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TREATING THE OIL ADDICTION IN KUWAIT: PROPOSALS FOR ECONOMIC REFORM

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Abstract

In 2015, for the first time in 16 years, Kuwait reported a fiscal deficit of 2.71 billion Kuwaiti Dinars (\$9.4 billion). The deficit was exacerbated by weakness in crude prices and mounting supply–demand imbalances in the global oil market. It is critical that Kuwait reacts with a fiscal contingency plan to avoid the uncertainties and volatility of depending primarily on oil to fund government activities. This paper aims to highlight the current economic condition and fiscal needs of Kuwait, as well as to propose a set of potential mitigating strategies for the government to consider.

Introduction

Whether Kuwait can retain sovereignty if oil reserves are depleted is a question often debated. While Kuwait has the financial power to maintain government spending for a considerable period, it may not be sustainable in the longer term. The government remains heavily dependent on oil exports, having failed to build an entrepreneurial system that can alleviate the burden of demographic drag on the fiscal budget. Oil exports comprise 59 percent of gross domestic product (GDP).¹ Due to the recent plunge in oil prices, Kuwait's GDP growth rate dropped from 2.3 percent in 2013 to an estimated 1.8 percent in 2015. Such a drastic change illustrates the degree to which Kuwait's income is affected by the inherent volatility in commodity markets. Other potential challenges to the Kuwaiti economy include geopolitical instability, the threat of clean and renewable energy, the scarcity of oil, and new oil producers entering the market and being likely to drive down prices. The stronger the country's fiscal position, the better it will be at absorbing political and economic shocks.

Therefore, the goal of this paper is to propose a set of fiscal reform strategies that are feasible in the short, medium and long term, even in the absence of substantial resource diversification. Relevant statistics and literature are reviewed to analyse Kuwait's economy and the potential impact of the fiscal reform strategies proposed, with the motivation of providing guidance to policymakers about feasible options to manage Kuwait's fiscal deficit. The paper highlights selected potential mitigating strategies for the government to consider but does not provide guidance on the optimal set of fiscal reforms or the order in which they should be implemented. The optimal set of reforms requires thorough scrutiny which depends on, among other factors, preferences for the role of Kuwait's government and the economic, political and distributional costs of reforms involved.

This paper provides an overview of Kuwait's economy in addition to current and past fiscal budget positions, and highlights the structure of its oil reserves as well as investments and strategies to minimise the deficit driven by low oil prices. An approach is proposed to calculate the Kuwait Investment Authority (KIA)'s assets and introduce new data on foreign aid.

The first section discusses Kuwait's economy and the characteristics of national revenues; the second section explains the structure of government reserve funds. The third section proposes a set of mitigating strategies, which includes issuing sovereign bonds, finding a new optimal level for foreign aid, reforming subsidies, introducing taxation and increasing fees, devaluing the Kuwaiti dinar and restructuring expatriates' benefits. The fourth section concludes and recaps recommendations.

¹ Abbreviations and acronyms that are used more than once in the paper are listed in Appendix E.

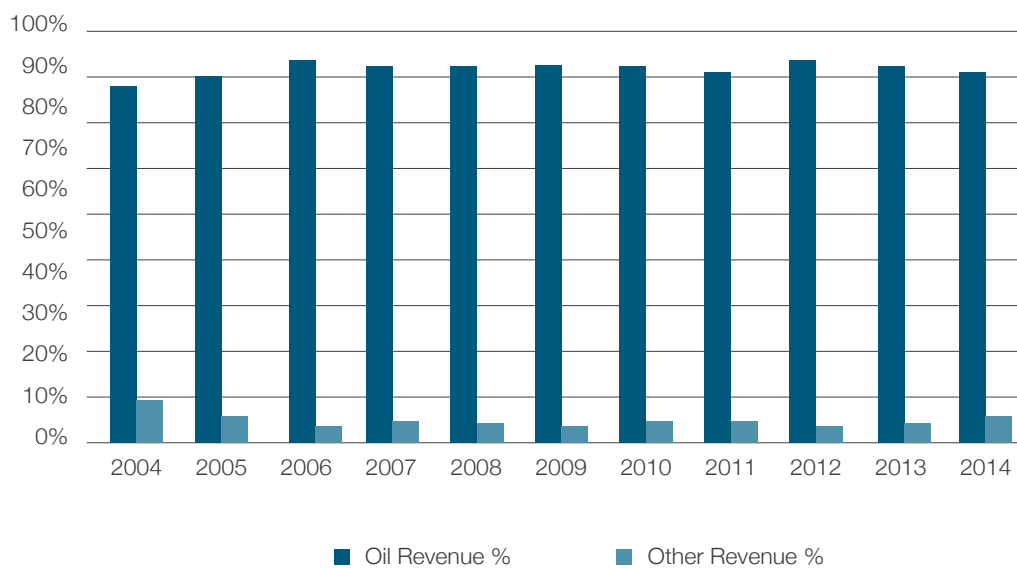
An Overview of Kuwait's Economy and Fiscal Position

Kuwait's Revenues

Traditional trade theory indicates that a country's welfare is maximised when it specialises in goods that it can produce relatively cheaply. In 1946, the state of Kuwait exported its first crude oil shipment and since then it has been heavily dependent on oil revenues. From 2004 to 2014, oil exports comprised almost 90 percent of revenues, with residual contributions from fees/fines, taxes on international companies and service revenues (see Figure 1).

Figure 1. Kuwaiti Government Revenues, 2004–14

Source: Ministry of Finance, Kuwait.



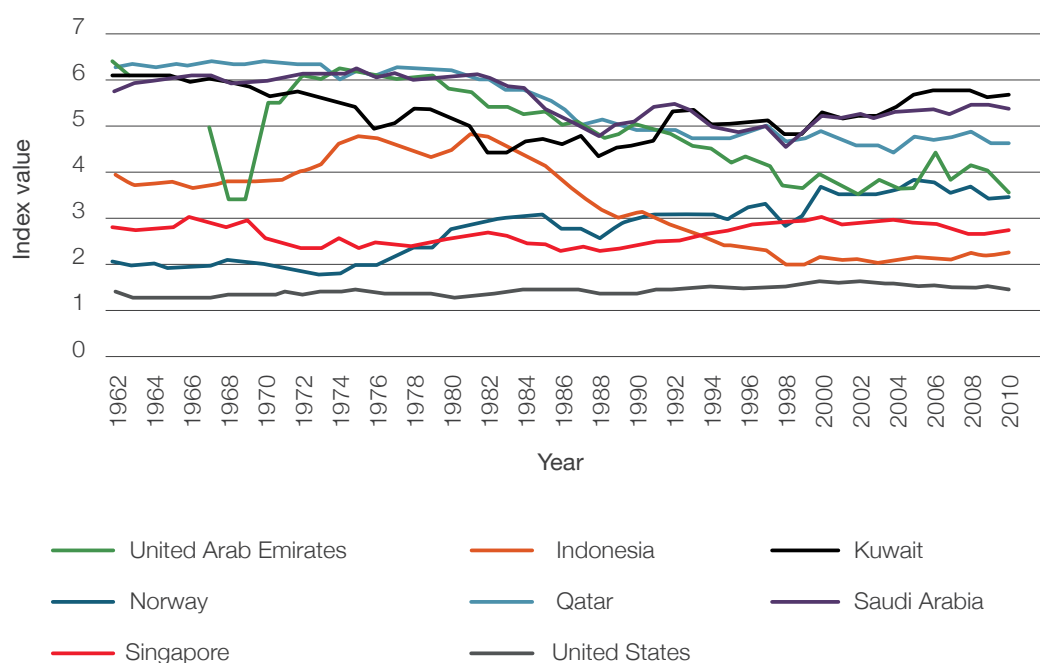
Oil production stood at 2.7 million barrels per day (mb/d) in July 2015, and the government has ambitious production targets for the future. Kuwait Petroleum Corporation (KPC) is targeting 3.15 mb/d by the end of 2015 and 3.65 mb/d by the end of 2020. Such an increase is feasible, considering that Kuwait holds the world's sixth largest oil reserves, the equivalent of 104.5 billion barrels according to US Energy Information Administration figures. If production of 4 mb/d is assumed, current reserves would be depleted in 70 years.

Diversification could boost national revenues. In fact, practitioners and academics often refer to it as one of the primary mechanisms to foster economic growth. For instance,

Papageorgiou and Spatafora,² as well as Lederman and Maloney,³ document an association between diversification and economic growth. Kuwait's government is aware of such correlations but has not been successful in adopting or implementing efficient diversification; as already noted, oil contributes almost 90 percent of public revenues. To support this point further, Figure 2 maps the International Monetary Fund (IMF)'s export diversification index over the period 1962 to 2010. From 2000 onward, Kuwait is ranked the lowest among eight oil-exporting countries.

Figure 2. Export Diversification Index, 1962–2010

Source: IMF Export Diversification and Quality Databases.



Note: High values indicate low ranking.

Aside from establishing a Sovereign Wealth Fund in the 1950s, economic growth in Kuwait was mainly driven by oil and imported labour and not by substantial manufacturing/private sector activities. The sovereign wealth story began in 1953 when the ruler of Kuwait, Abdullah Al-Salim Al-Sabah, established the Kuwait Investment Office (KIO), which was brought under the umbrella of the KIA in 1983. The government wanted to establish a stable

² Chris Papageorgiou and Nikola Spatafora, 'Economic Diversification in LICs: Stylized Facts and Macroeconomic Implications', *IMF Staff Discussion Note 12/13* (Washington, DC: International Monetary Fund, 2012).

