1,000 per citizen grant distributed in 2011), or ad hoc loan forgiveness that is used to write off capital or interest on loans financing home maintenance, holidays abroad or cars.²³

Most of the regular individual benefits listed here cost between 0.1 and 0.3 percent of GDP per year, so are much smaller in scale than energy subsidies or pensions. Yet their total volume is considerable: the cost of non-contributory social benefits provided by the government in 2018/19 reached KD 1.2 billion, representing 2.8 percent of GDP – a considerable item that, if well spent, should have substantial welfare benefits.²⁴

In practice, however, the allocation of benefits is less than efficient: first, the level of MoSAL social assistance provided is quite generous, equivalent to the minimum wage for Kuwaitis in the public sector, and more than three times the national poverty line if the foreign population is included in calculating it. Previous studies have identified benefits as an important disincentive to seeking a job and as an important reason for the presence of a large, economically inactive population of citizens.²⁵

To the extent that means-testing is implemented for specific benefits, it also creates incentives against work, as all benefits are lost once personal income from other sources passes a certain threshold. This drives individuals to keep work income below the threshold.

Anecdotally, it appears clear that some of the recipients of MoSAL support could easily work if they wanted to. In 2013, close to 50 percent of beneficiaries and their dependents had a BA or higher degree. Beneficiaries include divorced women in their mid-20s with bachelor's degrees from local or even US universities who chose to live off categorical

²² '50,000 Kuwaiti Families Could Be Eligible for Social Aid', *Kuwait Times*, 27 January 2019. Available at <https://news.kuwaittimes.net/website/50000-kuwaiti-families-could-be-eligible-for-social-aid> (accessed 21 February 2020).

²³ El-Katiri, Fattouh and Segal, 'Anatomy of an Oil-Based Welfare State'.

²⁴ 'Kuwait: 2019 Article IV Consultation', *IMF*.

²⁵ 'Developing a Strategic Social Safety Net Framework for Kuwait', *World Bank*.

assistance for divorcees instead of seeking gainful employment.²⁶ There is also evidence that single working females resign from their jobs after turning 35 years old in order to draw on assistance provided to single women of this age and older.²⁷ A 2014 World Bank survey of MoSAL beneficiaries revealed that 84 percent of them were not interested in finding a job and 9.8% wanted to work in the public sector only.²⁸ The evidence that the current benefits system provides incentives against work is strong.

In some cases, the social purpose of specific benefits is also unclear: in early 2014, all Kuwaiti females above 55 years of age were made eligible for social assistance, with no clear means-testing arrangements, causing a large increase in the number of beneficiaries – by 14,000 new cases.²⁹

In other cases, the categorical targeting of social assistance programmes invites manipulation: the category of divorced women, for example, doubled from 8,000 cases in 2011 to more than 16,000 by early 2014.³⁰ Interviews indicate that Kuwaiti women have started to get pro forma divorces in local courts, allowing them to apply for divorcee benefits, while getting immediately remarried to their spouses across the border in Saudi Arabia without the knowledge of Kuwaiti authorities. Conversely, there appear to be ‘ghost marriages’ for the sake of receiving housing benefits. The MoSAL’s capacity for assessing beneficiaries’ real incomes, family and household status seems limited and the annual follow-up research that should happen in principle rarely occurs.³¹

The complexity of the benefits system, the administration’s limited capacity for data-gathering and follow-up, and the government’s limited political appetite for cracking down on manipulation all create considerable opportunities to ‘game’ the system. In fact, according to a 2014 World Bank survey, half of the beneficiaries saw social assistance payments as an ‘ongoing assistance providing them with stability’ rather than a temporary form of support allowing them to rejoin the labour market. A quarter even perceived this social assistance as ‘one of their rights and the least they can receive.’³² Various social assistance programmes ensure that most Kuwaitis enjoy a middle-class lifestyle, but they do so in a costly and unaccountable fashion that undermines incentives to be economically productive and benefits those citizens who are most adept at gaming the system in their favour.

A closely related problem with the current social assistance systems is that they are regressive: 2013 household survey data – the most recent publicly available – shows that the poorest 20 percent of Kuwaiti households receive a total average government transfer of KD 90 per adult or equivalent per month, while the richest 20% of households receive around KD 180.³³ Just like energy subsidies, the current cash transfer system ben-

²⁶ Ibid., p. 33.

²⁷ Ibid.

²⁸ Ibid., p. 35.

²⁹ Ibid., p. 18.

³⁰ Ibid.

³¹ Ibid.

³² Ibid., p. 35.

³³ Ibid., p. viii.

efits richer households most of all – a feature that is pretty much unique to Kuwait, since in the rest of the world, cash benefits predominantly go to poorer households. While there are good justifications for sharing Kuwait's natural wealth with its citizens in the form of cash payments, there is no conceivable reason for doing so in a way that predominantly benefits richer households.

'Da'm al-'amala': Private Sector Wage Subsidies for Kuwaitis

There is one final type of government transfer that is worth discussing in more detail due to its importance for the labour market behaviour of Kuwaitis: the monthly subsidies for privately employed Kuwaitis that have been provided by the Manpower and Government Restructuring Program (MGRP) since 2001, and which are informally known as *da'm al-'amala* (wage support).

The levels of the basic allowance differ by family status and education level and are broadly in line with allowances in the public sector, which are similarly differentiated by family status. After a series of drastic public sector salary increases, the *da'm al-'amala* allowances were also almost doubled in early 2013, reaching KD 790 per month for an unmarried holder of a bachelor's degree in engineering. An unmarried high school graduate receives KD 557.

Table 4 shows the current *da'm* allowances for single and married individuals differentiated by education level. The allowance further grows by KD 50/month for each child, up to a total of seven children. The transfer schedule is unusual in that more educated nationals are more strongly subsidised. This contributes to the regressive nature of Kuwaiti social transfers mentioned above, as better-educated citizens generally have higher (non-benefit) incomes to start with. Interviews in Kuwait also indicate that many of the multi-year, post-high-school training courses attended by Kuwaiti citizens are of low quality and merely serve the purpose of formally increasing one's educational attainment to be able to draw higher benefits.

Table 4: Monthly Private Sector Wage Subsidy for Kuwaitis by Level of Education, 2019 (KD)

Degree	Single	Married
College degree: medicine, pharmaceuticals, engineering	790	898
College degree: law, accounting, information systems, finance, economics, statistics, financial management, insurance, international business, banking sciences	740	848
College degree: other majors	690	798
Diploma or high school certificate + training course of no less than two years	629	723
High school diploma + training course of no less than three years	571	663
High school certificate	557	638
Middle school certificate + training course of no less than one year	517	598
Middle school certificate	511	590
Below middle school	456	534

Source: MGRP

Of the profits of publicly listed companies in Kuwait, 0.5 percent are used to finance the scheme. The revenue from this falls far short of its actual costs, however, requiring considerable transfers from the government social affairs budget.

The programme initially contributed to a fairly fast increase in the private employment of Kuwaitis, which according to PACI data rose from about 30,000 in 2005 to 67,000 in 2009 – significantly above the private employment rates in the GCC's other two high-rent countries, Qatar and the United Arab Emirates (UAE), where the share of citizens in private jobs is less than half as high. The *da'm*'s impact was slowed if not reversed by a series of significant hikes in public sector salaries in the early 2010s, however, leading a considerable number of citizens to abandon private jobs for secure public sector employment again. Some Kuwaitis at the time spoke of a wave of *hijra* (migration) of Kuwaiti employees from the private to the public sector.

The *da'm al-'amala* allowances in turn were almost doubled in early 2013, but this has been insufficient to completely close the public/private salary gap discussed above, which is compounded by the more convenient working conditions in government. As a result, private employment for citizens has been stagnating since the early 2010s.

There is also evidence that not all of the Kuwaiti private employment that is supported by the *da'm* system is genuine: reports about Kuwaiti nationals signing job contracts and collecting support without performing any actual work abound. This allows companies to fulfil official Kuwaitisation quotas while generating free (though illicit) benefits for citizens. In some cases, the employees are allowed to keep the (usually small) salary employers provide to them, while in others it is clawed back by employers. That more than half of *da'm* recipients are female – despite a historically low labour market participation by females in Kuwait and the wider GCC – as well as the unusually large share

among them who receive wages just above the KD 230 per month minimum necessary to register for the social security system, strongly suggest that many of them are ‘phantom employees’.³⁴

This shows that the *da‘m* programme, while certainly helping with genuine private employment of Kuwaitis, has been subject to manipulation similar to other social assistance programmes. And again, the political economy of wealth sharing in Kuwait, under which government transfers are seen as a firm entitlement for citizens, has so far prevented the government from cracking down on abuse.

Fiscal Projections: Sustainability Issues

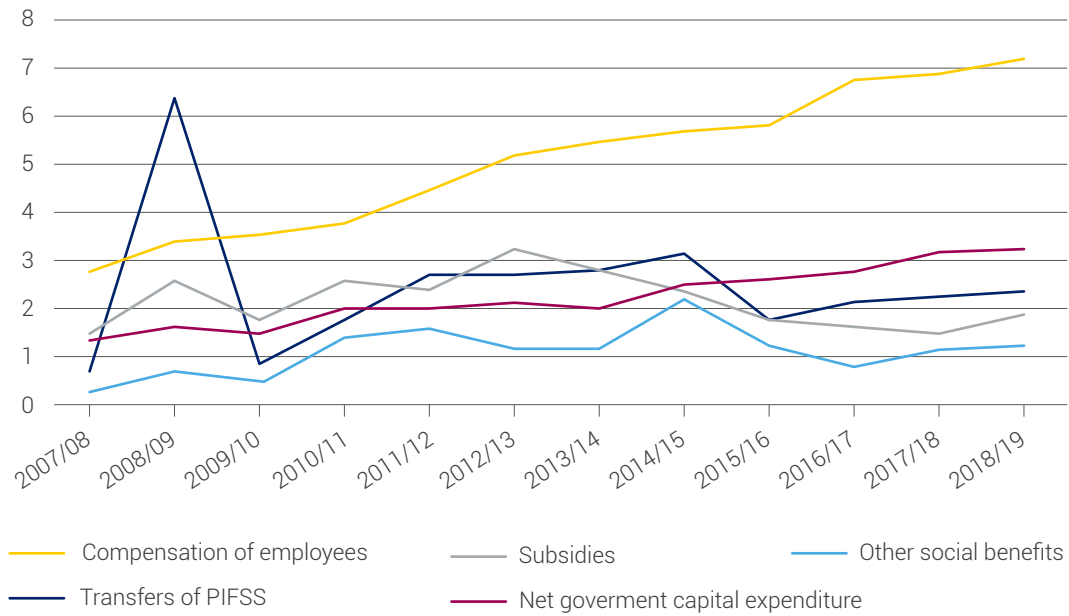
The current wealth distribution system is inefficient and unequitable, but perhaps a rich country like Kuwait can afford this? While this might have been the case historically, the sustainability of the system is increasingly in question. Already now, current spending on salaries and transfers dominates total government expenditure, crowding out development spending on infrastructure and projects. Figure 7 shows that government transfers to the PIFSS alone in some years have been larger than government net capital expenditure, while the cost of salaries is more than twice as large and has been trending upwards rapidly, more than doubling in the last decade and significantly growing its share in total expenditure since 2007/08 (Figure 8).

The subsidies item has dropped somewhat in recent years, but this is merely due to decreases in international energy prices, which reduce the estimated opportunity costs of providing cheap domestic energy. As we have seen above, water and electricity consumption has doubled in less than two decades, reflecting a growth path that could soon become unsustainable.³⁵

³⁴ MGRP data from 2011 furthermore show that a disproportionate number of females with intermediate education who are above 30 years of age receive wage subsidies – a category of females that evinces a much lower labour force participation rate in other GCC countries where no wage subsidies are available.

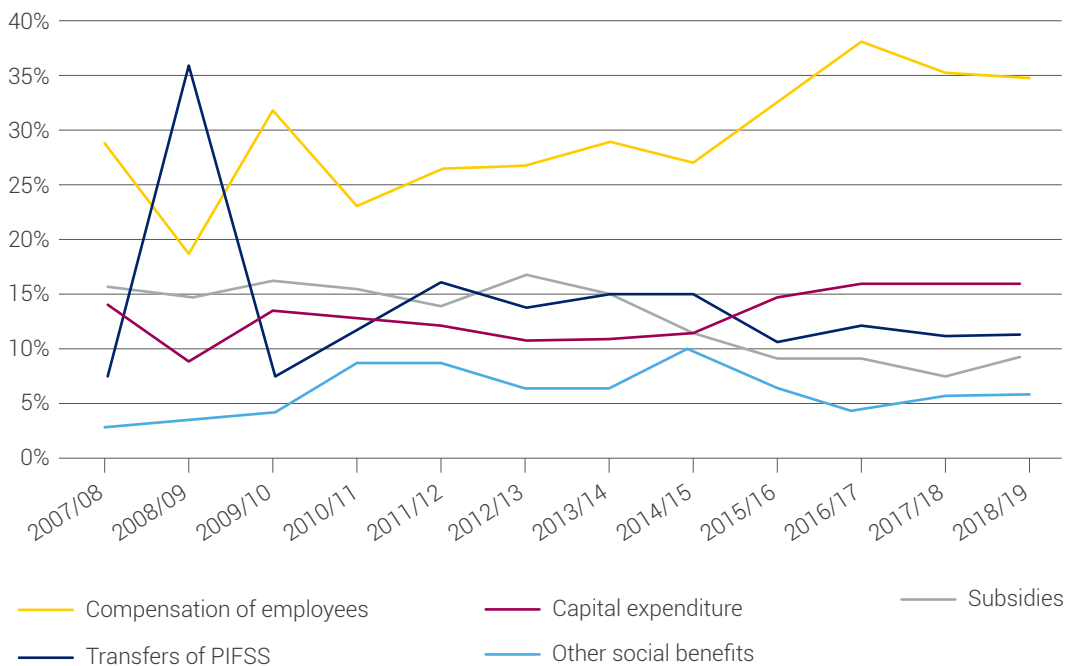
³⁵ The IMF’s as well as the government’s own subsidy estimates also appear low; using average international product prices for fuel, water and electricity to estimate lost income produces numbers that are about 50 percent higher; see footnote 81 in the UCG scenario section below.

