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Kuwait: 2003 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Kuwait

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with Kuwait, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **October 30, 2003,** with the officials of Kuwait on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 16, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its February 9, 2004 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Kuwait.

The document listed below have been or will be separately released.

Statistical Appendix

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KUWAIT

Staff Report for the 2003 Article IV Consultation

Prepared by Staff Representatives for the 2003 Consultation with Kuwait

Approved by Mohammad Shadman-Valavi and Juha Kähkönen

January 16, 2004

- The discussions for the 2003 Article IV consultation were held in Kuwait from October 15-30, 2003.
- The team comprised Messrs. Iqbal (Head), Elhage, Thai, Okogu, and Takizawa (all of MCD). Mr. Habermeier (MFD), head of the Joint IMF-World Bank Financial Sector Assessment Program (FSAP) team, and Mr. Shaalan, Executive Director for Kuwait also participated in the policy discussions, which included the recommendations of the FSAP exercise.
- The mission met with Mr. Mahmoud Al-Nouri, Minister of Finance; Sheikh Salem Abdulaziz Al-Sabah, Governor, Central Bank of Kuwait (CBK); Undersecretaries in the Ministries of Finance, Commerce, Energy, and Planning; Deputy Governor of CBK; Secretary General, Higher Committee for Economic Development and Reform; and other senior government officials. It also met with representatives of commercial banks, the Chamber of Commerce, the Kuwait Stock Exchange, and the Kuwait Petrochemical Company (Equate).
- In concluding the 2002 Article IV consultation on December 13, 2002, Executive Directors commended the Kuwaiti authorities for their continued pursuit of prudent fiscal and monetary policies under an open and free exchange and trade system, which have resulted in a strong macroeconomic position despite wide fluctuations in oil prices. While the medium-term outlook remains favorable, Directors noted that Kuwait would face unemployment pressures and sustaining intergenerational equity may become more difficult.
- Directors commended the authorities for addressing these emerging challenges by promoting non-oil growth through structural reforms, improving labor market performance, and strengthening the budget structure. They encouraged the authorities to continue with their efforts to broaden support for sustained implementation of reforms, based on expenditure restraint and structural reform, to accelerate growth of the private non-oil sector. They endorsed a cautious monetary policy to sustain exchange rate stability. Directors commended the authorities for their effective supervision of the financial sector and looked forward to the early enactment of the Privatization Law and implementation of the Foreign Investment Law and of the amended Banking Law. Directors also encouraged further efforts to continue improving the quality, currentness, and dissemination of economic data.
- Kuwait accepted the obligations of Article VIII on April 5 1963. It also accepted the Fourth Amendment of the Fund's Articles of Agreement. The authorities have agreed to issue a Public Information Notice (PIN) following the conclusion of the consultation process, and to publish the staff report.
- The principal authors of this report are Messrs. Zubair Iqbal and Hajime Takizawa.

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Present Setting

- Kuwait has been gradually pursuing a strategy of structural reforms supported by fiscal strengthening in order to address the dual objectives of accelerating non-oil growth with financial and monetary stability and maintaining intergenerational equity. Core elements of the strategy include a reduction in the role of the public sector, promotion of private investment, deepening and widening of the financial sector, reform of the labor market, and expenditure restraint.

- In 2002–03, the macroeconomic position was favorably affected by firmer oil prices and developments in Iraq. Real non-oil GDP growth rose sharply, in part, on account of the reconstruction activity in Iraq. The overall fiscal surplus rose in 2002/03 to 25 percent of GDP mainly because of higher oil revenues and restraint on expenditure. Though projected to fall, the overall surplus is expected to remain at a comfortable 19 percent of GDP in 2003/04. The underlying fiscal stance will be expansionary. The external current account surplus fell in 2002 before rising to about 19 percent of GDP in 2003. The net foreign assets of the Central Bank of Kuwait (CBK) fell to the equivalent of about eight months of imports in 2002 and are expected to fall further in 2003 on account of larger portfolio investments abroad.

- The macroeconomic position over the medium term under current oil price expectations and the maintenance of a cautious policy stance is projected to weaken, but is not expected to pose sustainability issues. Under this scenario, growth is expected to decelerate and be insufficient to address employment needs. Moreover, a steady increase in wealth per capita over the longer term will necessitate stronger fiscal effort.

Staff Appraisal

- The implementation of the official reform program should be accelerated to further strengthen the fiscal position and create the institutional and legal environment needed for promoting private investment, under an appropriately sequenced timetable. The staff welcomes the authorities' intention to accelerate privatization. It would benefit from market pricing of publicly supplied goods and services, reduction in and targeting of subsidies, and flexible wages with a cautious Kuwaitization policy. Steps to increase financial efficiency and strengthened regulation of the securities market would reinforce a sound financial system.

- Fiscal tightening should be aimed at a significant improvement in the non-oil deficits through current expenditure restraint and buildup of non-oil revenues. The counter-cyclicality of fiscal policy should be strengthened by casting the budget in a medium-term macroeconomic framework with a well-defined fiscal rule.

- More progress is needed in the collection and dissemination of economic data. Areas needing further improvement include aggregate expenditure, nonfinancial private capital flows, and labor and employment.

I. Background and Recent Developments

A. Introduction

1. Over the past few years, Kuwait has endeavored to: (a) accelerate non-oil growth and address the emerging unemployment pressures through structural reforms in a stable monetary and financial environment, and (b) strengthen further its fiscal position to maintain intergenerational equity. The authorities' strategy to achieve these objectives aims at reducing the role of the public sector through restructuring and privatization, promoting private investment (including FDI) and reforming the labor market, while further strengthening the fiscal position.

2. The staff and the authorities agree on the nature of the challenges facing the Kuwaiti economy, but there are differences in the pace of needed adjustment. In previous Article IV consultations, the staff has encouraged speeding up structural reforms to facilitate private sector investment to spur growth and generate employment opportunities, and to structurally strengthen the budget. The authorities have shared this view and have taken some steps toward addressing these issues. However, progress on the implementation of the official strategy has been hampered, in part, by difficulties in reaching political consensus especially between the government and the parliament on important policy initiatives, administrative constraints, and regional uncertainties. Moreover, the implementation of Fund technical assistance for strengthening public expenditure management and medium-term fiscal planning has lagged, in part, because of regional security concerns. The FSAP exercise has been completed.

3. **The 2003 consultation discussions were held at a time of accelerating non-oil growth with resurgence in private activity because of Iraqi developments.** Reflecting higher oil prices, internal and external surpluses have remained large. Following the July parliamentary elections, a new Cabinet was installed in August 2003. With security concerns becoming more manageable and oil prices remaining firm, the authorities currently see better prospects for an acceleration of their reform agenda in the near term. However, the time-consuming process of political consensus building is likely to constrain any expeditious action toward implementing these reforms. Kuwait has committed to providing $500 million to Iraq in 2004, in addition to about $1 billion, which has already been disbursed in 2003. Kuwait's economic assistance to developing countries has amounted to about 2 percent of GDP per year.

B. Recent Economic Developments [1]

4. **In 2002, the macroeconomic position was favorably affected by developments in the oil market and the run-up to the Iraq conflict (Box 1).** Real non-oil GDP growth rose to 5 percent from 3.4 percent in 2001, in part, on account of the increased demand for goods and services associated with Iraqi developments (Table 1 and Figure 1).[2] However, real oil GDP fell sharply by 8 percent on account of a 10 percent decline in oil production in line with OPEC-mandated cuts. Overall, real GDP declined slightly. Inflation and unemployment remained low. Reflecting the buoyant non-oil activities, and ample private sector liquidity associated, in part, with the UN compensation payments, the stock market index rose further by 39 percent in 2002 after a 27 percent increase in 2001.

5. **Fiscal performance strengthened in 2002/03.**[3] The overall surplus rose to about 25 percent of GDP, reflecting favorable oil market developments in the last quarter of the fiscal year (first quarter of 2003) and a decline in current expenditures equivalent to 2.5 percent of GDP (Table 2 and Figure 2). The wage bill declined slightly as a percent of GDP. Expenditure on subsidies fell by 1.6 percent of GDP, returning to the trend levels after a one-time increase in allocation to the housing agency in 2001/02. However, the underlying fiscal position weakened slightly as the non-oil deficit rose to 44 percent of non-oil GDP because of lower non-oil revenues.

6. **The external current account surplus fell to about 12 percent of GDP from 24 percent in 2001 (Table 3 and Figure 3)**. Reflecting the weaker performance in the international financial markets and the decline in global interest rates, net investment income declined by 31 percent, while imports rose by about 15 percent, partly, for inventory build up in anticipation of the Iraq conflict. With an increase in capital outflows, the overall balance of payments registered a small deficit resulting in a 7 percent decline in net foreign assets of the Central Bank of Kuwait (CBK), which remained comfortable at the equivalent of over eight months of imports.[4]

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[1] The Kuwaiti economy continues to be heavily oil-dependent. While the oil GDP is about 45 percent of real total GDP, oil constitutes about 90 percent of total exports. About 70 percent of total revenue is derived from the oil sector, while 23 percent of total revenue represents investment income.

[2] National account data since 1995 have been revised. For details, see Appendix III on Statistical Issues.

[3] The fiscal year corresponds to April 2002–March 2003. However, the calendar year is used to estimate the external current account.

[4] In addition to assets held by the CBK, substantial official foreign assets are managed by the Reserve Fund for Future Generations (RFFG).

Box 1. Developments Relating to the Oil Market in 2002 and 2003

Oil Market Developments in 2002

- Developments in the world oil market in 2002 were driven largely by security concerns in the Middle East, the strike in Venezuela, the after-effects of the September 2001 events, and weak global economic recovery. World oil demand grew by 0.3 percent—about the same level as in 2001—compared to the historical average growth of about 1.2–1.5 percent. This slow growth was due to the slowdown in global economic activity, as well as the effect of the sharp price increases since 2000. The average price of the WEO basket rose by 2.8 percent for the year, as non-fundamental factors drove the price upward from the low levels attained in 1Q2002. OPEC quota discipline was mostly lax in 2002, but this had limited impact on the price as uncertainty factors dominated market sentiments.

Developments in 2003 and the medium term

- The factors that kept the oil price high in 2002 continued into 2003, culminating in the Iraq war, with the WEO oil price reaching a peak of US$34.24 on March 7. In response to the rising prices, OPEC increased the quotas of its members from 21.5Mb/d to 24.5 Mb/d on February 1, and again to 25.4 Mb/d, effective June 1) partly to make up for the shortage from Venezuela and Iraq (as well as to validate the over-quota production of its members that had gone on since 3Q 2002). However, this increase was reversed, effective November 1 (quota ceiling now stands at 24.5 Mb/d), in a preemptive move to protect the oil price against the effect of rising Iraqi output and growing non-OPEC production. Kuwait's current quota is 1.966 Mb/d. Oil price levels have continued to be firm because of a variety of non-fundamental factors, with the average price in 2003 being much higher than the 2002 level. Going forward, the oil price is expected to fall from the projected US$28 per barrel in 2004 to US$21.50 per barrel in 2008—as Iraq returns fully to the market and uncertainty recedes.

Domestic oil sector developments

- The authorities are pressing ahead with plans to develop the North fields, with the involvement of international oil companies (IOCs) on a service contract basis. The timing of the project is uncertain, as approval by the National Assembly is required. The Assembly is presently considering the matter. Kuwait Petroleum Company (KPC) has received expressions of interest from three consortiums. It is expected that the field would add some 0.25 Mb/d to Kuwait's production capacity, although it may not result in output expansion immediately because of the requirements of OPEC quota obligations. The involvement of the IOCs would be at the technical and management level, and will not result in equity ownership by them. They will bring in technology, finance the projects, manage the wells, and be paid for their services based on cost-reduction and savings achieved by their involvement.

- The private sector is being given greater opportunity for participation in the oil sector: KPC has recently transferred 40 gas stations (out of a total of 100) to private sector operators on a trial basis. The rest of the stations would be transferred to them after the pilot phase has been successfully completed.

- The prices of domestic petroleum products in Kuwait were last increased in 1999, and no further increases are planned for now. There are no subsidies on petroleum products.

7. **Growth of broad money decelerated to about 5 percent in 2002 (Table 4 and Figure 4).** While net foreign assets declined, credit growth to the private sector remained robust at 11 percent of the beginning stock of broad money in response to the low interest rates and rising domestic economic activity. Much of the credit expansion, however, was to finance personal consumer loans, real estate, and securities trading. Monetary policy continued to be aimed primarily at exchange rate stability under an open exchange and trade system. Following trends in the global financial markets, the CBK reduced its discount rate twice in 2002. The differential of the Kuwaiti dinar deposit rate over the U.S. dollar deposit rate was allowed to rise slightly to 63 basis points compared with the historical 50 basis points. In addition, the deposit facilities at the CBK and liquidity ratios were used to stabilize liquidity in the banking system, while ceilings on lending rates remained in effect.[5]

8. **The financial sector continued to perform well.** The recent FSAP exercise has confirmed that the banking sector is sound and remains well regulated and supervised. Capitalization, asset quality, earnings, and liquidity are all strong; and the major Kuwaiti banks offer a wide variety of up-to-date banking products and services. The risk-adjusted capital/assets ratio remained high (20 percent) at more than two times the Basel Committee recommended rate. Total nonperforming loans declined by June 2003 to 7 percent from 10.3 percent in 2001; only about 3 percent of loans extended since the invasion in 1991 were nonperforming and were fully provisioned. The comprehensive system for bank regulation and supervision broadly conforms to the Basel Core Principles (BCP), and the anti-money laundering law (AML) is now in effect. A risk-management framework has been implemented to improve monitoring the quality of bank loans while a credit bureau is now in place to help lenders assess the loan risk of borrowers. Stress tests conducted by the FSAP exercise indicate that the banking system could stand significant shocks.

9. **The Kuwaiti dinar depreciated in real effective terms during 2002 and the first 10 months of 2003 in line with the depreciating U.S. dollar (Figure 5).** Effective January 2003, Kuwait shifted its exchange regime from pegging to a basket of currencies (with a large weight of the U.S. dollar) to a peg with the U.S. dollar with margins of plus/minus 3.5 percent as a step toward the planned monetary union among member countries of the Cooperation Council for the Arab States of the Gulf (GCC). External vulnerability indicators remained strong (Table 6).

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[5]The CBK relies on both indirect and direct instruments for monetary policy. The most frequently used instrument has been deposits of banks with the CBK. They are based on the daily determination of liquidity needs of the banking system. In addition, liquidity is regulated through the use of liquid asset requirements with banks required to hold government securities at least equal to 20 percent of the private Kuwaiti dinar deposits, primarily for prudential purposes. The CBK also uses its unsecured overnight lending facility at a penalty rate (10 percent presently) as a monetary policy instrument.

10. **Progress remained limited on structural reforms (Box 2).** Steps toward the establishment of the legal and institutional framework for structural reforms have been constrained by difficulties in reaching political consensus. The Privatization Law, which would allow divestment of major public sector utilities and clarify the domain for the private sector remains to be approved by the National Assembly. However, the private sector has been encouraged to invest in areas where explicit approval by the National Assembly is not required, including in telecommunications, health, and education services. While the Foreign Direct Investment law has been approved allowing for full foreign ownership of companies, bylaws are required for its implementation including clarification of areas open to foreign investment including for 100 percent foreign ownership. The planned revised corporate income tax law, lowering the tax from 55 percent to 25 percent, remains under consideration. Moreover, administered prices of publicly supplied goods and services have remained unchanged. However, effective October 2003, the authorities formally implemented Kuwaitization policy to generate employment opportunities for Kuwaiti workers in the private sector (Box 3).

11. **Transparency, quality, currentness, and availability of economic data have continued to improve.** National accounts data have been revised for 1995 and beyond. A new consumer price index based on the Household Expenditure Survey for 2000 has been put in place. The authorities also expect to develop a data warehouse in 2004 as an extension of the General Data Dissemination System (GDDS) so as to allow easy access for users. Similarly, more detailed data are now available on nonfinancial private capital flows.

Box 2. Structural Reforms

Kuwait initiated structural reform efforts in 2000 aimed at reducing the role of the government in the economy, encouraging private sector activities, and providing employment opportunities for the growing labor force. Key areas of the reform consist of privatization, promotion of foreign direct investment, labor market reform, and the financial sector deepening.

Measures already implemented

- The National Assembly approved the **Foreign Direct Investment (FDI) Law** (April 2001), which would allow foreigners to own up to 100 percent of Kuwaiti companies subject to certain conditions as compared with the current maximum of 49 percent, and offer various incentives to foreign investors.
- The National Assembly approved the **Labor Market Law** (May 2000), resulting in establishment of Manpower and Government Restructuring Program which provides vocational training, job-placement services, and job search allowances to unemployed Kuwaitis. Social allowance has been extended to Kuwaitis employed in the private sector. Enforcement of the "**Kuwaitization**" went into effect in October 2003 (Box 3).
- The CBK issued instructions to local banks to **enhance the management and monitoring of operational risks** (October 2003), requiring banks to establish a framework to manage operational risks and to disclose the information on their operational risk management.
- **The Islamic Banking Law** was approved (June 2003), whereby Islamic banking will be brought under the CBK's supervision effective December 2003.
- Full functioning of a **credit bureau**, known as Ci-Net, took place in April 2002.
- **A regulatory and supervisory framework for anti-money laundering activities (AML)** has been developed and has recently been strengthened. Measures include enactment of a law criminalizing money laundering activities (March 2002), issuances of AML/CFT regulations to banks and exchange companies, and the establishment of the Kuwait Financial Intelligence Unit at the CBK (July 2003).
- For capital markets, implemented measures include: expansion of the primary market through the opening of a parallel stock exchange; cross-listing agreements with Bahrain, Egypt, and Lebanon; and establishment of a guaranteed fund to cover default by brokers (June 2002).
- An amendment to the **Banking law** was approved by the National Assembly in January 2004 to allow establishment of foreign banks in Kuwait.