³ Daniel Lederman and William F. Maloney, *Does What You Export Matter? In Search of Empirical Guidance for Industrial Policies* (Washington, DC: World Bank, 2012).

source of funds which could support future generations when oil reserves become depleted or insufficient. Thereafter and until 2010, the government of Kuwait did not adopt efficient policies to stimulate a major non-oil sector's economic growth as a means to support government spending. Why is this the case?

A number of studies show that resource-rich countries grow more slowly when compared to resource-deficient countries,⁴ a phenomenon called 'the resource curse'.⁵ The phenomenon exists in countries with plentiful national resources even after controlling for climate and geography.⁶ Additionally, in an effort to explain the factors behind the curse, Mehlum, Moene and Torvik⁷ show that the resource curse phenomenon is attributed to the differences in the quality of institutions. On the one hand, a wealth of natural resources (oil in Kuwait's case) pushes aggregate income down when institutions allow entrepreneurs to seek rent without incentivising new wealth creation; on the other hand, resource wealth raises income when institutions encourage entrepreneurs to pursue growth-driven activities, making it producer friendly. Another study highlights the deficiencies of institutions particularly in Kuwait;⁸ the study argues that some government rent distribution policies resulted in substantial distortions, inefficiencies and institutional deficiencies there. The authors list eight channels through which the Kuwaiti government distributes rents: public investment in infrastructure, land purchases, public transfer payments and pensions, subsidies, government employment, intervention in the private sector, the regulation of Kuwait's foreign direct investment environment, and investment abroad.

Although the underdevelopment of institutions could explain the curse in Kuwait at least to a certain extent, further empirical research is required to verify that this is indeed the case. Other barriers to diversification include: growth scenarios for the world economy, the duplication of economic activities among the Gulf Cooperation Council (GCC) states, the sizeable barriers to interregional trade, weaknesses that the GCC regimes exhibited under the stress of the Arab Spring, and governments' abandonment of their plans.⁹ Addressing these barriers will foster more efficient diversification, but this is a slow process and consequently may require a longer timeline for execution than the current fiscal balance sheet stress may allow.

⁴ Jeffrey D. Sachs and Andrew M. Warner, 'Natural Resource Abundance and Economic Growth', in Gerald M. Meier and James E. Rauch (eds), *Leading Issues in Economic Development*, 7th ed. (Oxford: Oxford University Press, 2000).

⁵ Richard M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (London and New York: Routledge, 1993).

⁶ Jeffrey D. Sachs and Andrew M. Warner, 'The Curse of Natural Resources', *European Economic Review* 45/4–6 (2001), pp. 827–38.

⁷ Halvor Mehlum, Karl Moene and Ragnar Torvik, 'Institutions and the Resource Curse', *Economic Journal* 116 (2006), pp. 1–20.

⁸ Laura El-Katiri, Bassam Fattouh and Paul Segal, 'Anatomy of an Oil-Based Welfare State: Rent Distribution in Kuwait', *LSE Kuwait Programme Paper Series* No. 13 (2011).

⁹ Martin Hvidt, 'Economic Diversification in GCC Countries: Past Record and Future Trends', *LSE Kuwait Programme Paper Series* No. 27 (2013).

Regardless of past obstacles to diversification, the government of Kuwait is keen to expand the economy independent of oil. Recent developments include launching a 25-year development plan in 2010.¹⁰ This strategy includes privatisations and infrastructure projects worth billions of dollars, all of which are expected to foster development and contribute to GDP. Also in 2012, the government established a 2 billion Kuwaiti Dinars (KD) fund to support the development in Kuwait of small and medium enterprises (SMEs). Research studies have emphasised the importance of SMEs' role in job creation and economic growth. For instance, Ayyagari, Demirgüç-Kunt and Beck¹¹ provide evidence of the contribution of the SME sector to total employment in manufacturing and GDP across 76 countries. In a similar manner, Ayyagari, Demirgüç-Kunt and Maksimovic¹² find that small firms globally have the largest share of job creation and some of the highest sales and employment growth, even after controlling for firm age. The government of Kuwait is hopeful that the aforementioned mega-projects will help diversify resources, but completing these projects will take a long time, and the Ministry of Finance is already wavering.

This paper argues unequivocally that efforts to foster diversification taken by Kuwait's government have been limited and thus have failed to generate significant revenues which can support government spending over the long run – especially given the constant turbulence in energy markets and the increasing burden of demographic drag on the budget (discussed in more detail in the next subsection). The strategies recommended in the third section will strengthen the government's fiscal position and foster growth even in the absence of significant diversification.

An Overview of Kuwait's Fiscal Budget

The inherent turbulence of global energy markets poses major threats to the government of Kuwait, which depends almost entirely on oil revenues. A considerable amount of wealth goes to national expenditures, with between 75 and 90 percent of total expected revenues allocated to such spending, while the remainder is allocated to the KIA.

The State of Kuwait's national expenditures budget ranged between \$18.4 billion and \$68.3 billion over the period 2003/4–13/14 and is distributed over five chapters (see Figure 3). The first chapter covers salaries, wages and government employee benefits, which include travel and government contributions to the public pension fund. The second chapter covers goods and services. The third chapter covers transportation, equipment and supplies, while the fourth covers construction projects and public acquisitions. Finally, the fifth chapter covers miscellaneous expenditure and transfer payments and includes any expenditure that cannot be accounted for under the other chapters.

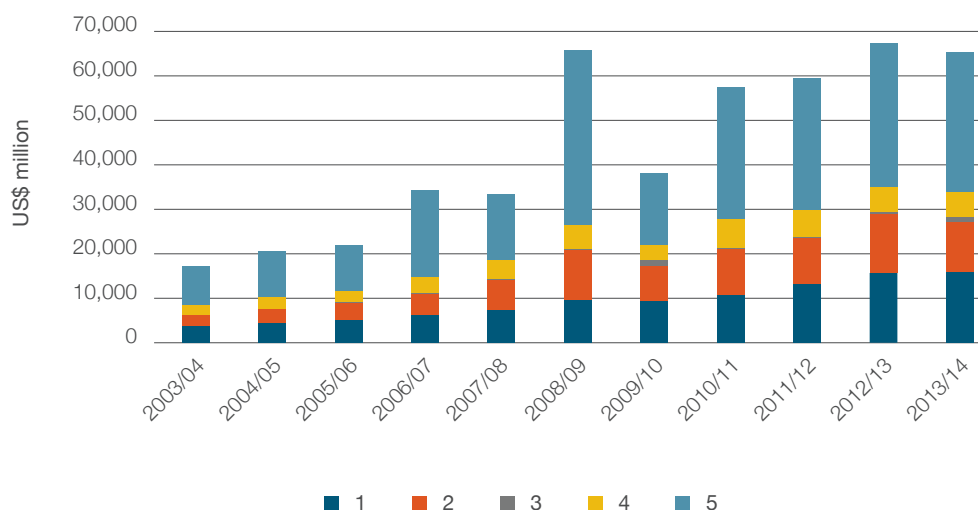
¹⁰ 'Kuwait's Government Development Plan for the Years 2010–2014', *General Secretariat of the Supreme Council of Planning and Development, Ministry of Planning*. Available at http://www.mop.gov.kw/Final-Mid_range_plan.pdf (accessed 18 February 2016).

¹¹ Meghana Ayyagari, Asli Demirgüç-Kunt and Thorsten Beck, 'Small and Medium Enterprises Across the Globe', *Small Business Economics* xxix/4 (2007), pp. 415–34.

¹² Meghana Ayyagari, Asli Demirgüç-Kunt and Vojislav Maksimovic, 'Small vs. Young Firms Across the World: Contribution to Employment, Job Creation, and Growth', *World Bank Policy Research Working Paper* No. 5631 (Washington, DC: World Bank, 2011).

Figure 3. Kuwait Budget Expenditures by Chapter, 2003/4–13/14 (\$ million)

Source: End-of-year reports by the Ministry of Finance, Kuwait.



Note: For descriptions of the chapters shown here, see the main text. Exchange rate conversion is based on Central Bank of Kuwait reports.

The fifth chapter also serves the country's national security and foreign policy needs; Appendix A provides a breakdown of the fifth-chapter categories. It can be seen that the majority of the fifth-chapter expenditures is kept inside Kuwait: 53.5 percent of the chapter is allocated to public authorities and organisations, 12.8 percent to the Ministry of Defence and 8.5 percent to general subsidies.

In terms of allocation of expenditures, over the period 2003/4–13/14 on average, 25 percent of expenses was allocated to the first chapter, 16 percent to the second and 1 percent to the third, while the fourth and fifth chapters consumed 9.8 percent and 48 percent, respectively.

Current demographics indicate that the state wage bill is likely to grow substantially by 2020. The total workforce in Kuwait at the end of 2013 was 2.37 million (see Table 1), of which 18.5 percent (see Table 2) work in the government sector – the equivalent of 441,007 employees, including 310,602 Kuwaitis. The government has of late attempted to nationalise the private sector workforce and terminate government contracts with expatriates. According to Kuwait's constitution, the government is obliged to employ citizens; currently the average Kuwaiti employee's monthly salary is KD1,600, equivalent to about \$5,559, according to Ministry of Finance (MOF) figures. Furthermore, the World Bank estimates that Kuwait's population will grow at an annual rate of 3.6 percent to 2020. If a similar growth rate is assumed in the public sector workforce, an aggregate government wage bill of at least \$25.62 billion can be expected by 2020 (note that this wage bill excludes expatriates working in the government sector and does not adjust for inflation). Given these assumptions for the first chapter of the budget and holding the remaining chapter spending at 2013/14 levels, it is reasonable to assume that the total expenditures budget will be at least \$75.90 billion by 2020 simply because of Kuwait's demographic profile.