Figure 7: Government Expenditure, 2007/08 to 2018/19 (KD billion)



Source: IMF, various reports

Figure 8: Share of Expenditure Items in Total Government Spending, 2007/08 to 2018/19



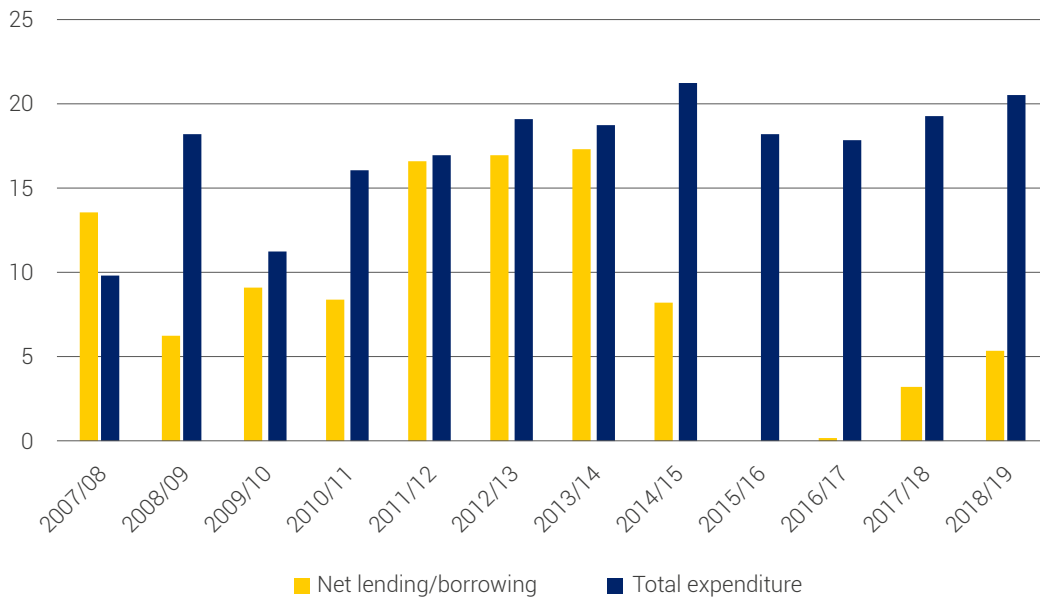
Source: IMF, various reports

The total share of salaries, subsidies and transfers in Kuwaiti government expenditure reached an estimated 61.3 percent in 2018/19, a very high proportion by international comparison – and four times as much as capital expenditure. Interviews also indicate that some of the 15–16% of capital expenditure is not investment in productive infrastructure but rather expenditure on ministerial buildings, the growth of which is mostly a function of inflated public employment, hence not contributing to the productivity of the national economy.

The data also shows that government salaries are by far the largest individual item, more significant than either social spending or subsidies and on the most unsustainable growth path. Any meaningful reform of the Kuwaiti wealth distribution system will therefore have to put salaries at its centre.

While the composition of government expenditure is increasingly skewed, it could still be sustainable in accounting terms. Figure 9 shows, however, that the considerable fiscal surpluses of the mid-2010s (blue bars) have almost entirely disappeared with recent declines in the oil price.

Figure 9: Total Government Expenditure and Net Lending/Borrowing, 2007/08 to 2018/19 (KD billion)

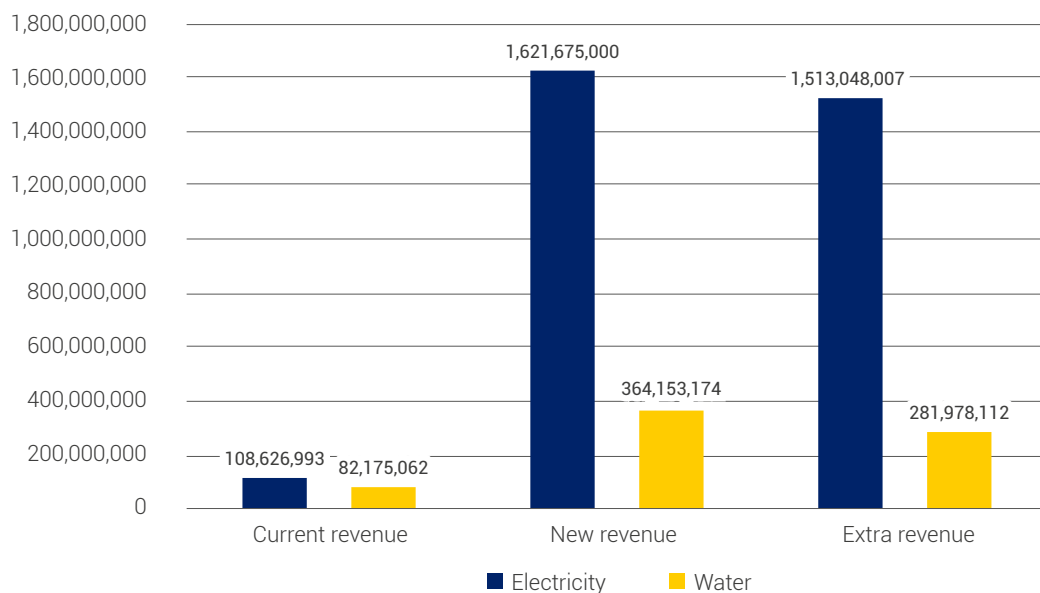


Source: IMF, various reports

Given recent trends, and unless oil prices recover considerably, a continuation of the wealth sharing trends of recent years could soon push Kuwait into significant fiscal deficits. This is both because the citizen population continues to grow by at least 2 percent per year and because per capita spending has been trending up, accelerated by occasional political and economic shocks like temporary oil price increases, which incentivise spending increases that are hard or impossible to reverse. And while birth rates have been dropping, the growth of the working-age citizen population will remain high for many years to come; the current cohort of five- to nine- year-olds who will enter the labour market in ten years and after numbers 159,000 citizens, a full 25 percent more than the cohort of 15–19-year-olds who are just about to enter and of whom there are only 127,000 (see 2019 CSB population estimates).³⁶

Figure 10 shows the development of government expenditure and deficits under a ‘business as usual’ scenario, based on IMF forecasts until 2024 and our own extrapolation of fiscal trends after that. Under this scenario – which includes fairly optimistic assumptions of increasing investment and oil income in the coming years – a deficit would appear after the mid-2020s and escalate soon afterwards.

Figure 10: Forecast Expenditure and Deficit Trends under Business as Usual, 2007/08 to 2033/34



Source: IMF up to 2024, own calculation afterwards

³⁶ ‘Population Statistics’, CBS. Available at https://www.csb.gov.kw/Pages/Statistics_en?ID=67&Parent-CatID=%201 (accessed 4 March 2020).

The above estimate does not count payments into the Future Generations Fund (FGF) as expenditure. Given the legal requirement to transfer at least 10 percent of the government's income to the FGF on an annual basis, a tight fiscal situation will, in fact, occur earlier: Moody's estimates that the General Reserve Fund, which is used as a short-term fiscal balancing tool, could be depleted as early as the 2021–22 fiscal year. After this, Kuwait would have to incur significant debt above the current debt ceiling or – more problematically – tap the FGF.³⁷ Already now, Kuwait incurs significant deficits – between KD 2 billion and 6 billion/year since 2015/16 – if money transferred to the FGF and reinvested investment income are not included in state revenue.

The above means that the wealth distribution system that drives Kuwaiti fiscal trends is not only inefficient but also unsustainable. There is an urgent need to shock-proof the Kuwaiti fiscal system by reforming its wealth distribution policies. Avoiding the near-automatic escalation of expenditure through energy subsidies and government employment is of particular importance. This needs to happen soon, as adjustment will be politically more difficult once significant deficits are incurred: resources for compensating the losers from reform and financing the temporary extra costs of transitioning to a new system will not be available then, leading to zero-sum conflict that could prevent any meaningful reform.

Summary

To sum up, the Kuwaiti government shares wealth with its citizenry in an exceptionally generous way, thereby sustaining a large national middle class. Unconventional wealth sharing policies through the provision of cheap energy and, most of all, very generous government employment is the dominant policy and its costs are orders of magnitude larger than those of conventional social safety and security. That said, conventional social welfare policies are also unusually generous, even by regional GCC standards.

Almost all current forms of wealth sharing are distortive of economic incentives and typically benefit richer households more than poorer ones. Social assistance in particular is rather complex, its purpose is not always clear and there is limited monitoring and follow-up capacity, which in some cases invites manipulation and abuse. The partial success of some wealth distribution policies – like the *da'm* system's initial ability to draw Kuwaitis into the private sector – has often been offset by expansion of wealth distribution in other areas, such as government employment.

The system is not only distortive and inefficient, but also fiscally unsustainable. Depending on which metric is used, a 'business as usual' scenario of expenditure will lead to significant fiscal stresses by the early to mid-2020s.

The material interests of the Kuwaiti middle class are well organised through parliament and other political channels, leading to an inability to consolidate spending policies or crack down on abuse. The only politically feasible reform is arguably one that does not cut wealth distribution in the first instance, but consolidates it into a fairer, less distortive (and less easily manipulated) system. Such reform options will be discussed in the rest of this paper.

³⁷ Samad Khan, 'Kuwait's Sovereign Wealth Fund Assets Grow Despite Oil Price Volatility', *NBusiness*, 29 May 2019. Available at <https://www.thenational.ae/business/economy/kuwait-s-sovereign-wealth-fund-assets-grow-despite-oil-price-volatility-1.867600> (accessed 21 February 2020).

Alternative Wealth Sharing Mechanisms: Conceptual Debate

It is clear that the current wealth distribution system in Kuwait is distortive and not sustainable in the long run. The following section will discuss conceptually how wealth should ideally be shared to minimise economic distortions and maximise inclusion, fairness, transparency and fiscal sustainability. The key focus will be unconditional cash grants (UCGs) as a substitute for energy subsidies and surplus employment in the public sector. Kuwait (like other GCC economies) offers a unique opportunity for introducing a cash grant system. Unlike in non-oil economies, the grants could be financed purely out of reforms of existing wealth sharing mechanisms, would not require any new taxation and would drastically improve economic incentives for citizens to become active in the private economy while safeguarding their material welfare. While the key focus is on reducing energy subsidies and excess public employment, the paper will also discuss how a cash grant system could facilitate the reforms of other social safety and security mechanisms.

Unconditional Cash Grants

UCGs (or ‘universal basic income’) are a welfare policy option that has been increasingly widely debated in both advanced and developing economies.³⁸ At the same time, the discussion around such cash grants in high-rent economies like Kuwait is still in its infancy, although they offer a uniquely propitious environment for their introduction.

In the Kuwaiti case, the basic policy idea would be to gradually replace energy subsidies and excess public employment with a regular UCG for all adult citizens who are not already employed in government, and a proportionally smaller grant for underage citizens.³⁹ Its introduction should be combined with a clear political signal that, in the future, the government would provide basic welfare for citizens through the UCG mechanism and would stop hiring citizens more or less indiscriminately, but only hire selectively in line with its actual functional needs. The separation of public employment from rent distribution would facilitate government recruitment that is purely needs-based, meritocratic and more selective, resulting in greatly reduced intake numbers.

A UCG would be a more incentive-neutral, transparent, fair and efficient way of sharing the nation’s wealth, while acting as potent political justification for increasing domestic energy prices and reducing public sector recruitment. It would allow nationals to ‘top

³⁸ Philippe Van Parijs, ‘Basic Income: A Simple and Powerful Idea for the 21st Century’, presented at the Basic Income European Network VIIIth International Congress, Berlin, 2000; Philippe Van Parijs and Yannick Vanderborght, ‘Basic Income in a Globalized Economy’, in Brigid Reynolds and Seán Healy (eds), *Does the European Social Model Have a Future?* (Dublin: Social Justice Ireland, 2012), pp. 31–60; Karl Widerquist and Michael A. Lewis, *The Basic Income Guarantee and the Goals of Equality, Efficiency, and Environmentalism* (New York: Bepress, 2009). Available at <http://works.bepress.com/widerquist/17> (accessed 21 February 2020); Paul Segal, ‘Resource Rents, Redistribution, and Halving Global Poverty: The Resource Dividend’, *World Development* 39/4 (April 2011), pp. 475–89.

³⁹ See Hertog, ‘Rent Distribution’, for a detailed case for a UCG in high-rent countries.

up' modest private sector earnings so as to reach an acceptable overall income, without creating the disincentives to work that means-tested social security provisions create, under which benefits are lost once individuals generate their own earnings (the so-called 'welfare trap').⁴⁰

A UCG would hence allow citizens to compete more effectively with migrant labour and, due to the basic security it provides, enable citizens to upgrade their skills and take risks as entrepreneurs. The larger number of citizens that would be active in the private economy would create a political constituency for private-driven growth. Reduced energy subsidies for their part would incentivise the private sector to invest in technology-intensive production rather than low-tech, energy-intensive structures – especially if government supported such technology acquisition. This, together with the larger availability of qualified national labour, would push private business towards the much-vaunted 'knowledge economy'.

A UCG would be financed through subsidy reductions, reduced public sector hiring and, in the long run, potentially a permanent dividend on Kuwait's overseas investments. It would create none of the fiscal trade-offs, economic disincentives and moral problems that bedevil the basic income concept in tax-based economies, where the discussion about UCGs originated.⁴¹ Given that current wealth sharing mechanisms have been identified as mostly regressive, a flat rate UCG for all citizens outside of the public sector would have a progressive income distribution effect.

The delinking of public employment and rent distribution would make wealth sharing broader, less exclusive, less discretionary and much less distortionary in term of labour market incentives. With UCGs, citizens would not have to take on idle, often unrewarding government jobs to share in the country's wealth but would be free to pursue their own preferences, including on the private labour market. Although the size of the private employment effect would depend on grant level as well as prevailing private wage levels, it is clear that with prospects of an easy public job more remote, at least some citizens would seek other sources of work income.

⁴⁰ On work incentive effects of UCGs, and a general review of relevant literature, see Ugo Colombino, 'Is Unconditional Basic Income a Viable Alternative to Other Social Welfare Measures?', *IZA World of Labor* (2019), art. 128.

⁴¹ A detailed discussion of counter-arguments is contained in Hertog, 'Rent Distribution', which also compares UCGs to alternative, means-tested welfare mechanisms.

Relevant Literature on Resource-Rich Countries

The case for direct cash grants has been made in some detail for lower-income resource-rich countries, showing that compared to regressive energy subsidy systems they are more equitable,⁴² less distortive of consumption decisions and more transparent.⁴³ Compared to means-tested support systems, they are easier to administer, generate smaller overheads and are less prone to stigmatisation and errors of exclusion.⁴⁴

Cash grants could impart a sense of ownership in citizens, increasing their 'buy in' into the political system,⁴⁵ and creating both a constituency for sound natural resource management and a more level playing field between state and citizens.⁴⁶ Pressures for fiscal transparency and accountability would increase.⁴⁷

By providing a secure revenue stream to citizens, cash grants could boost private investment and entrepreneurship.⁴⁸ Authors in the wider literature on cash grants have adduced considerable evidence that private agents are adept at investing their money well.⁴⁹ Devarajan et al. have developed a model that shows the superiority of direct dividend transfers in resource-rich countries over ways for governments to use the revenues.⁵⁰

Practical Experiences with Cash Grants in Non-Rentier Countries

While UCGs are yet to be trialled on a large, longer-term scale in rich countries, there is already a wide range of research about the practical impacts of cash grants (both conditional

⁴² Martin E. Sandbu, 'Natural Wealth Accounts: A Proposal for Alleviating the Natural Resource Curse', *World Development* 34/7 (July 2006), pp. 1153–70.

⁴³ Todd J. Moss, 'Oil to Cash: Fighting the Resource Curse Through Cash Transfers', *Social Science Research Network* (Rochester, NY, 4 January 2010). Available at <http://papers.ssrn.com/abstract=1824605> (accessed 21 February 2020).

⁴⁴ Segal, 'Resource Rents'.

⁴⁵ Thomas Palley, 'Combating the Natural Resource Curse with Citizen Revenue Distribution Funds: Oil and the Case of Iraq', *Institute for Policy Studies* (Washington, DC, December 2003).

⁴⁶ Alan Gelb and Sina Grasmann, 'How Should Oil Exporters Spend Their Rents?', *Social Science Research Network* (Rochester, NY, 10 August 2010). Available at <http://papers.ssrn.com/abstract=1660570> (accessed 21 February 2020); Alexandra Gillies, 'Giving Money Away? The Politics of Direct Distribution in Resource Rich States', *Social Science Research Network* (Rochester, NY, 11 November 2010). Available at <http://papers.ssrn.com/abstract=1824444> (accessed 21 February 2020).