Measures to be implemented

- Introduction of **new products in the stock market** is planned. These include bond trading and derivatives and convertible bonds, which are expected to be introduced by end-2003.
- **Lifting of the implicit blanket guarantee on bank deposits** is planned. In preparation, the liquidity ratio has been modified into a range (25–35 percent) to be applied differentially to banks according to their financial strength.

Measures still under consideration or pending

- **Bylaws for the implementation of the FDI Law** are awaited.
- The government has proposed to amend the **Tax Law** to lower corporate income tax, which applies only to foreign companies, from the current rate of 55 percent to 25 percent.
- A comprehensive **Privatization Law** has been approved by the Finance Committee of the National Assembly and is awaiting approval by the latter. **Privatization** of state enterprises including electricity, water, telecommunications, and port, which will require legislative approval, is under consideration.
- An amended **Labor Law** is under consideration while the **Civil Service Law** is being revised to streamline public sector employment.
- For labor market, the government is considering introducing **on-the-job vocational training**.
- For capital markets, further expansion of **cross-listing agreements** is planned. Also under consideration are liberalizing rules governing **nonresident participation in the capital market** and upgrading the current electronic trading system for real time transactions.

Box 3. Labor Market Reforms

Labor market reforms are centered on two fronts: Kuwaitization to create employment opportunities in the private sector, and generation of skills needed by and incentives for employment in the private sector.

I. Kuwaitization

- In September 2002, the Council of Ministers (Council) established quotas for percentages of Kuwaiti workers to be employed by individual non-government entities depending on their type of economic activities. In addition, owners of projects can stipulate terms of the contract, engagement, or bid that require a higher percentage of Kuwaiti workers than that established by the Council.
- The quotas range from 1 percent for agriculture and construction to 39 percent for banks. These quotas were determined in line with the existing distribution of Kuwaiti workers across economic activities.
- Starting October 2003, non-government entities not complying with the quota are:
    - i. subject to an annual fine of KD 100 for each non-Kuwaiti worker renewing the work permit or obtaining an authorization of a residency, in excess of the permitted maximum percentage;
    - ii. not allowed to conclude contracts, do business, or negotiate directly with the government; and
    - iii. not eligible for financial or material support provided by government entities (such as disposition, leasing, or allocation of government property).
- Non-compliant entities could be exempted if despite best efforts, employers were unable to hire the requisite Kuwaitis, or existing long-term contracts do not allow them to change their composition of workers. Examples include education and medical services for which supply of Kuwaiti workers with right skills is limited over the short term, and agriculture and certain services such as cleaning for which expatriate workers is the only source of labor. Most companies are complying with the quota requirements.

II. Other labor market reform. The following measures have been implemented to encourage Kuwaiti workers to seek employment in the private sector:

- providing off-the-job **vocational training** financed by a 2.5 percent tax on all share-holding companies operating in Kuwait;
- providing **job search allowances** for a maximum period of one year to unemployed Kuwaiti nationals who have been registered for at least six months as a job seeker for a private sector job;
- extending **social allowances**, which were provided only to Kuwaiti workers in the public sector, to Kuwaiti workers employed in the private sector, and thus equalizing allowance levels; and
- enhancing **job-placement services** by providing matching services for job vacancies and job seekers.

II. REPORT ON DISCUSSIONS

12. **Macroeconomic conditions in 2003 are estimated to have remained comfortable (Table 5).** Real non-oil GDP growth is estimated to have picked up briskly to about 6.5 percent because of the spillover effects of developments in Iraq and improved domestic confidence, resulting in sharply higher private sector investment.[6] The stock market has also continued to rise sharply, registering an increase of 80 percent in the first nine months of the year.[7] Concurrently, credit expansion has been brisk and broad money is estimated to have risen by about 13 percent. Notwithstanding a 26 percent increase in imports partly for re-exports to Iraq, the external current account surplus is estimated to remain high at close to 20 percent of GDP as oil export receipts are estimated to have increased by 34 percent owing to higher prices and output. With an estimated sharp increase in both portfolio and other investments abroad, in response to a recovery in the foreign equity markets and asset diversification, CBK's net foreign assets are estimated to have declined to the equivalent of less than six months of imports. However, foreign assets of the RFFG are projected to have increased by about $8 billion. **The budget surplus in 2003/04 is projected to moderate under an expansionary fiscal stance.**[8] With oil prices projected to weaken in the last quarter of the fiscal year and an 11 percent increase in expenditures, the overall surplus is projected to decline to about 19 percent of GDP. The non-oil fiscal deficit is expected to rise further to the equivalent of about 46 percent of non-oil GDP.

13. **The macroeconomic position is projected to remain manageable over the medium-term (2004–08).** On the basis of the current expectations for declining oil prices, official foreign asset position, and the authorities' intentions to follow a cautious fiscal policy, the budget and external current account surpluses are projected to contract. The overall fiscal surplus is expected to decline gradually to about 7 percent of GDP in 2008/09,[9]

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[6] The sectors that have shown a significant pickup in activity include construction, trade, hotels and restaurants, transport, storage, real estate, and business services.

[7] Market capitalization increased by end-September 2003 to over 250 percent of non-oil GDP. The authorities attribute the rapid rise in the stock index to several factors including the high liquidity levels, downward drift in the interest rates, limited opportunities for alternative investment, improved business climate in Kuwait, and the continued corporate profitability, especially in the banking sector.

[8] The budget for 2003/04, which was based on a low oil price assumption (US$15 per barrel) and excludes investment income, projected a deficit equivalent to 18 percent of GDP (Table 2).

[9] The medium-term macroeconomic forecasts remain highly sensitive to oil price developments and the behavior of transfers under the UN Compensation Program. These forecasts are based on the WEO prices prevailing at the time of the consultation discussions. In November 2003, such prices were adjusted upward. Based on these WEO prices, the budget surplus could be about 10 percent of GDP in 2008/09 on unchanged policies. The decline in external current account surplus would moderate to about 13 percent by 2008 and CBK's net foreign asset position would improve to the equivalent of

(continued…)

while non-oil fiscal balance in relation to non-oil GDP would improve somewhat. However, the fiscal position will remain vulnerable to any sustained downside oil price shocks and may not be sufficient to ensure intergenerational equity in the longer term. Concurrently, external current account surpluses would decline gradually to about 9 percent of GDP in 2008 despite rising investment income. Growth of real non-oil GDP is projected to decelerate gradually effective 2005 to the trend levels of about 3 percent per annum, as the transitory positive impact of Iraqi developments wears out. Such growth may not be adequate to address the employment needs of the rapidly growing Kuwaiti labor force, which is estimated to increase by about 6 percent per year over the medium term and is likely to accelerate in the longer run.[10]

14. **The authorities agreed that the twin challenges of accelerating non-oil growth in a sustained fashion to address unemployment pressures, and ensuring a steady increase in wealth per capita in the longer term will call for speeding up structural reforms and strengthened the fiscal position in a socially acceptable fashion and without exacerbating short-term unemployment pressures**. They noted that the recently announced three-pronged, four-year Action Program for the next four years reaffirms the government's commitment to addressing the structural imbalances in the domestic labor market, strengthening the fiscal position, and enhancing private sector's role in the economy. Priority will continue to be accorded to encouraging private investment and generation of employment opportunities in the nongovernmental sector, which in turn would facilitate government expenditure restraint and help improve the fiscal position. Given the time-consuming process of political consensus building, the authorities intend to explore avenues under the existing legal structures to speed up reforms.

15. **Policy discussions concentrated on the adequacy and implementation of the authorities' reform program in achieving their twin objectives.** The mission also reviewed the preliminary recommendations of the FSAP exercise. Other matters discussed included transparency issues, technical assistance, and regional integration.

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nine months of imports. The authorities have indicated that any changes in the planned inflow of the UN compensation payments will be reflected in the accumulation of official foreign assets.

[10] Data available as of end-June 2003 indicate that Kuwait's population stood at 2.48 million including 914,000 Kuwaitis or 37 percent of total population. The labor force totaled 1.42 million including 272,000 Kuwaitis (19 percent of total). Ninety percent of Kuwaiti labor force is employed in the public sector. Unemployment at end-June 2003 stood at 3.6 percent of total Kuwaiti labor force.

A. Structural Policies

Restructuring and privatization

16. **The private sector has increased opportunities for investment in public utilities and downstream activities.** The authorities intend to pursue their strategy along two parallel tracks in order to accelerate the process.[11] First, increased efforts will be made to seek an early approval of the Privatization Law by the National Assembly. Second, the existing legal, regulatory, and institutional foundations will be strengthened, administrative obstacles eliminated, and government procedures simplified in order to encourage private investment, including in joint ventures with the public sector. The authorities intend to continue identifying public sector entities that do not require explicit legislative approval for privatization to be sold to the private sector. In this context, the Kuwait Petroleum Company (KPC) is expected to soon allow the private sector to participate in the downstream marketing of petroleum products.

17. While calling for an early enactment of the Privatization Law, the mission supported the authorities' initiatives to identify activities, which could be privatized under the existing laws, and encouraged their early privatization. Such a step could signal the authorities' serious intent to support private sector-led growth and, thus, further strengthen the environment for private investment. The market pricing of publicly supplied goods and services in conjunction with targeted subsidies should also facilitate a more efficient allocation of resources and reduce the burden on the budget. Noting that the establishment of an unambiguous legal framework is crucial for appropriate private investment decisions, the mission called for an early clarification of rules governing FDI under the Foreign Investment Law, particularly the identification of the "negative list", the enactment of a non-discriminatory corporate income tax, and steps to ensure equal access for both domestic and foreign investors to the domestic financial markets.

Labor policies

18. **The authorities have continued to follow a two-pronged strategy to address the emerging unemployment pressures while minimizing the burden on the budget.** It includes: (a) Kuwaitization of the labor force, and (b) gradual integration of the segmented labor markets. **Effective October 2003, the Kuwaitization policy was formally implemented (Box 3).** While the authorities intend to continue pursuing a liberal foreign

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[11] The privatization strategy aims, in a sequential fashion, to autonomize, commercialize, and finally privatize state enterprises while market-based prices are introduced and regulatory authorities are established to ensure protection against monopolies. The Privatization Law, which is presently under review of the National Assembly, will establish a comprehensive framework for large-scale privatization, identify areas and modes of privatization, and establish a pricing mechanism and safeguards against job losses.

labor policy, the Kuwaitization policy calls for all non-governmental entities to fulfill specified mandatory quotas for Kuwait workers, based on the type of activity. Noncompliance will be subject to an annual fee of KD 100 per each foreign worker in excess of the thresholds that depend on the type of economic activities.[12] Penalties for noncompliance could be waived if existing long-term contracts do not allow compliance or if the supply of Kuwaiti workers with required skills is limited in the short run. The integration of the labor market is being pursued through equalizing benefits for Kuwaiti workers in both the public and the private sectors. The social allowances which were limited to Kuwaiti workers in the public sector have, effective 2002, been extended to Kuwaiti workers in the private sector. The policy of providing vocational training to generate skills and, thus, employability in the private sector, under the Manpower and Government Restructuring Program (MGRP), has remained broadly unchanged.

19. The mission called for greater focus on the development of skills and an early integration of the labor market with flexible wages to protect competitiveness and encourage private investment. It called for an early assumption of allowances and benefits by the private sector along with a gradual reduction in such benefits both in the public and the private sectors. The mission encouraged a cautious application of Kuwaitization and more concerted civil service reforms aimed at linking wages to productivity in the public sector.

Financial sector policies

20. **The FSAP mission has concluded that there are no immediate threats to financial stability in Kuwait.** Stress tests indicate that the banking system could withstand significant shocks including stock market-related risks. However, the major concern in the near and medium term is financial efficiency rather than stability. In particular, increased financial intermediation and an efficient growth of the private sector in a globalized environment will require continued further development of the financial infrastructure. This will call for the modernization of legal and regulatory institutions, increased competition, and new financial products to meet the evolving market conditions. The authorities broadly agreed with the staff recommendations as summarized in Box 4.

[12] In addition, noncomplying companies could be excluded from government contracts and other benefits. The quotas are in line with the present broad composition of workers in the various economic activities.

Box 4. Priority Recommendations of the Financial Sector Assessment Program (FSAP)

- **General.** Take steps to reduce moral hazard and encourage economic agents to deal prudently with risk, including through the elimination of the blanket deposit guarantee, bank bailouts, and bailouts of investors in the stock and real estate markets.
- **Banking.** (i) enact amendments to the CBK law that enhance the independence and powers of the CBK in its capacity as banking regulator and supervisor, to firmly establish its ability to conduct consolidated supervision and take remedial measures; (ii) continue to closely monitor banks' lending risk associated with the stock market and real estate sectors, and further develop related stress testing procedures and capabilities within the banking supervision department, and be prepared to take quick supervisory action if necessary; (iii) ease or remove the ceiling on lending rates, to enable lenders to better price the risks of lending, including in particular to SMEs; and (iv) seek authority to share confidential information for supervisory purposes with appropriate domestic and foreign authorities.
- **Securities.** (i) enact a new Capital Markets Law creating a single, independent and accountable authority with full powers to develop and regulate the securities market and industry; (ii) prohibit insider trading and market manipulation, and enforce by establishing comprehensive inspection, investigation and surveillance systems; (iii) define entry standards for all types of market intermediaries; (iv) develop unified code of prudential regulations; and (v) allow the market to diversify product lines, and liberalize participation of foreign intermediaries in the market.
- **Insurance.** (i) enact a new insurance law that includes the elements of a modern insurance supervision framework, including independent status for the supervisory agency; (ii) strengthen the capacity of the insurance department of the MoCI in the near term.
- **AML/CFT.** (i) formally extend Law 35/2002 to cover the broad financial sector; (ii) exercise more control over ownership of financial institutions; (iii) strengthen procedures for international cooperation in AML/CFT; and (iv) criminalize the financing of terrorism.
- **Monetary operations.** (i) in liquidity management, reduce reliance on banks' deposits with CBK by using marketable instruments in monetary operations; (ii) simplify and streamline the multiple liquid asset requirements, and in the medium term, reduce or introduce more flexibility in the 20 percent liquid asset requirement (e.g., counting deposits with the CBK and permitting banks to meet the requirement on average over a period of time rather than every day); and (iii) building on the preceding steps, foster secondary market development.
- **Payment system.** Continue high priority implementation of the RTGS system, ensuring that its regulations comply with Core Principles 3 (management of credit risks and liquidity risks) and 9 (objective and publicly disclosed criteria for participation, and in general publicly disclosing major policies).

21. **The amended Banking Law, which is expected to be implemented in 2004, will further deepen the financial sector.** While the financial market will be opened to foreign banks to increase competition and efficiency, the authorities did not consider the

establishment of new financial institutions as necessary to enlarge the market.[13] It is expected that the amended law will help introduce new instruments including mortgage financing and Shariah-compliant bonds. The introduction of new instruments will be governed by the requirements of the economy and meet stringent regulations so as not to adversely impact banks' soundness. Islamic instruments will be tradable and marketable and could be used in open market operations under new prudential regulations and supervision rules to govern further development of Islamic banking. The mission encouraged the authorities to promote the development of the corporate bond market, which, in conjunction with the government bond market, could deepen the financial market and provide more flexible financing options for the private sector.[14] The authorities recognize that a faster growth of the corporate bond market will call for accelerated privatization.

22. **The regulatory, supervisory, and licensing powers of the CBK will be strengthened under the amended Banking Law.** These powers will include: (a) extension of the role of external auditors; (b) authorization for sharing information with other regulatory agencies for supervisory purposes; (c) approval of the CBK for changes in bank ownership; and (d) stiff financial penalties for noncompliance with laws and regulations. Finally, the blanket deposit guarantee will be discontinued over the next three to four months. Liquidity management has been strengthened effective November 2003, requiring banks to maintain liquidity ratios (within a range of 25–35 percent) consistent with each bank's CAMELS rating.[15] The enlarged range of liquidity ratios would, in addition to containing credit growth, give less secure banks a larger liquidity margin to meet potential deposit withdrawal resulting from the planned abolition of the blanket guarantee. The mission encouraged the establishment of a limited deposit insurance scheme to reinforce liquidity management and to protect small savers for social reasons.[16]

23. **The mission also called for a new Capital Markets Law to establish a single independent and accountable authority with full powers to develop and regulate the securities market**. Such an agency would be crucial to a continued orderly market

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[13] In January 2004, the Parliament approved a bill allowing foreign banks to operate in Kuwait. Two international banks have so far applied to open branches in Kuwait.

[14] The corporate bond market is small at the equivalent of KD 600 million or 10 percent of non-oil GDP at end-2002. Its relatively small size reflects the presently limited scope of the private sector, which accounts for about 25 percent of GDP. Marketed by investment companies, such bonds, prior to issuance, must have a rating and meet requirements of transparency and disclosure.

[15] The CAMELS methodology is based on six groups of indicators of bank soundness: capital adequacy, asset quality, management soundness, earnings, liquidity, and sensitivity to market risk.

[16] In the absence of such a scheme, the CBK should be prepared to act swiftly in case of bank runs with the establishment of clear conditions to borrow from the central bank.

development and support for private sector-oriented growth. To reduce the impact of potential shocks, the mission agreed with the authorities' plans to introduce bond trading to complement share trading; encouraging development of new products such as derivatives, options, and convertible bonds; and liberalizing rules governing nonresident participation under appropriate safeguards against speculative activities.[17] The authorities intend to closely monitor bank lending for securities trading to minimize potential stock market-related risks. The mission noted that an accelerated privatization of state enterprises would generate demand for long-term financing and thus help deepen the market.

B. Macroeconomic Policies

Fiscal policy

24. **Although the fiscal position is projected to remain manageable over the medium term, fiscal performance will have to be strengthened further to ensure a steady increase in wealth per capita over the longer term.** A continuation of the projected medium-term trends would imply declining wealth per capita effective 2014. Moreover, dependence on oil revenues will need to be curtailed to reduce vulnerability to oil price fluctuations, strengthen counter-cyclicality of expenditures, and improve non-oil growth prospects. Therefore, there will be a need for a structural strengthening of the budget through a reduction in expenditures and an increase in non-oil revenues.