Table 1. Kuwaiti Workforce, 2011–13*Source: Public Authority for Civil Information, Kuwait.*

Nationality	2011	2012	2013
Kuwaiti	389,746	399,345	410,254
Percentage Kuwaiti	17%	17%	17%
Non-Kuwaiti	1,837,657	1,896,910	1,960,747
Percentage non-Kuwaiti	83%	83%	83%
Total Workforce	2,227,403	2,296,255	2,371,001

Table 2. Workforce Distribution by Sector, 2011–13 (in percentage)*Source: Public Authority for Civil Information, Kuwait.*

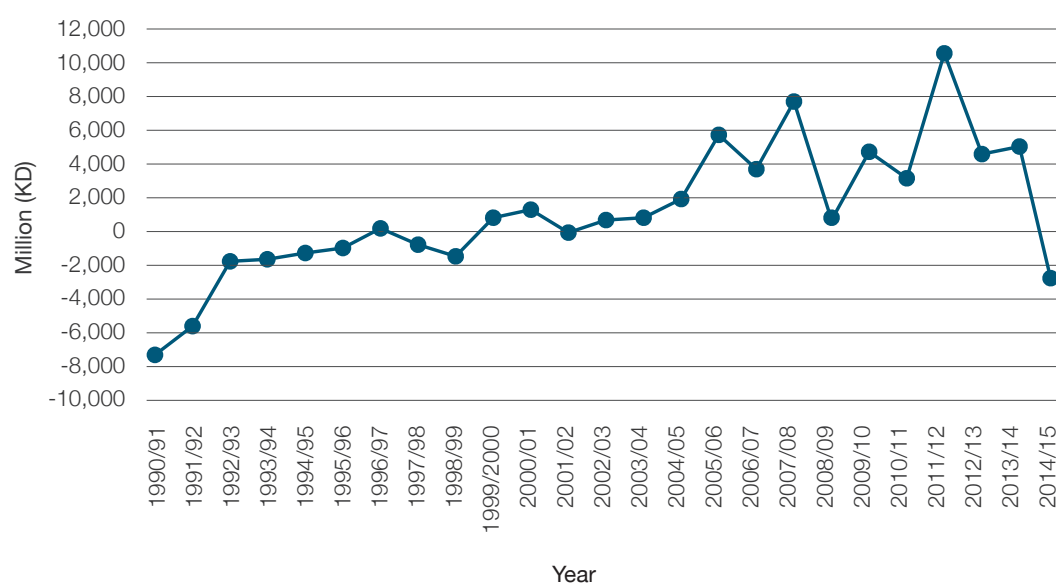
Workforce	2011	2012	2013
Government Sector	18.9	18.7	18.5
Kuwaiti	13.3	13.2	13.1
Non-Kuwaiti	5.6	5.5	5.5
Private Sector	53.6	54.7	55.5
Kuwaiti	3.6	3.6	3.8
Non-Kuwaiti	50	51.1	51.7
Family Sector	25.5	24.6	24.2
Kuwaiti	0	0	0
Non-Kuwaiti	25.5	24.6	24.2
Unemployed	2.1	2	1.8
Kuwaiti	0.6	0.5	0.5
Non-Kuwaiti	1.5	1.4	1.3
Total	100	100	100
Kuwaiti	17.5	17.4	17.3
Non-Kuwaiti	82.5	82.6	82.7

As a result of these simple estimates, an implied oil price of approximately \$69.84 is required for the budget to break even in 2020, assuming oil production remains at 2.7 mb/d, and non-oil revenues remain at the 2013/14 level of \$7.08 billion. Note that production could increase, however. Whether KPC will be successful in increasing production to 3.65 mb/d by 2020 is another widely debated and uncertain topic. If targeted production increases are indeed achieved, the required fiscal breakeven oil price per barrel will decline from \$69.84 to \$51.66 (see Appendix D for exchange rates).

An Overview of Kuwait's Historical Fiscal Position

During the period 1990–9, the MOF consistently reported fiscal deficits, with the exception of 1996/7, which recorded a surplus of KD63 million (see Figure 4). The Iraqi invasion in 1990 is partially responsible for the aforementioned period's deficit. According to former public officials who chose to remain anonymous, Kuwait depleted 80 percent of the Future Generations Fund (FGF) to rehabilitate its territory from the impact of the Gulf War. Withdrawing FGF assets is prohibited by law (discussed in more detail in the next section), and as such, the transaction was recorded as a loan granted by the FGF to the General Reserve Fund (GRF); the loan was thereafter repaid in instalments during the 1990s. Note that the FGF and GRF are cornerstones of Kuwait's financial system and are effectively the national Sovereign Wealth Fund and the Central Bank's current account, respectively. Also, in order to accelerate urbanisation after the war, the government commissioned many projects to the private sector under the umbrella of the Build–Operate–Transfer (BOT) law, which is a form of privatisation. Under the BOT framework, the private sector builds and operates a public project, usually for 25 years, after which time its ownership is transferred back to the government. During the 1990s and under the umbrella of BOT, many commercial, shopping, entertainment and sport projects were completed. BOT infrastructure projects (water, electricity, roads) scarcely existed, with the exception of Sulaibiya water station.

To manage the 1998/9 deficit, the government reduced its capital expenditures/tenders – a move later widely perceived as imprudent. Thereafter Kuwait enjoyed a long run of fiscal surpluses until 2014/15, when the government reported a deficit of \$8.9 billion. By the same token, 2015/16 estimates point to an even larger deficit of \$27.5 billion, assuming an oil price of \$45.

Figure 4. Actual Surplus/(Deficit), 1990–2015 (in KD)*Source: Ministry of Finance, Kuwait.**Note: Please refer to Appendix D for exchange rates*

Ongoing developments in global energy markets are indeed alarming, as increased supply is expected from Iran and possibly Libya and as demand has sustained sluggish growth at best. The IMF retained its trend of downward revisions to its global growth forecasts for 2015 (with a 4 percent forecast in January revised down to 3.3 percent in July). Concurrently, the Organization of the Petroleum Exporting Countries (OPEC) has demonstrated no interest in cutting production. The confluence of these factors contributed to Brent oil prices hitting a post-financial crisis low in January and August of 2015. The supply/demand balance in global crude markets is currently loose, and oversupply could increase further given the aforementioned potential production sources combined with lacklustre demand. This scenario would most probably put additional pressure on oil prices and on the fiscal position of Kuwait.

For Kuwait's national revenues to meet or exceed expenses in the 2015/16 budget, oil prices must equal or exceed \$55 per barrel assuming a daily production of 2.70 mb/d, an exchange rate of \$3.2 to KD1, and non-oil revenues of \$6.5 billion. In reality, Hashim Hashim, the CEO of Kuwait Oil Company (KOC), has announced plans to boost production by the end of 2015 to 3.15 mb/d and to 3.65 mb/d by the end of 2020. This target will be achieved through three main projects: the heavy oil project in the northern field of Ratqa, three assembly centres in northern Kuwait, and buying 50 rigs to drill and maintain current wells. KOC is likely to face four key challenges in carrying forward with its plans: (1) opposition coming from the National Assembly; (2) disagreement with Saudi Arabia over the neutral production zone (Al Khafji and Wafra fields); (3) insufficient

initial budget allocations to KPC tenders, which convolutes and prolongs executing the expansion projects; and (4) potential OPEC refusal to adjust Kuwait's production quota.

In this section, I have discussed the disappointing track record Kuwait has posted during the last 30–50 years in its effort to diversify the economy away from oil and sovereign investments. The government has failed to establish a saleable entrepreneurial system which could alleviate the burden of demographic drag on state liabilities (i.e. wages). Given the uncertainties inherent in global oil supply and demand, as well as the uncertainties in expanding local oil production, Kuwait could eventually face solvency problems. While it is true that Kuwait has tapped into the FGF reserve (once), this was during a state of emergency (i.e. an unprovoked war). Under normal conditions this is not a prudent solution given other viable options. As such, I strongly believe that other fiscal reform strategies (discussed in the following sections) should be attempted prior to calling for tapping FGF assets. The next section discusses in more detail the structure of government reserves, their financial characteristics and their ability to support government spending.

The Structure of Government Reserves

Before the mitigating strategies can be fully highlighted in the next section, it is necessary to explain the structure of government reserve funds and try to estimate KIA assets, as these funds are the equivalent of Kuwait's current and savings accounts. The State of Kuwait allocates reserves to two major government funds: the GRF and the FGF. The GRF receives all government revenues and pays all national expenditures (i.e. it acts like a current account). The GRF also holds government assets, including Kuwait's participation in public enterprises such as the Kuwait Fund for Arab Economic Development and KPC, as well as Kuwait's participation in multilateral and international organisations such as the World Bank, the IMF and the Arab Fund. The FGF was established in 1976 under Law Number 106, which states that 10 percent shall be deducted from annual revenues and transferred to the FGF for the purpose of supporting future generations. Also, no assets are to be withdrawn from the FGF unless sanctioned by law, which is partially why I propose the mitigating strategies in the next section. The KIA manages the surpluses of the GRF and all FGF assets. KIA financial statements are not public documents, however. They are made available annually to the Council of Ministers and to the State Audit Bureau (which reports to the National Assembly). The only semi-official estimate of FGF assets was made publicly available by the newspaper *Al-Qabas*, which cited a State Audit Bureau report for the year 2011–12. In the report, FGF assets were shown as KD75.3 billion (\$270 billion) on 31 March 2012. Table 3 lists the actual annual allocations by the government of Kuwait to the FGF and the GRF. Table 3 also contains my estimates of expected total allocations to the KIA over the period 2003–14.