⁴⁷ Sandbu, 'Natural Wealth Accounts'; Segal, 'Resource Rents'.

⁴⁸ Gelb and Grasmann, 'How Should Oil Exporters Spend Their Rents?'; Palley, 'Combating the Natural Resource Curse'; Sandbu, 'Natural Wealth Accounts'.

⁴⁹ Nancy Birdsall and Arvind Subramanian, 'Saving Iraq From Its Oil', *Foreign Affairs*, 1 July 2004. Available at <http://www.foreignaffairs.com/articles/59923/nancy-birdsall-and-arvind-subramanian/saving-iraq-from-its-oil> (accessed 21 February 2020); Alan Gelb and Stephanie Majerowicz, 'Oil for Uganda – or Ugandans? Can Cash Transfers Prevent the Resource Curse?', *Center for Global Development* (Washington, DC, July 2012); Chang-Tai Hsieh, 'Do Consumers React to Anticipated Income Changes? Evidence from the Alaska Permanent Fund', *American Economic Review* 93/1 (2003), pp. 397–405; Sandbu, 'Natural Wealth Accounts'.

⁵⁰ Shanta Devarajan and Marcelo Giugale with Helène Ehrhart, Tuan Minh Le and Huong Mai Nguyen, 'The Case for Direct Transfers of Resource Revenues in Africa', *Center for Global Development* (Washington, DC, 2013).

and unconditional) in the developing world. An experiment with unconditional grants in Kenya has shown a strong consumption response to transfers, thereby benefiting both household welfare and the local private sector; large increases in psychological well-being; and higher spending on durables, helping to overcome savings and credit constraints.⁵¹

Cash transfers in the developing world generally lead to higher household expenditure and an increase in productive household investment, even if this is not generally a policy objective of transfer programmes. Effects on labour supply (which could decrease due to the availability of non-wage income) are either absent or very small.⁵² On the basis of seven randomised control trials of cash transfer programmes in six countries (Honduras, Indonesia, Mexico, Morocco, Nicaragua and the Philippines), a team of economists found no evidence that cash transfers have impacts on either the propensity to work or the overall number of hours worked.⁵³ The literature also shows that if transfers are to have a bigger and sustainable impact, they should be provided for longer periods of time.⁵⁴

Impact evaluations also show that beneficiaries of cash transfer programmes are more likely to save, as demonstrated by Ghana's Livelihood Empowerment Against Poverty (LEAP), Kenya's Hunger Safety Net Programme and Zambia's Child Grant Program.⁵⁵ The experience in developing countries also indicates that categorical programmes that are not universal can lead to errors of exclusion⁵⁶ – another argument for making basic cash grants unconditional.

There is significant regional experience with energy subsidy reforms that are accompanied by cash grant policies which compensate households for the higher costs. The Jordanian reform of energy subsidies in 2012, for example, introduced a large-scale cash transfer programme to households earning less than JOD 10,000 a year, covering about two-thirds of all Jordanian households,⁵⁷ thereby generating political support for the reform while substantially increasing energy efficiency. Converting subsidies into less distortive welfare tools is a standard recommendation in international literature and an approach

⁵¹ Johannes Haushofer and Jeremy Shapiro, 'The Short-Term Impact of Unconditional Cash Transfers to the Poor: Experimental Evidence from Kenya', *Quarterly Journal of Economics* 131/4 (2016), pp. 1973–2042.

⁵² Francesca Bastagli, Jessica Hagen-Zanker, Luke Harman, Georgina Sturge, Valentina Barca, Tanja Schmidt and Luca Pellerano, 'Cash Transfers: What Does the Evidence Say? A Rigorous Review of Programme Impact and of the Role of Design and Implementation Features', *Overseas Development Institute* (London, 2016). On labour supply responses, see also Independent Evaluation Group, 'Social Safety Nets and Gender: Learning from Impact Evaluations and World Bank Projects', *World Bank* (Washington, DC, 2014).

⁵³ Abhijit V. Banerjee, Rema Hanna, Gabriel E. Kreindler and Benjamin A. Olken, 'Debunking the Stereotype of the Lazy Welfare Recipient: Evidence from Cash Transfer Programs', *The World Bank Research Observer* 32/2 (2017), pp. 155–84.

⁵⁴ Bastagli et al., 'Cash Transfers'.

⁵⁵ *Ibid.*

⁵⁶ Marito Garcia and Chairy M. T. Moore, 'The Cash Dividend: The Rise of Cash Transfer Programs', *World Bank* (Washington, DC, 2012).

⁵⁷ Aziz Atamanov, Jon Robbert Jellema and Umar Serajuddin, 'Energy Subsidies Reform in Jordan: Welfare Implications of Different Scenarios', *World Bank* (Washington, DC, 2015).

that numerous countries have practised already.⁵⁸ The Kuwaiti context provides unique opportunities in this regard as the energy subsidies per citizen are unusually high.

There is also some experience with cash grants in developed countries that are closer to Kuwait in terms of GDP per capita, although the number of policy experiments conducted in such contexts is much smaller. One oft-cited set of trials involved negative income taxes provided to select US citizens in the 1970s. Negative income taxes are not quite the same as a UCG, as their financial benefits disappear with larger non-benefit income, therefore creating larger work disincentives. Even under these conditions, however, the observed reduction in labour efforts was only marginal.⁵⁹ More recently, Finland has experimented with a two-year unconditional cash benefit for a subset of unemployed citizens. The recipients reported higher levels of happiness and health than a control group that did not receive the benefits, while there was no clear impact on employment (probably because other unemployed Finns are required to participate in active labour market programmes and can lose their benefits if they don't).⁶⁰

The policy context of both developing and advanced countries is rather different from the Kuwaiti one. Yet the positive behavioural response to cash grants in a wide variety of settings is encouraging, including the responsible use of newly available resources and the fact that additional income does little to reduce labour supply. In the Kuwaiti context, of course, UCGs would replace other types of wealth transfer that create much stronger incentives against private sector work, including public sector employment and social assistance grants, so are more likely to create a positive labour market response.

Experience in Resource-Rich Countries

There are two resource-rich economies in which UCGs have been deployed on a national scale, although on fairly low levels: first, Iran introduced unconditional household cash grants as compensation for higher energy prices from 2010 on. Although the programme has met some elite-level political resistance, popular opposition has been limited, not least because, unlike means-tested welfare schemes, the programme included all citizens.⁶¹ Similarly, Alaska has been sharing parts of its reinvested oil revenue on an annual basis with all of its residents since 1982. In 2018, the annual grant to each man, woman and child meeting

⁵⁸ Shanta Devarajan, Lili Mottaghi, Farrukh Iqbal, Gabriela Mundaca, Maria Laursen, Maria Vagliasindi, Simon Commander and Isabelle Chaal-Dabi, 'MENA Economic Monitor: Corrosive Subsidies', *World Bank* (Washington, DC, 2014); 'Case Studies on Energy Subsidy Reform', *IMF*.

⁵⁹ Philip K. Robins, 'A Comparison of the Labor Supply Findings from the Four Negative Income Tax Experiments', *The Journal of Human Resources* 20/4 (1985), pp. 567–82.

⁶⁰ Olli Kangas, Signe Jauhiainen, Miska Simanainen and Minna Ylikännö, 'The Basic Income Experiment 2017–2018 in Finland: Preliminary Results', *Reports and Memorandums of the Ministry of Social Affairs and Health* 9 (Helsinki, 2019).

⁶¹ El-Katiri and Fattouh, 'Brief Political Economy of Energy Subsidies'; 'Case Studies on Energy Subsidy Reform', *IMF*, p. 30.; Hamid Tabatabai, 'The "Basic Income" Road to Reforming Iran's Subsidy System', presented at the 13th International Congress of the Basic Income Earth Network (BIEN), Universidade de São Paulo, São Paulo, Brazil, 2010. It is somewhat different from the citizens' income proposed here as the Iranian grants are paid to heads of household rather than individuals.

the residency requirement reached \$1,600. The policy has been highly popular, but the level of the grant is relatively low, making a precise economic impact assessment difficult.⁶²

The economy that comes closest to the Kuwaiti one that has some experience with converting subsidies to cash grants is Saudi Arabia: starting in January 2018, the Saudi government provides a means-tested, household-based benefit that compensates lower-to-mid-income households for higher energy prices and the introduction of value-added tax. In December 2017, more than 3.7 million households had registered, representing 13 million people, more than half the citizen population. Benefits reach up to SAR 938 /month (KD 76) per household. The system, while initially creating some negative social media reaction, is now widely accepted and has created significant fiscal savings for the Saudi government, while also reversing the growth of domestic energy consumption in 2018.⁶³

While the Saudi reform is partial and the sums provided are far below what would be required to guarantee the basic material welfare of citizen households, the Saudi example shows that it is possible in principle to convert subsidies to cash grants in the GCC too – a policy that by now has become a standard recommendation for countries with controlled domestic energy prices.⁶⁴

Counter-Arguments

There are a number of arguments against UCGs, mostly coming from the debate around UCGs in advanced countries. None of them applies in the Kuwaiti context.

The most prominent arguments against ‘basic income’ schemes relate to tax rates, labour market incentives and redistribution.⁶⁵ A basic income in the West, as well as in lower-rent countries under at least some proposals,⁶⁶ would require significantly higher tax rates on middle to high earners.⁶⁷ In Kuwait, by contrast, the basic challenge is not how to raise revenue and from whom, but rather how to distribute the existing rent that accrues from outside of the local economy.⁶⁸ A UCG in Kuwait would be financed by a restructuring of wealth distribution, not taxes.

⁶² Karl Widerquist and Michael Howard (eds), *Alaska’s Permanent Fund Dividend: Examining Its Suitability as a Model* (New York: Springer, 2012).

⁶³ Rania El Gamal and Stanley Carvalho, ‘Saudi Arabia Sees Domestic Energy Use Falling, Plans Renewables Push’, *Reuters*, 15 January 2019. Available at <https://uk.reuters.com/article/us-saudi-energy-reforms/saudi-arabia-sees-domestic-energy-use-falling-plans-renewables-push-idUKKCN1P918N> (accessed 21 February 2020).

⁶⁴ ‘Case Studies on Energy Subsidy Reform’, *IMF*.

⁶⁵ For an overview, see Van Parijs, ‘Basic Income’.

⁶⁶ Sandbu, ‘Natural Wealth Accounts’; Segal, ‘Resource Rents’.

⁶⁷ Philippe Van Parijs and Claudio Salinas, ‘Basic Income and Its Cognates: Puzzling Equivalence and Unheeded Differences Between Alternative Ways of Addressing the “New Social Question”’, *Basic Income Europe Network* (Louvain, 1998).

⁶⁸ Paul Segal, ‘How to Spend It: Resource Wealth and the Distribution of Resource Rents’, *Energy Policy* 51 (December 2012), pp. 340–8.

A tax-financed citizens' income in a system with progressive taxation would potentially decrease work incentives for mid- and high earners.⁶⁹ A basic income implies a 'principled though partial disconnection between labour and income'.⁷⁰ This again is not the case in Kuwait, at least as far as productive work is concerned: as we have argued above, a well-designed citizens' income would in fact substantially increase private sector work incentives for nationals compared to the status quo that relies on public jobs.

Closely related, the moral argument that a citizens' income creates a system of free-riders clinging to the coat-tails of taxpayers does not apply in the Kuwaiti scenario.⁷¹ Critics of basic income schemes in the West paint a gloomy picture of an army of idle or near-idle citizens living off state-provided payments. In Kuwait, however, large-scale idleness already exists – including in significant parts of the public sector – and is supported in very inequitable ways. There would be less of it under a citizens' income.

A citizens' income would create what economists call an 'income effect', which could potentially reduce citizens' desired work hours compared to a hypothetical situation of radical austerity under which no benefits are provided. But the latter is an extreme scenario that is very unrealistic in the Kuwaiti context. The question instead is which incentives a UCG would provide compared to the status quo. The answer is clear: if citizens received a UCG but were not able to easily join the public sector, the incentive to top up the UCG earnings with private income would increase. Similarly, as the UCG would be available independent of one's income, there would be no 'welfare trap' in which benefits are lost once an individual generates private earnings. The UCG therefore also provides stronger work incentives than conventional social safety policies.

Even in cases where few or no benefits are available, the work disincentive effects of universal income schemes have been shown to be small. Both US and Indian negative income tax and UCG experiments have shown large welfare gains accompanied by only small reductions in work effort,⁷² while most other studies on cash grants in developing countries have found no negative impact on work effort at all.

Unconditional Cash Grants and Other Benefit Policies

With a UCG, it will also become politically easier to streamline existing social assistance programmes, making them more targeted and outcome-oriented. Economists have shown that targeted programmes are, on average, 3.2 times more effective in reducing poverty rates than categorical programmes⁷³ – and the effectiveness gain could be even higher in Kuwait, where categorical programmes disproportionately benefit richer households.

⁶⁹ Van Parijs, 'Basic Income'; Widerquist and Lewis, *Basic Income Guarantee*.

⁷⁰ Philippe Van Parijs, 'Basic Income and the Two Dilemmas of the Welfare State', *The Political Quarterly* 67/1 (1996), pp. 63–6.

⁷¹ Philippe Van Parijs, 'Free Riding versus Rent Sharing', in Francesco Farina, Frank Hahn and Stefano Vannucci (eds), *Ethics, Rationality and Economic Behaviour* (Oxford: Clarendon Press, 1996), pp. 159–81.

⁷² Colombino, 'Is Unconditional Basic Income a Viable Alternative'.

⁷³ Pablo Acosta, Phillipe Leite and Jamele Rigolini, 'Should Cash Transfers Be Confined to the Poor? Implications for Poverty and Inequality in Latin America', *World Bank* (Washington, DC, 2011).

If basic wealth distribution happens through a separate UCG channel, it will become easier to introduce genuine means-testing for supplementary benefits for, say, widows, disabled people or orphans, and abolish categorical benefits that are of no obvious social use, like cash grants to women above 55 without clear income testing. Once all Kuwaitis are assured of a basic livelihood through UCGs, assessment of household structures and incomes through a real means-testing administration will become more socially acceptable, allowing the government to build inspection and follow-up capacity, and tying social assistance more effectively to activation measures helping citizens out of inactivity (all discussed in more detail in the ‘Policy Design Options’ section below).

On the back of a UCG, it will also become easier to deploy employment subsidies in the private sector in a more targeted fashion. Current wage structures are such that a UCG by itself, unless quite generous, is likely to be insufficient to ensure that Kuwaiti citizens can earn a socially acceptable income through private employment. A supplementary *da‘m* system will therefore probably still be required to activate private sector employment for Kuwaitis. But it will become easier to crack down on ‘phantom employment’, as the UCG will allow the government to clearly separate legitimate wealth sharing from manipulation – and everyone will be entitled to basic cash grants without having to manipulate the system in any way.

A UCG will also make it possible to adjust the current schedule of the *da‘m* system, which privileges degree holders over less educated citizens, although the latter face the largest wage cost gap relative to foreigners on the private labour market. Cuts of the *da‘m* payments at the top end (i.e. for degree holders) can be compensated through the universally received UCG.