25. **The authorities are cognizant of the need for a greater fiscal effort, mainly through expenditure restraint.** They expressed their intention to introduce new taxes, but noted opposition to such measures. This will go hand-in-hand with the strategy to reduce the government's role in the economy. In 2003/04, expenditure as a percentage of GDP will be contained at 43 percent or about the same as in 2002/03. While no policy change is planned in 2003/04, the authorities aim to shift toward a more effective and efficient implementation of capital projects, improved expenditure management, and stricter controls on new hiring. While investment income and the UN compensation payments are estimated to increase, domestic non-oil revenues will remain small at 4.5 percent of non-oil GDP. The non-oil deficit relative to non-oil GDP is expected to rise to about 46 percent, implying an expansionary fiscal stance.

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[17] The authorities are of the view that the banking system could absorb a stock market shock because of a number of factors. First, the risks of bank exposure to equities are lower now than in the previous correction because of a higher capital base and better risk management. Second, the CBK monitors developments in consumer and stock trading loans more closely, with prudential limit of 10 percent on bank lending for stock trading being strictly enforced. Third, the consumer and stock trading lending have ample and liquid collaterals and are subject to prudential limits. Fourth, the stock market depth has increased, providing some cushion in case of price shocks. The authorities are of the view that a correction of up to 50 percent would not affect the stability of the financial system and the economy.

26. **Over the medium term, the authorities are considering taking the following measures:**

- Reduce subsidies by increases in prices of publicly supplied **water and electricity** and **services,** including health and education.
- Introduce a uniform **Corporate Income Tax** to ensure equal treatment of Kuwait and foreign corporation; the planned amended tax law would reduce the tax on the latter to 25 percent from the present 55 percent.
- **Contain current expenditures** by restricting the increase in government employment in conjunction with incentives for new Kuwaiti job entrants to seek employment in the private sector.[18]
- **Strengthen the efficiency and productivity of capital spending** based on more clearly defined priorities so as to contain such outlays.

The authorities generally agreed that an expedited reduction in current expenditures would entail reduction in the public sector employment under a comprehensive civil service reform as an integral part of the overall labor policy.

27. **The mission noted that a sustained increase in non-oil revenue would not only strengthen the fiscal position over the long run, but also reduce vulnerability to volatile oil prices**. Consideration should, therefore, be given to an early introduction of the value-added-tax, which would also facilitate fiscal coordination among GCC member countries toward the establishment of the planned monetary union by 2010. The authorities, however, felt that, given the ample financial cushion, the fiscal consolidation would be implemented gradually in a socially acceptable fashion and consistent with the creation of employment opportunities in the private sector.[19] They noted that the public expenditure management

[18] Civil service employment will be streamlined through the centralization of hiring and placement under stricter application of existing regulations. It is also hoped that the extension of social benefits to Kuwaiti workers in the private sector will reduce real wage differentials and encourage migration to the private sector.

[19] A number of steps that had been initiated in 2001–02 to strengthen budget management will continue to be applied. These include the use of private companies to collect utility charges and fees and upward adjustment in employee contributions toward services. Expenditure management has been strengthened through improved coordination of expenditure procedures under the Ministry of Finance.

reform is getting under way as recommended by the Fund technical assistance, which would underpin their fiscal consolidation strategy over the medium term.[20]

28. **The mission observed that the introduction of a fiscal policy framework targeting a fiscal rule would help strengthen counter-cyclicality of fiscal policy**. The lagged positive relationship between oil price developments and the non-oil fiscal balance over the past several years could point to the potential of weakening effectiveness of fiscal policy in stabilizing aggregate demand, engendering bias toward declining fiscal surpluses, and negatively impacting private sector growth (Figure 7).[21] Targeting a steady decline in non-oil deficit relative to non-oil GDP under a medium-term macroeconomic framework, based on realistic oil prices could provide a useful anchor to minimize the effect of oil price fluctuations. Such an approach would also improve the effectiveness of the General Reserve Fund (GRF) as a stabilization fund. The authorities concurred with the mission and noted that they intended, over the period ahead, to target the fiscal position net of exogenous factors, including oil price fluctuations and returns on investments, through the implementation of a three-year rolling budget effective 2005/06.

29. **Strengthened fiscal strategy would also reinforce the authorities' ability to ensure a steady increase in public wealth per capita over the longer term as an indicator of long-term fiscal sustainability.** Staff estimates indicate that under current policies, population growth rate, and oil price expectations (the baseline scenario), wealth per capita will start to decline from 2014 (Figure 8). Unchanged wealth per capita will require additional fiscal effort during the medium term to shift the path of non-oil deficit/non-oil GDP ratio to about 36 percent in 2008/09 as against 40 percent under the baseline scenario. These results are highly sensitive to oil price developments; a faster fall in oil prices would require a commensurately smaller non-oil deficit/non-oil GDP ratio.

III. Monetary Policy and the Exchange System

30. **The authorities intend to follow a cautious monetary policy in 2004 to maintain stability of the exchange rate under an open and free exchange and trade system.** While

[20] The Fund has provided technical assistance in 2002–03 to help reform the Kuwaiti public expenditure management system so it will better reflect the government's key priorities and to generate accurate information on public sector spending. The assistance involved several measures: (i) streamlining budget preparation under a macroeconomic-fiscal framework; (ii) amending the budget preparation process; and (iii) facilitating program budgeting under an appropriate budget classification and accounting system. According to the authorities, implementation has remained slow due, in part, to the uncertainties relating to the run-up to the Iraq war, together with domestic administrative bottlenecks.

[21] A procyclical fiscal policy could negatively impact private sector growth by destabilizing aggregate demand, increasing cost of reallocating resources, and generating real exchange rate volatility.

no money growth rate is targeted, broad money is expected to slow down in 2004 to about 7 percent from about 13 percent in 2003. Net foreign assets are projected to increase somewhat while growth of credit to the private sector would be limited to about 6 percent of the beginning stock of broad money as growth of non-oil GDP starts to return to trend levels.

31. Money supply will continue to be regulated, mainly by adjustments in domestic interest rates in order to maintain the differential with rates prevailing in the global markets, and the use of direct bank deposits with the CBK. The mission supported the authorities' strategy, but felt that the reintroduction of the market oriented central bank paper for use in the open-market operations could, in conjunction with the direct deposits facility provide greater flexibility in managing liquidity. Similarly, a wider range of government debt instruments for use in the open-market operations would also support the development of the secondary market.[22] The mission also recommended discontinuing lending rate ceilings or adjusting these rates to reflect differential risks in order to ensure a better allocation of resources.

32. **Progress continued to be made toward regional integration under the GCC.** Tariff rates have been raised slightly to 5 percent effective 2003 in line with the Common External Tariff (CET).[23] The GCC Common Market is targeted to come into effect in 2007, while steps are being taken on the regional basis for the introduction of a monetary union by 2010. The authorities have started considering steps for policy coordination and convergence for an orderly transition to the planned monetary union.[24] In addition to issues relating to fiscal convergence criteria, the authorities attach high priority to the harmonization of bank regulatory and supervisory framework among GCC countries in line with the International Accounting Standards (IAS) and Basel Core Principles (BCP). As part of the

[22] The authorities have been cautious about a larger use of government securities on the grounds that such a practice could incorrectly imply a weakening fiscal position. The outstanding amount of government paper, which is used primarily for monetary management purposes, stood at 22 percent of GDP in 2002 and is declining.

[23] A minimum tariff rate of 5 percent applies to non-GCC imports while no tariffs apply to imports from other GCC countries with at least 40 percent local value added. Kuwait applies higher tariffs in industries where domestic producers cater to at least 40 percent of the local market. If the domestically produced goods contain at least 20 percent, 30 percent, or 40 percent domestic value added, protective duties of 15 percent, 20 percent, and 25 percent, respectively, may be applied to competing imports. The maximum duty imposed on products that compete with locally manufactured goods is 100 percent.

[24] Currently, the experiences of other monetary unions are being considered to determine the legal and institutional requirements that will need to be put in place for an effective GCC monetary union. The European Central Bank is presently developing a detailed framework for such a monetary union.

Greater Arab Free Trade Agreement, Kuwait aims to eliminate duties on imports from other Arab countries by 2005.[25]

IV. Statistical Issues and Technical Assistance

33. **Kuwait continues to make progress in improving the quality, currentness, and dissemination of economic data.** Monetary, financial, and balance of payments data are timely and adequate for surveillance purposes. Data on the international investment position have been provided. Improvements have been made in the national accounts for 2002, with the adoption of the System of National Accounts (SNA) 1993 data collection system and a sampling frame based on a new establishment survey (2002), and with the expansion of the coverage of questionnaires. The quality and coverage of the consumer price index (CPI) has significantly improved with new weights derived from the recently completed household expenditure survey (2000). Dissemination of the data has also improved and lags in the release of the national accounts and the CPI data have been shortened. Notwithstanding these improvements, there is a need for further improvements in statistics, particularly in the areas of aggregate expenditure, nonfinancial sector private capital flows, FDI, and the national accounts' consistency with the balance of payments data. Furthermore, fiscal data submitted for publication in the Fund (GFS) can be improved in its coverage and currentness, particularly for major components of extra-budgetary revenues (including investment income and transfers of profits of public institutions) and extra-budgetary expenditures (interest on treasury bills and bonds). Collection and sharing of data on labor market would help improve the formulation of policies to address unemployment pressures.

34. The authorities indicated that the delay in implementing the recommendations of the recent technical assistance missions in the fiscal area was due to uncertainties relating to the war in Iraq. They stressed that appropriate preparations were under way for a speedy implementation of the recommendations for public expenditure management reforms. The staff emphasized that additional technical assistance would be conditional on the implementation of the recommendations of earlier technical assistance missions.

V. Staff Appraisal

35. **The main challenge for the Kuwaiti economy over the medium term is to generate a sustained increase in non-oil growth and create productive employment opportunities for the rapidly growing indigenous labor force, while maintaining intergenerational equity over the long run.** These require key structural reforms and prudent financial policies focusing, inter alia, on further diversifying the Kuwaiti economy, reducing the role of the public sector, eliminating underlining rigidities (particularly in the labor market), and promoting transparency. Over the past several years, Kuwait has

[25] Kuwait is a member of the World Trade Organization (WTO).

endeavored to implement such a strategy. However, progress has been relatively slow because of difficulties in reaching political consensus on important reform measures, administrative limitations, and regional political uncertainties.

36. **The macroeconomic position over the medium term is projected to weaken, but is not expected to pose sustainability issues under the current cautious policy stance.** Unless there is a significant pick up in structural reforms to improve resource allocation, the growth rate of non-oil GDP is likely to decelerate as the transitory impact of Iraq wears off and would be insufficient to meet the employment needs of the rapidly growing Kuwaiti labor force. Moreover, a steady increase in public wealth per capita over the longer term will necessitate stronger fiscal effort. Additional steps would also be needed to reduce vulnerability to the volatile oil export receipts, thus strengthening the counter-cyclicality of fiscal policy, minimizing the bias toward shrinking fiscal surpluses, and improving growth prospects.

37. **The authorities should take advantage of the presently strengthened macroeconomic position and buoyancy in the private sector to step up reforms**. The focus should be on further strengthening the fiscal position and creating the institutional and legal environment needed for a significant increase in private investment under prudent monetary policies with a stable exchange rate. The effectiveness of the reform program will also require proper planning, increased coordination, and an appropriate sequencing of policies under a well-defined timetable. Moreover, a wider dissemination of the policy imperatives and of the likely gains of the planned reform measures for the current and future generations, should aid the reform process.

38. **A sustained buildup in private investment will require an expeditious passage of the Privatization Law, which would help define the domain for the private sector and establish the needed legal and institutional framework**. In the interim, the authorities should identify activities that do not require explicit legislative approval for privatization and take steps for their early divestiture. Moreover, rules governing FDI under the Foreign Investment Law should be clarified quickly and steps taken to establish a level playing field for domestic and foreign investors in terms of access to the domestic financial markets and tax treatment. An early initiation of the North Kuwait oil field development would also promote FDI in other related sectors. Given the limited size of the nontradable sector, focus should be on developing opportunities in the tradable sector including upstream oil and petrochemicals as well as the service sector. This will call for steps to ensure competitiveness through flexible wages and the maintenance of a stable real effective exchange rate. The staff also calls for an early transition to full market pricing of publicly supplied goods and services, including water and electricity, in order to ensure an efficient allocation of resources and to reduce burden on the budget. Targeted subsidies could be considered to protect vulnerable groups from the inevitable increase in the cost of living.

39. **It is important to ensure continued effective regulation and supervision of the financial system.** The authorities have succeeded in maintaining financial system stability.

Sound macroeconomic policies, effective banking regulation and supervision, and ongoing efforts to prevent a repetition of earlier bailouts of private investors, have been key to this achievement. Moreover, the most critical elements of systemic liquidity and crisis management policies are in place. Stress tests indicate that the banking system could withstand significant shocks. While some institutions are sensitive to price declines in the equity and property markets, the exposures seem to be manageable, and the authorities have begun to take the necessary corrective steps. In other areas, early action to strengthen the regulation and supervision of the securities markets is highly desirable to ensure the integrity of these markets, enhance their prospects for further development, and to help mitigate the large boom and bust cycles. An improved regulatory infrastructure would also be helpful in the insurance sector. Kuwait's regulatory and supervisory framework for anti-money laundering and combating the financing of terrorism (AML/CFT) has recently been strengthened, including through enactment of new legislation, but vulnerabilities remain that should be addressed promptly.

40. **The staff considers the authorities' plans to continue addressing the emerging unemployment pressures through training, thus creating skills needed by the private sector as appropriate.** However, it is important that quotas under the Kuwaitization policy be applied flexibly so that the competitiveness of the private sector is not adversely affected. The staff encourages the authorities to gradually reduce benefits, both to the public sector as well as the private sector, under a well-defined timetable to reduce burden on the budget. Moreover, promotion of market-based flexibility in wages for the Kuwaiti workforce would be critical in the integration of segmented labor markets. However, labor market reforms should be closely linked with state enterprise reform and private investment so that job creation in the private sector is in step with the potential job losses in the public sector, thus minimizing the budgetary costs.

41. **Structural reforms should be underpinned by a tighter fiscal policy.** Stemming the projected decline in budgetary surpluses over the medium term will also be critical in ensuring a steady increase in wealth per capita over the longer term. This will entail strengthening the structure of the budget in order to significantly reduce the non-oil deficit. The staff encourages the authorities to reduce outlays on wages and subsidies, which account for about 60 percent of total expenditures. An early implementation of Fund's technical assistance recommendations to improve expenditure management and tighter rules governing wage increases associated with civil service reforms would be helpful. Upward adjustment in prices of electricity and water toward cost recovery would not only strengthen the budget, but also improve resource allocation. The authorities should continue to press forward with political consensus building in order to mobilize revenue through the introduction of a VAT and a revamped corporate income tax applicable to both foreign and Kuwaiti companies.

42. **The counter-cyclicality of fiscal policy should be strengthened by casting the budget in a medium-term macroeconomic framework with a well-defined fiscal rule.** The staff welcomes the authorities' intention to introduce a three-year rolling budget in the period ahead. The underlying medium-term framework should be based on realistic oil price

assumptions and should target a declining non-oil deficit relative to non-oil GDP as a fiscal rule so as to cushion the impact of oil revenue variability. This should help define the magnitude of non-oil revenue effort over the chosen policy horizon. Given the oil price uncertainties, the fiscal rule and the accompanying medium-term framework should be reviewed periodically.

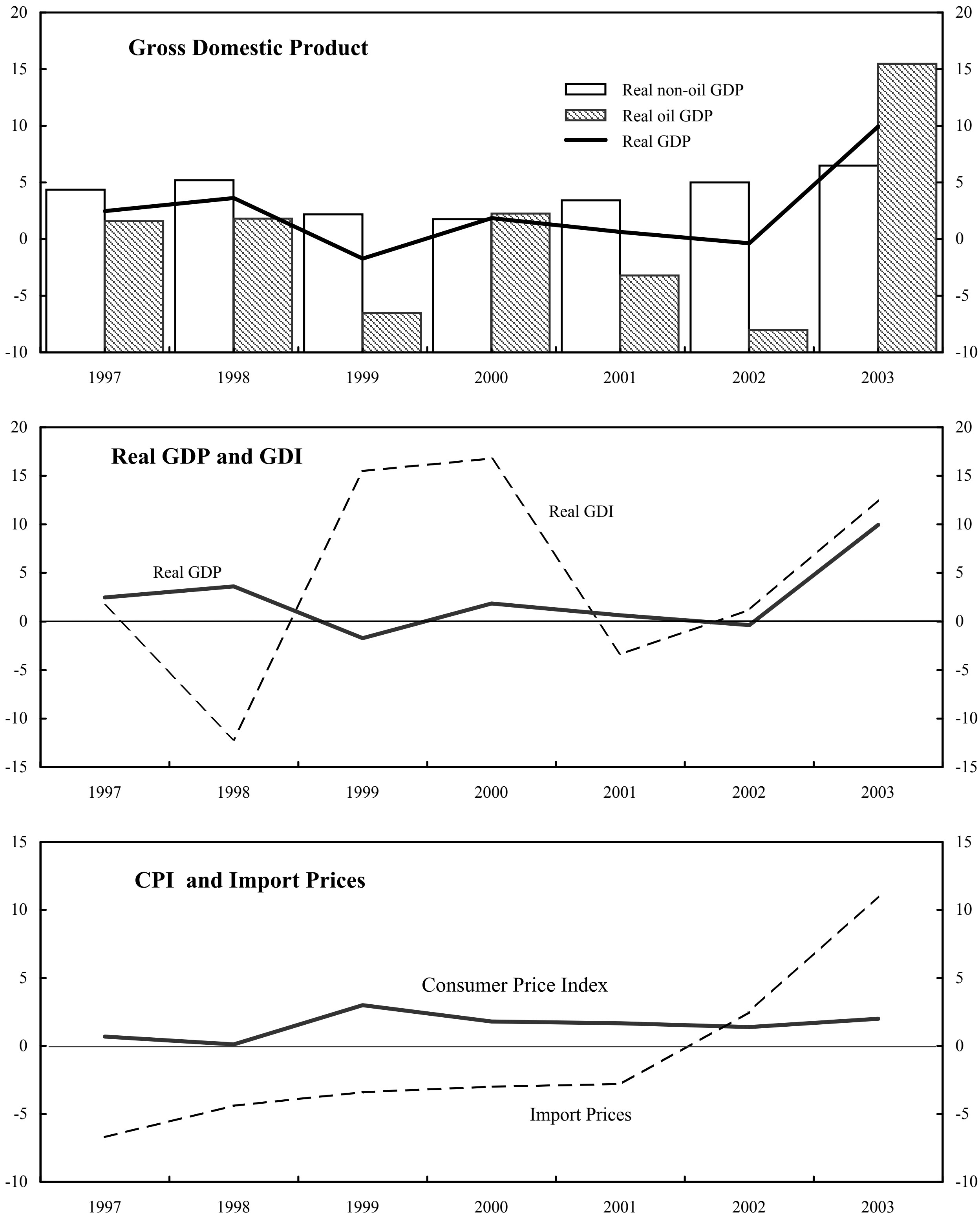
43. **The staff considers as appropriate the authorities' policy of maintaining a pegged exchange arrangement with the U.S. dollar under an open and liberal exchange and trade system as a first step toward the GCC-wide monetary union.** The planned pursuit of cautious monetary policy stance in 2004 for moderating liquidity growth, consistent with the projected growth in the non-oil sector, is appropriate. The staff agrees with the thrust of the policy, which is aimed at keeping CBK's discount rate in line with those prevailing in the global market and continuing to use direct bank deposits with CBK to regulate liquidity. However, expanding the variety of debt instruments, which could be used for open market operations, would allow increased flexibility. Given that the ceilings on lending rates cannot be eliminated because of the difficulties in amending the relevant law, the staff encourages the authorities to consider adjusting these rates to reflect differential risks. Consideration should also be given to introducing a limited deposit insurance scheme to, at least, cover small depositors for welfare reasons.