Table 3. Total Expected Allocation to KIA, 2003–14 (KD)

Source: Actual numbers were obtained from the Ministry of Finance's end-of-year records, excluding actual allocations to FGF and GRF for the period 2003–5, which were calculated manually.

Year	Actual Revenues	Actual Expenses	Actual Allocation to FGF	Actual Allocation to GRF	Expected Allocation to KIA
2003–4	6,937,264,230	5,522,814,806	693,726,423	720,723,001	693,726,423
2004–5	8,962,370,731	6,315,216,598	896,237,073	1,750,917,060	896,237,073
2005–6	13,728,108,218	6,861,977,838	1,372,810,821	5,493,319,559	6,866,130,380
2006–7	15,509,262,505	10,306,377,533	1,550,926,250	3,651,958,721	5,202,884,971
2007–8	19,022,622,528	9,698,018,470	1,902,262,252	7,422,341,804	9,324,604,056
2008–9	21,005,800,240	18,262,198,464	2,100,580,024	643,021,751	2,743,601,775
2009–10	17,687,937,563	11,250,709,963	1,768,793,756	4,668,433,844	6,437,227,600
2010–11	21,501,984,649	16,221,001,904	2,150,198,464	3,130,784,279	5,280,982,743
2011–12	30,236,086,614	17,007,429,079	3,023,608,661	10,205,048,873	13,228,657,534
2012–13	32,008,542,620	19,307,556,125	8,002,135,655	4,698,850,839	12,700,986,494
2013–14	31,811,422,456	18,903,305,806	7,952,855,614	4,955,261,036	12,908,116,650
Total	218,411,402,354	139,656,606,586	31,414,134,993	44,869,020,706	76,283,155,699

Notes: The Kuwaiti government financial year starts on 1 April and ends on 31 March. The percentage allocation of actual revenues to the FGF increased in 2012 from 10 to 25 percent and was reduced back to 10 percent in the 2015/16 budget. Allocation to GRF = Actual revenues - Actual expenses - Other Allowances. Expected Allocation to KIA = Actual Allocation to GRF + Actual Allocation to FGF. Please refer to Appendix D for exchange rates.

KIA does not disclose the strategy or the location of investments, making it difficult to ascertain the historical rate of return. In an interview with the newspaper *Al-Rai* on 12 October 2014, the Kuwait minister of finance, Anas Al-Saleh, disclosed the rate of return KIA earned annually during the previous 20 years.¹³ Over the preceding 5, 10 and 20 years, KIA grossed a rate of return of 12.1 percent, 7.6 percent and 8.6 percent, respectively.

On the basis of these official average rates of returns, KIA total assets are calculated on the following set of assumptions:

1. A rate of return of 12.1 percent was employed to calculate the FGF fund assets over the last two years.
2. A rate of return of 7.6 percent was employed to calculate the GRF fund assets over the last ten years.

¹³ Abada Ahmed and Redha AlSinary, 'Al-Saleh: The Strategic Alternative Will Improve More than Half the Public Employees Status', *AlRai Newspaper*, 12 October 2014. Available at <http://www.alraimedia.com/UI/PDF.aspx?i=12886&p=36> (accessed 19 February 2016).

3. The balance of the FGF assets at the end of 2011/12 was KD75.3 billion, according to State Audit Bureau reports).
4. The Ministry of Finance allocations were as reported in Table 3.
5. The exchange rate (Kuwaiti dinar/US dollar) was that of the official Central Bank of Kuwait (CBK).

Total KIA assets were estimated as ranging between KD159 billion and KD176 billion, the equivalent of \$530 billion and \$626 billion as of 31 March 2014. The lower limit of this range excludes interest earned on the GRF.

KIA investment revenues are not reported in the fiscal budget. If investment revenues (i.e. interest and capital appreciation) were reported, an additional KD18.4 billion (\$61.4 billion) would feed into the 2015/16 budget, which should be sufficient to cover almost 95 percent of expenses. However, this is not sustainable and, more importantly, the government is prohibited from using FGF assets unless otherwise indicated by a new law. The GRF assets, however, could be used to fund shortfalls, although this is also a widely debated topic domestically. If the government moved to tap into the GRF, assets would be completely depleted in approximately five years (assuming the deficit remains KD8.9 billion and a GRF balance at the 2014/15 year-end is KD42.2 billion). Depleting either fund's assets would result in the KIA forgoing an annual rate of return ranging from 7.6 percent to 12.1 percent. Any loss of foreign investment returns would actually make Kuwait's position less diverse and less solvent, given these foreign returns come from various geographies, sectors and asset classes. For this reason, I examine other alternatives. I have, however, presented this section to provide context as to the social and political challenges and pressures the government is likely to face when deciding not to tap FGF or GRF assets. In other words, Kuwait has obvious options for mitigating the deficit in the short term (i.e. the next five years) and is likely to be under pressure from less financially savvy citizens to take 'the easy way out'. In the medium and long term, however, this easy option reduces Kuwait's future flexibility and safety net. As such, a different set of strategies, described in the next section, is preferable at this juncture in Kuwait's fiscal history.

Mitigating Strategies

As highlighted in the first section, Kuwait is expecting another fiscal deficit in 2015/16 due to volatility in the oil market and weak diversification in the local non-oil export sector. In the previous section, Kuwait has been shown as having significant general reserves managed in the GRF and FGF, some of whose assets could be used to plug expected fiscal deficits. Nonetheless, these funds will not sustain government spending over the longer term, especially given the demographic drag highlighted in the first section. Therefore, this section proposes core mitigating strategies suitable for Kuwait. Each of the six sections below provides an overview of the advantages and disadvantages of one potential strategy.

Sovereign Debt Issuance

Borrowing from the global and regional credit markets via issuing bonds is one option available to Kuwait's government to meet near-term budget shortfalls. Sovereign borrowing simply involves a government issuing debt (selling bonds), receiving proceeds to cover expenses, and paying back investors the notional value of the bond in addition to predetermined interest. The CBK is responsible for selling, purchasing and retiring government bonds. Currently, only local Kuwaiti banks can invest in CBK bonds.

Depending on government policy, a country usually issues a combination of bonds, bills and notes to finance expenditures. The size and price of the bond or bill depend on the country's credit rating, as it provides a benchmark for other issuers of debt. Sovereign creditworthiness depends on four main factors: the country's economic strength, institutional strength, fiscal strength, and susceptibility to event risk. Lower than expected growth, geopolitical risk and the ability and willingness of governments to progress planned structural reforms are shocks that may undermine a country's credit rating. Generally, the greater the risk of default, the higher the yield investors will require to invest in a given sovereign bond (i.e. borrowing costs become more expensive for governments as current and potential risks mount).

Aside from the aforementioned qualitative factors, certain quantitative ratios also govern ratings. These include but are not limited to the current account balance as a percentage of GDP, government debt as a percentage of GDP and the national loan to deposit ratio. Table 4 summarises Moody's sovereign credit ratings for various countries along with the coupon each currently pays on a ten-year bond and the percentage of gross debt/GDP (a measure for the financial leverage of an economy).

Table 4. Creditworthiness and Coupon Ratings

Sources: Moody's ratings; IMF World Economic Outlook; Wall Street Journal. GCC member coupon rates and bond duration data were obtained from their Central Bank websites.

Country	Credit Rating	Gross Debt/ GDP	Current Account Balance/GDP	Coupon Rate	Bond Duration
Bahrain	Baa2	76.12%	2.06%	5.50%	10 years
Kuwait	Aa2	4.48%	32.13%	3.125%	10 years
Oman	A1	11.03%	-2.79%	4.50%	10 years
Qatar	Aa2	13.92%	9.61%	9.75%	30 years
Saudi Arabia	Aa3	2.08%	7.85%	5.50%	10 years
France	Aa1	95.88%	0.013%	1.75%	10 years
Germany	Aaa	60.45%	4.99%	1.00%	10 years
Greece	Caa1	135.34%	1.07%	10.00%	10 years
Italy	Baa2	125.62%	-0.24%	3.75%	10 years
UK	Aa1	84.90%	-1.43%	2.75%	10 years
USA	Aaa	103.70%	-2.78%	2.25%	10 years

Surprisingly, on 30 March 2015, *Al-Qabas* in Kuwait reported that the law governing CBK borrowing via bond issues is no longer valid, as it was passed in the 1960s for a period of ten years. Henceforth, the government needs to issue a new law which regulates issuing sovereign bonds, especially if it is interested in attracting regional or international buyers for such securities. The sooner the government acts, the more favourable the cost of borrowing will be – especially given the US Federal Reserve's tightening of interest rates (increasing rates) that took place in 2015, which could have negative relative implications for global credit markets.

One advantage of issuing sovereign bonds would be an increase in the government's financial transparency and reporting; more disclosure will decrease risk and the cost of borrowing. Another advantage is that sovereign debt should discipline the government and make it more forward-looking and fiscally responsible; any poor performance will indicate higher risk and result in higher borrowing costs that may block future access to markets.