Unconditional Cash Grant Scenarios and their Distributional and Economic Consequences

The following section will estimate which levels of UCG could be paid to Kuwaiti citizens under a variety of assumptions. The core analysis will estimate possible UCG levels merely on the basis of domestic energy price reforms and the resulting savings, but we will also discuss the possibility of higher UCGs that could be financed through additional savings from gradual attrition of the public sector workforce.

The section will then analyse the distributional consequences of such reforms for households and individual citizens, drawing on 2013 household survey consumption data, the most recent data publicly available (data from a 2018 survey is not yet public). The analysis will estimate both the cost imposed by higher energy prices across different households of different income levels and the net income effects of UCG across different households. This is followed by a discussion of the likely labour market consequences of the UCG and the impact of higher energy prices on operational costs in the private sector, differentiated by subsectors.

Assumptions

In estimating the UCG that could be financed through energy price reforms, we take the IMF estimate of about KD 1.8 billion of annual energy subsidies as our point of departure (taken from the IMF's most recent Article IV report).⁷⁴ Using international price benchmarks, we then estimate which water and electricity price reforms would lead to about KD 1.8 billion of extra government revenue and how these savings could be redistributed to the citizen population. We do not propose further reforms to gasoline, diesel and kerosene prices, which are already close to (if still mostly below) international benchmark prices.⁷⁵

Tables 5 and 6 show a set of electricity and water prices which would lead to extra revenue of KD 1.8 billion at current consumption levels. The assumed new electricity price of KD 0.025 per kWh for all consumers is in line with price reforms originally proposed by the government in the mid-2010s, is already paid by government consumers, and still lies significantly below electricity prices in developed benchmark countries (which lie between KD 0.033/kWh in Canada and KD 0.1/kWh in Germany).⁷⁶

The proposed new water price of KD 0.5 per m³ actually lies below the current price paid by government units. It is roughly on the level of average water tariffs in Latin America and Eastern Europe, while being less than half of prices in Western Europe or North America.⁷⁷

The above is merely illustrative. In practice, a different water and electricity tariff mix could lead to the same extra income. It will be important, however, to keep new tariffs as simple as possible, justify them with relevant benchmarks and remove implicit subsidies as far as possible. Only if these criteria are met can these subsidies be converted to more efficient and incentive-neutral direct payments for citizens.

⁷⁴ The IMF estimates subsidies at KD 1.5 billion in 2017–18, KD 1.9 billion in 2018/19 and KD 1.7 billion in 2019–20. 'Kuwait: 2019 Article IV Consultation', p. 30.

⁷⁵ The recent average wholesale spot price for gasoline and diesel in the US is \$1.8 per gallon. See 'Diesel Daily Price', *Index Mundi*. Available at <https://www.indexmundi.com/commodities/?commodity=diesel&months=60> (accessed 21 February 2020). This corresponds to about 150 fils per litre. Current Kuwait National Petroleum Company (KNPC) product prices for end consumers lie between 85 and 165 fils, see 'Petrol Stations', *KNPC*. Available at <https://www.knpc.com/en/our-business/petrol-stations> (accessed 21 February 2020).

⁷⁶ See 'Global Electricity Prices in 2018, by Select Country', *Statista*. Available at <https://www.statista.com/statistics/263492/electricity-prices-in-selected-countries> (accessed 21 February 2020).

⁷⁷ The proposed water price of KD 0.5 per m³ is equivalent to \$1.65. For comparable US dollar figures from different world regions, see 'What Does the World Pay for Water?', *Water Security Solutions Centre*. Available at <https://globalwatersecurity.org/content-hub/2019-02-11/What-does-the-world-pay-for-water> (accessed 21 February 2020).

Table 5: Electricity Prices, 2019, and Proposed New Prices (KD)

Sector	Current prices/ kWh	New proposed price/kWh	Increase rate (%)
Government	0.025	0.025	0.0
Investment and commercial	0.005	0.025	400.0
Industry and agriculture	0.005	0.025	400.0
Industry and agriculture (producers)	0.003	0.025	733.0
Others (except residential)	0.012	0.025	108.3

Source: MoEW

Table 6: Water Prices, 2019, and Proposed New Prices (KD)

Sector	Current water price per 1,000 imperial gallons	New proposed price per m ³	New proposed price per 1,000 imperial gallons	Increase rate (%)
Government	4	0.5	2.273	-43.0
Investment and commercial	2	0.5	2.273	13.7
Others (except residential)	2	0.5	2.273	13.7
Industry and agriculture	1.25	0.5	2.273	81.8
Industry and agriculture (producers)	0.75	0.5	2.273	203.1

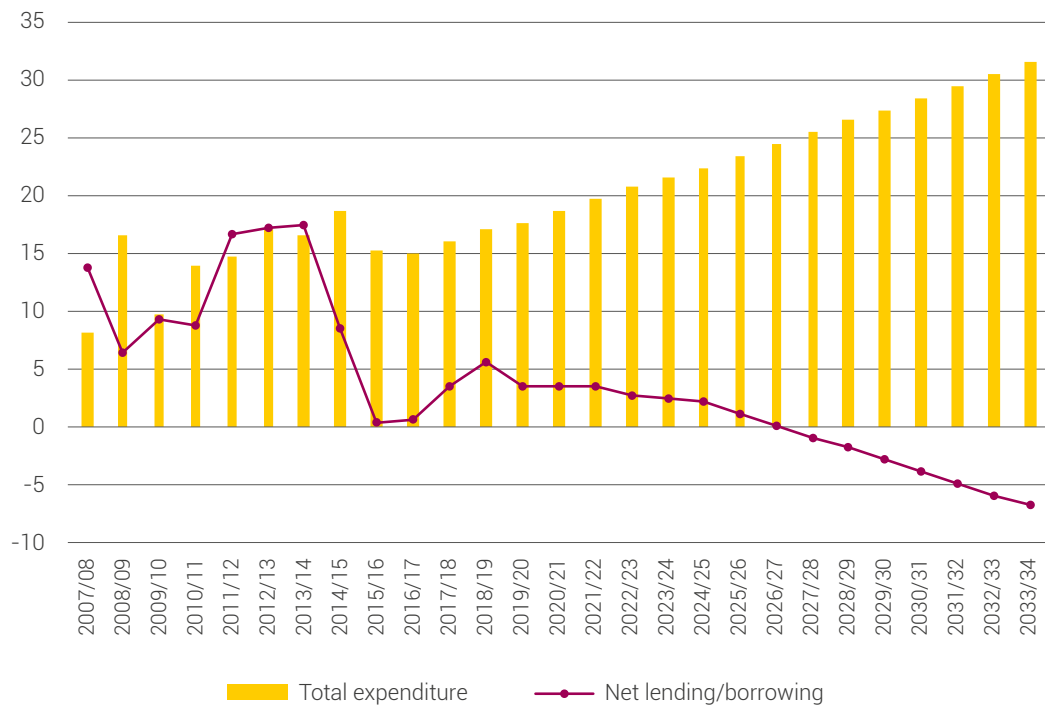
Source: MoEW

To estimate the additional revenue generated by the proposed new prices, we use MoEW statistics on current water and electricity revenue and consumption by sector. We assume that the revenue due from the new tariffs is fully collected. Interviews indicate that the collection of utility dues is currently deficient, but we argue that the introduction of a UCG would make it politically easier to enforce actual collection, as is already happening in other GCC countries.⁷⁸

Figure 11 compares current MoEW revenue (for 2017) with the new revenue that would be generated under the new tariffs. The net gain amounts to KD 1.8 billion, about 84 percent of which would be generated through higher electricity prices.

⁷⁸ In the case of electricity, we assume that consumption by sector is proportional to installed capacity, as the MoEW electricity yearbook only provides a sectoral breakdown by capacity, not consumption.

Figure 11: Current (2017) and New Water and Electricity Revenue Compared (KD)



Source: MoEW, own calculations

It is worth pointing out that the proposed utility prices are still considerably below those customary in developed countries, including energy-rich ones like the US or Canada. If US prices are used as a benchmark for local pricing, the total extra revenue at current consumption levels would amount to KD 3.27 billion, almost twice as much as under the core scenario used here. This would allow a correspondingly higher UCG. The proposal here should therefore be used as a lower boundary estimate, and authorities should consider more ambitious energy price reforms at least in the medium term.

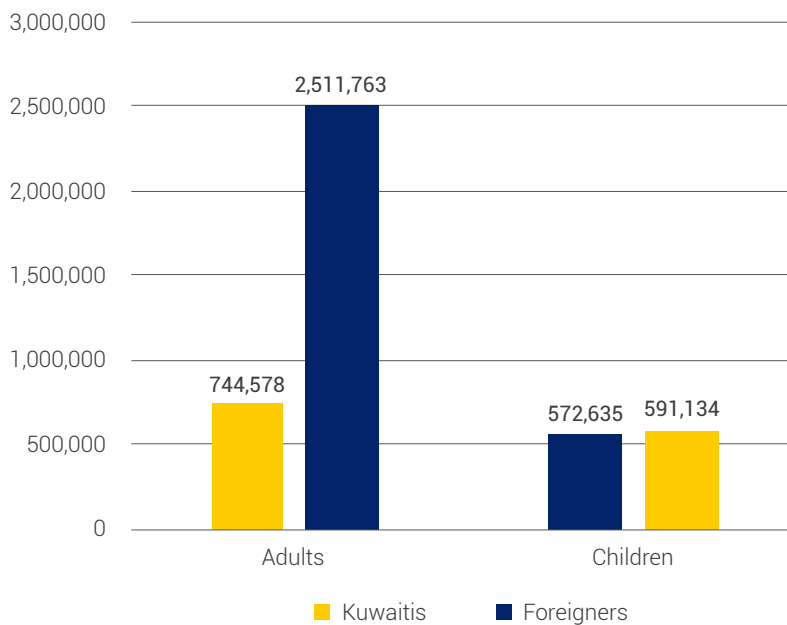
Distributional and Economic Consequences for Households

The following subsection will model the welfare consequences for various types of Kuwaiti households if the extra revenue generated through higher utility prices is redistributed to citizens via a UCG. We will consider a number of scenarios, including a flat UCG for all adults and – as preferred option – a UCG that is higher for adults with no government jobs and lower for public employees, who already receive implicit subsidies through their public jobs. We model the resulting income effects for households with different sizes, employment statuses and income levels. In all cases, the UCG has a significant progressive impact because it is paid independent of income levels, while under the current system poorer households benefit less from subsidies due to their lower average consumption levels. Despite the reform's positive redistributive effect, there are no net losers, even among households where all adults are employed in the public sector.

In a first step, we calculate the extra costs per capita that the proposed higher utility prices would create, assuming in the first instance that consumption levels remain unchanged. Unfortunately, MoEW reports do not provide a precise breakdown of consumption between citizens and foreign residents. We therefore use figures from a research report recently cited in the local press that indicates that expatriate households (apartments) consume 20 percent of total electricity and 22% of water, as opposed to 40% and 43% for private (Kuwaiti) houses (the rest is accounted for by the government and the private sector).⁷⁹ Should more precise primary consumption data become available, our estimates could easily be fine-tuned.

Figure 12 shows that most adult residents in Kuwait are foreigners. The higher total water and electricity consumption of Kuwaitis hence implies much larger per capita consumption by citizens (see Table 7).

Figure 12: Demographic Composition of Kuwait, mid-2018⁸⁰



Source: CSB

⁷⁹ 'Houses Consume 40% of Energy, Apartments 20%: Houses Take 43% Water Output, Apartments 22%', *Kuwait Times*, 11 April 2016. Available at <https://news.kuwaittimes.net/website/houses-consume-40-energy-apartments-20-houses-take-43-water-output-apartments-22> (accessed 21 February 2020).

⁸⁰ We count as children all individuals under 20 years of age (available demographic data is only broken down into five-year brackets).

Table 7: Estimated Annual per Capita Water and Electricity Consumption by Nationality, 2017

	Kuwaitis	Foreign residents
m ³ water	225.8	48.9
kWh electricity	22015.5	4767.0

Source: MoEW, own calculation

This breakdown of consumption by nationality allows us to estimate the average per capita utility costs for Kuwaitis and foreign residents under current tariffs (assuming bills are actually paid) as well the extra cost of new tariffs. Table 8 shows that the current cost for Kuwaitis and foreign residents is roughly the same at KD 44–5/year, mostly because foreigners in apartments pay considerably higher tariffs.

Table 8: Old and New Annual per Capita Costs of Water and Electricity by Nationality (KD)

	Existing per capita cost		Extra cost/year new tariffs, unchanged consumption		Extra cost/year if consumption drops by 30%	
	Kuwaitis	Expats	Kuwaitis	Foreigners	Kuwaitis	Foreigners
Water	0	21.51	112.90	2.94	79.027	2.94
Electricity	44.03	23.83	506.36	95.34	341.24	59.59
Total	44.03	45.34	619.25	98.28	420.27	62.52

Source: Own calculations using MoEW consumption and price data

Should all households be moved to the unified higher tariffs proposed here, the extra cost would amount to KD 620/year per Kuwaiti and KD 98/year for foreigners if consumption levels do not change. Given the high current levels of inefficiency and waste it is likely, however, that households would in practice adjust their consumption downwards when facing higher prices. We have no historical data to reliably estimate the price elasticity of water and electricity consumption in Kuwait, but using international research on such elasticities,⁸¹ we cautiously assume that consumption could in the mid-term drop by an average of 30 percent under the new, higher prices. In that case, the extra annual cost per capita would on average be KD 420 per Kuwaiti and KD 62 per foreigner. In practice, savings could be even higher once infrastructure, technology and habits have adjusted to higher prices.⁸²

As mentioned, the higher utility prices would generate additional revenue of about KD 1.8 billion at current consumption levels, all of which would in principle be available to

⁸¹ Charap, Ribeiro da Silva and Rodriguez, 'Energy Subsidies and Energy Consumption'.

⁸² Available literature suggests price elasticities of energy consumption of around -0.5, which would imply stronger consumption effects given the larger proposed increase in electricity tariffs in particular; *ibid.*

finance UCG payments. It should be noted that a potential drop in consumption levels would not necessarily mean less government revenue: to the extent that electricity and desalinated water are generated by burning crude, fuel oil, diesel and expensively imported liquefied natural gas, lower household consumption would mean lower use of these forms of energy, meaning lower input costs and more availability of crude and related products for export. The precise fiscal impact of this substitution is beyond this paper, not least as we lack data on the precise input mix of the Kuwaiti electricity and desalination industry, but it is unlikely to change the UCG estimates here materially.⁸³

How should the KD 1.8 billion be distributed among Kuwaiti citizens? A good case can be made that every Kuwaiti, including children, should be entitled to some payment: the idea of the UCG reform is to make every household at least as well off as before the reform. Children contribute to household consumption and a UCG limited to adults only would penalise households with more children. That said, consumption per child is likely to be considerably lower than that of adults, and the key economic rationale of the UCG – creating a less distortive incentive environment, including on the labour market – primarily applies to adults. We therefore follow standard practice in counting a child as half a person for welfare purposes and accordingly apportion half the UCG of a typical adult for each child.⁸⁴

We count Kuwaiti individuals as adults from age 20 on. This allows for more precise estimates due to the breakdown of available demographic data in five-year brackets, but also has a substantial justification: until that age, most Kuwaitis are still in education and almost all live with their parents. The age cut-off point can potentially be modified for future estimates.