44. **More progress is needed in the development and dissemination of economic data.** The staff welcomes improvements in the national accounts and balance of payments data and their reporting. It is to be hoped that steps will be taken to further improve data on aggregate expenditure, nonfinancial private capital flows, FDI, labor and employment, and on further improving consistency between national accounts and the balance of payments. Steps will also be needed in coordination with other GCC member countries to develop common and transparent data series as a step toward establishing convergence criteria for the planned monetary union. Fund technical assistance, perhaps on a GCC-wide basis, would be particularly beneficial.

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

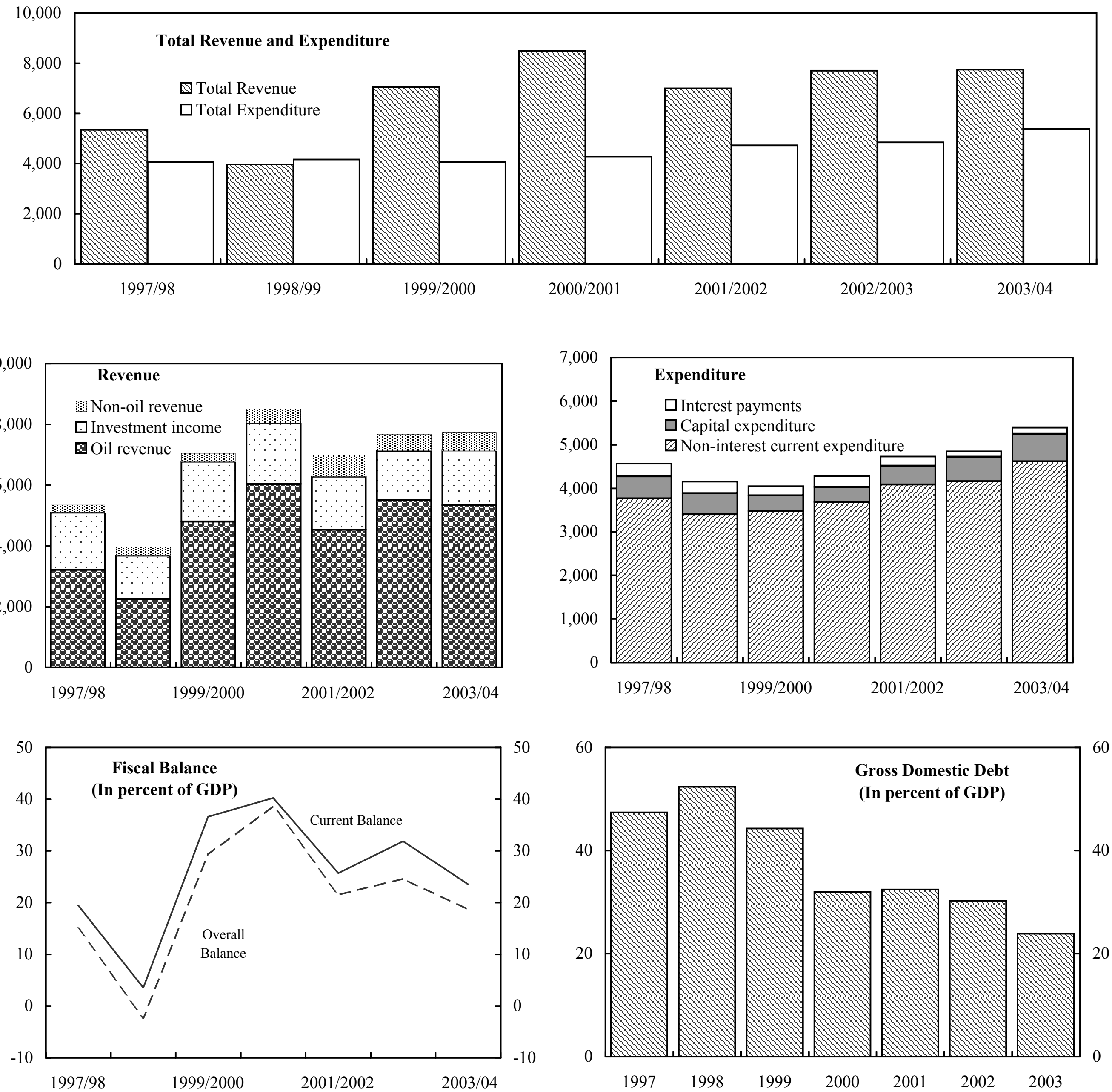
Figure 1. Kuwait: Selected Real Sector Indicators, 1997–2003

(Annual percentage change)



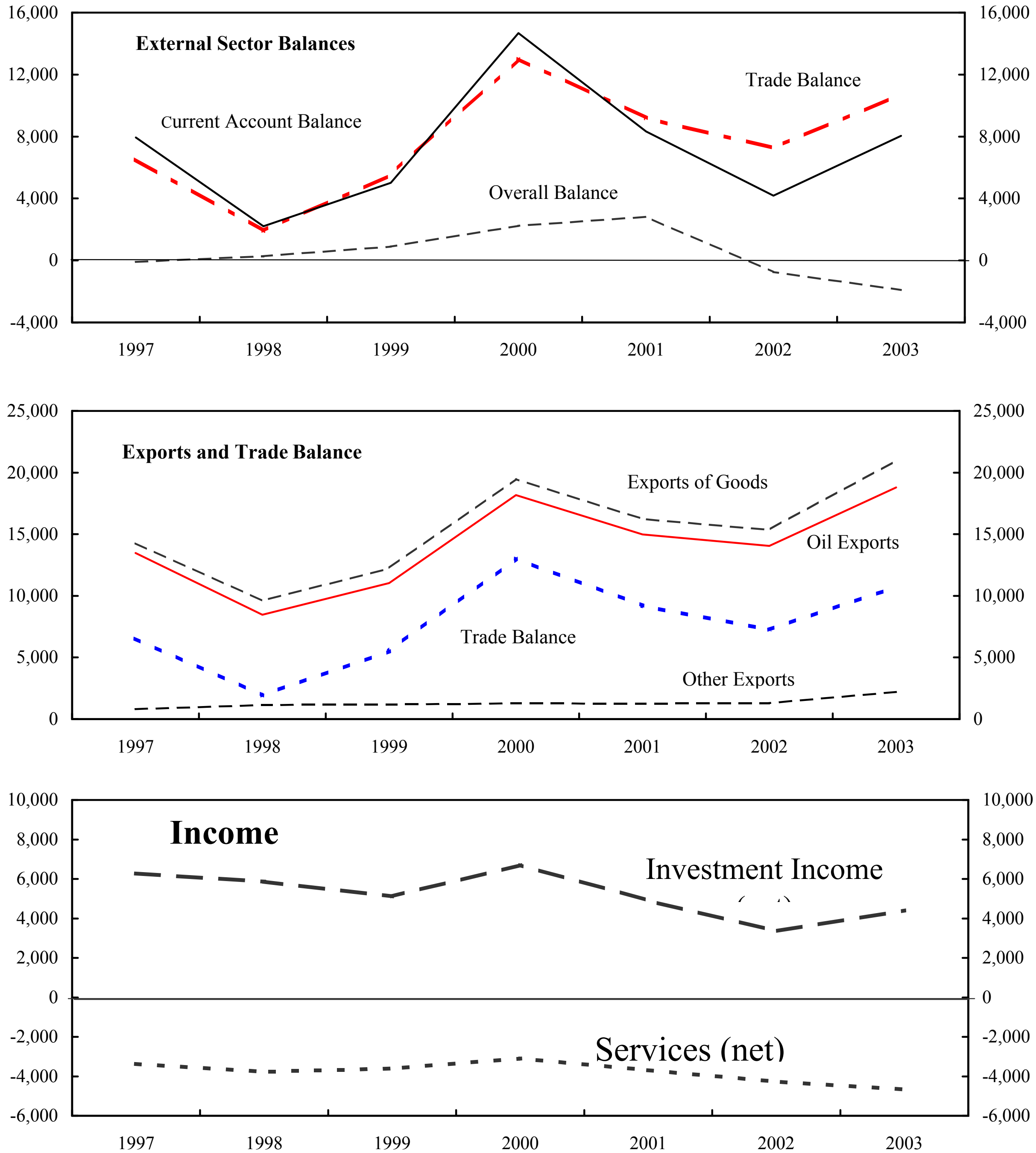
Sources: Data provided by the Kuwaiti authorities; and Fund staff estimates.

Figure 2. Kuwait Central Government Fiscal Indicators, 1997/98–2003/04
(In millions of Kuwaiti Dinars, unless otherwise indicated)



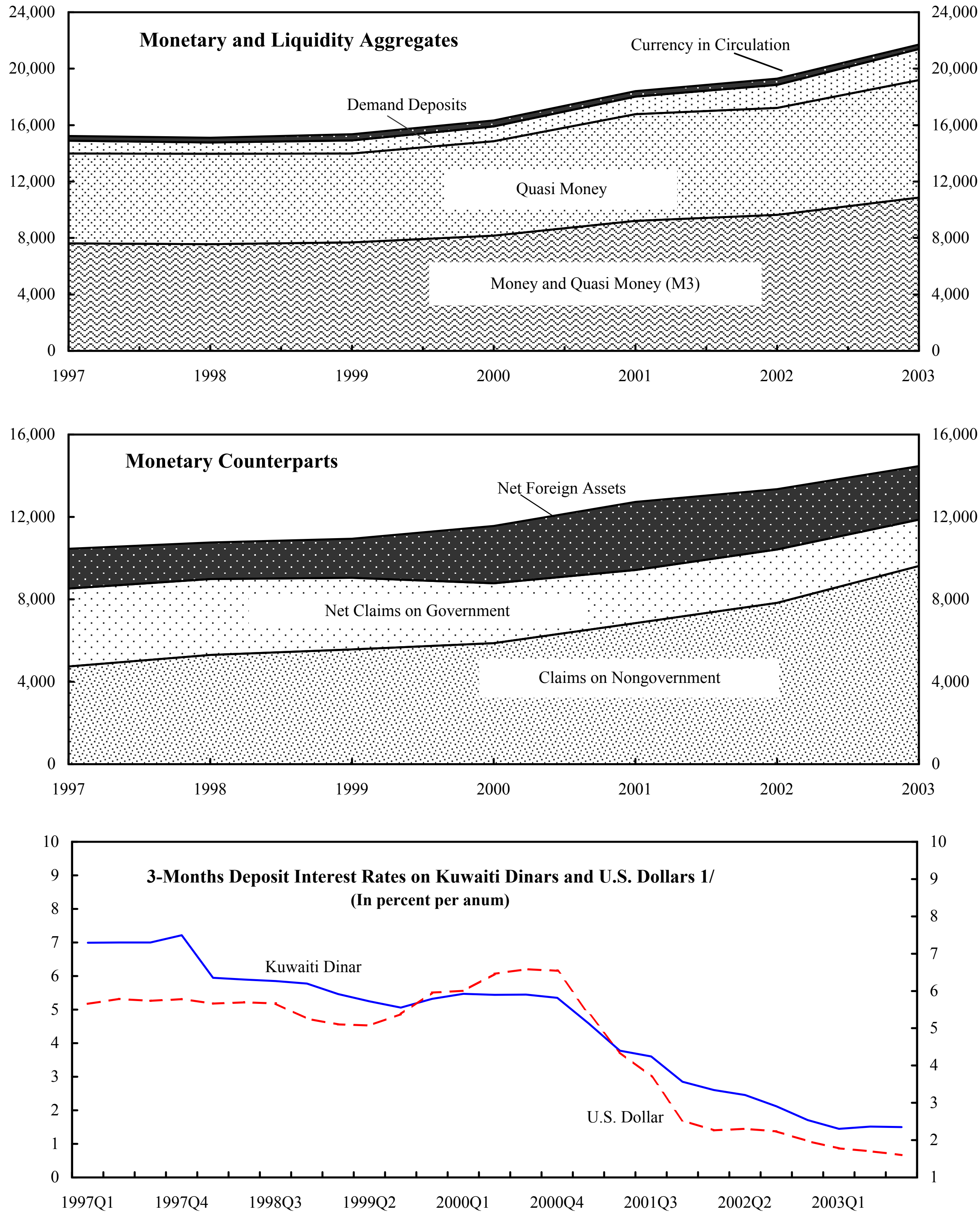
Sources: Data provided by the Kuwaiti Authorities; and Fund staff estimates.

Figure 3. Kuwait: External Sector Developments, 1997–2003
(In millions of U.S. dollars)



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

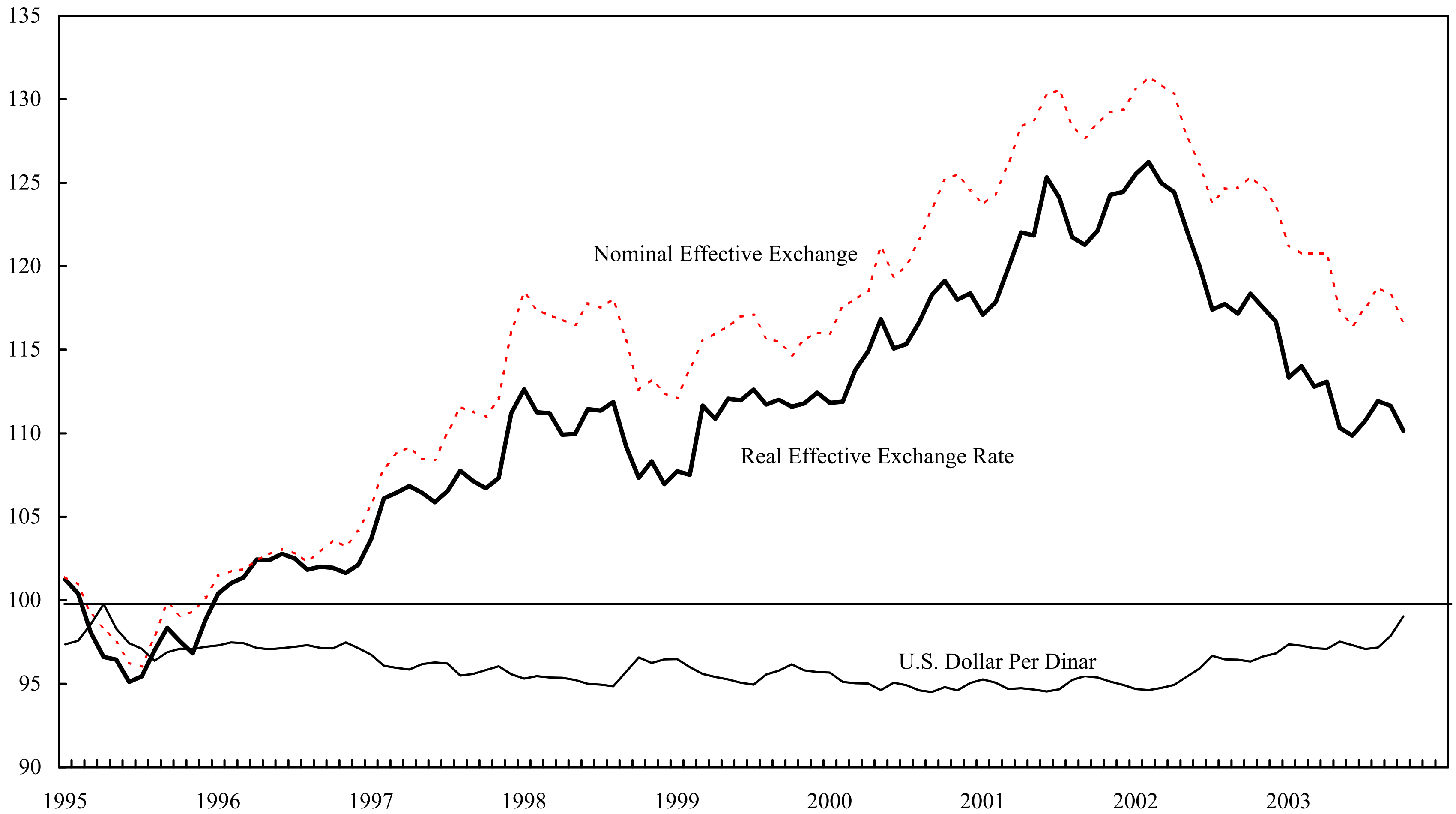
Figure 4. Monetary and Financial Developments, 1997–2003
(In millions of Kuwaiti Dinars; unless otherwise indicated)



Sources: Data provided by the Kuwaiti authorities; and Fund staff estimates.
1/ U.S. dollar rates available until 2003, third quarter.