Kuwaiti government bonds are currently offered only to domestic banks. If the government offered bonds to the public, one would expect higher demand by investors who have a lower appetite for risk. Investors who primarily invest in bonds could thus suppress liquidity and fund flows into the Kuwait Stock Exchange (KSE) and into the real estate market – one disadvantage of a sovereign bond sale to the public. High demand for sovereign bonds by the domestic public could be exacerbated in the event that the government

simultaneously cut expenses by terminating expatriate contracts, for instance (driving down rents and demand for goods and services in the process). Another disadvantage could be depositor reactions to an alternative asset class – that is, Kuwaiti investors might find the rate of return on bonds more desirable than those on the certificates of deposits (CDs). As such, depositors might relocate their funds to bonds, which could eventually reduce the bank's ability to lend, given current CBK reserve requirements.

Finding a New Optimal Level for Foreign Aid

Alesina and Dollar¹⁴ find evidence that the direction of foreign aid is dictated by political and strategic considerations, rather than by the economic needs and policy performance of the recipients. Bearce and Tirone¹⁵ argue that foreign aid can promote economic growth in recipient countries by facilitating economic reform, but only when the strategic benefits associated with providing aid are small for donor governments. When the strategic benefits are large, foreign aid becomes ineffective because Western governments cannot credibly enforce their conditions for economic reform. Kuwait has a reputation for giving large amounts of foreign aid through at least five channels: foreign aid grants (fifth chapter), foreign aid grants and foreign loans (Kuwait Fund for Arab Economic Development, KFAED), multilateral agencies and oil products (KPC and its subsidiaries). Prior literature that measured Kuwait's foreign aid used the AidData database, which accounts for aid provided by KFAED. In addition to the aid reported by KFAED, my research takes into account another channel of aid provided by the MOF (fifth chapter).

Overall, Kuwait's foreign aid reaches different parts of the globe; however, it is fair to say that most of it is political and directed to Arab countries. These are more likely to receive a higher amount of aid from other Arab donor countries (namely Kuwait, Saudi Arabia and the United Arab Emirates).¹⁶ Further evidence is presented in Table 5, which provides information on the geographical allocation of loans provided by KFAED since its establishment in 1961. As the table illustrates, Arab countries were by far the largest recipients of loans (over 56 percent), which is not surprising given the mandate of the fund.

¹⁴ Alberto Alesina and David Dollar, 'Who Gives Foreign Aid to Whom and Why?', *Journal of Economic Growth* 5/1 (2000), pp. 33–63.

¹⁵ David Bearce and Daniel Tirone, 'Foreign Aid Effectiveness and the Strategic Goals of Donor Governments', *Journal of Politics* xl/3 (2010), pp. 837–51.

¹⁶ Eric Neumayer, 'What Factors Determine the Allocation of Aid by Arab Countries and Multilateral Agencies?', *Journal of Development Studies* xxxix/4 (2003), pp. 134–47.

Table 5. Loans from KFAED, from 1961*Source: Kuwait Fund for Arab Economic Development (KFAED).*

Region	Total Loans (KD 000's)	Share (%)
Central Asia and Europe	305,774	5.61
Latin America and the Caribbean	167,120	3.07
East Asia, South Asia and the Pacific	992,952	18.22
Arab Countries	3,052,920	56.03
West Africa	534,489	9.81
Central and South-East Africa	395,874	7.26
Total	5,449,129	100.00

Werker¹⁷ explains the Gulf countries inclination towards giving aid to other Arab countries: 'No doubt the motivation for this was largely political: the Gulf countries quell unrest due to the huge inequality among their coreligionists (between the oil haves and have-nots).' Even though the author concludes that Gulf aid is largely politically motivated, he does not dismiss the possibility that it could contain a development component; but he argues that such a component is difficult to measure.

Ahmed and Werker¹⁸ argue that aid from Gulf oil-producing countries to Muslim non-producing countries is correlated with the price of oil. It picked up in the 1970s and slowed down in the 1980s, opening the door to civil wars and to the recent Arab Spring. The authors insinuate that Gulf aid slowed the process of democratisation in Muslim non-oil recipient countries; such a result could be perceived as a negative outcome of the concentration and abundance of Arab foreign aid.

Neumayer¹⁹ indicates that over the period 1974–94, Arab countries donated 1.5 percent of their gross national product (GNP, currently known as gross national income or GNI) in foreign aid, which is above the 0.7 percent United Nations target. While this target is not a limit to foreign aid, it could nonetheless be an indicator of the degree of generosity involved. Globally, the average amount of foreign aid has rarely exceeded the UN target. According to the OECD Net Official Development Assistance (ODA) statistics, out of 45 countries that reported their Net ODA as a percentage of GNI for 2000–14, the only seven which exceeded the UN target of 0.7 percent in at least one year were Denmark, Norway, Luxembourg, the Netherlands, Sweden, the United Kingdom and the United Arab Emirates (see Appendix C). Unfortunately, the OECD statistics do not

¹⁷ Eric Werker, 'The Political Economy of Bilateral Foreign Aid', *Harvard Business School BGIE Unit Working Paper* No. 13-026 (Boston, MA: Harvard Business School, 2012), p. 7.

¹⁸ Faisal Ahmed and Eric Werker, 'Aid and the Rise and Fall of Conflict in the Arab Muslim World', *Princeton University Working Papers* (Princeton, NJ: Princeton University, 2013).

¹⁹ Neumayer, 'What Factors Determine the Allocation of Aid'.

cover Kuwait, but from my calculations it can clearly be seen that Kuwait is considered generous. In three channels of aid alone, over the period 2005–13 Kuwait exceeded the 0.7 percent target in every year except 2006–7 (see Table 6).

Table 6. Foreign Aid, 2005–13 (KD)

Year	Foreign Aid	Foreign Loans	Foreign Grants	Total Foreign Aid	Foreign Aid/GNI
2005–6	89,714,071	197,975,000	3,332,997	291,022,068	0.89%
2006–7	110,815,133	138,400,000	4,523,000	253,738,133	0.69%
2007–8	289,453,751	185,300,000	4,293,500	479,047,251	1.08%
2008–9	166,369,585	197,050,000	2,080,000	365,499,585	1.16%
2009–10	53,662,019	198,940,000	1,363,830	253,965,849	0.71%
2010–11	137,055,156	194,750,000	5,429,292	337,234,448	0.74%
2011–12	288,557,567	210,410,000	1,963,223	500,930,790	0.98%
2012–13	564,863,761	211,120,000	739,424	776,723,185	1.46%

Notes: Foreign aid data are provided by the MOF. Foreign loans and foreign grants data are provided by KFAED. GNI data are provided by the World Bank (average end-of-year values). Exchange rate conversions are CBK annual average \$/KD rates. Please refer to Appendix D for exchange rates.

As much as foreign aid is critical for the success of national policy and security, research has documented that significant amounts of it can have a negative impact on the governments of the recipient countries. It is possible that Kuwait is currently giving too much, but to be able to tell this with certainty, the government must set performance measures for past loans/donations and determine the effectiveness of the lending. It should also set priority and optimal future donation ranges that strike a balance between its foreign relationships and national fiscal needs. Further, the government should consider giving more loans and fewer grants, which would increase national revenue visibility and decrease its volatility. Cutting inefficient foreign direct aid could alleviate some pressure on Kuwait's fiscal deficit.

Reforming Subsidies

The government of Kuwait subsidises electricity, water, gas, basic food products and Kuwaiti employee wages in the private sector, along with other items reported in Appendix B.²⁰ The total cost of all subsidies was KD6.2 billion during the 2014/15 fiscal year, about 26 percent of the budget. Fuel for power plants is the most heavily subsidized item, costing the government KD2.7 billion or about 12 percent of total budget expenditure. Privatising water and electricity assets is an option which should be given serious consideration at this juncture in Kuwait's finances, given that it moves the needle the most in terms of savings. Another option would be to sell electricity, water and gas at market prices and give cash transfers to lower-income households to achieve equality. Removing subsidies should be addressed in more gradual ways (as opposed to outright immediate privatisation). Jiang, Ouyang and Huang²¹ analyse the possible impact of removing energy subsidies on Chinese household income distribution under different scenarios and suggest that energy subsidy reform has the strongest progressive effect and a minimal impact on households.

In 2014, the Kuwaiti government announced a reduction in diesel subsidies. This resulted in an increase in the price of diesel-dependent products and services. To mitigate price inflation and its negative effects on companies and citizens, the government could simultaneously introduce price controls (i.e. ceilings) to protect consumers from increasing prices of goods and services. This might help lessen the impact of a reduction in subsidies; however, it would negatively impact company margins, if they failed to obtain efficiency gains elsewhere in their businesses.

Some believe that subsidies can redistribute resources and correct market failures. However, critics often warn of the economic distortions created by subsidies beyond a certain threshold. Lucas²² examined global fuel subsidies, using World Bank data, and found that pricing fuels below cost is inefficient because it leads to overconsumption and that the total annual deadweight loss worldwide is \$44 billion. Plante²³ shows that fuel subsidies lead to crowding out non-oil consumption, inefficient inter-sectoral allocations of labour, and other distortions in macroeconomic variables and reduction in aggregate welfare.

Reforming subsidies in Kuwait is a very challenging task for the government to implement given objections from the parliament. The MOF charged the professional services firm Ernst and Young with preparing a study about reforming subsidies, and the recommen-

²⁰ Abbas Al-Mejren, 'Impacts of Fiscal Legal Setting and Institutions on Budget Outcomes in the Rentier State of Kuwait', *Economic Research Forum Working Paper* No. 920 (Giza: Economic Research Forum, 2015), Table 4, p. 39.

²¹ Zhujun Jiang, Xiaoling Ouyang and Guangxiao Huang, 'The Distributional Impacts of Removing Energy Subsidies in China', *China Economic Review* 33 (2015), pp. 111–22.