Table 9 shows the UCGs that could be financed through extra utilities revenue of KD 1.8 billion. A completely flat UCG for all citizens (including children) would reach KD 1,340 per year – more than twice as much as the average per capita cost of the higher utility tariffs even if consumption remains unchanged (the net gain is mostly explained by the fact that private sector and foreign consumers will also pay higher water and electricity charges, which will contribute to the overall UCG pot that is divided among citizens).

If we set the UCG for adults at twice the level of the UCG for children, annual payments reach KD 1,726 and KD 863 for adults and children respectively. The reduced payment to children would still be considerably above the average per capita cost of higher utility prices.

As mentioned above, a key rationale for the UCG is to provide basic income to citizens that is independent of either subsidies or public sector employment. This means that public sector employees, most of whom already receive a considerable if implicit wealth transfer

⁸³ According to the Minister of Electricity and Industry, Kuwait uses 350,000 barrels per day of oil equivalent to produce electricity and water. This amount of crude would be worth KD 2.7 billion per year at current prices of \$65 per barrel. This implies that any reduction in domestic oil consumption due to lower electricity demand could generate even more income than the proposed electricity and water price increases, which would only yield net income of KD 1.8 billion.

⁸⁴ 'Developing a Strategic Social Safety Net Framework for Kuwait', *World Bank*, p. 26.

through their government jobs, should not be entitled to a full UCG. Instead, they should merely be compensated for the extra cost of higher utility prices so that they do not incur net losses. We therefore propose a reduced UCG of KD 720 per year for Kuwaitis employed in the public sector. This is KD 100 more than the average extra cost of higher utility tariffs, thereby guaranteeing that the majority of government employees will be slightly better off under the new system – especially if they have children, who would each receive the full child UCG of KD 863/year. The typical public employee would be likely to experience a small net income gain even if we consider the secondary inflation effects that higher energy prices could generate via private sector energy costs, and which we discuss below.

According to data from the PACI, about 45 percent of Kuwaitis aged 20 years or older are currently employed in the public sector. If they receive a reduced UCG of KD 720 per year, this liberates resources for a correspondingly higher UCG for Kuwaiti adults who are not government employed. Such individuals could receive a UCG of KD 2,550 per year (or KD 212 per month), more than four times the average cost resulting from higher utility prices.

Table 9: UCG Options (KD)

	Monthly	Annual
UCG per Kuwaiti, flat	111.99	1343.87
UCG adults, flat	143.81	1725.75
UCG children, flat	71.91	862.87
UCG adults in government	60.00	720.00
UCG other adults	212.52	2550.22

Source: *Own calculations*

KD 212 per month is not enough for a comfortable life in Kuwait, but it exceeds the basic poverty line, estimated at KD 170 per month and person by the World Bank, so could be considered as a basic maintenance grant.⁸⁵ For a family of two adults who are not government employed and have two children, the monthly UCG income would amount to KD 569. This is slightly above current levels of income maintenance paid by MoSAL to certain categories of beneficiaries, close to the lowest salaries available in the public sector and roughly the threshold for household poverty that is informally used by the General Secretariat of the Supreme Council for Planning and Development. While not enough to guarantee a middle-class lifestyle, the availability of such income is likely to create significant incentives to eschew public employment and potentially seek complementary private income through work or entrepreneurship, discussed in more detail below. We also go on to discuss complementary options to finance higher UCG payments (which would give correspondingly stronger incentives to leave government employment) through the gradual and voluntary erosion of public employment.

⁸⁵ *Ibid.*, p. 28.

Modelling Redistribution Effects

The average income effects of all of the UCG options discussed above are positive, even for individuals employed in government receiving a reduced UCG. But what about income effects across different types of households with different income and consumption levels? We now break down net income effects by different levels of total household expenditure as recorded in the 2013 household survey.⁸⁶ This is motivated by three concerns: first, are there any net losers from the reform if we differentiate households that way? Secondly, what is the redistributive (progressive) effect of shifting from regressive subsidies to general lump sum payments? Thirdly, given that the UCG in our preferred scenario is differentiated by employment status, how do the incentive effects for Kuwaitis inside and outside of public employment compare?

We did not manage to obtain raw data from the household survey, which forces us to use aggregate data broken down into a number of pre-set categories. Publicly available survey data categorises Kuwaiti households into six monthly expenditure categories, reaching from KD 450–1,049/month to KD 3,450+/month, accompanied by the average number of household members, which reaches from 3.9 in the poorest to 9.2 in the richest category (see Table 10). Published data unfortunately does not provide specific data on water and energy consumption data but only a broader category for ‘Housing, Water, Electricity, Gas, and Other Fuels’.

To approximate the likely consumption of and expenditure on water and electricity, we assume that the consumption gradient for these two subcategories across different types of households is the same as that for the broader category. This procedure implies that the households in the richest category consume 2.5 times as much per capita as the poorest ones. We then take the average per capita increase in utility expenditure under the UCG scenario and weight it across different household categories in line with this gradient (third row in Table 10). Micro-data from the household survey could make these estimates much more precise and allow us to analyse household size and expenditure independently of each other. That said, we are confident that the below estimates are broadly correct.

We then proceed to estimate the net annual per capita gain (or loss) across different household categories by adding up UCG incomes and subtracting the estimated extra spending on utilities under the new prices. We do this for our preferred policy scenario under which public employees receive a reduced UCG of KD 720/year while adults outside of the public sector receive KD 2,550/year. For the sake of simplicity (and in the absence of more fine-grained data on household composition), we assume that each type of household contains two adults, with all other members being children. We provide estimates both for a scenario of unchanged consumption (middle section of Table 10) and for a scenario where consumption drops by 30 percent (bottom section of Table 10).

⁸⁶ A new survey was conducted in 2018, but results are not yet available.

Table 10: Per Capita Annual Net Gains under UCG by Household Expenditure Level (KD)

Monthly household expenditure	450–1049	1050–1649	1650–2249	2250–2849	2850–3349	3450+
Average household size (adults and children)	3.9	6.1	6.4	7.8	8.0	9.2
Reference: per capita extra cost of new utility tariffs ⁸⁷	318.90	325.01	442.89	501.15	657.44	805.80
Net annual per capita income effects at 100% consumption						
Two adults, none in public sector	1409.28	1091.10	947.28	794.38	627.27	423.89
Two adults, one in public sector	939.99	791.06	661.31	559.73	398.49	224.96
Two adults, both in public sector	470.70	491.02	375.33	325.09	169.71	26.02
Net annual per capita income effects at 70% consumption						
Two adults, none in public sector	1511.75	1195.53	1089.59	955.41	838.53	682.82
Two adults, one in public sector	1042.46	895.50	803.62	720.77	609.75	483.88
Two adults, both in public sector	573.18	595.46	517.65	486.12	380.97	284.95

Source: Own calculations

Table 10 shows that all the types of households considered here witness net per capita gains. These gains are, however, considerably larger for poorer households: their net benefit is up to three times larger than that of households in the richest category. Similarly, households with no public employees have much larger per capita gains than ones with two public employees, again up to a factor of three. The relative and absolute gains do not change dramatically in the scenario with reduced consumption (they are somewhat stronger for richer households, as their absolute drop in per capita consumption is larger under the 70 percent scenario).

This means that the proposed UCG reform would fulfil all of its criteria: while there would be no net losers among different household categories, the reform would have a strong progressive effect, benefiting poorer households more and reversing the regressive impact of subsidies. As importantly, households with no public sector employees would derive significantly larger per capita benefits than those relying on government employment.

In the poorest expenditure category, the difference in total income gains between households having two and those having no public sector employee amounts to KD 3,660/year

⁸⁷ Weighted in line with the general distribution of consumption in the 'Housing, Water, Electricity, Gas, and Other Fuels' category.

or KD 305/month. This can give a potentially significant incentive to seek gainful employment outside of the public sector.⁸⁸

We need to consider that energy price reforms and UCGs imply some extent of redistribution from private sector and foreign residents to Kuwaiti citizens, as neither private businesses nor foreign workers would be compensated for higher utility prices. We expect welfare effects on foreign residents to be relatively small, however, as indicated by the above estimate of between KD 62 and 98 of per capita extra costs due to new tariffs. This is both because of lower consumption levels (especially among poorer foreigners) and because foreigners already pay somewhat higher prices. The poorest foreigners, that is, domestic and construction workers, by and large live in Kuwaiti households and worker camps, where they do not pay utility bills themselves. Some of the higher cost of living for other foreigners is likely to be recouped through (slightly) higher wage demands.

It would be difficult to make a case that foreign residents are entitled to subsidised utility services, and considerably higher rates for foreigners are already a reality in neighbouring countries like the UAE. That said, it will be important to stringently enforce Kuwait's existing minimum wage rules to reduce the vulnerability of low earners to higher utility prices. A more precise analysis of electricity and water consumption patterns among expatriate households, based on raw survey data, would be appropriate to assess the likely social impact for foreigners.

Inflation Effects

The above estimates have only considered the direct cost effect of higher utility tariffs on households. There could in principle be indirect inflationary effects, as the production of goods and services in Kuwait also involves water and electricity consumption, the cost of which would increase. Such effects are likely to be very small, however: according to MoEW data, the private sector currently only consumes 23 percent of electricity in Kuwait, and its share in water consumption is likely to be similar (as shown above, residents consume 62%, with the rest divided between government and business). This means that even if all of the new costs of about KD 400 million incurred by private firms were passed on to consumers, this would only lead to an inflation shock of less than 1 percent.

In practice, the private sector is very likely to absorb some of the cost itself, while also improving its energy and water efficiency, thereby reducing its gross utility expenditure to start with. International experience shows that energy price shocks are passed on via higher consumer prices only weakly.⁸⁹ We therefore anticipate an inflationary impact of

⁸⁸ The difference for households with more than two adults (of which there are likely to be some, especially among richer households) is even larger. Unfortunately the aggregate survey data does not allow us to distinguish the composition of households by age.

⁸⁹ John Peterson, 'Economic Effects of Recent Increases in Energy Prices', *Congress of the United States, Congressional Budget Office* (Washington, DC, 2006). For the weak secondary impacts of commodity price increases, see also Stephen G. Cecchetti and Richhild Moessner, 'Commodity Prices and Inflation Dynamics', *Social Science Research Network* (Rochester, NY, 8 December 2008). Available at <https://papers.ssrn.com/abstract=1517224> (accessed 21 February 2020).

less than 0.5 percent, which would have a negligible impact on household welfare. At a 0.5 percent inflation shock, even rich households spending KD 3,450 per month would experience a loss of annual per capita real income of only KD 22 – orders of magnitude below the UCG income effects discussed above. For comparison, Kuwait's inflation rate hit its peak in 2008 at 10.6 percent, a level with much more significant consequences for real incomes.

Labour Market Incentives and Behaviour Among Kuwaitis

One key motivation for introducing a UCG would be to politically justify a reduction in public sector hiring while closing the income gap between the private and public sector so as to make private employment relatively more attractive. We lack raw labour force survey data that would allow us to model Kuwaitis' labour market behaviour with any precision. We can, however, broadly indicate what the average income gaps are and to what extent the above UCG policies would close them.

Aggregate labour force survey data shows an average gap in public and private wages of KD 426/month for Kuwaiti males and 446/month for females. We are unable to control for level of education, type of work and the fact that some private sector employment is not genuine, so are unable to make a like-for-like comparison of wages in the two sectors. If we take the aggregate wage gap levels at face value, however, then the UCG scenario proposed above is insufficient for closing the income gap between the sectors: the difference between monthly grants for public sector employees and other adult Kuwaitis is only KD 152, less than half of the wage gap.

That said, the proposed UCG of KD 212 could, together with the existing *da'm al-'amala* system, make more private sector jobs materially attractive to Kuwaitis. We saw above that the vast majority of private jobs that are currently held by foreigners, 96.2 percent, pay KD 600 or less per month (see Figure 6). A combination of *da'm*, UCG and available (low) wages would, however, lift many Kuwaitis into mid-income status even if they took low-paid private jobs. With average private sector wages for Kuwaitis of KD 1,354/month for males and KD 828/month for females, an income gain of KD 212/month is substantial. Combined with reduced availability of public sector jobs, the incentive to seek private employment would increase substantially.

New entrants to the labour market could still complain that even with a UCG, they would not quite reach the income levels of previous cohorts that were able to join the public sector. To address this concern, the government should consider topping up the UCG in line with anticipated exit rates from the public sector. As mentioned above, the availability of a higher UCG would incentivise at least some public employees to leave the public sector. The savings generated this way could be partially or completely redirected towards UCG payments for adults who are not on the public payroll. This would create a self-reinforcing mechanism: a higher UCG would incentivise more incumbent public employees to leave, thereby creating larger savings that can finance the higher UCG.

Unfortunately we do not have sufficient data to assess the likely exit rates from the public sector under different UCG scenarios. Anecdotally, it appears that female public employees in particular might be willing to give up their public jobs in return for a UCG (without necessarily joining the private labour force) – but the effect is impossible to quantify. We therefore strongly recommend the commissioning of surveys among current public employees to gauge their willingness to leave the public sector under different UCG scenarios. This could then be used to identify feasible UCG levels that would both slim the public sector and generate sufficient savings to finance the accompanying cash grants.

The quantitative estimates of the present paper focus mostly on the baseline UCG that can be generated through subsidy reforms, as these scenarios are more tractable with available data. As the section below on the longer-term fiscal impact of UCG reform shows, however, it would be possible to easily finance a KD 200 top-up to the UCG for adults outside of the public sector through a reduction in public employment of about 10 percent – or by simply halting the current trend of public sector payroll increases for about two years. With the KD 200 top-up, the total UCG would roughly bridge the current income gap between publicly and privately employed Kuwaitis. This would equalise average income incentives in the public and private sectors, which should be the ultimate target of any comprehensive wealth distribution reform. It would also provide an income stream that is much closer to the basic needs of Kuwaiti citizens. The long-term budgetary implications of the basic and the augmented UCG are discussed in the fiscal section below.

The new incentive environment provided by the UCG would generate broader, medium-term structural effects on productivity and entrepreneurship among Kuwaitis. As government employment would not be easily available, citizens would have stronger incentives to acquire skills relevant for the private sector and to start their own businesses. These effects are difficult to quantify but are likely to be substantive, given how many Kuwaitis are currently ‘parked’ in the civil service at low activity and productivity levels.