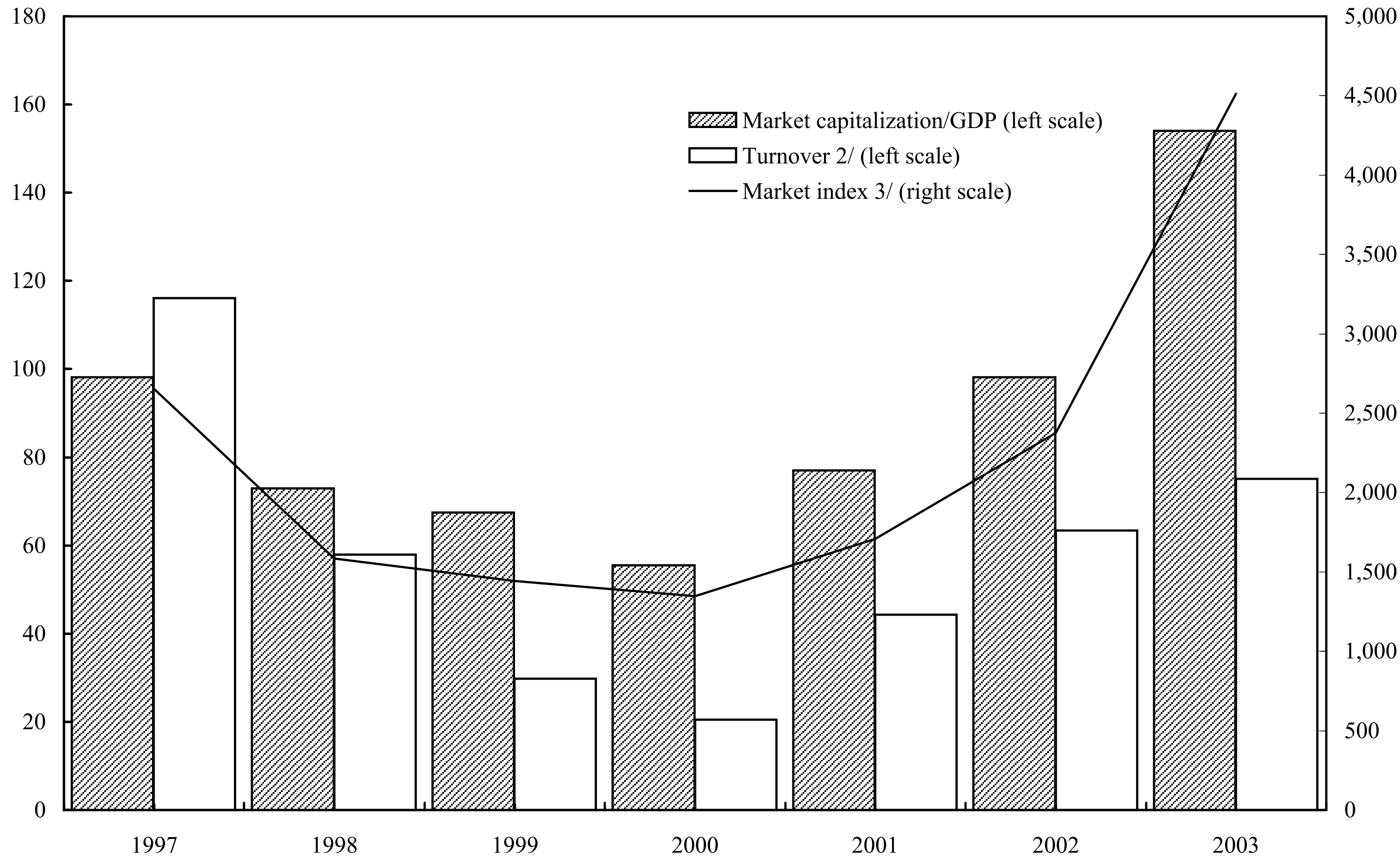
Figure 5. Kuwait: Exchange Rate Movements, January 1995–October 2003

(1990 = 100)



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

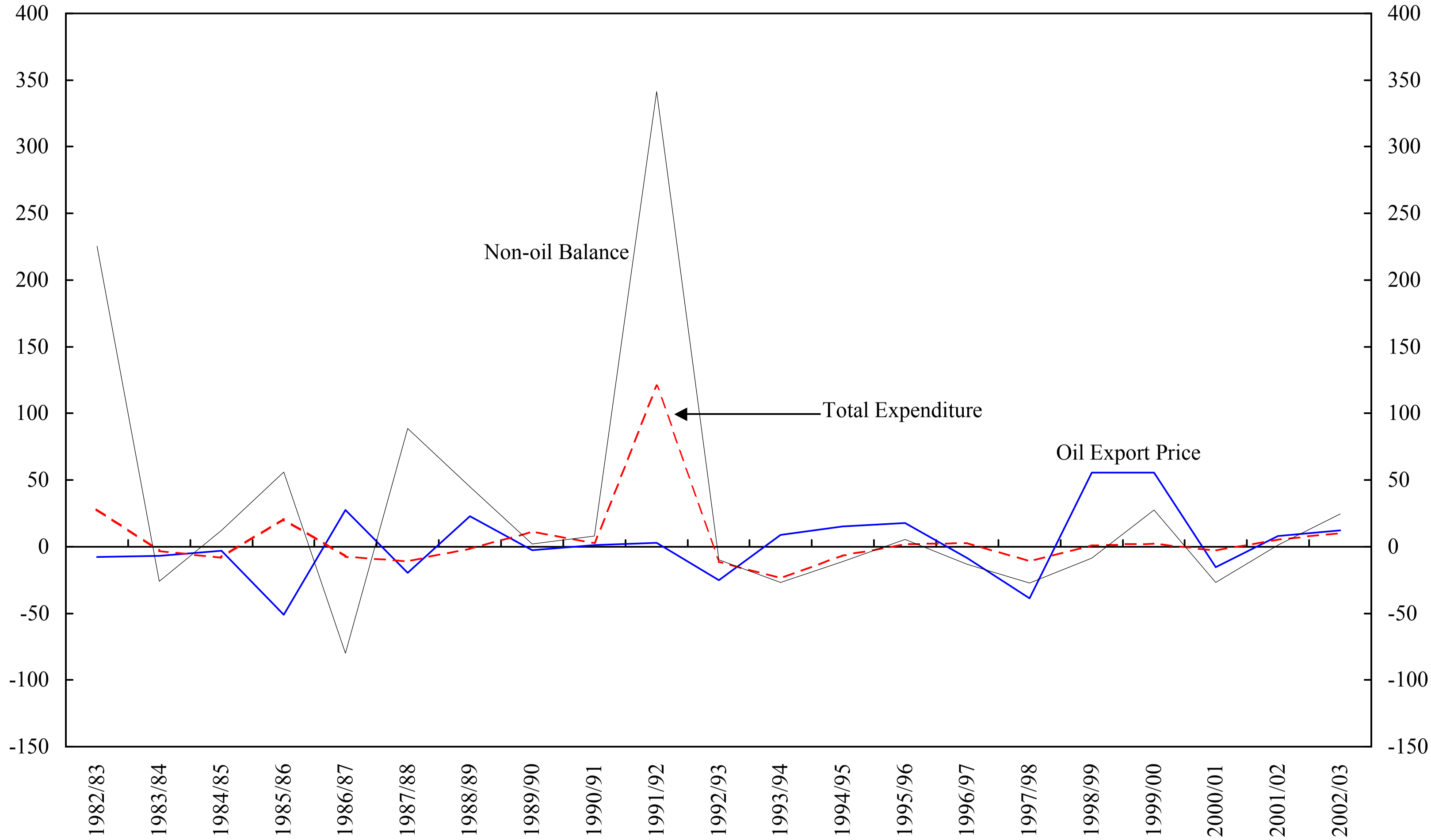
Figure 6. Kuwait: Stock Market Indicators, 1997–2003 1/
(In Percent)



Source: Central Bank of Kuwait.

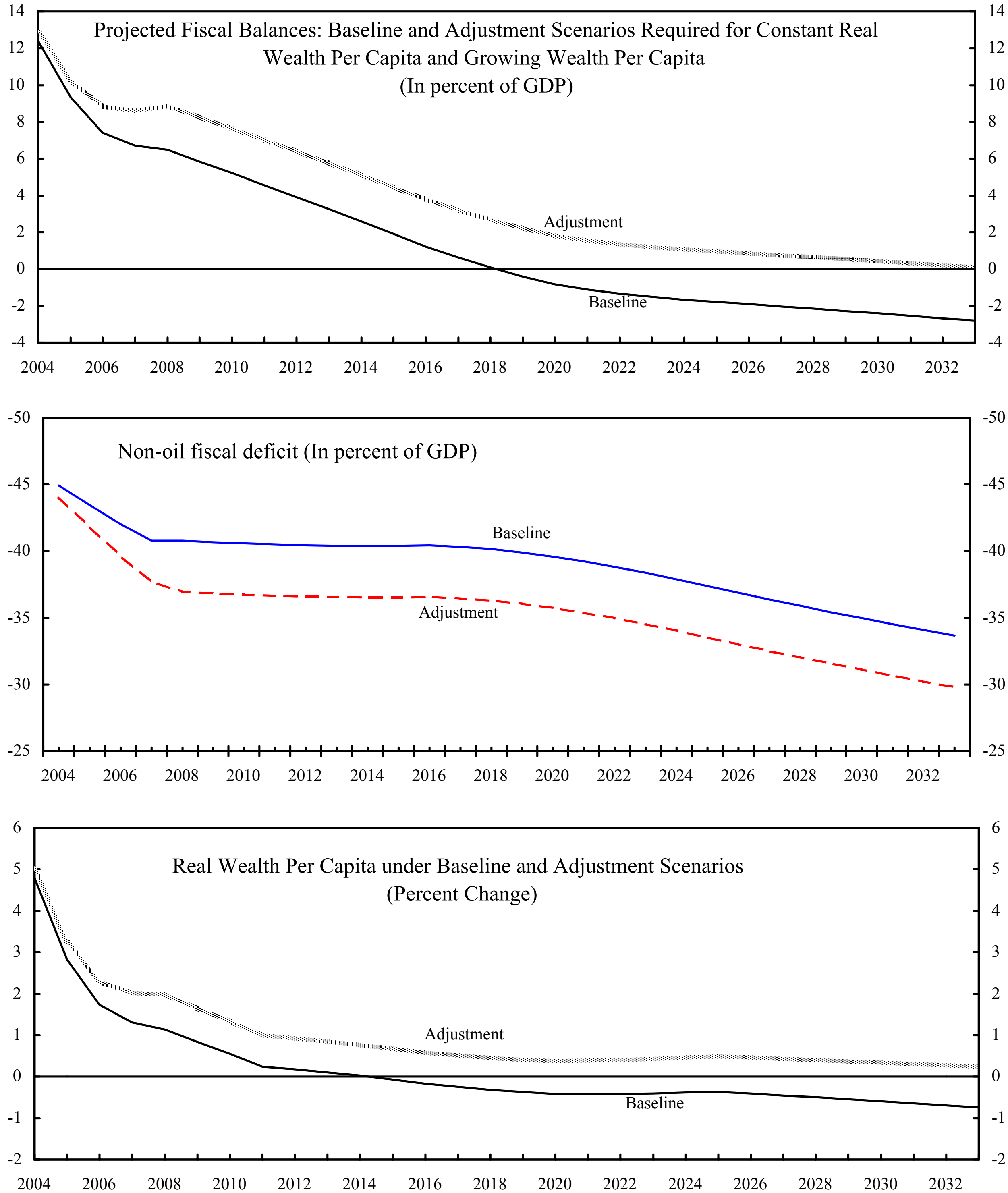
1/ 2003 covers January to September.
2/ Value of shares traded divided by market capitalization.
3/ December 29, 1993 = 1000

Figure 7. Kuwait: Oil Prices, Fiscal Expenditure, and Non-oil Balance, 1982/83–2002/03
(Percent changes)



Sources: Data provided by the Kuwaiti authorities and IMF staff estimates

Figure 8. Kuwait: Projected Fiscal Developments and Real Per Capita Wealth, 2004–33



Source: Fund staff projections.

Table 1. Kuwait: Selected Economic Indicators, 1998–2003

	1998	1999	2000	2001	2002	Est. 2003
Nominal GDP (market prices, US$ millions)	25,945	30,077	37,017	34,236	35,333	42,372
Crude oil production (millions barrels per day)	2.05	1.87	1.98	1.95	1.75	2.03
Kuwait crude export price (US$ per barrel)	10.3	16.1	25.0	21.2	22.9	25.6
	(Percent changes)					
Production and prices						
Nominal GDP	-14.1	16.0	23.8	-7.6	2.3	18.2
Nominal non-oil GDP	5.9	3.9	3.5	4.2	6.6	7.1
Real GDP	3.6	-1.7	1.9	0.6	-0.4	9.9
Real oil GDP	1.8	-6.5	2.3	-3.2	-8.0	15.5
Real non-oil GDP	5.2	2.2	1.8	3.4	5.0	6.5
Consumer price index	0.1	3.0	1.8	1.7	1.4	2.0
	(Changes in percent of beginning broad money stock)					
Money and credit						
Foreign assets (net)	-1.9	1.5	11.4	6.5	-4.1	-3.4
Domestic assets (net)	1.1	0.1	-5.1	6.3	8.8	16.0
Claims on government (net)	-1.4	-2.7	-7.3	-4.1	0.2	-3.5
Claims on nongovernment sector	7.3	3.6	3.9	12.0	10.6	18.5
Broad money	-0.8	1.6	6.3	12.8	4.8	12.5
	(Percent per year)					
Interest rates 1/						
Kuwaiti dinar three-month deposits	5.9	5.3	5.4	3.7	2.2	1.5
U.S. dollar three-month deposits	5.1	4.9	6.0	3.3	1.3	0.7
	(In millions of U.S. dollars unless otherwise indicated)					
External sector						
Exports	9,616	12,225	19,476	16,246	15,365	20,992
Of which : oil and refined products	8,470	11,027	18,184	14,976	14,058	18,784
Imports	-7,715	-6,708	-6,451	-7,049	-8,118	-10,241
Current account	2,215	5,013	14,672	8,328	4,190	8,046
In percent of GDP	8.5	16.6	39.6	24.3	11.9	19.0
Overall balance	288	894	2,241	2,827	-741	-1,907
In percent of GDP	1.1	3.0	6.1	8.3	-2.1	-4.5
International reserve assets	4,034	4,928	7,170	9,997	9,256	7,348
In months of imports of goods and services	3.7	5.0	7.4	9.7	8.3	5.6
Total external debt (incl private sector)	9,938	10,057	9,955	11,095	12,939	12,480
In percent of GDP	38.3	33.4	26.9	32.4	36.6	29.5
	(Percentage change)					
Exchange rates						
Exchange rates (US$ per KD, period average) 2/	3.28	3.28	3.26	3.26	3.29	3.35
Nominal effective exchange rate 3/	5.5	-0.6	4.7	5.8	-0.7	-6.4
Real effective exchange rate 3/	3.1	0.9	4.2	5.1	-1.5	-6.8

Table 1. Kuwait: Selected Economic Indicators, 1998–2003 (concluded)

	1998/99	1999/2000	2000/01	2001/02	2002/03	Est. 2003/04
			(In percent of GDP)			
Public finance 4/						
Total revenue, *of which* :	46.4	68.7	77.8	66.3	68.6	61.3
Oil and gas revenue	26.4	46.7	55.3	42.9	49.0	42.3
Investment income	16.6	19.3	18.2	16.6	14.4	14.2
Total expenditures	48.7	39.5	39.2	44.8	43.2	42.6
Current	43.1	36.0	36.0	40.7	38.2	37.6
Capital	5.6	3.5	3.1	4.1	5.0	5.0
Fiscal balance (deficit -)	-2.3	29.3	38.7	21.5	24.6	18.6
Fiscal balance excluding investment income (defi	-18.9	10.0	20.5	4.9	10.2	4.4

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

1/ In 2003, up to September.
2/ For 2003, average for January to October.
3/ In 2003, up to October.
4/ The fiscal numbers are for fiscal year which was changed from July–June to April–March effective 2001/02.