²² Davis Lucas, 'The Economic Cost of Global Fuel Subsidies', *American Economic Review* civ/5 (2014), pp. 581–5.

²³ Michael Plante, 'The Long-Run Macroeconomic Impacts of Fuel Subsidies', *Journal of Development Economics* cvii/1 (2014), pp. 129–43.

dations report was published by the press on 27 December 2015.²⁴ The recommendations did not go down well with the parliament. MP Faris Al-Otaibi threatened to question Minister of Finance Anas Al-Saleh on subsidy reform. Also, on 12 January 2016, some MPs objected to the reforms and announced the following: 'Parliament members don't want to touch people's pockets [citizens' disposable income] and affect their lifestyle negatively; therefore, we suggest that the parliament form a team of MPs and relevant government officials to study subsidies reform and follow up with a report.'²⁵ The cutting of subsidies has thus been tabled since this time.

In summary, while subsidies may boost the welfare of citizens by correcting market failure, they might also cause overconsumption and economic distortions. The government should study the impact of Kuwait's remaining subsidies on economic efficiency and choose an optimal level of subsidy and cash transfer which maximises both citizen welfare and economic efficiency. In the Jiang et al.²⁶ framework, starting with cutting the subsidies with the strongest progressive effect is recommended, on the assumption that the framework holds for Kuwait; this assertion could be investigated in future work.

Introducing Taxation and Increasing Fees

Kuwait is currently a tax free country; imposing taxes could boost government revenues and help offset public expenditures. The government needs to remain cautious when introducing taxes, however, as the literature has documented a relationship between the structure of taxes and economic growth as well as between taxes and inequalities.

Arnold²⁷ conducted a study of 21 OECD countries over the period 1971–2004 to investigate the effects of tax structure on economic growth. The results indicate that income taxes are generally associated with lower economic growth than taxes on consumption and property. The author then establishes a ranking of tax instruments with respect to their relationship to economic growth. Property tax, particularly recurring taxes on immovable property, emerged as the most growth-friendly, followed by consumption tax and then by personal income tax. Corporate income taxes appear to have the most negative effect on GDP per capita.

²⁴ Redha Al Sinary, 'Surprises in Proposed Reform Recommendations: Reconsidering Housing Mortgage and Accommodation Allowance', *AlRai Newspaper*, 27 December 2015. Available at <http://www.alraimedia.com/ar/article/economics/2015/12/27/645589/nr/kuwait> (accessed 19 February 2016).

²⁵ 'A Team of MPs and Ministers to Study Reforms', *Al Jarida Newspaper*, 13 January 2016. Available at <http://www.aljarida.com/news/index/2012793221> (accessed 19 February 2016).

²⁶ Jiang et al., 'Distributional Impacts'.

²⁷ Jens Arnold, 'Do Tax Structures Affect Aggregate Economic Growth?', *Quarterly Journal of Economics* 106 (2012), pp. 407–23.

Kuwait's government recently announced new taxation plans.²⁸ On 24 March 2015, the former minister of commerce, Dr Abdulmohsen Al-Medeij, announced that the ministry had commissioned the IMF to work on a proposal for taxation to be imposed by 2017. As noted above, Arnold finds that corporate income taxes appear to have the most negative effect on GDP per capita, and therefore it is recommended that Kuwait's government take into account the importance of the tax structure hierarchy and its relationship with economic growth. In fact, on the same date as Al-Mudeaj's statement, Saudi Arabia announced property taxes on 'white lands' (i.e. vacant land suitable for construction); the decision is in line with the Arnold recommendation. Because Kuwait is a small country (17,820 km²), mostly owned by KPC, starting with taxing property there might not be the best revenue-generating option.

In addition to highlighting the relationship between taxes and economic growth, the literature has also documented a relationship between taxes and inequality.²⁹ Through taxation, governments can alter the distribution of income. In that regard, personal income tax and corporate tax are classified as progressive; that is, the tax rate increases when income increases. In contrast, consumption and real estate tax are considered regressive: expenditures on goods/services subject to the tax represent a larger percentage for lower-income individuals than for higher-income individuals. Under a progressive taxation framework, given that everyone pays a different tax rate according to his or her income, progressive taxes reduce income inequality (corporate tax effectiveness is subject to the mobility of capital) but hurt economic growth, while regressive taxes do exactly the opposite. To find a balance between achieving economic growth and reducing income inequality, cash transfers may be considered. According to the IMF, direct income taxes and transfers have decreased inequality in advanced economies by an average of one third. Note, however, that targeted social benefits do not always reduce inequality; benefits should be designed in a way which does not encourage withdrawal from the labour market.

Currently, fees and taxes on imports and foreign companies contribute 10 percent to Kuwait government revenues. In Dubai, fees currently represent 67 percent of government revenue; the emirate claims that the increase is due to economic expansion, as opposed to a hike in fees (i.e. volume over value). Saudi Arabia currently imposes a 20 percent tax on income generated from companies owned by expatriates. Kuwait could study the impact of such procedures and determine whether it makes sense to adopt similar actions.

²⁸ Redha AlSinary, 'Surprises in Proposed Reform Recommendations; Reconsidering Housing Mortgage and Accommodation Allowance', *AlRai Newspaper*, 27 December 2015. Available at <http://www.alraimedia.com/ar/article/economics/2015/12/27/645589/nr/kuwait> (accessed 19 February 2016).

²⁹ Jorge Martinez-Vazquez, Blanca Moreno-Dodson and Violeta Vulovic, 'The Impact of Tax and Expenditure Policies on Income Distribution: Evidence from a Large Panel of Countries', *International Center for Public Policy Working Paper Series* No. 12-30 (Atlanta, GA: Andrew Young School of Policy Studies, Georgia State University, 2012). Leonel Muinelo-Gallo and Oriol Roca-Sagalés, 'Joint Determinants of Economic Growth, Income Inequality, and Fiscal Policies', *Economic Modelling* 30 (2013), pp. 814–24.

In summary, the government should conduct thorough research on the best tax structure to optimise both citizens' welfare and fiscal balances. If lessening inequality is a priority for the government, I recommend starting with imposing progressive taxes and specifically personal income tax, as corporate tax has a more negative impact on growth. On the other hand, if fostering growth is a priority to the government, I recommend imposing a consumption tax, as the efficiency of property tax in Kuwait is limited by the small area of land. The government should also tax products and services that are not essential to its citizens and which cannot be bought easily in neighbouring tax-free GCC countries, or it should choose a low tax rate that does not negatively impact Kuwaiti companies' profitability. Failure on this front will be counterproductive, hurting local businesses, unless the GCC agrees on imposing a fixed consumption rate region-wide.

Devaluing the Kuwaiti Dinar

Monetary policy in Kuwait is the responsibility of the CBK. The prime objective of CBK policy is to maintain monetary stability, with the aim of mitigating the impact of inflation. Expatriate remittance outflow³⁰ and the annual allocation to the FGF are two factors that help curb the level of inflation. The CBK manages monetary policy in a manner which enhances social and economic progress and growth of the national income. During the period from 1975 until the end of 2002, the CBK adopted a fixed but adjustable exchange rate policy, pegging the KD to a weighted basket of major currencies which have significant trade and financial relations with Kuwait. Between January 2003 and May 2007, the KD was pegged to the US dollar. In 2007, the KD exchange rate was re-pegged to an undisclosed weighted basket of international currencies of Kuwait's major trade and financial partner countries. The decision to abandon the dollar peg in 2007 was motivated by the depreciation of the dollar against other major currencies, and the potential impact of increasing inflationary pressures from imported goods.³¹

Oil products comprise 90 percent of Kuwait's exports and are sold in US dollars rather than dinars. Devaluation of the KD is one way by which the CBK could increase oil revenues in local dinar terms. After the devaluation, one US dollar could buy more Kuwaiti dinars. This solution would create an immediate surge in oil revenues in local terms but would reduce the dinar's value, its purchasing power and real wages. Devaluation could also cause inflation, as imports become more expensive.

Krugman and Taylor³² argue that the favourable short-run effect of devaluation on the trade balance can come primarily through contraction (a slowdown of an economy)

³⁰ Ali. Termos, George Naufal and Ismail Genc, 'Remittance Outflows and Inflation: The Case of the GCC Countries', *Economics Letters* cxx/1 (2012), pp. 45–7.

³¹ Mohsin Khan, 'The GCC Monetary Union: Choice of Exchange Rate Regime', *Peterson Institute for International Economics Working Paper* No. 09-1 (Washington, DC: Peterson Institute for International Economics, 2009).

³² Paul Krugman and Lance Taylor, 'Contractionary Effects of Devaluation', *Journal of International Economics* 8 (1978), pp. 445–456.

rather than substitution. In other words, devaluation not only reduces output and employment but also redistributes income from labour to capital. The authors conclude that devaluation is a costly cure, especially if it is accompanied by an increase in taxes; in such a scenario the overall effect could be deflationary and might result in a steep decline in output. The authors recommend introducing devaluation together with demand-increasing measures. Edwards³³ showed that devaluations generate a small contractionary effect in the first year, while in the second year this effect is reversed, and in the long run devaluations are neutral.

In summary, devaluation seems to be the least favourable mitigating strategy because of its effect on imports and residents' purchasing power. Kuwait's government must be aware of the risks of devaluation. Nonetheless, this strategy could be worth the fiscal benefits it would bring if implemented cautiously.