Consequences for Businesses

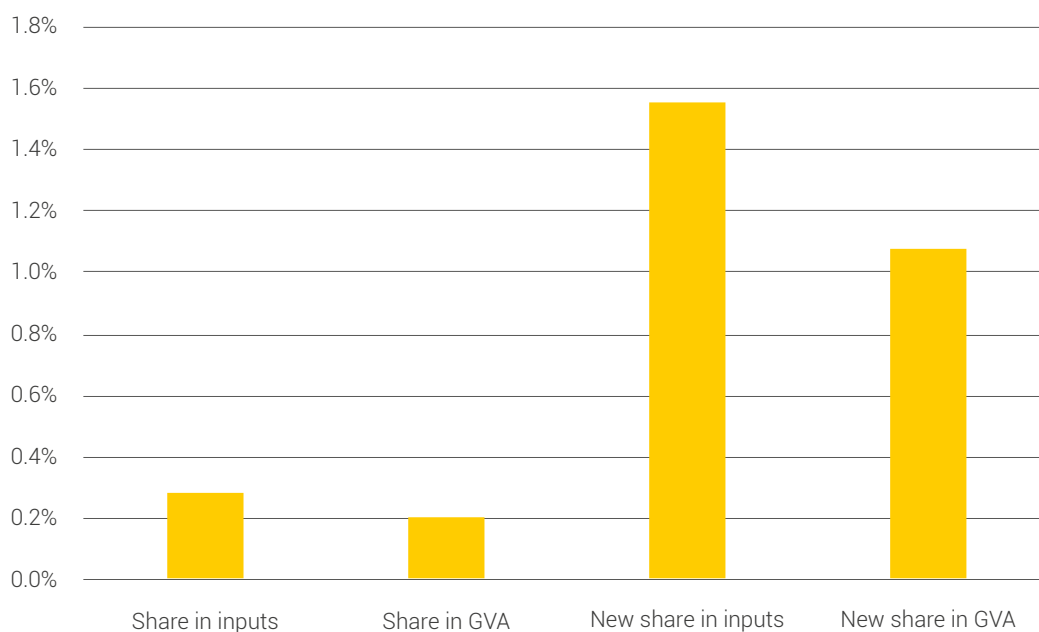
Above, we have assessed the welfare consequences of higher energy prices for households. Higher energy prices will also have consequences for businesses, which also consume water and electricity. As mentioned, some of this might be passed on to consumers in the shape of higher prices, although the impact of this would be quite small. But what about costs that are not passed on to consumers – is there a risk that Kuwaiti firms’ profitability would suffer significantly? The following subsection uses aggregate data establishment surveys in key sectors to estimate the impact of higher energy costs on business operations. We focus on industry, construction, retail and other services, thereby covering all major services with significant energy inputs. We did not have access to raw survey data, which means that our estimates focus on general averages as we lacked information on the distribution of energy consumption or profit margins within sectors.

Establishment surveys provide sectoral figures on utility consumption, gross value added (GVA) and gross inputs. We use these to calculate the costs of more expensive electricity

and water as a share of both GVA and gross inputs by sector. We use GVA as the closest available approximation of profit.⁹⁰ We assume no price elasticity of consumption, that is, that firms do not reduce their water and electricity inputs as prices rise. This way, we obtain an upper boundary estimate for the actual costs, because in practice firms are likely to seek efficiencies in the face of higher prices. We also assume that firms' current expenditure on water and electricity prices reflects the full payment of utility bills under current prices, that is, there are no significant payment defaults. This might not always be the case for smaller firms, but the published establishment survey data provides no information on consumption in terms of litres or kWh that would allow a more precise estimate.

Figure 13 shows the current and future shares of electricity and water expenditure in inputs and GVA for industry. While the new tariffs would considerably increase such costs in proportional terms, they would remain very low (less than 2 percent) as a share of total costs and value added. We can therefore conclude that the material impact on industry would be very small.

Figure 13: Current and Estimated Future Electricity and Water Costs: Industry, 2016



Source: Based on 2016 establishment survey data

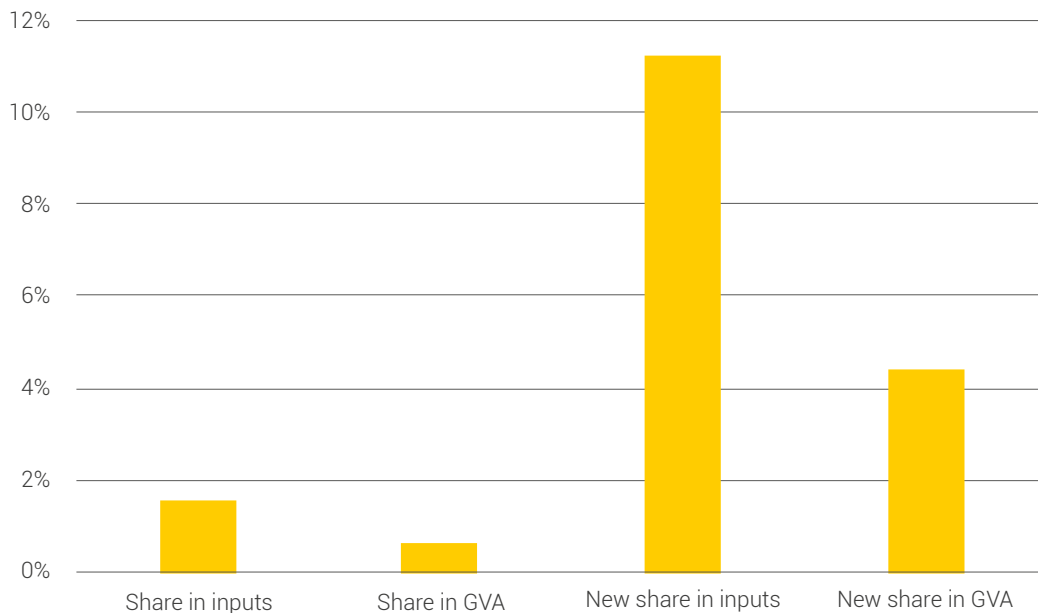
The share of utility costs varies significantly by subsector, with some forms of production incurring higher energy costs under the new tariffs. They reach 12.5 percent of GVA in the

⁹⁰ We assumed that the current cost of electricity for active industrial and commercial consumers is 3 fils per kWh. Cost increases would be lower for companies paying 5 fils per kWh (which are considered inactive by government). Public and private industry are combined in our estimates, as the available survey data provides no breakdown by ownership.

case of tanning and dressing of leather, 9.1% for refined petroleum products, 8.8% for wood products, 8.4% for apparel and 7.9% for fabricated metal. All these are fairly low shares and, with the exception of refining, the sectors are quite small in the Kuwaiti context.

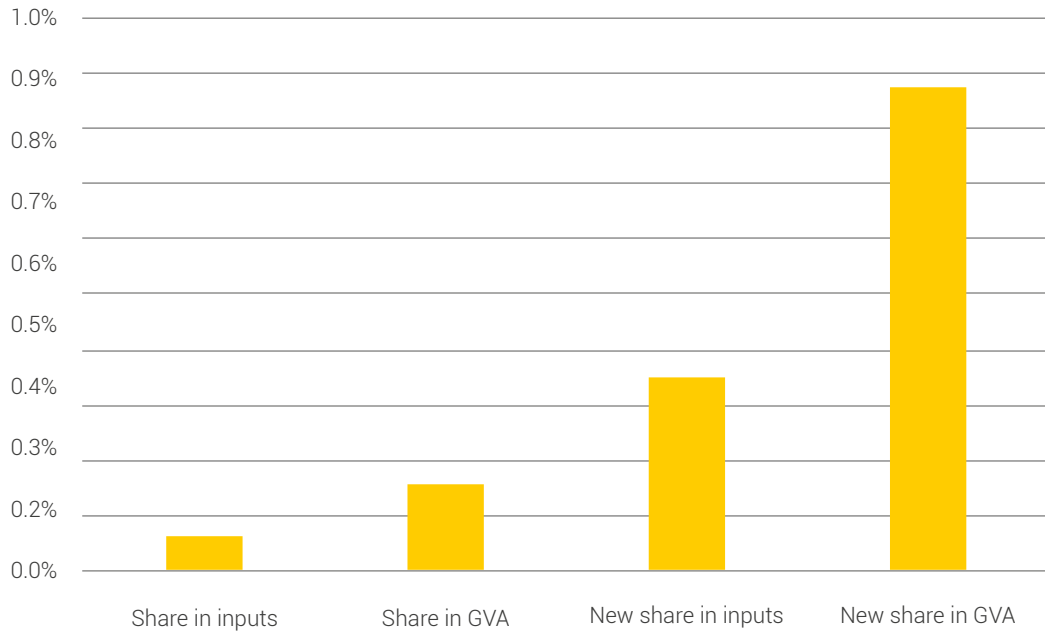
The cost effects for the other sectors under study – construction, retail and other services – are similarly manageable (Figures 14–16). The somewhat higher impact on retail is mostly due to higher electricity prices, leading to an estimated reduction of GVA by about 4.4 percent. In practice, operational adjustments to lower electricity costs should be fairly straightforward, for example by using energy-efficient LED lighting, more efficient insulation for buildings and more efficient air conditioning systems.

Figure 14: Current and Estimated Future Electricity and Water Costs: Construction, 2016



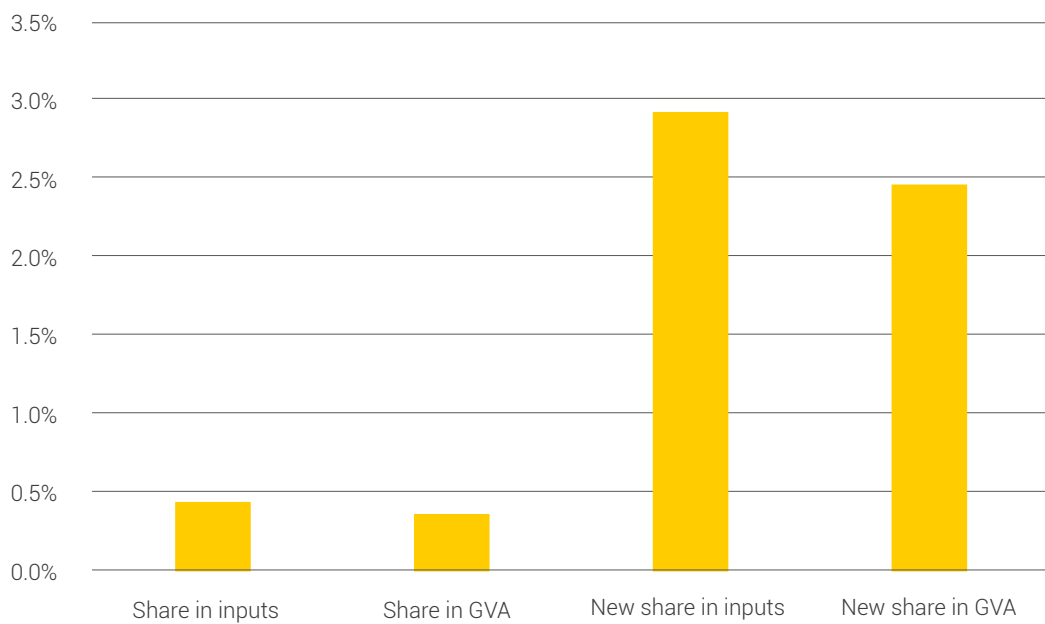
Source: Based on 2016 establishment survey data

Figure 15: Current and Estimated Future Electricity and Water Costs: Retail, 2014



Source: Based on 2014 establishment survey data

Figure 16: Current and Estimated Future Electricity and Water Costs: Other Services, 2016



Source: Based on 2016 establishment survey data

Many sectors, including construction and ‘other services’, currently have considerably higher expenditure on fuels than on electricity and water, reflecting past increases in gasoline and diesel prices. It is worth noting that they by and large absorbed these past price increases without suffering significantly.

In sum, the impact of higher (if still quite affordable) water and electricity tariffs on Kuwaiti business would be limited even if we assume that they cannot pass on any of the cost to consumers and are unable to find any efficiencies in their current use of such utilities. That said, a closer study of the effects based on raw establishment survey data would be advisable. Should individual subsectors be exposed to an unusually high cost impact, the government could consider temporary financial and/or technical assistance to such firms for retooling their operations to become more energy efficient. This could be considered particularly for export competing, energy-intensive sectors that operate in international markets. The share of such firms in total production is so small, however, that the cost of such programmes would be immaterial in the context of the larger fiscal implications of the proposed UCG policy.

What is arguably more important is that the UCG policy is likely to have a countervailing positive effect on industries serving domestic consumers that would be larger than the direct cost effect. We have shown that most households would derive significant net income gains from the UCG policy. Assuming that some of the extra income will be spent on goods and services locally, this will give the private sector a considerable boost.

We assume that Kuwaiti households spend 75 percent of their income, the ‘propensity to consume’ ratio suggested by the household survey across different income groups. At an average net per capita income gain of KD 721 in the case of unchanged energy consumption, this would imply extra consumer spending of KD 720 million per year. Should households reduce energy consumption by 30 percent under higher prices, the average net income gain would amount to KD 920 per capita, leading to KD 920 million of extra consumption spending. The latter figure is more than 2 percent of Kuwaiti GDP, a potentially considerable boost for the local economy that would far outweigh any cost effects of energy reforms for business.

The above assumes no other effects of the UCG on household incomes. In practice, there would probably be indirect effects as the UCG would allow some consolidation of social safety spending (see below) which would somewhat reduce consumption effects. To the extent that the UCG incentivises public employees to leave government, this would also have consumption effects: potentially positive ones if they sought private income that is subsidised through *da‘m* and UCG, but potentially negative ones if they chose to remain inactive and only draw on the UCG instead of their public salaries. Such effects are too indirect to estimate, but their magnitude is likely to be secondary to the immediate consumption effect of the UCG reform. But even if a reduction in the public payroll should have a contractionary impact on private consumption, it should be noted that such a reduction is strictly necessary for reasons of fiscal sustainability. The UCG policy would contribute much to dampening the contractionary effects of reducing public employment.

Policy Design Options

This paper cannot offer a full and detailed implementation package for UCG and social safety reform. It can, however, offer an overview of key policy design choices that will have to be made.

UCG Options

There are a number of administrative choices that will have to be made about the UCG beyond determining how it is financed and setting its level. First of all, the government will need to decide **how quickly to transition into the UCG**. This will mostly boil down to deciding how quickly and comprehensively energy subsidies are to be phased out. A ‘big bang’ option under which both the new tariffs and the full UCG financed through them are immediately introduced seems preferable. As we have seen, the negative impact of the new tariffs on the private sector will be limited, reducing the need for a phased introduction. Conversely, a gradualist approach creates the risk of organised resistance from the small minority of energy consumers that might be (or think they will be) negatively affected. There is precedent for a successful one-off price adjustment without compensation in the increase in gasoline and diesel prices in September 2016.

Some Kuwaiti economists have in the past argued for a **multi-tier tariff**, under which water and electricity prices rise with consumption levels. While such an approach makes sense to protect the welfare of smaller (and poorer) consumers in cases where no other compensation is provided, there is no clear rationale for such tariff differentiation under the UCG scenario. A unified tariff that reflects opportunity costs of production is preferable because it maximises revenue and provides incentives to consume efficiently at any level of consumption, rather than giving away some electricity and water cheaply.

While the UCG can be financed through utility reforms and potential shrinkage of the public payroll in the short to medium term, questions remain about its **long-term financing**: assuming that in the long run oil income will drop and potentially disappear, the responsibility for financing citizen cash grants could gradually transition to Kuwait’s sovereign wealth funds (SWFs), notably the FGF. The FGF has been set up precisely to safeguard the welfare of future generations of Kuwaitis once hydrocarbons revenues disappear and a UCG would be an ideal vehicle to share overseas investment wealth in a fair, transparent and sustainable fashion with the country’s citizens. Precise financial estimates for transitioning to an SWF-financed UCG are beyond the scope of this paper, but we can note that the investment returns registered by the Kuwaiti government in 2018/19 amounted to KD 5.5 billion (and are projected to slightly increase in future years). This compares favourably to the cost of the baseline UCG in this paper of KD 1.8 billion, as well as to the KD 2.8 billion annual cost in case additional KD 200/month payments are provided to adults outside of the government sector.

The government will also need to decide **whether UCG payments will be provided to individuals or heads of households**. Given MoSAL’s current difficulty in determining indi-

viduals' exact household status, a simple system under which payments are provided to all adults directly (and no adjustment to UCG levels is made in line with personal status etc.) is preferable. The reduced UCG for children could be provided to mothers, given that they in practice tend to be responsible for expenditure affecting their children.