Table 2. Kuwait: Summary of Government Finance, 2000/01–2008/09 1/

	2000/01	2001/02	2002/03	Budget 2003/04	Projections 2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
					(In millions of Kuwaiti dinars)					
Total revenue	8,505	6,995	7,707	3,397	7,747	7,175	6,837	6,640	6,633	6,714
Oil and gas	6,037	4,525	5,499	2,971	5,340	4,761	4,393	4,158	4,115	4,156
Investment income and transfer of profits of public entities 2/	1,991	1,751	1,619	…	1,800	1,832	1,863	1,894	1,923	1,952
Other current revenue3/	476	718	563	392	580	580	579	586	594	604
Capital revenue	0	1	26	34	27	2	2	2	2	2
Total expenditure	4,279	4,729	4,848	5,666	5,390	5,487	5,578	5,672	5,758	5,847
Current	3,935	4,299	4,285	4,761	4,757	4,854	4,945	5,039	5,125	5,214
Wages and salaries	1,573	1,636	1,706	1,834	1,779	1,850	1,915	1,982	2,041	2,103
Goods and services	985	1,062	1,200	1,421	1,378	1,392	1,406	1,420	1,434	1,449
Interest on domestic debt 4/	249	213	124	49	142	141	139	138	137	135
Interest on foreign debt 2/	0	0	0	0	0	0	0	0	0	0
Transfers abroad	91	97	61	85	85	85	85	85	85	85
Subsidies and transfers	1,036	1,291	1,194	1,372	1,372	1,386	1,400	1,414	1,428	1,442
Capital	344	430	563	905	634	634	634	634	634	634
Overall balance	4,226	2,266	2,765	-2,270	2,357	1,688	1,258	968	875	867
Overall balance exc. oil rev.	-1,811	-2,259	-2,640	-5,240	-2,983	-3,073	-3,135	-3,190	-3,240	-3,289
Financing	-4,226	-2,266	-2,765	2,270	-2,357	-1,688	-1,258	-968	-875	-867
Domestic (net)	-303	-135	-162	....	-248	-168	-117	-82	-71	-70
Banks	-438	-169	-196	....	-282	-202	-151	-116	-105	-104
Nonbanks	135	34	34	....	34	34	34	34	34	34
External	0	0	0	....	0	0	0	0	0	0
Reserve funds	-3,923	-2,131	-2,603	....	-2,109	-1,520	-1,142	-886	-804	-797
					(In percent of GDP)					
Revenue	77.8	66.3	68.6	26.9	61.3	57.6	55.0	52.9	51.6	50.7
Oil and gas	55.3	42.9	49.0	23.5	42.3	38.2	35.4	33.1	32.0	31.4
Investment income	18.2	16.6	14.4	....	14.2	14.7	15.0	15.1	15.0	14.7
Other	4.4	6.8	5.0	3.1	4.6	4.7	4.7	4.7	4.6	4.6
Expenditure	39.2	44.8	43.2	44.8	42.6	44.1	44.9	45.2	44.8	44.2
Current	36.0	40.7	38.2	37.7	37.6	39.0	39.8	40.2	39.9	39.4
Wages and salaries	14.4	15.5	15.2	14.5	14.1	14.9	15.4	15.8	15.9	15.9
Goods and noninterest services	9.0	10.1	10.7	11.2	10.9	11.2	11.3	11.3	11.2	10.9
Interest on domestic and foreign deb	2.3	2.0	1.1	0.0	1.1	1.1	1.1	1.1	1.1	1.0
Subsidies and transfers	9.5	12.2	10.6	10.9	10.9	11.1	11.3	11.3	11.1	10.9
Capital	3.1	4.1	5.0	7.2	5.0	5.1	5.1	5.0	4.9	4.8
Overall balance	38.7	21.5	24.6	-18.0	18.6	13.6	10.1	7.7	6.8	6.5
Non-oil deficit/Non-oil GDP	-33.8	-40.2	-44.0	...	-46.4	-45.1	-43.7	-42.3	-41.1	-39.8

Table 2. Kuwait: Summary of Government Finance, 2000/01–2008/09 1/

	2000/01	2001/02	2002/03	Budget 2003/04	Projections 2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
					(In percent of GDP)					
Memorandum items:										
Overall balance (excluding investment income and profit transfers)	2,235	515	1,146	-2,270	557	-144	-604	-926	-1,048	-1,086
(In percent of GDP)	20.5	4.9	10.2	-18.0	4.4	-1.2	-4.9	-7.4	-8.2	-8.2
Average Kuwait oil export price ($/b)	23.1	21.6	23.6	...	25.1	23.0	21.1	19.9	19.5	19.5

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

1/ Fiscal year has been changed to April-March effective 2001/02. The 2000/01 data were obtained by grossing up the 2000/01 (9-month) fiscal data.
2/ Excluded from national budget presentation.
3/ Excludes revenues from utility tariffs (included in the national budget presentation), but includes UN (Iraq) compensations.
4/ Covers interest on treasury bills and bonds, and on DCP bonds. Only the latter is included in the national budget presentation.

Table 3. Kuwait: Summary Balance of Payments, 2000–08

(In millions of U.S. dollars)

				Est.	Projections				
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Current account	14,672	8,328	4,190	8,046	6,482	5,973	5,826	4,789	3,957
Goods (trade balance)	13,025	9,197	7,247	10,751	8,150	7,156	5,840	5,157	4,838
Exports	19,476	16,246	15,365	20,992	19,045	17,107	16,303	16,106	16,296
Oil exports	18,184	14,976	14,058	18,784	16,736	15,501	14,632	14,375	14,502
Non-oil exports including re-exports	1,292	1,270	1,307	2,207	2,309	1,605	1,671	1,731	1,794
Of which: re-exports	209	203	216	967	1,012	432	450	466	483
Imports	-6,451	-7,049	-8,118	-10,241	-10,896	-9,950	-10,463	-10,949	-11,458
Services	-3,096	-3,693	-4,271	-4,669	-5,049	-5,180	-5,547	-5,689	-5,970
Transportation	-153	-372	-619	-772	-871	-819	-1,001	-966	-1,063
Travel	-2,396	-2,741	-2,902	-3,109	-3,308	-3,485	-3,665	-3,835	-4,014
Other services	-547	-580	-750	-788	-870	-875	-882	-888	-894
Investment income	6,699	4,903	3,359	4,414	6,109	7,013	8,852	8,956	9,055
Receipts	7,315	5,428	3,724	4,786	6,496	7,462	9,323	9,448	9,571
General government 1/	4,704	3,673	2,796	3,416	4,472	5,199	6,546	6,710	6,870
Other sectors 2/	2,611	1,755	928	1,369	2,024	2,263	2,777	2,738	2,701
Payments	-616	-525	-365	-371	-388	-449	-470	-493	-516
General government	-16	-52	-13	-15	-24	-65	-65	-65	-65
Other	-600	-473	-352	-356	-364	-384	-405	-427	-451
Current transfers	-1,956	-2,079	-2,145	-2,451	-2,728	-3,017	-3,320	-3,636	-3,966
Capital and financial account	-11,555	-3,382	-3,489	-10,425	-5,642	-4,969	-4,659	-3,513	-2,671
Capital account (UN compensation)	2,217	2,933	1,668	1,650	993	1,000	1,167	1,333	1,350
Financial account	-13,772	-6,315	-5,157	-12,075	-6,636	-5,969	-5,826	-4,846	-4,021
Direct investment	319	-512	165	-250	-300	-50	-10	40	100
Abroad	303	-365	158	-350	-500	-350	-350	-350	-350
In reporting country	16	-147	7	100	200	300	340	390	450
Portfolio investment	-12,667	-7,447	-3,265	-8,520	-5,372	-4,950	-4,828	-3,969	-3,280
Assets	-12,921	-7,369	-3,426	-8,739	-5,510	-5,077	-4,952	-4,070	-3,364
Liabilities	254	-78	161	218	138	127	124	102	84
Other investment	-1,424	1,644	-2,057	-3,304	-964	-969	-988	-918	-842
Trade credits	-274	470	-405	-394	171	103	72	21	11
Loans	-489	-42	-270	-268	-216	-199	-194	-160	-132
Currency and deposits	-1,040	2,055	-1,504	-2,688	-959	-923	-913	-839	-780
Other	378	-838	122	45	41	50	47	60	60
Net errors and omissions 3/	-876	-2,119	-1,443	472	0	0	0	0	0
Overall balance	2,241	2,827	-741	-1,907	840	1,003	1,167	1,276	1,286
International reserve assets (-increase) 4/	-2,241	-2,827	741	1,907	-840	-1,003	-1,167	-1,276	-1,286

Table 3. Kuwait: Summary Balance of Payments, 2000–08

(In millions of U.S. dollars)

				Est.	Projections				
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Memorandum items									
Current account/GDP	39.6	24.3	11.9	19.0	15.6	14.4	14.0	11.3	9.0
Overall balance/GDP	6.1	8.3	-2.1	-4.5	2.0	2.4	2.8	3.0	2.9
International reserve assets (US$ millions) 4/	7,170	9,997	9,256	7,348	8,188	9,191	10,358	11,634	12,920
Total reserves minus gold	7,066	9,894	9,150	7,244	8,084	9,087	10,254	11,530	12,816
Gold (national valuation)	104	103	106	104.2	104.2	104.2	104.2	104.2	104.2
In months of imports of goods and services	7.4	9.7	8.3	5.6	6.0	7.1	7.7	8.4	9.0

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

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

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

3/ Includes other unclassified private sector flows.

4/ As reported in the international investment position table in the Statistical Appendix.

Table 4. Kuwait: Monetary Survey, 1998–2004

End of period	1998	1999	2000	2001	2002	Est. 2003	Proj. 2004
	(In millions of Kuwaiti dinars)						
Foreign assets (net)	1,784	1,899	2,778	3,307	2,930	2,600	3,001
Central bank	1,080	1,320	2,005	2,850	2,521	1,950	2,202
Local banks	704	579	773	457	409	650	799
Domestic assets (net)	5,773	5,780	5,386	5,902	6,716	8,256	8,652
Claims on government (net)	3,678	3,475	2,911	2,573	2,595	2,257	2,043
Central bank (net)	-205	-392	-532	-598	-354	-454	-483
Claims	0	45	0	0	0	0	0
Deposits	205	437	532	598	354	454	483
Local banks (net)	3,883	3,867	3,443	3,171	2,949	2,711	2,526
Claims	4,140	4,062	3,628	3,402	3,248	3,027	2,883
Government debt bonds	2,246	1,931	1,491	1,294	1,006	885	624
Public debt instruments	1,895	2,132	2,137	2,108	2,242	2,142	2,259
Other claims	0	0	0	0	0	0	0
Deposits	257	195	185	231	299	316	357
Claims on nongovernment sector	5,303	5,572	5,871	6,851	7,824	9,613	10,222
Credit facilities	4,802	5,015	5,252	6,125	6,954	8,801	9,360
Local investments	501	557	619	726	870	811	863
Other items (net)	-3,209	-3,268	-3,396	-3,522	-3,703	-3,614	-3,614
Broad money	7,557	7,678	8,163	9,209	9,646	10,856	11,653
Money	1,143	1,371	1,468	1,641	2,067	2,515	2,696
Quasi money	6,413	6,307	6,695	7,567	7,580	8,341	8,957
Of which : Foreign currency deposits	1,037	881	895	892	904	1,135	1,219
	(Annual percentage change)						
Foreign assets (net)	-7.5	6.4	46.3	19.0	-11.4	-11.3	15.4
Central Bank	4.5	22.2	51.9	42.2	-11.6	-22.6	12.9
Local banks	-21.4	-17.7	33.5	-40.9	-10.3	58.8	23.0
Domestic assets (net)	1.5	0.1	-6.8	9.6	13.8	22.9	4.8
Claims on Government (net)	-2.7	-5.5	-16.2	-11.6	0.8	-13.0	-9.5
Claims on nongovernment sector	11.8	5.1	5.4	16.7	14.2	22.9	6.3
Other items (net)	-13.0	-1.8	-3.9	-3.7	-5.1	2.4	0.0
Broad money	-0.8	1.6	6.3	12.8	4.8	12.5	7.3
Money	-8.3	19.9	7.0	11.8	25.9	21.7	7.2
Quasi money	0.7	-1.7	6.2	13.0	0.2	10.1	7.4
Of which : Foreign currency deposits	-10.1	-15.1	1.6	-0.3	1.3	25.6	7.4
	(Change in percent of beginning broad money stock)						
Foreign assets (net)	-1.9	1.5	11.4	6.5	-4.1	-3.4	3.7
Central bank	0.6	3.2	8.9	10.4	-3.6	-5.9	2.3
Local banks	-2.5	-1.7	2.5	-3.9	-0.5	2.5	1.4
Domestic assets (net)	1.1	0.1	-5.1	6.3	8.8	16.0	3.7
Claims on government (net)	-1.4	-2.7	-7.3	-4.1	0.2	-3.5	-2.0
Claims on nongovernment sector	7.3	3.6	3.9	12.0	10.6	18.5	5.6
Other items (net)	-4.8	-0.8	-1.7	-1.5	-2.0	0.9	0.0
Broad money	-0.8	1.6	6.3	12.8	4.8	12.5	7.3
Money	-1.4	3.0	1.3	2.1	4.6	4.6	1.7
Quasi money	0.6	-1.4	5.1	10.7	0.1	7.9	5.7
Of which : Foreign currency deposits	-1.5	-2.1	0.2	0.0	0.1	2.4	0.8
Memorandum items							
Net domestic credit (annual percentage change)	5.3	0.7	-2.9	7.3	10.6	13.9	3.3

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

Table 5. Kuwait: Selected Economic Indicators and Illustrative Baseline Scenario, 1998–2008

(Percent of GDP, unless otherwise specified)

						Est.	Baseline Scenario				
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Production and prices											
Nominal GDP (KD millions)	7,907	9,170	11,357	10,496	10,738	12,696	12,471	12,410	12,482	12,746	13,162
Nominal GDP (percent change)	-14.1	16.0	23.8	-7.6	2.3	18.2	-1.8	-0.5	0.6	2.1	3.3
Nominal non-oil GDP (percent change)	5.9	3.9	3.5	4.2	6.6	7.1	6.4	5.4	5.2	4.7	4.7
Real GDP (percent change)	3.6	-1.7	1.9	0.6	-0.4	9.9	1.9	2.7	2.7	2.3	2.4
Real oil GDP (percent change)	1.8	-6.5	2.3	-3.2	-8.0	15.5	-2.4	0.7	1.0	1.0	1.2
Real non-oil GDP (percent change)	5.2	2.2	1.8	3.4	5.0	6.5	4.5	3.7	3.5	3.0	3.0
Kuwait crude export price (US$ per barrel)	10.3	16.1	25.0	21.2	22.9	25.6	23.5	21.5	20.0	19.5	19.5
Crude oil output (millions of barrels per day)	2.05	1.87	1.98	1.95	1.75	2.03	1.97	1.99	2.01	2.03	2.05
Public finance 1/											
Revenue, *of which*:	46.4	68.7	77.8	66.3	68.6	61.3	57.6	55.0	52.9	51.6	50.7
Oil and gas	26.4	46.7	55.3	42.9	49.0	42.3	38.2	35.4	33.1	32.0	31.4
Investment income 2/	16.6	19.3	18.2	16.6	14.4	14.2	14.7	15.0	15.1	15.0	14.7
Expenditure	48.7	39.5	39.2	44.8	43.2	42.6	44.1	44.9	45.2	44.8	44.2
Current	43.1	36.0	36.0	40.7	38.2	37.6	39.0	39.8	40.2	39.9	39.4
Capital	5.6	3.5	3.1	4.1	5.0	5.0	5.1	5.1	5.0	4.9	4.8
Fiscal balance (deficit -)	-2.3	29.3	38.7	21.5	24.6	18.6	13.6	10.1	7.7	6.8	6.5
Fiscal balance excluding investment income (deficit -)	-18.9	10.0	20.5	4.9	10.2	4.4	-1.2	-4.9	-7.4	-8.2	-8.2
Non-oil fiscal balance (in percent of non-oil GDP)	-48.7	-34.3	-33.8	-40.2	-44.0	-46.4	-45.1	-43.7	-42.3	-41.1	-39.8
Balance of payments 3/											
Exports of goods and services excl. re-exports	40.8	43.8	55.7	49.3	45.5	47.6	43.7	44.2	42.3	41.2	40.5
Of which: oil and refined products	32.7	36.9	49.1	42.8	39.2	44.3	40.2	37.4	35.1	33.8	33.0
Imports of goods and services excl. re-exports	-48.2	-37.3	-28.9	-33.8	-37.4	-33.2	-36.3	-39.5	-41.6	-42.4	-43.1
Investment income (net)	22.6	17.1	18.1	14.0	9.4	10.4	14.7	16.9	21.2	21.1	20.6
Current account	8.5	16.6	39.6	24.3	11.9	19.0	15.6	14.4	14.0	11.3	9.0
Saving-investment balance 3/											
Final consumption	88.8	78.9	65.5	75.3	82.2	69.7	77.0	81.3	85.2	88.2	89.3
Government	30.5	26.9	21.9	24.0	26.4	24.4	25.8	26.6	27.1	27.1	26.8
Private	58.3	52.1	43.7	51.2	55.8	45.3	51.1	54.7	58.1	61.0	62.5
Gross domestic investment	18.5	14.6	7.6	8.7	9.1	16.0	15.6	13.9	14.1	13.1	13.3
Government	6.2	4.6	3.1	3.7	4.9	4.9	5.1	5.1	5.1	5.0	4.8
Private	12.2	10.0	4.6	5.0	4.2	11.1	10.5	8.8	9.0	8.1	8.4
Savings	27.0	31.4	47.3	32.8	21.2	35.0	31.2	28.4	28.0	24.3	22.3

Sources: Kuwait authorities, IMF World Economic Outlook, and Fund staff estimates.

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

2/ Includes profits of public enterprises.

3/ Domestic demand and net export do not add up to GDP because of the difference in available data coverage of balance of payments and national accounts.