Restructuring Expatriates' Benefits

Kuwait's oil wealth has attracted large numbers of expatriates who seize employment opportunities (both direct and ancillary) created by crude extraction. Expatriates increase the supply of labour and provide different sets of skills, thereby making the economy more efficient. Expatriates make up 69 percent of the population and 83 percent of the workforce, with most in the private sector. The majority of expatriates working in the private sector are educated to below secondary level; those who are educated to above secondary level are a minority representing only a little over 8 percent of the workforce (see Table 7).

Table 7. Percentage Distribution of Expatriot Labour Employment in the Private Sector by Education Level and Gender, as of 30 June 2014

Source: State of Kuwait Central Statistical Bureau

Educational level	Number	Males (%)	Females (%)	Total (%)
Illiterate	57,330	0.16	0.06	0.15
Under Secondary	443,791	41.74	29.62	40.69
Secondary	119,096	15.62	22.11	16.19
Above Secondary	71,819	7.43	17.27	8.28
Not Stated		35.05	30.94	34.69
Total	692,036	100.00	100.00	100.00

³³ Sebastian Edwards, 'Are Devaluations Contractionary?', *Review of Economics and Statistics* lxviii/3 (1986), pp. 501–8.

Very few expatriates are employed in the categories of professional and technical workers. These skill sets represent 11 percent and 3 percent of the workforce, respectively. The majority of expatriates work in the services, manufacturing, agricultural or construction sectors (see Table 8). The professional and technical workers category includes scientists, engineers, architects, aircraft and ship officers, doctors, pharmacists, mathematicians, nurses, accountants, jurists, teachers and others.

Table 8. Numerical and Percentage Distribution of Expatriate Labour in the Private Sector for Males and Females by the Main Divisions of Occupation, as of 30 June 2014

Source: State of Kuwait Central Statistical Bureau.

Divisions	Males		Females		Total	
	Number	%	Number	%	Number	%
Professional and Technical Workers	123,556	9.68	30,450	25.28	154,006	11.03
Managers	37,131	5.77	4,283	3.55	41,414	2.97
Clerical Workers	73,579	10.20	18,657	15.49	92,236	6.60
Sales Workers	130,099	10.90	21,583	17.92	151,682	10.86
Services Workers	139,038	4.83	28,210	23.42	167,248	11.98
Agriculture, Animal Husbandry, Hunting and Fishing Workers	61,651	55.71	20	0.02	61,671	4.42
Production and Related Workers, Transport Equipment Operators and Labourers	710,914	100.00	17,256	14.32	728,170	52.14
Total	1,275,968	100.00	120,459	100.00	1,396,427	100.00

According to the State of Kuwait Central Statistics Bureau, the majority of expatriates (43 percent) earn a monthly salary ranging between KD60 and KD120, while 13 percent earn a salary above KD420; the remaining portion of workers earn a salary ranging between KD120 and KD420, and 1.5 percent of expatriates earn a salary below KD60. The educational level, type of job and level of salary all indicate that the majority of expatriates are low-skill workers, which is a widely known characteristic of Kuwait's population.

Expatriates comprise the majority of the population and the workforce in Kuwait, with the status of temporary workers. Expatriates are not eligible for permanent residency or citizenship and cannot own real estate or corporations fully. Lacking such privileges, many expatriates typically depart before putting down roots that last more than a generation. Annually, expatriates transfer billions abroad. Kuwait, along with other GCC countries, often makes the list of top ten countries in terms of remittance outflows as a percentage of the GDP, according to figures from the Migration and Remittances Factbook.

Between 2005 and 2013, remittance outflows in Kuwait ranged from \$2.7 billion to \$15.8 billion and up to 11 percent of GDP (see Table 9).

Table 9. Remittance Outflows, 2005–13 (\$ million)

Source: Migrant Remittance Outflows and GDP Data were obtained from the World Bank. Remittance/GDP is based on author's calculations.

Year	Migrant Remittance Outflows	GDP	Remittance/GDP (%)
2005	2,648	80,797.95	3.28
2006	3,183	101,558.97	3.13
2007	9,764	114,635.47	8.52
2008	10,323	147,380.28	7.00
2009	11,749	105,905.30	11.09
2010	12,126	115,416.40	10.51
2011	13,421	154,034.94	8.71
2012	15,874	174,044.70	9.12
2013	15,242	175,826.72	8.67

Not only do expatriates allocate funds away from Kuwait's economy, they also pose a substantial drag on public resources. They currently enjoy many state benefits for no charge or at a subsidised rate. Doctors visits cost KD1 per visit, and water and energy are both subsidised. Many enjoy the benefits of free education, public roads and other free infrastructure services. Offsetting these costs is difficult without income or consumption tax systems. Expatriates also reduce the level of consumption and investment in the GCC, thereby affecting economic activity. Alkhathlan documents a negative relationship between remittance outflows and economic growth in Saudi Arabia over the short term. This effect, however, fades over the long term.³⁴

On the other side of the equation, Kuwait, by comparison with other countries, has not fully captured the potential of expatriates. Immigrant roles were vital for the development of countries like Australia, Canada, the USA and the UK, as they create new businesses and new jobs, and contribute to taxes and to GDP. Using the USA as an example, a 1940–2000 state panel shows that a 1 percentage point rise in the immigrant college graduate population increased patents by 9–18 percent.³⁵ Another study shows that immigration has a positive effect on native wages of about 0.6 percent.³⁶

³⁴ Khalid Alkhathlan, 'The Nexus between Remittance Outflows and Growth: A Study of Saudi Arabia', *Economic Modelling* 33 (2013), pp. 695–700.

³⁵ Jennifer Hunt and Marjolaine Gauthier-Loiselle, 'How Much Does Immigration Boost Innovation?', *American Economic Journal: Macroeconomics* ii/2 (2010), pp. 31–56.

³⁶ Gianmarco I. P. Ottaviano and Giovanni Peri, 'Rethinking the Effects of Immigration on Wages',

In summary, nationalisation policy, immigration policy and the tax system in Kuwait should all be transformed in a manner which reduces the expatriate drag on public benefits, captures the fruit of immigration and fosters economic growth without hindering potential innovation. The government should provide better incentives and channels to allow expatriates who wish to work in Kuwait to contribute to its economy and to come with the intention of staying. A longer-term, more autonomous visa/residency programme for higher-skilled workers and for economic contributors is a rational place to start.

Conclusion

In this paper, I have highlighted the current economic conditions in Kuwait and proposed a set of relevant strategies for the government to consider. To alleviate the uncertainties of depending on oil, the government should establish reform goals with short-term and long-term milestones; measuring and assessing performance are a must to ensure the efficiency of reforms. Also, it is important that the government conducts thorough research to have a better understanding of the economic, political and distributional costs of associated reforms, helping it to determine when to propose each strategy and to what extent.

I believe that optimising the government's capital structure is the most logical first step and thus I welcome the idea of a prudent quantity of sovereign debt while interest rates remain attractive. Any increase in regional instability, either via a deteriorating Saudi balance sheet, an escalation of the conflict in Yemen or an increase in ISIS activity within GCC borders, would be likely to weigh on credit ratings and increase borrowing costs. Now is the time to obtain a reasonable price for borrowing. I also believe that Kuwait's aid is an important component of its philanthropic and political agenda. As such, I advocate not for a decrease in this activity but for its transformation. A portion of grant-giving could be replaced with long-duration loans, which would serve as visible revenue sources for Kuwait and allow recipient nations time to use the funds effectively. This would not meaningfully compromise Kuwait's political or social objectives and would ease the burden of giving. Furthermore, I believe that Kuwait's high-potential expatriates (i.e. entrepreneurs and job creators) should be more enfranchised through a longer-term visa system with more fiscal autonomy than currently exists.

The government should find mechanisms to curb subsidies in a manner which reduces overconsumption and fiscal imbalances while increasing social equality; I favour reforming subsidies over introducing taxes, given the near-term logistical challenges of a tax system. I do believe, however, that, in the medium term, taxation can be an effective tool in optimising economic output. While I heed the evidence of property tax being the most effective form of initial taxation, I acknowledge that Kuwait's status as a city state with a small amount of taxable property complicates the application of that system. As such, I favour consumption taxes together with an item-specific cash payment system for poor or low-income households to counter the regressive nature of this type of taxation method.

(Note that the USA has an item-specific cash payment system called Food Stamps). I also encourage consumption taxes in preference to corporate taxes, given the well-understood and well-researched impact of corporation tax on growth. Additionally, to make taxation more socially acceptable, I advocate introducing an initiative jointly, via a GCC-wide agreement.

Kuwait's challenges are thought-provoking and its reserves and wealth are substantial. Balancing the need to address the future of both assets and liabilities should remain at the forefront of government policy and action. Treatment of Kuwait's oil addiction must start now, while popular support can be cultivated and difficult decisions justified, such that a cure becomes a realistic goal in the not too distant future – a future which can still be influenced by present-day decisions.

Appendices

Appendix A. Breakdown of Fifth-Chapter Expenditure, 2013/14

Source: Ministry of Finance, Kuwait.