The potential availability of an augmented UCG of more than KD 400/month raises the problem that salaries at the bottom end of the public sector scale might not be attractive enough to retain any Kuwaiti citizens in low-skilled jobs. According to 2015 data, 11.5 percent of public sector employees earn between KD 600 and 799/month (see Figure 3), a salary range in which the attractiveness of dropping out of public employment could be overwhelming. While this issue needs further investigation, ideally drawing on detailed public sector salary data, the government should be prepared to somewhat adjust the lower tiers of the civil service salary pay-scale upwards to prevent a disproportionate drain of employees in these ranks.

A key practical question will be **who administers the UCG**. Given its access to relevant population and employment status data, it would make sense for PACI to do this in cooperation with the Ministry of Finance. The registration process for UCG could be based on self-targeting; that is, Kuwaiti citizens would have to make an active application to receive the benefit. This would potentially discourage wealthy Kuwaitis who are not in need of any welfare or social assistance from applying, generating some (however marginal) savings. Voluntary relinquishment of the UCG should be presented as a socially desirable decision in the communications campaign introducing the reforms, and unclaimed UCG funds could be earmarked for specific welfare and development funds. That said, the UCG registration process should be made as easy as possible, ideally through a simple online interface and registration centres in all neighbourhoods, so that no vulnerable citizens are left out.

Policy Options for Other Distribution Policies

The UCG reform policy only makes sense if it is used as an opportunity to adjust other inefficient and distortionary welfare policies. Providing all Kuwaitis outside of the public sector with a substantial, unconditional benefit will create political flexibility for reforming other distribution policies, as the implicit subsidies incorporated in them will be bundled into the UCG. The UCG will specifically make it easier to introduce more stringent means-testing and targeting for social support policies, which can be linked more clearly to explicit social objectives. Sanctioning of abuse will also become easier once targeted social benefits and general wealth sharing are separated.

Da'm Reform

As discussed above, without further deep reforms to the private labour market, wage subsidies through the *da'm al-'amala* system will still be needed to incentivise nationals to work in the private sector and close the remuneration gap to the public sector. In principle, the *da'm* system could be discontinued and turned into a higher UCG, but this would create the risk of widespread idleness among citizens, an outcome that our interviews

indicate is socially undesirable especially for young Kuwaiti men (and the risks of which are discussed more below).

That said, the current structure of the *da'm* benefits is unusual and could be usefully reformed in the course of UCG introduction. It is not clear in particular why higher levels of education are rewarded with higher subsidies. The effect of this policy is regressive, as Kuwaitis with degrees are likely to find better-paid jobs to start with. It is very unusual in international comparison to subsidise the educated. We have also seen above that the absolute wage gap between citizens and foreign workers is roughly the same across all education levels, and the ratio of Kuwaiti to foreign wages is actually larger at lower levels of education. If the *da'm* system aims at closing this gap, making payments proportional to education makes little sense. As a general principle, the labour market itself should reward education and skills, thereby providing incentives to acquire the types of education that are actually needed.

We therefore propose a unified *da'm* payment around KD 600/month for singles. Existing marriage and child allowances can be retained, but should be unified across education levels. Thanks to the introduction of the UCG, even educated Kuwaitis in the private sector will still be net beneficiaries of the reform despite the standardisation of *da'm* payments. A unified *da'm* payment might create slight incentives for more educated Kuwaitis to seek public sector employment, but the UCG will allow the government to recruit much more selectively. Removing the education rewards from the *da'm* would also reduce incentives for acquiring low-quality or fake education, which has been a recurrent issue in Kuwait.

The government should consider creating an automatic link between adjustments of public service salaries and the amount of *da'm* payments. In the past, government salary rises have led to delayed increases in the *da'm*, thereby initially hiding the effective total cost of the rise and creating temporary incentives to exit the private sector. An automatic link would make the effective fiscal cost of increasing public salaries more transparent and ensure a continued level playing field between public and private employment.

The availability of the UCG for citizens outside of the public sector will make it easier to crack down on the fraud currently happening in the *da'm* system we have discussed above, which could be easily done through workplace inspections and statistical analysis of current salary patterns in the private sector. Tighter policing would become politically easier as no citizen would become penniless and everyone would receive a minimum share of the national wealth thanks to the UCG.

While tightening the *da'm* system, the government should strengthen active labour market policies to upskill Kuwaitis and integrate them into the private labour market. The demand for such policies is likely to increase, since nationals will have a stronger incentive to seek skills needed in the private sector as public employment becomes more remote. International experience shows that wage subsidies are most effective when combined with other labour market programmes such as on-the-job training, counselling, information sessions and job search assistance.⁹¹

⁹¹ Helena Ribe, David A. Robalino and Ian Walker, 'From Right to Reality: Incentives, Labor Markets, and the Challenge of Universal Social Protection in Latin America and the Caribbean', *World Bank* (Washington, DC, 2012), p. 281.

Pensions Reform

We have seen above that the current pensions system, while having a solid basic architecture, is unsustainable due to the generosity of defined benefit pensions payments. Despite regular large government contributions to the PIFSS, the scheme is far from fully funded.

The introduction of the UCG could serve as justification for a gradual move towards ‘defined contributions’ (DC) pensions above a certain income level, while retaining a general defined benefits base that guarantees a minimum payment for all pensioners and reduces market risks. A reform along these lines is inevitable in the long run and politically more defensible at the moment when a UCG will start ‘topping up’ pensions for all citizens, including ones who have left public employment for retirement.

The proposed lower-boundary UCG of KD 212/month amounts to 17 percent of the average pension in Kuwait,⁹² implying a significant rise. In cases of a couple where only one partner receives a pension, the effective rise would amount to 34 percent. If we assume a supplementary increase of the UCG of KD 200/month for citizens outside of the public sector (financed by exits from government employment), the effective pensions increases would amount to 33 percent for the average pensioner and 65% for a couple relying on one pension. Against this background, it should be politically possible to convert pensions payments above a certain threshold towards DC with a view to making the system financially sustainable, while exposing richer pensioners to slightly more market risk.

The DC pensions component could still be administered by the PIFSS, which could offer a variety of investment products that contributors could choose from; contributors should, however, also be allowed to invest in other pensions products provided by the financial sector. Matched employer and government contributions should also continue for DC pensions.

The UCG would also work as a basic pension for individuals with no PIFSS pension, including divorced or single women of retirement age, requiring correspondingly less MoSAL transfers (see below). Pensions reform is a complex topic that cannot be fully covered here, not least as we have no raw household survey data on which to assess the distribution and correlates of current pensions incomes. It is clear, however, that pensions reforms will be politically difficult unless there is a quid pro quo arrangement like the introduction of a UCG.

⁹² ‘Kuwait Has Lowest Retiring Age Among GCC Countries’, *Arabic Times*.

Social Safety Net Reform

The introduction of a UCG would also allow a significant clean-up, tightening and clearer targeting of social safety payments administered by MoSAL and other agencies.⁹³ A detailed assessment of the SSN system and the impact of a UCG on different types of recipients is not possible without raw household survey data, but it is still possible to spell out a number of policy principles for reform.

The general principle of SSN modernisation should be a move from categorical benefits without means-testing to an SSN that focuses on specific deserving segments only. Benefits should have clear and explicit purposes, including labour market activation and assisting individuals to move out of beneficiary status into economic independence. Once again, such tightening would be politically facilitated by the availability of the unconditional UCG benefit that would in practice replace categorical benefits for individuals without specific needs. Tighter targeting would also allow more effective linkage of social assistance to microfinance and entrepreneurship programmes.

In moving away from categorical benefits, the government and MoSAL would need to build stronger means-testing capacity in terms of accessing data on individuals' assets, income, household status and so forth – all of which is standard in advanced countries. As a general rule, benefits should be phased out gradually with increasing non-benefit income, rather than being lost all at once the moment a certain income threshold is passed, which currently creates strong incentives to never cross this threshold (the 'welfare trap'), thereby discouraging labour market participation.

At the same time, the government should conduct a detailed review of all individual benefits and abolish ones that serve no clear social purpose, including the general benefits for women above 55. In cases where benefits are retained, their maximum amount should be reduced by the level of the UCG amount minus the increased average per capita utility costs created by the subsidy reforms. Benefits with a clear social purpose and no obvious negative externalities, such as rent and housing benefits, disability benefits, student stipends and marriage allowances, can be retained. In principle, they could all be rolled into the UCG, but the savings would be comparatively modest. All MoSAL social safety payments, for example, amounted to 0.43 percent of GDP in 2013, while our estimated savings from the above energy reforms amount to 4.2% of GDP – about ten times as much. The risk of political resistance from specific concerned groups probably outweighs the fiscal benefits of abolishing (rather than tightening) many social allowances.

The government should also retain its current unemployment insurance arrangements, which are based on a solid systems design and fairly low cost. In the long run, the ability to draw on unemployment benefits in the case of voluntary quits might be reconsidered.

Experience in other countries suggests that means-testing is likely to experience general political support in Kuwait. In the World Bank's MENA SPEAKS surveys, citizens noted a

⁹³ This section is informed by the 2015 report on the Kuwaiti SSN by the World Bank, but addresses social safety reforms beyond MoSAL and against the background of broader distributional reforms, particularly the UCG.

strong preference for poverty-based targeting as opposed to categorical targeting of social benefits.⁹⁴ As the UCG will replace the unconditional component of existing transfers, it will be easier to tie benefits over and above the UCG to specific conditions, such as participation in labour market training or job search efforts in cases where beneficiaries are able-bodied and of working age. The general idea would be that SSN payments would selectively top up income from the UCG for targeted interventions with specific social purposes. International experience shows that conditional programmes are more effective at influencing behaviour⁹⁵ and that conditional grants clearly outperform unconditional grants in terms of affecting educational and training outcomes.⁹⁶

To enable the consolidation of programmes, clearer means-testing and stricter conditionality, the SSN administration will require significant reforms, many of which are already outlined in the 2015 World Bank report on SSN reforms in Kuwait. Perhaps most importantly, the government needs to move towards an integrated system that links different government agencies that determine benefit eligibility and delivering social assistance. There is wide-reaching international experience with such consolidation, with the savings it creates and with the integration of SSN tools with other support policies.⁹⁷ In that process, the government should reduce overstaffing at its various social units and provide core employees with appropriate specialised training.

Building on existing internal reform debates, the government should consider the creation of a central social protection fund under a new high council of social protection, which would oversee not only MoSAL's support payments but all other benefits including those in areas like housing, labour market support and student assistance. The council could also oversee the UCG policy and assess its impact.

The overlap in current programmes could be reduced by developing a unified registry of beneficiaries, using modern information technology. The use of biometrics in countries like India has created large savings in the SSN area.⁹⁸ A central electronic portal should allow all concerned citizens to manage their benefits and provide required data and documents.

Once the administration has been strengthened and the purpose of specific benefits is more clearly defined, the government should introduce performance evaluations for different social policy programmes, using field trials to assess their impact on beneficiaries and creating tracer studies to assess the long-term impact of specific interventions on individuals. This would allow ongoing policy adjustment to maximise programme impact and efficiency.

⁹⁴ Victoria Levin, Matteo Morgandi and Joana C. G. Silva, 'Inclusion and Resilience: The Way Forward for Social Safety Nets in the Middle East and North Africa', *World Bank* (Washington, DC, 2012).

⁹⁵ Sarah Baird, Francisco H. G. Ferreira, Berk Özler and Michael Woolcock, 'Conditional, Unconditional and Everything in Between: A Systematic Review of the Effects of Cash Transfer Programmes on Schooling Outcomes', *Journal of Development Effectiveness* 6/1 (2014), pp. 1–43.

⁹⁶ Sarah Baird, Craig McIntosh and Berk Özler, 'Cash or Condition? Evidence from a Cash Transfer Experiment', *The Quarterly Journal of Economics* 126/4 (2011), pp. 1709–53.

⁹⁷ Kathleen G. Beegle, Aline Coudouel and Emma Mercedes Monsalve Montiel, 'Realizing the Full Potential of Social Safety Nets in Africa', *World Bank* (Washington, DC, 2018).

⁹⁸ Karthik Muralidharan, Paul Niehaus and Sandip Sukhtankar, 'Building State Capacity: Evidence from Biometric Smartcards in India', *American Economic Review* 106/10 (2016), pp. 2895–929.

Fiscal Impact

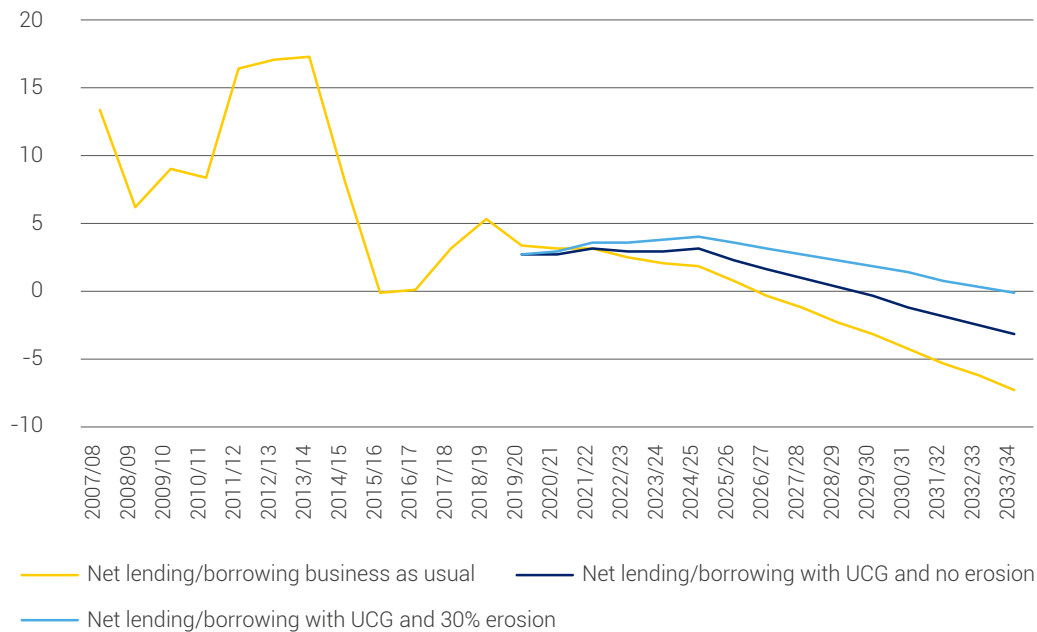
A key objective of converting subsidies, excess public employment and inefficient social safety provisions into a UCG is to improve the fiscal sustainability of Kuwait's government operations. This section therefore simulates the fiscal impact of these reforms over time and compares them to a 'business as usual' scenario where state employment and energy subsidies continue to grow on their current trajectory.

We consider two scenarios: one where a UCG allows the freezing of public employment, with the payroll merely growing 2 percent per year due to the natural effect of promotions, and one where the UCG leads to a gradual erosion of public sector employment by 30% over ten years. In both cases, we assume that the basic UCG financed through subsidy reforms is complemented by a supplementary KD 200 monthly payment to adults outside of the public sector. We argue that such a supplementary payment is needed to politically justify the freezing of public employment. As discussed above, the basic UCG would be insufficient to close the gap between public and private salaries and would only guarantee a very basic livelihood.