Table 6. Kuwait: Vulnerability Indicators, 1998–2003

(In percent, unless otherwise indicated)

	1998	1999	2000	2001	2002	Est. 2003	
External solvency indicators							
REER (CPI based, period average)	3.0	0.9	4.1	5.1	-1.0	-6.8	11/
External debt including private sector (in millions of U.S. dollars)	9,938	10,057	9,955	11,095	12,939	12,480	
Short-term debt (original maturity) 1/	2,600	2,000	2,000	2,000	2,000	2,000	
Medium- and long-term debt 1/	7,338	8,057	7,955	9,095	10,939	10,480	
External debt/GDP	38.3	33.4	26.9	32.4	36.6	29.5	
External debt/total exports of goods and services	87.3	72.8	46.6	56.0	69.6	50.9	
Short-term debt/total exports of goods and services	22.8	14.5	9.4	10.1	10.8	8.2	
External debt service/total exports of goods and services	11.5	7.1	2.9	2.6	2.0	1.5	
Public sector solvency indicators							
General government domestic debt/GDP 2/	54.0	46.5	34.9	35.8	32.3	26.4	12/
Interest payments/total revenue	7.0	3.1	2.9	3.0	1.6	1.8	
Distribution of the public domestic debt by holders							
Local commercial banks	93.5	91.2	86.4	85.6	91.0	88.9	12/
Other (including nongovernment public institutions)	6.5	6.9	13.6	14.4	9.0	11.1	12/
Oil revenue/total revenue	56.9	68.0	71.0	64.7	71.4	68.9	
External liquidity indicators							
CBK net foreign assets (in millions of U.S. dollars)	3,545	4,336	6,535	9,297	8,295	6,508	
CBK gross foreign assets (in millions of U.S. dollars) 3/	3,552	4,344	6,547	9,308	8,334	6,575	
In months of imports of goods and services	3.2	4.4	6.8	9.0	7.6	5.4	
Relative to short-term external debt	136.6	217.2	327.4	465.4	416.7	328.7	
Relative to M0	238.9	226.7	373.5	549.6	423.1	443.6	
Relative to M1	93.7	96.3	136.2	174.6	120.8	78.3	
Total official net foreign assets/M3	14.3	17.2	24.6	30.9	26.1	18.0	
Local banks' net foreign assets (in millions of U.S. dollars)	2,308	1,901	2,519	1,489	1,347	2,170	
Foreign assets	5,866	5,869	6,415	6,612	8,032	7,795	
Foreign liabilities	3,558	3,968	3,896	5,123	6,686	5,625	
Oil exports/total exports	88.7	90.2	93.4	92.2	91.5	89.5	
Financial sector indicators							
Increase in net bank profits 4/	-8.2	13.7	20.9	9.9	0.6	15.2	13/
Ratio of net profits to total bank assets	1.6	1.8	2.0	2.0	1.8	2.0	13/
Ratio of net profits to total shareholders' equity	13.8	15.3	17.6	18.2	17.4	18.6	13/
Banks' capital-asset ratio	11.4	11.6	11.5	11.2	10.4	10.8	13/
Banks risk-weighted capital-asset ratio	22.5	23.7	22.2	22.0	19.7	18.4	13/
Banks' leverage 5/	8.8	8.6	8.7	9.0	9.6	9.8	13/

Table 6. Kuwait: Vulnerability Indicators, 1998–2003

(In percent, unless otherwise indicated)

	1998	1999	2000	2001	2002	Est. 2003
Financial sector indicators						
Banks' liquidity ratio 6/	15.5	17.6	16.3	14.8	14.0	13.0 13/
Ratio of banks' nonperforming loans to total loans	10.3	12.8	19.2	10.3	7.8	7.0 13/
Nonperforming loans from before invasion	7.3	6.8	12.8	5.1	4.8	4.1 13/
Nonperforming loans since liberation	3.0	6.0	6.4	5.2	3.0	2.9 13/
Loan provisions as a proportion of nonperforming loans	68.2	53.2	50.1	53.7	64.3	72.4 13/
Ratio of bank lending to total domestic credit facilities						
Stock market-related	6.1	4.3	4.7	6.3	5.7	5.6 13/
Real estate 7/	17.5	19.9	16.3	19.0	18.7	18.7 13/
Total (stock market, real estate)	23.6	24.3	21.0	25.3	24.4	24.3 13/
Ratio of bank lending to banks' own funds						
Stock market-related	19.9	14.4	15.7	22.9	22.5	...
Real estate 7/	57.3	66.5	53.9	69.3	73.3	...
Total (stock market, real estate)	77.2	80.9	69.6	92.2	95.8	...
Banks' interest rate spread 8/	0.8	0.4	-0.6	0.4	0.9	0.7 14/
Investment companies' capital and reserve/total assets	38.6	39.5	37.4	31.5	31.4	...
	(In millions of Kuwaiti dinars)					
Net foreign assets of local banks	703.5	578.7	772.8	456.5	409.3	650.1
Net foreign assets of investment companies 9/	601.3	705.5	794.8	667.1	709.0	699.0 13/
Open foreign exchange position of banks 10/	26.0	19.4	6.8	-13.5	-12.5	...

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

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

2/ Treasury bills and bonds, and debt purchase bonds.

3/ Excludes SDRs and IMF reserve position.

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

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

6/ Ratio of liquid assets (cash, central bank current deposits, and treasury bills and bonds) to total assets.

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

8/ Calculated as the difference between 3- month deposits rates in KD relative to the 3-month deposit rates in US$.

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

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

11/ January-August.

12/ As of end-September 2003.

13/ As of end-June 2003.

14/ Data covers January-September 2003.

KUWAIT

Fund Relations
(As of October 31, 2003)

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

II. **General Resources Account**:	**SDR Million**	**% Quota**
Quota	1,381.10	100.00
Fund holdings of currency	855.36	61.93
Reserve position in Fund	525.74	38.07

III. **SDR Department**:	**SDR Million**	**% Allocation**
Net cumulative allocation	26.74	100.00
Holdings	105.33	393.84

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangement**:

Since January 1, 2003, the Kuwaiti dinar has been pegged to the U.S. dollar. The decision to peg the dinar to the U.S. dollar reflected plans to create a single currency for the six members of the Cooperation Council for the Arab States of the Gulf (GCC). Previously, the Kuwaiti dinar was pegged to a U.S. dollar-dominated basket of currencies. The central bank normally maintains buying/selling rates for the U.S. dollar at one-sixteenth of 1 percent on either side of the Kuwaiti dinar exchange rate: US$1=KD 0.29387 as of end-October 2003.

VIII. **Article IV Consultations**:

The latest Article IV consultation was completed by the Executive Board on December 13, 2002. The staff report and the associated Selected Issues and Statistical Appendix were issued in November 2002, Country Report No. 03/13.

IX. **FSAP Participation**

A FSAP exercise was conducted in September 2003 in order to assess three international standards and codes (banking, securities, and AML/CFT). A FSSA report is currently under preparation and will be discussed by the Executive Board along with the staff report for the 2003 Article IV consultation.

X. **Technical Assistance**:

FAD	Advisory mission	April 1992
MAE	Advice on bank report forms	October 1992
FAD	Advice on fiscal reform	February–March 1993
STA	Multi-topic statistics mission	April–May 1994
FAD	Budget advisor	September 1993–October 1994
MED	Macroeconomic model	September 1996
MAE	Early warning system and banks supervision	May 1997
STA	Balance of payments statistics	November 1998
MAE	Monetary policy instruments	November 1998
MAE	Early warning system	December 1998
MAE	Monetary policy issues	March 1999
MAE	Bank supervision	April 1999
INS	Financial programming	April 1999
MAE	Bank deposit insurance scheme	October/November 1999
STA	Seminar on GDDS	February 2000
STA	National Accounts and Price Statistics	June 2001–June 2002
FAD	Restructuring Budget Processes	January/February 2002
FAD	Kuwait: A Program for Tax Reform	December 2002

XI. **Resident Representative**: None

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

KUWAIT

Relations with the World Bank Group

As of November 30, 2003

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

- **Post-war reconstruction:** In January 1991, the Bank submitted to the government a report, *Kuwait: Emergency Relief Program* that included action plans and a framework for reconstruction following liberation.

- **Privatization:** The World Bank has carried out a study of privatization strategies in the industrial, services, health, telecommunications, power, ports, and transportation sectors, (World Bank, *Kuwait: A Privatization Strategy*, Washington, 1993); assisted delegations from the National Assembly and the KIA in studying worldwide experience in the implementation of privatization (1994-97); and provided assistance on the draft and privatization law. In addition, the World Bank has been advising the Kuwait Investment Authority (KIA) on the divestiture phase of the privatization program.

- **Development strategy:** The Country Economic Memorandum (CEM) prepared in 1995 focused on several issues (i) the role of government and public sector productivity; (ii) fiscal policies and public saving; (iii) welfare and subsidization; and (iv) the labor market and employment policies. The World Bank also provided the National Assembly with its views on the draft Five-Year Plan (1996), in addition to providing advice on the draft reform plan prepared by the Higher Committee for Economic Development and Reform over the period 1998–99. Also, the World Bank in collaboration with Kuwait's Higher Planning Council, and Kuwait University has in early March 2001 completed a study entitled "Energizing the Private Sector" in Kuwait. In 2002, the World Bank is conducting various missions in land policy, power sector reform, telecommunications, transportation, and tourism to identify areas where technical assistance might be needed.

- **Reform implementation:** Based on this recent study on "Energizing the Private Sector," as well as other technical assistance activities, the Government of Kuwait has requested World Bank assistance in implementation of the various reform initiatives, including the institutional set-up for an implementation agency. The Government of Kuwait and the World Bank are currently exploring mechanisms for more World Bank technical assistance involvement in this regard.

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

- **Public awareness:** As a first step to support the Economic Reform Program, the Bank began managing on behalf of the government a *Public Awareness Campaign* for its reform agenda in April 2001.

- **Transparency and anti-corruption:** At the request of the government, a scoping mission was conducted in September 2002. One central objective of the mission was to develop the Terms of Reference (TORs) and identify the key institutions to be involved. The Council of Ministers assigned the responsibility for developing the Transparency and Anti-Corruption Strategy to the Citizens Services and Governmental Bodies Assessment Agency. A working group was also formed based on Bank recommendation. Last June, a Bank mission produced a report, "Toward a Comprehensive Transparency and Anti-Corruption Strategy in Kuwait." The report proposed a number of measures that could be initiated in the short term, as well as a framework that encompassed the main elements of a long-term strategy. Next step is to organize a high-level workshop on international experience and strategies currently planned for early 2004.

- **Small business promotion:** The World Bank has provided technical assistance, which has led to the establishment of the Kuwait Small Projects Development Company (KSPDC). The World Bank is currently advising KSPDC on its operations.

- **Labor market:** The World Bank, in partnership with Kuwait Institute for Scientific Research (KISR), carried out a labor market study. The study includes a household survey, and an employee/employer survey. The study was conducted at the request of the Higher Committee for Economic Reform and Development and was completed in January 1999. In March 1999, a presentation of the main recommendations of the study was made to the government. The presentation was attended by three ministers, namely Finance, Planning and Education. Some recommendations of the study were proposed by the government for legislative approval.

- **Employment generation:** As a follow up to the Labor Market Study, the government requested Bank support in creating private sector jobs for Kuwaitis. A Bank mission visited Kuwait in late August 2003 to develop the Terms of Reference for this activity.

- **Education Sector Reform:** Following the successful completion of "Education Expenditure Analysis" study, the government sought Bank assistance in implementing the recommendations. It was agreed to focus on these issues: (i) indicators for general education system; (ii) introducing program budgeting; and (iii) carrying out more in-depth analysis on the financing issues and of the costs at school level. This is expected to be carried out in four phases. Phase one, which includes development of indicators, has started and a mission visited Kuwait in late last June. A larger mission visited Kuwait in September 2003 to continue the development of indicators and begin work on program budgeting for education.

- **Kuwait health sector**: The government recently requested Bank support in assessing the general performance of the health sector and in identifying areas of potential reform, and missions were sent in October 2002 and January 2003. The study (June 2003) provided a general overview of the main issues facing the health sector plus special coverage of five priority areas identified by the government: (i) developing the National Health Accounts (NHA), and financing the expatriate health insurance system; (ii) hospital accreditation and quality; (iii) regulation of private health insurance; (iv) assessing hospital efficiency; and (v) program budgeting for the health sector.

- **Telecommunications:** The Bank received a request from the government in 2002 to develop a Sector Reform Strategy and an implementation action plan. Both have been completed. Recently the government appointed KMPG as advisor on sector reform. Bank will continue to advise government on strategic sector reform issues and help supervise their advisors.

- **Power and water strategy:** Two draft reports, one on possible LNG options and the other on reforms in the power and waters sector, were submitted to government for comments in early August. The next steps include several tasks: (i) developing the government's vision for the development of the electricity and water sectors; (ii) working out key principles for a legal and regulatory framework and the role for an independent regulatory agency; (iii) determining options for industry restructuring; (iv) discussing various options with key stakeholders; and (v) working out an implementation plan.

- **Concessions/BOT:** Based on the Concessions Study submitted in early 2002, implementation steps for the Build-Operate-Transfer (BOT) were sent to the government. In addition to addressing the background of the BOT issue, the note identified the required decisions and responsibilities of the various ministries and departments, and included TORs for a BOT Manager and a Value-for-Money Committee.

- **Public private partnerships:** The project is in the early stages of being defined with the government—(with its focus on its scope and plan of action. The government is considering combining current Concessions/BOT activity with the planned PPP project.

- **Land Transport Reform:** In July 2002, Kuwait launched an initiative to explore options for reforming its public transport sector, and requested Bank assistance in a Land Transport Sector Reform project consisting of two phases. Phase I (completed August 2002) addressed sector shortcomings in policy, strategy, regulations, and service. Phase II (completed August 2003) recommended interventions, the institution of a "Land Transport Regulatory Authority" to focus on near term needs and private sector participation. The next steps will be to finalize the regulatory strategy and decrees; structure future industry including Public Transport Corporation (KPTC); and prepare a transition package for privatization.

- **Bubyan Port Strategic Assessment:** This pre-feasibility study was requested in July and implemented on an accelerated basis. Consultants provided their draft final report August 8 for Bank review. Project was completed in September 2003.

- **Land Policy:** Land management in Kuwait is in transition. A review of the existing situation in the land and real estate was prepared. The review identified barriers for more productive and efficient use of urban land and set out an action plan for the sector. The review and action plan were submitted in October 2002.

- **Housing Policy:** As a follow up to the work done on land policy, a study on housing subsidies was conducted by the Bank. A draft report entitled "A Study of the Housing Benefits Program" was delivered to government for comments last May.

- **Competition Policy:** Work began in July 2002 and included: (a) preliminary assessment of laws and policies in place as they interface with or impact competition policy; and (b) provision of a draft outline of the type of competition law/policy that Kuwait may wish to consider. The report was finalized in October 2002, and the letter of invitation and the TOR for law firms to engage in the drafting of the competition law/policy were sent in January 2003.

- **General public reform:** The World Bank has been advising government on various reform initiatives, and has provided ad hoc technical assistance on various topics. In November 2000, the Bank finalized an Evaluation of the Offset Program in Kuwait, which assessed the current structure and presented options for reform. As for ad hoc issues, the Bank made a presentation to high-level decision makers on WTO issues and how Kuwait can benefit from its membership in WTO.

KUWAIT

Statistical Issues

National Accounts and Production

The Central Statistical Office has prepared estimates of GDP at both current and constant prices through 2002 (the 2002 estimates are still provisional). Recent improvements of national accounts include: change of the base year for the constant price data from 1984 to 1995; and improvements in the estimates of value-added for subsidized-goods and services of the public utilities sector through the use of input costs (the household expenditure survey was used previously). The estimates of GDP have been published at the Central Statistical Office website. Starting from the final 2002 data, further improvements will be made to national accounts reflecting the adoption of the SNA 1993 data collection system and a sampling frame based on the establishment survey (2002), and the expansion of the coverage of questionnaires. Continued progress, especially in the estimation of value-added data for the oil sector, requires the dedication of adequate resources and improved coordination between the Ministries of Planning, Oil, and Finance. STA has provided the Ministry of Planning with technical assistance (including fielding of a resident expert) in a project to evaluate and enhance Kuwait's national accounts and price data. It would also be useful if the Central Bank of Kuwait (CBK) would publish oil sector information in the Quarterly Statistical Bulletin pertaining to output, refining, domestic consumption, export price for crude and refined products and the domestic price of petroleum products. These data are readily available from the Ministry of Oil.

Price Statistics

The household expenditure survey (2000) has been completed, and a revised basket of goods and services for the consumer price index (CPI) was finalized by the end of 2001. Improved monthly CPI based on a revised basket has been published in monthly CPI bulletins with about a two months lag. The wholesale price index (WPI) needs to be revised to a more modern statistical measure, such as a producer price index (PPI), which is also more useful for national accounting needs. Also, consideration should be given to compiling data on wage rates and developments in the private sector.

Government Finance Statistics

Kuwait reports regularly annual GFS data for publication in the Government Finance Statistics Yearbook (GFSY) and monthly GFS data for publication in IFS. However, since 1987, Kuwait has not reported major components of its extrabudgetary revenues (investment income and transfers of profits of public institutions), extrabudgetary expenditures (interest on foreign debt and treasury paper), and financing operations conducted by two reserve funds. Data on investment income, and on interest on foreign debt and treasury paper, however, are usually provided to Article IV consultation missions. The authorities have made some progress in fiscal data presentation, but the lack of a suitable classification of data on the execution of the budget remains a constraint on monitoring effectively fiscal developments during the year. Moreover, data on the operations of the Public Institute for Social Security are not made available. Much of the weaknesses in the fiscal accounts stem from the limitations on the sharing of information between various government agencies. STA has indicated to the authorities that operations of the two reserve funds should be classified as part of government as they perform activities for public policy purposes (management of debt and assets, and financing of the budget).[1] The authorities have also been briefed on the IMF's ongoing work to enhance the transparency of fiscal accounts and presentations detailed in the "Code of Good Practices on Fiscal Transparency" and were encouraged to adopt some of the practices recommended in the Code. According to the FAD report entitled "*Restructuring Budget Processes*" which was finalized in March 2002, the weakest part of the Kuwaiti Public Expenditure Management (PEM) system is the accounting system.[2]

Money and Banking Statistics

Money and banking data are reported on a regular and timely basis. Coverage in *IFS* of the data on deposit money banks and other banking institutions for January 1981 onward was revised according to recommendations of the 1994 STA multisector mission. On an issue noted by that mission it was clarified that the Savings and Credit Bank (SCB) does not accept transferable deposits from the public. Nevertheless, the status of the SCB remains to be ascertained to determine its proper sectorization.

Balance of Payments Statistics

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

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

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

estimation of travel services, but further improvements are needed in compilation practices and in the estimation of data on several service items and private transfers.