Expenditure category	Actual consumed (\$)
A: General expenditures	
The Ruler of Kuwait Allowances	50,000,000.00
Ministry of Defence	1,141,167,728.53
Army reinforcement law	569,689.53
Conferences for government employees	70,844,310.91
Sports tournaments	49,075.27
Official missions abroad	49,580,622.25
Scholarships	204,655,525.07
Religious campaigns	1,461,247.08
Training	14,467,338.77
Employees' accommodation	27,051,973.73
Judicial ruling expenditures	6,550,193.92
Judicial affairs	151,052,133.11
Total for category A	1,717,449,878.00
B: Internal transfers and subsidies	
Individuals' transfer (humanitarian)	425,393,995.51
NGO subsidies	6,699,384.98
General subsidies	757,253,608.47
Transfers to public authorities and organisations (with separate budgets)	4,769,180,614.80
Special activities and companies' compensation	175,089,528.94
Kuwaiti Nationals Working in the Private Sector Subsidy	458,175,999.30
Zakat	10,013,234.59
Total for category B	6,601,806,366.58
C: External transfer and aid	
Health expenditures for citizens and students abroad	151,223,886.42
The State of Kuwait annual subscription fees in international organisations	23,045,946.34
Foreign aid	412,965,270.33
Total for category C	587,235,103.09
Fifth-chapter total	8,906,491,347.84

Appendix B. Total Subsidies, 2014/15

Source: Al-Mejren, *Impacts of Fiscal Legal Setting*, Table 4, p. 39.

Items in 2014/15 Budget	Million KD	Share (percent)
Funding fuel for power generation plants	2723.4	43.655
Funding refined oil products and liquefied gas	751.9	12.053
Support of national labour working in the private sector	554.7	8.892
Private universities students' tuition, fees and rewards	480.9	7.709
Support of social care programmes	351.8	5.639
Abroad medical treatment	276.2	4.427
Allowance for reducing cost of living	242	3.879
Other subsidies	224.5	3.599
Rent compensations for citizens awaiting housing care	208	3.334
Disabled allowances	98.2	1.574
Cancellation of real estate loans	70.8	1.135
Interest on real estates' loans	67.5	1.082
Central Bank of Kuwait (money market operations)	60	0.962
Support of sports clubs and other local activities	56.9	0.912
Subsidy to fuel prices	30.7	0.492
Marriage grants	16	0.256
Funding fuels of Kuwait Airways	14.8	0.237
Support of labour unions and civil societies	5.1	0.082
Funding the House of Islamic Charity (Bait al-Zakat)	2.9	0.046
Support of local newspapers	1.5	0.008
Summer and Spring training	0.1	0.002
Total	6238.4	100.00

Appendix C. OECD Net ODA as a Percentage of GNI, 2000–14

Note: DAC = OECD Development Assistance Committee.

Location	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Australia	0.27	0.25	0.25	0.25	0.25	0.25	0.3	0.32	0.32	0.29	0.32	0.34	0.36	0.33	0.27
Austria	0.23	0.34	0.26	0.2	0.23	0.52	0.47	0.5	0.43	0.3	0.32	0.27	0.28	0.27	0.26
Belgium	0.36	0.37	0.43	0.6	0.41	0.53	0.5	0.43	0.48	0.55	0.64	0.54	0.48	0.45	0.45
Bulgaria											0.09	9	0.08	0.1	
Canada	0.26	0.22	0.28	0.24	0.27	0.34	0.29	0.29	0.33	0.3	0.34	0.32	0.32	0.28	0.24
Chinese Taipei						0.14	0.14	0.13	0.11	0.13	0.1	0.09	0.06	0.05	
Cyprus						0.09	0.14	0.17	0.17	0.2	0.23	0.16	0.11	0.1	
Czech Republic	0.03	0.05	0.7	0.11	0.11	0.11	0.12	0.11	0.12	0.12	0.13	0.13	0.12	0.11	0.11
DAC Total	0.22	0.21	0.23	0.24	0.25	0.32	0.3	0.27	0.3	0.31	0.32	0.31	0.29	0.3	0.29
Denmark	1.06	1.03	0.96	0.84	0.85	0.81	0.8	0.81	0.82	0.88	0.91	0.85	0.83	0.85	0.85
Estonia					0.05	0.08	0.09	0.08	0.1	0.1	0.1	0.12	0.11	0.13	0.15
Finland	0.31	0.32	0.35	0.35	0.37	0.46	0.4	0.39	0.44	0.54	0.55	0.53	0.53	0.54	0.6
France	0.31	0.31	0.38	0.4	0.41	0.47	0.47	0.38	0.39	0.47	0.5	0.46	0.45	0.41	0.36
Germany	0.27	0.27	0.27	0.28	0.28	0.36	0.36	0.37	0.38	0.36	0.39	0.39	0.37	0.38	0.41
Greece	0.2	0.17	0.21	0.21	0.16	0.17	0.17	0.16	0.21	0.19	0.17	0.15	0.13	0.1	0.11
Hungary				0.03	0.07	0.11	0.13	0.08	0.08	0.01	0.09	0.11	0.1	0.1	0.12
Iceland	0.1	0.13	0.15	0.17	0.18	0.18	0.27	0.27	0.47	0.35	0.29	0.21	0.22	0.25	0.21
Ireland	0.3	0.33	0.4	0.4	0.39	0.42	0.54	0.55	0.59	0.55	0.52	0.51	0.47	0.46	0.39
Israel		0.08	0.12	0.1	0.07	0.08	0.06	0.07	0.07	0.07	0.07	0.09	0.07	0.07	0.07
Italy	0.13	0.15	0.2	0.17	0.15	0.29	0.2	0.19	0.22	0.16	0.15	0.2	0.14	0.17	0.16
Japan	0.28	0.23	0.23	0.2	0.19	0.28	0.25	0.17	0.19	0.18	0.2	0.18	0.17	0.23	0.19

Korea	0.04	0.06	0.05	0.06	0.06	0.1	0.05	0.07	0.09	0.1	0.12	0.12	0.14	0.13	0.13
Latvia		0.01	0.06	0.07	0.06	0.07	0.06	0.06	0.07	0.07	0.06	0.07	0.08	0.08	0.08
Liechtenstein								0.44	0.53	0.68	0.62	0.69	0.75		
Lithuania		0.01	0.04	0.06	0.06	0.07	0.08	0.11	0.11	0.11	0.11	0.13	0.13	0.11	
Luxembourg	0.7	0.77	0.78	0.86	0.79	0.79	0.89	0.92	0.97	1.04	1.05	0.97	1	1	1.07
Malta										0.18	0.18	0.25	0.23	0.2	
Netherlands	0.84	0.82	0.81	0.8	0.73	0.82	0.81	0.81	0.81	0.82	0.82	0.75	0.71	0.67	0.64
New Zealand	0.25	0.25	0.22	0.23	0.23	0.27	0.27	0.27	0.3	0.28	0.26	0.28	0.28	0.26	0.27
Norway	0.76	0.8	0.89	0.92	0.87	0.94	0.89	0.95	0.89	1.06	1.05	0.96	0.93	1.07	0.99
Poland	0.02	0.02		0.01	0.05	0.07	0.09	0.1	0.08	0.09	0.08	0.08	0.09	0.1	0.08
Portugal	0.26	0.25	0.27	0.22	0.63	0.221	0.21	0.22	0.27	0.23	0.29	0.31	0.28	0.23	0.19
Romania									0.09	0.08	0.07	0.09	0.09	0.07	
Russia										0.03	0.03	0.03	0.02	0.03	
Saudi Arabia															
Slovak Republic	0.03	0.04	0.02	0.05	0.07		0.1	0.09	0.1	0.09	0.09	0.09	0.09	0.09	0.08
Slovenia						0.11	0.12	0.12	0.13	0.15	0.13	0.13	0.13	0.13	13
Spain	0.22	0.3	0.26	0.23	0.24	0.27	0.32	0.37	0.45	0.46	0.43	0.29	0.16	0.18	0.14
Sweden	0.8	0.77	0.84	0.8	0.78	0.94	1.02	0.94	0.98	1.12	0.97	1.02	0.97	1.01	1.1
Switzerland	0.32	0.33	0.32	0.36	0.39	0.42	0.38	0.37	0.42	0.44	0.39	0.46	0.47	0.45	0.49
Thailand							0.04	0.04	0.09	0.02	0	0.01	0	0.01	
Turkey	0.04	0.04	0.04	0.04	0.11	0.17	0.18	0.09	0.11	0.12	0.13	0.17	0.32	0.4	0.41
United Arab Emirates										0.37	0.14	0.21	0.2	1.34	1.17
United Kingdom	0.32	0.32	0.31	0.34	0.36	0.47	0.51	0.36	0.43	0.51	0.57	0.56	0.56	0.71	0.71
United States	0.01	0.11	0.13	0.15	0.17	0.23	0.18	0.16	0.18	0.21	0.21	0.2	0.19	0.18	0.19

Appendix D. Exchange Rates (USD/KD)

Fiscal year	Exchange rate (US\$1 = KD)
2003/4	0.2996
2004/25	0.2930
2005/6	0.2920
2006/7	0.2891
2007/8	0.2800
2008/9	0.2729
2009/10	0.2876
2010/11	0.2789
2011/12	0.2781
2012/13	0.2825
2013/14	0.2821
2014/15	0.2878

Note: Exchange rates were obtained from the Central Bank of Kuwait annual reports.

Appendix E. Abbreviations and Acronyms

BOT	Build–Operate–Transfer
CBK	Central Bank of Kuwait
CDs	certificates of deposits
FGF	Future Generations Fund
GCC	Gulf Cooperation Council
GNI	gross national income
GNP	gross national product
GRF	General Reserve Fund
IMF	International Monetary Fund
KD	Kuwaiti dinar
KFAED	Kuwait Fund for Arab Economic Development
KIA	Kuwait Investment Authority
KIO	Kuwait Investment Office
KOC	Kuwait Oil Company
KPC	Kuwait Petroleum Corporation
KSE	Kuwait Stock Exchange
MOF	Ministry of Finance
ODA	Official Development Assistance
OPEC	Organization of the Petroleum Exporting Countries
SMEs	small and medium enterprises

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