The supplementary payment of KD 200 would cost KD 982 million per year in Kuwait's current demographic structure. This is 5.7 percent of current state expenditure, that is, a substantial item – yet the public payroll grew by roughly that amount from 2015 to 2016 alone and is expected to add a similar amount about every two years going forwards. If the extra transfer can staunch the growth of the public payroll, it will quickly pay for itself. A KD 412 monthly payment for each adult outside of the public sector would provide a basic livelihood to everyone and send a powerful political signal justifying substantial reforms to the existing wealth distribution system in Kuwait.

Figure 17 shows the estimated fiscal balance in a business as usual scenario (based on IMF forecasts but extrapolated beyond 2024; see also Figure 10), in a UCG scenario with a public sector of constant size and in a UCG scenario with a public sector reducing its workforce by 30 percent within ten years. UCG costs are assumed to increase naturally by 2 percent a year due to population growth, with additional growth under the erosion scenario as former civil servants join the ranks of UCG recipients (adding about KD 50 million annually to the UCG budget). We assume that non-payroll expenditure continues on the same trajectory in all three scenarios.

Figure 17: Surpluses/Deficits under Business as Usual vs. UCG Scenarios, 2007/08 to 2033/34



Source: IMF, own calculations

The graph shows that after incurring small start-up costs, the UCG quickly provides considerable savings – particularly if we assume that it will lead to erosion of public employment. The savings kick in only gradually, underlining how important it is that the UCG is accompanied by a durable commitment to freeze net hiring in the public sector.

In the long run, reduction in the public payroll is essential to allow the government to break even. While further research is needed on the issue, provisional interviews and an internal survey by the General Secretariat of the Supreme Council for Planning and Development indicate that a UCG would cause a considerable share of incumbent public sector workers, women in particular, to leave government to be able to receive a UCG. A higher UCG could quickly pay for itself by accelerating the exodus from the public sector. Should the exit rate exceed expectations, the UCG could potentially be further increased, while using retention tools for critical staff to avoid the loss of core expertise in government (see below).

One unknown that is not modelled here is how many individuals leaving the public sector would join the private sector as employees, typically drawing on *da'm* support payments which would reduce fiscal savings. Even in such cases, however, the total cost of UCG and *da'm* would be considerably lower than that of the average public employee, both because of the fairly high average salary in government and because government employment creates considerable overhead costs. As a precautionary measure, our scenarios above do not assume any reduction in the social benefits budget despite the proposed consolidation

and tightening of social assistance, thereby leaving spare fiscal resources for *da'm* payments.

Even if we assume shrinkage of the public sector, Kuwait faces continued population growth that could lead to long-term fiscal pressures. Even then, the UCG reforms proposed here would buy considerable time for a longer-term transition towards either a more productive economy that could generate new non-oil revenue sources or a scenario where Kuwaitis increasingly live off returns from the accumulated overseas assets in the FGF, which would continue to grow for at least another decade. Under the business as usual scenario, Kuwait would face deficits in the mid-2020s, while a UCG scenario with a shrinking public sector would see deficits only a decade later.

The estimates above are meant to be illustrative. Actual fiscal developments will be strongly impacted by the unpredictable cycle of the oil markets. Nonetheless, our modeling demonstrates the superiority of UCG reforms over business as usual in fiscal terms.

Political Communication

A sustained political communication effort will be key for building public support for the UCG introduction and, critically, the accompanying reforms to energy pricing, public sector hiring and SSNs. In designing the communications strategy, authorities will be able to draw on a range of insights about which types of policies and framings are likely to receive popular support. Survey experiments in Jordan have shown that middle-class individuals tend to support redistribution to the poor,⁹⁹ demonstrating the need to highlight the redistributive effects of the UCG reform which will particularly benefit lower-income households. The UCG's universality will also be an asset for the communications strategy, as self-interested voters typically support positive welfare benefits when the policy is targeted sufficiently broadly.¹⁰⁰

A survey experiment designed by the author and conducted by YouGov in Saudi Arabia in 2014 also showed that around 75 percent of Saudi job-seekers and private sector employees supported a policy under which public employment guarantees are replaced with a UCG system. While the generosity of the Saudi state vis-à-vis its citizens is relatively lower than that of the Kuwaiti state, public employment is as central a component of the social contract as in Kuwait, making the survey results relevant for our context.

It will be important to frame the UCG as a policy that provides Kuwaiti citizens with their share in the country's wealth – and to make very explicit that it will replace other forms of wealth sharing permanently. The policy's higher transparency and inclusiveness should be highlighted as much as the fact that the vast majority of households will gain from the reform.

Authorities need to be very clear about which other channels of wealth sharing will be

⁹⁹ Levin, Morgandi and Silva, 'Inclusion and Resilience'.

¹⁰⁰ Karl Ove Moene and Michael Wallerstein, 'Targeting and Political Support for Welfare Spending', *Economics of Governance* 2/1 (2001), pp. 3–24.

reformed or entirely closed, and that these adjustments are permanent. The point that there will be no more public employment guarantee needs to be highlighted in particular. The communications strategy should also signal that most remaining welfare schemes will be means-tested, serve specific social purposes and often be conditional on beneficiaries' efforts to improve their skills or labour market situation.

These signals will reduce future political pressures for discretionary patronage and allow the government to use its non-UCG spending for purposes of economic development and the provision of public goods. An unconditional cash benefit provides an ideal line of defence against demands for discretionary social spending, as it formalises wealth distribution for all to see and separates it from other forms of spending, unlike the fragmented status quo system where patronage is often hidden.

Simple infographics and videos can be used to show how typical households (including pensioners) will be better off under the new system and how it improves the sustainability of the Kuwaiti system. The information materials should also highlight what households can do to benefit even more from the reforms, for example by leaving the public sector, improving energy efficiency in their personal lives and so forth. The communications strategy should be accompanied by regular focus groups and public opinion surveys to gauge the general support for the reforms and assess which frames and communication tools are the most efficient.

Follow-up research that is planned after this project will include several surveys among incumbent Kuwait civil servants, retirees and job-seekers to assess their reaction to different UCG scenarios. The objective will be both to identify which type of UCG and transition policies will find the strongest support and which kinds of 'framing' and justification of the policies will be the most impactful. Short of such work, any planning of political communications needs to remain preliminary.

Known Unknowns in the Reform Process

We have been able to estimate the immediate consequences of UCG reforms for Kuwait's fiscal situation and for the net income of Kuwaiti households fairly precisely. Other behavioural consequences of the reform are harder to predict with precision. There are a number of 'known unknowns' on which we need to generate further data, which would need to be monitored closely as reforms are rolled out, and which might require complementary policies to ensure that the UCG reforms achieve their main targets.

How Many Citizens Will Leave the Public Sector?

While the Kuwaiti government has some preliminary survey data indicating that many women would voluntarily leave government employment for a UCG, we lack more precise data to forecast the number of exits over time and as a function of different UCG levels. Further surveys would be useful, but even they might not predict actual behaviour reliably.

This means that the government will need tools both to prevent excessive short-term erosion of public employment and to further incentivise exit in case the uptake of the exit option remains below expectations. Exits could be limited through the selective provision of retention bonuses in important government agencies and, potentially, the temporary reduction of UCG payments to individuals who newly exit public employment. It would also be possible to create a lottery under which only a certain number of applicants who want to leave the public sector are entitled to the full UCG, while others receive only a reduced grant for a certain period.

The reverse problem would be if too few individuals leave the public sector. This would be an issue both fiscally and in terms of government efficiency, which would benefit considerably from a reduction of excess employment. To ensure sufficient uptake of the exit option, the government could experiment with golden handshakes, that is, additional cash bonuses for those willing to leave the public sector. Should this be insufficient, the government could consider permanently increasing the UCG to reduce the relative advantage of being in public employment.

Who Will Leave the Public Sector?

As important as ensuring that the overall number of exits is acceptable is that those who leave do not disproportionately come from the ranks of the best-performing employees. ‘Adverse selection’ of remaining employees is a problem experienced by the Kuwaiti police force and military as well as Kuwait Airways, where golden handshake policies have often led to better-skilled employees exiting. Some of this is in fact desirable, as ‘high potentials’ can often use their skills more productively in the private sector. That said, there is a need for a critical mass of qualified workers in government.

This risk of losing too many of them can be mitigated by conducting surveys that record individuals’ likely reaction to the UCG policy, which would allow the identification of key educational and career features of those most likely to leave. The above-mentioned option of paying retention bonuses should be used especially to avoid the exit of too many ‘high potentials’ from the public sector. In the medium term, more flexible salary structures could permanently incentivise a critical mass of better-performing employees to stay in government.

How Many Nationals Will Remain Idle?

A higher UCG creates the possibility that some nationals will decide to seek neither public nor private employment and instead live off their UCG. In principle, this should be an acceptable decision: a basic income grant increases citizens’ freedom of choice – and why shouldn’t some choose to avoid wage labour and instead devote their life to other activities? Interviews indicate, however, that in the Kuwaiti context, some forms of economic inactivity are seen as less socially desirable than others. Not being in gainful employment is not generally considered a social problem for Kuwaiti women, especially when they have children. Inactivity for men is seen as potentially more problematic and could, in the case of young men with ‘too much time on their hands’, potentially lead to undesirable

social behaviour.

The UCG proposed in this paper will provide good material security but not great comfort. Our expectation is that most young men would go on to seek private employment (and *da'm* subsidies) in order to satisfy their lifestyle expectations and be able to start a family. Men are the demographic with the highest income needs and expectations, so are more likely to join the labour market. More precise information on the issue is needed, however, notably surveys investigating reservation wages and desired incomes as well as the likelihood that individuals will eschew employment in cases where they can avail themselves of a basic income grant.

The risk of socially deleterious idleness should also be mitigated through community programmes, active labour market policies and the above-mentioned closer linkage of social benefits with labour market conditions and activation efforts, as well as microfinance and entrepreneurship programmes. It should be noted that as long as UCG-supported economic inactivity does not lead to delinquency or other undesirable social behaviour, it is economically much more preferable to excess employment in the public sector, which is costlier and undermines government efficiency.

Although it is outside the scope of this paper, the government should also consider complementary labour market reforms that can help to improve available wages on the private market. As things stand, for many Kuwaiti private sector employees the share of employer-provided wages in their total income would be rather small under a combined UCG and *da'm* scenario. This potentially decreases incentives for work effort and career development. Improved training can help increase Kuwaitis' earning power, but in the medium term, the government should also consider broader migration reforms that reduce the availability of low-cost, low-skilled foreign labour and augment the general wage level, especially in the lower-skilled segment. A lump sum fee on foreign labour could be considered as an incentive to shift towards more productive, higher-skilled workers. Migration reform would be politically and economically easier to undertake if more skilled national labour was available for employers to start with – which UCG and public employment reform would contribute to.

Irresponsible Household Behaviour

One final 'known unknown' that has been highlighted by some interviewees is the risk of irresponsible financial behaviour by households reliant on the UCG. What if the available cash is regularly frittered away quickly before the end of the month and political pressure builds for additional patronage measures?

We can note that the experience with cash grants in the developing world in this regard is encouraging: poor households generally increase their savings when receiving SSN transfers and the transfers lead to additional investment in micro-enterprises.¹⁰¹ Cash transfer

¹⁰¹ Paul J. Gertler, Sebastian W. Martinez and Marta Rubio-Codina, 'Investing Cash Transfers to Raise Long-Term Living Standards', *American Economic Journal: Applied Economics* 4/1 (2012), pp. 164–92.

programmes in Ghana and Zambia, for example, led to reported increases in savings of 11 and 24 percentage points, respectively. In Ethiopia, Ghana and Malawi, transfers led to a reduction of loans and debt repayments.¹⁰²

To minimise the risk of self-inflicted destitution among UCG recipients, we suggest accompanying the UCG introduction with comprehensive awareness campaigns and training programmes on responsible budgeting for Kuwaiti citizens. As mentioned above, we also suggest maintaining current transfer mechanisms for the in-kind provision of subsidised foodstuffs as well as the rent and housing assistance provided by government. While it would be economically optimal to roll all such in-kind provision into cash grants, the symbolic value and basic safety aspect of in-kind benefits appear important in the Kuwaiti context, and their cost is comparatively small relative to the more problematic energy subsidies and public employment outlays. Should the impact evaluation of a fully implemented UCG demonstrate that households largely behave responsibly, further consolidation of in-kind benefits into the UCG could be considered.

Conclusion

This paper has shown that a move away from energy subsidies and excess public employment towards direct provision of UCGs for Kuwaiti citizens would improve the fiscal sustainability of the Kuwaiti welfare system, would be fairer, more transparent and more inclusive, and would specifically benefit lower-income households. It would also provide a powerful political justification for reforming existing social safety and security mechanisms in Kuwait, which are inefficient and fragmented and in many cases benefit higher-income households more than lower-income ones.

The paper has particularly focused on the conversion of current electricity and water subsidies into citizen cash grants. We have argued that cash grants should be differentiated by employment status, with Kuwaitis outside of the public sector receiving higher grants as they do not enjoy the implicit subsidy incorporated in government employment. Our estimates show that bringing utility prices to the lower level of what is customary in advanced countries would create extra income that could finance monthly payments of KD 72 to all Kuwaiti children, KD 60 to all Kuwaitis employed in the public sector and KD 212 to Kuwaitis outside of the public sector. We have demonstrated that despite higher utility prices, the vast majority of Kuwaiti households would be net beneficiaries from the new grant. The paper also shows that the impact of higher utility prices on business profits and inflation is negligible.

The paper has argued that the KD 212 grant for adults outside of government could be augmented by another KD 200/month on the assumption that this will give the government a strong political justification for freezing net hiring in the public sector, thereby creating

¹⁰² Silvio Daidone, Benjamin Davis, Sudhanshu Handa and Paul Winters, 'The Household and Individual-Level Economic Impacts of Cash Transfer Programmes in Sub-Saharan Africa: Synthesis Report', *Food and Agriculture Organization of the United Nations* (Rome, 2017).

considerable long-term savings relative to a business as usual scenario. We also expect the availability of an augmented UCG to lead a significant share of public sector employees to leave their government jobs in order to avail themselves of the new grants, thereby creating additional fiscal savings through a smaller public payroll. This would address the most important and most problematic component of the current social contract in Kuwait: a de facto guarantee of public employment that far exceeds the actual administrative needs of government. An augmented UCG would allow more Kuwaitis to become entrepreneurs or seek productive employment in the private sector, activities that would become more attractive thanks to the ability to top up one's income with the UCG.

The introduction of a UCG would make it possible to consolidate existing social safety tools and introduce stringent means-testing, a policy that currently is not consistently applied for both administrative and political reasons. The government should build a central, consolidated database that allows a reliable assessment of all individuals' and households' income and wealth situations. The dedicated use of a UCG for general wealth sharing with Kuwaiti citizens would make it easier to use social safety tools exclusively for dedicated social purposes affecting lower-income households and, where applicable, to link social safety payments more closely to labour market activation. We recommend retaining certain general welfare payments with high symbolic and political value, such as rental and housing support, marriage grants and food subsidies, as their cost is comparatively limited.

The paper has also shown that there are a number of 'known unknowns' relating to the above reforms: it will be difficult to predict how many citizens will leave the public sector in general, how many of the better-performing public servants will leave in particular, how many nationals will choose to use the UCG to become economically inactive, and what levels of financial responsibility among UCG-dependent households will be. The paper has suggested data-gathering strategies and mitigation tools to limit potential negative outcomes in all these regards.

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