F. Data dissemination

Kuwait is a participant in the GDDS, and its metadata were last updated in the Fund's DSBB in October 2002. In preparation for the eventual move to the SDDS, the CBK has established its own webpage, which contains the following data that are made available online to the public: money and banking (monthly); balance of payments (annually); trade balance (monthly); exchange rate (average, monthly); GDP by sector and expenditure at current and constant prices (annually); public finance (selected data are available monthly); CPI and WPI (monthly with about a three-month lag); and securities market indicators (quarterly). Similarly, the Ministry of Planning has constructed a webpage corresponding to the CSO, which publishes data on national accounts, prices, and other related statistics. The Ministry of Finance's webpage includes elaborated data for the actual and estimated budget. In addition, the KIA's webpage provides data on stock market indices, volume and value of securities traded, as well as privatization schedules and other related information.

Kuwait: Core Statistical Indicators, as of December 11, 2003

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance 2/	GDP/ GNP	External Debt/ Debt Service 7/
Date of latest observation	11/03	11/03	11/03	11/03	11/03	11/03	07/03	09/03	2002	FY2002/03	2002	...
Date received	12/03	12/03	12/03	12/03	12/03	12/03	10/03	10/03	10/03	10/03	10/03	...
Frequency of data	M	M	M	M	M	M	M	M	A	A 3/	A	...
Frequency of reporting	M	M	M	M	M	M	M	M	A	A	A	...
Source of update	Central Bank of Kuwait (CBK)	CBK	CBK	CBK	CBK	CBK	Central Statistical Office (CSO)	CBK	CBK	Ministry of Finance	CSO	...
Mode of reporting	Fax QSB 4/ MMS 5/	STA Reports, QSB, MMS, on-line	STA Reports, QSB, MMS, on-line	STA Reports, QSB, MMS, on-line	STA Reports, QSB, MMS, on-line	STA Reports, QSB, MMS, on-line	CTA Reports, QSB	STA Reports, QSB, on-line	STA Reports, QSB	QSB, STA Reports	STA Reports, QSB	...
Confiden-tiality 6/	U	U	U	U	U	U	U	U	U	U	U	...
Frequency of Publication	M	Q	M, Q 5/	M, Q	M, Q	M	M	Q	A	Not pub. on Fund standards	A	...

1/ Central Bank of Kuwait only. Government external assets are confidential.
2/ Fiscal year data only.
3/ Higher frequency data available only in national format.
4/ *Quarterly Statistical Bulletin*.
5/ *Monthly Monetary Statistics*.
6/ U stands for Unrestricted.
7/ Except for a small volume of trade credits, Kuwait has no public external debt.

Statement by A. Shakour Shaalan, Executive Director for Kuwait
February 9, 2004

1. The Kuwaiti economy has once again coped well with a difficult regional situation and swings in oil prices, thanks to the authorities' relentless pursuit of stability-oriented policies and reforms to diversify the economy's productive base. The implementation of prudent fiscal policies, including restraint in public expenditures, as well as the existence of a sound and well-supervised banking system have helped the economy withstand the financial repercussion of fluctuating oil-related revenues and maintained confidence during and in the period leading to the conflict in the region.

2. The significant decline in oil GDP growth in 2002 was offset to a large extent by a robust and broad-based growth in the non-oil sector, which continued in 2003. This reflected the environment of stable exchange rate and low interest rates, and strong consumer and investor confidence in spite of the regional tension. Stability in the region and the resumption of trade relations with neighboring Iraq is likely to further improve the prospects for the non-oil sector. The boom in the real estate prices, the acceleration of the stock market and the sharp increase in domestic credit demand also attest to the enhanced confidence in the economy's outlook.

3. Despite the uncertainties and security concerns associated with the Iraq war, which fortunately was short-lived, the authorities persisted in implementing the structural reform agenda, albeit at an understandably slower pace than they had hoped for. Notable advances were made in labor market reform, privatization, and strengthening the financial sector.

4. Looking forward, while the economy's outlook remains favorable over the medium term, the authorities are aware of the need to address the challenges of increasing employment opportunities for the growing labor force and reducing the economy's high dependence on oil, while ensuring intergenerational equity. They are determined to take advantage of the current favorable environment and vigorously continue the pursuit of economic policies aimed at strengthening public finance, further diversifying the economy, and promoting private sector investment, both domestic and foreign.

5. Fiscal developments in the past two years affirm the authorities' long-standing approach to fiscal prudence whose hallmark has been expenditure restraint. In spite of increasing demands on the budget engendered by high oil prices, the authorities maintained a significant degree of spending discipline, which is reflected in a broadly unchanged ratio of current spending to GDP over the past three years. In fact, in 2002/03 when oil revenue increased by some 6 percentage points of GDP, total current spending was reduced by over 2 percentage points of GDP. For the current fiscal year, strict control over wages and public sector hiring is likely to result in a decline in the wage bill relative to GDP. The prudent policy conduct has allowed the government to accumulate further foreign assets in the Reserve Fund for Future Generations.

6. Despite the broadly comfortable fiscal situation, the Kuwaiti authorities are keen to push forward an ambitious fiscal reform strategy to speed up the accumulation of financial assets for future generations on the one hand, and to reduce vulnerability of the budget to oil price shocks on the other. An important step in this regard is the introduction of a three-year rolling budget effective 2005/06 that would target the fiscal position net of exogenous factors. The authorities intend to pursue their fiscal consolidation strategy in a pragmatic and gradual manner to ensure broad support for the planned reforms. Policies to reduce public employment and diversify the revenue base including through the introduction of a value added tax, are best implemented along with the envisaged reforms to promote the role of the private sector, in order to reduce their potential adverse social impact on the population. Priority at this time is accorded to achieving a significant reduction in current spending and improving the efficiency of capital outlays. Consideration is given to control the wage bill by limiting employment in the public sector, as well as better defining capital spending priorities. The authorities have already initiated measures to strengthen budget and expenditure management in line with the recommendations of the Fund technical assistance and are planning on carrying out other Fund recommendations in this regard. On the revenue side, the authorities are considering a number of measures to secure stable sources of revenue. They are planning on raising the tariffs of publicly supplied goods and services for expatriates and Kuwaitis, reforming the corporate income tax to extend its coverage to domestic companies, and eventually introducing the value added tax.

7. Monetary policy in Kuwait continued to be prudent and aimed at maintaining stability of the exchange rate under an open exchange and trade system. Deposit auctions for banks are being used effectively by the Central Bank of Kuwait (CBK) to manage domestic liquidity. The authorities moved to a peg with the US dollar as a step towards establishing a Gulf Cooperation Council monetary union in 2010. Consistent with this objective, the CBK will continue to monitor domestic interest rates and adjust its discount rate in line with developments in global markets with a view to maintaining an interest rate differential on domestic currency-denominated assets. The CBK will also maintain a cautious monetary stance in 2004 to ensure that money and credit growth remains in line with the expansion of non-oil activity.

8. The banking system remains sound and provides a solid supporting environment for the private sector. The system is highly liquid, and well capitalized, regulated, and supervised, and therefore, can withstand significant shocks as highlighted in the FSSA report. Banks activity increased in recent years in line with economic growth, while their financial soundness indicators improved, notably the significant decline in non-performing loans and increased provisioning. In an effort to maintain the soundness of the sector, the authorities strengthened supervision further in 2003, by adopting a comprehensive regulatory and supervisory system in accordance with international standards and practices. Additional measures were taken in 2003 to enhance risk management and information disclosure in the banking system and a credit bureau was established to help banks better assess credit risks. A recent legislation has also been enacted to bring all Islamic banks under the supervision of the CBK including their licensing. Furthermore, the amended Banking Law, which was approved by the National

Assembly in January of this year, will further strengthen the licensing power of the CBK, deepen the financial sector by introducing new financial instruments, and enhance efficiency and competition in the banking system by allowing the establishment of foreign banks in Kuwait. Capital markets have also been deepened through the opening of a parallel stock market, and consideration is given to introducing options, derivatives and convertible bonds.

9. The authorities are committed to accelerating their reform agenda within a four year action plan to reduce the role of the state in the economy and establish a friendly business environment to encourage private investment and attract FDI, and have already initiated efforts to this end. A comprehensive privatization law, which awaits approval by the National Assembly will provide the legal and institutional framework for the government to divest from major state enterprises, including water, electricity, telecommunications, and ports. In the meantime, the authorities are focusing on promoting the role of the private sector in areas that do not require approval by the National Assembly. They have encouraged private sector participation in activities in the oil sector, health, communications, and education services. The approval of the foreign direct investment law by the National Assembly, which allows a 100 percent foreign ownership in Kuwaiti companies and provides incentives for foreign investors, is an important step to attracting foreign direct investment. In addition, the government is proposing a tax law to reduce corporate income tax from 55 to 25 percent on foreign businesses and apply it uniformly on Kuwaiti and foreign companies.

10. Labor reform is another important pillar in the authorities' economic strategy. Intensive efforts are underway to encourage private employment as a vehicle to reduce the size of the state in the economy and to help absorb the rapidly growing labor force in the country. The recent decision to extend social allowances to the private sector was taken with a view to integrating the labor market and to render private jobs more attractive. The authorities have also provided incentives for Kuwaitis to join the private sector including through putting in place a program to provide vocational training, providing job search allowances for the unemployed, and enhancing job placement services.

11. Finally, progress has been made in improving the quality and dissemination of data. The national accounts have been improved by the adoption of the System of National Accounts and the consumer price index has been revised to reflect new weights based on a recent household expenditure survey. The lag for releasing the national accounts and the CPI data has also been shortened, and the ministry of finance, the ministry of planning, and the central bank are now publishing economic data on their web sites. The authorities are committed to continue to develop economic data in line with the recommendations of Fund technical assistance missions.

INTERNATIONAL MONETARY FUND
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FOR IMMEDIATE RELEASE
February 25, 2004

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

IMF Concludes 2003 Article IV Consultation with Kuwait

On February 9, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the 2003 Article IV consultation with Kuwait.[1]

Background

In 2002, overall real GDP declined slightly as oil output fell sharply in line with OPEC-mandated cuts. However, real non-oil GDP growth rose to 5 percent from 3.4 percent in 2001, in part, on account of the increased demand for goods and services associated with Iraqi development. Inflation remained low at about 1.5 percent.

The fiscal position improved, with the overall fiscal surplus rising to 25 percent of GDP in 2002/03. The rise in the surplus reflected, mainly, favorable oil market developments in the last quarter of the fiscal year (first quarter of 2003) and restraint on current expenditures.
The external position remained comfortable despite a drop in the external current account surplus to about 12 percent of GDP as imports rose, partly, for inventory build up in anticipation of the Iraq conflict. Net investment income declined reflecting the weaker performance in the international financial markets and the decline in global interest rates. With an increase in capital outflows, net foreign assets of the Central Bank of Kuwait (CBK) declined slightly to the equivalent of about eight months of imports of goods and services.

Growth of broad money decelerated to about 5 percent in 2002 from 13 percent in 2001. While net foreign assets declined, credit growth to the private sector remained robust in

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

response to the low interest rates and rising domestic economic activity. The financial sector continued to perform well. Reflecting the buoyant non-oil activities and ample private sector liquidity associated, in part, with the United Nations compensation payments, the stock market index rose further by 39 percent in 2002 after a 27 percent increase in 2001. Following trends in the global financial markets, the CBK reduced its discount rate twice in 2002, down to the present 3.25 percent. The Kuwaiti dinar-U.S. dollar deposit rate differential was allowed to rise slightly to 63 basis points compared with the historical 50 basis points. The Kuwaiti dinar depreciated in real effective terms by about 1.5 percent.

The macroeconomic position is estimated to have remained comfortable in 2003. Real non-oil GDP growth picked up briskly to about 6.5 percent because of the spillover effects of developments in Iraq and improved domestic confidence. The stock market has also continued to rise sharply. Concurrently, credit expansion has been brisk and broad money is estimated to have risen by about 13 percent. The external current account surplus is estimated to have improved further to 19 percent of GDP due, in part, to an increase in oil export receipts. With an estimated sharp increase in portfolio and other investments abroad, CBK's net foreign assets are estimated to have declined to the equivalent of about six months of prospective imports. The overall fiscal surplus for 2003/04 is projected to decline to about 19 percent of GDP. The macroeconomic position is projected to remain manageable over the medium term (2004–2008). The fiscal and external current account surpluses are projected to contract on the basis of the expectation for declining oil prices, official foreign asset position, and the authorities' intention to follow a cautious fiscal policy.

Progress remained limited on structural reforms. The privatization law, which would allow divestment of major public sector utilities and clarify the domain for the private sector, remains to be approved by the National Assembly. However, the private sector has been encouraged to invest in areas where explicit approval by the National Assembly is not required. Implementation of the Foreign Investment law requires clarification of areas open to foreign investment including 100 percent foreign ownership. The planned revised corporate income tax law, lowering the tax rate from 55 percent to 25 percent, remains under consideration. Moreover, administered prices of publicly supplied goods and services have remained unchanged. Effective October 2003, the authorities formally implemented the Kuwaitization policy to generate employment opportunities for Kuwaiti workers in the private sector. The policy imposed quotas for percentages of Kuwaiti workers to be employed by individual non-government entities. Regarding the financial sector, the Banking law was amended in January 2004, which approves the establishment of foreign banks in Kuwait. The Financial Sector Assessment Program (FSAP) exercise has been completed.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They commended the Kuwaiti authorities for pursuing cautious macroeconomic policies over the past several years, which have resulted in sizeable fiscal and external current account surpluses, a comfortable level of net foreign reserves, and low inflation. They agreed that the macroeconomic outlook over the medium term is likely to remain favorable. Directors considered that the main challenges ahead are to accelerate non-oil economic growth in order to absorb the rapidly growing Kuwaiti labor force and maintain intergenerational equity over the long run, and to reduce the budgetary dependence on oil revenue. They endorsed the official strategy of pursuing structural reforms and fiscal strengthening to achieve these objectives. While noting the likely positive effects of Iraq reconstruction in the period ahead. Directors encouraged the authorities to take advantage of the current favorable macroeconomic conditions and buoyant private sector, and step up the pace of implementation of their strategy. In particular, they encouraged accelerating reforms to reduce state involvement in the economy, promote private investment, and improve the functioning of the labor market.

Directors looked forward to the early passage of the Privatization Law to establish the legal and institutional framework for promoting private investment. In the meanwhile, they encouraged the authorities to move forward with early divesture of public sector activities that do not require explicit legislative action for privatization. They considered that such a step would signal the authorities' commitment to private sector-led growth and further strengthen the environment for private investment. Directors also called for an early clarification of rules governing foreign direct investment, including the "negative list" under the Foreign Investment Law, and the establishment of a level playing field for domestic and foreign investors in terms of access to the domestic financial markets and tax treatment. In this context, they recommended early enactment of a non-discriminatory corporate income tax.

Directors supported the authorities' strategy of addressing unemployment pressures through the development of skills needed by the private sector. However, they urged authorities to apply the Kuwaitization policy flexibly in order to avoid adverse effects on the competitiveness of the private sector. They stressed the importance of promoting market-based wage flexibility for the Kuwaiti workforce. In this context, they supported civil service reforms aimed at linking wages to productivity in the public sector. Moreover, in order to minimize the burden on the budget, Directors encouraged the authorities to adopt a plan for rationalizing benefits to workers in both the public and private sectors. There was broad support for linking labor market reforms to state enterprise restructuring and private sector development, to facilitate redeployment of jobs from the public to the private sector.

Directors commended the authorities for maintaining financial system stability through sound macroeconomic policies and effective banking regulation and supervision. They welcomed the FSAP findings that the most critical elements of the systemic liquidity and crisis management policies are in place. They noted that, while some banks are sensitive to fluctuations in equity and property prices, their exposure appears to be manageable. Directors also noted that the newly implemented Islamic Banking Law and the recently amended Banking Law would further strengthen the effectiveness of banking regulation and supervision, and called for determined enforcement of these laws.

Noting the large swings in stock prices, Directors called for steps to strengthen the regulation and supervision of the capital market—including the creation of a single, independent, and accountable regulatory agency to oversee the securities market. There was broad support for the authorities' plan to encourage development of new financial products and to liberalize rules governing nonresident participation. Directors commended the authorities for the recent strengthening of regulatory and supervisory framework for combating money laundering and terrorism financing.

Directors commended the maintenance of a strong overall fiscal balance in 2002/03 and 2003/04. However, they noted that the non-oil fiscal deficit remains high. They therefore welcomed the authorities' plans to tighten fiscal policy in the period ahead, notwithstanding the recent rise in oil prices. Directors encouraged the authorities to improve the budget structure by reducing current expenditure, particularly on wages and subsidies, in conjunction with civil service reform and adjustment of prices of goods and services provided by the public sector toward cost recovery. On the revenue side, they stressed the need to boost non-oil revenue, and encouraged the authorities to work with regional partners toward the introduction of the value added tax. Directors supported the authorities' intention to implement fiscal policy in the context of a medium-term macroeconomic framework by adopting a three-year rolling budget. In this context, they advised the authorities to target a declining non-oil deficit relative to non-oil GDP, based on realistic oil price assumption, in order to cushion the impact of oil revenue volatility and strengthen the counter-cyclicality of fiscal policy.

Directors endorsed the authorities' policy of maintaining a pegged exchange rate arrangement with the U.S. dollar under the prevailing free exchange and trade system as a first step toward the GCC-wide monetary union. They supported a continued prudent monetary policy, backed by a sound financial system and a tight fiscal policy, to help ensure the stability of the peg. They considered that further strengthening the independence of the central bank will be important to boost the credibility of monetary policy and investor confidence. Directors encouraged the authorities to adjust the ceilings on lending rates to reflect differential risks and improve resource allocation, and to introduce a limited deposit insurance scheme for social welfare reasons. Directors welcomed the progress in trade liberalization and regional integration in the GCC states, observing that it will contribute to the diversification and efficiency of Kuwait's economy.

Directors commended the progress made in improving the quality and dissemination of economic data, particularly in the areas of public finances, national accounts, and the balance of payments. They encouraged continued progress in improving the quality, timeliness, and transparency of the economic data.

Directors commended Kuwait for its generous financial assistance to developing countries.

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

Kuwait: Selected Economic Indicators

	1998	1999	2000	2001	2002
	(Percent Change)				
Production and prices					
Real GDP	3.6	-1.7	1.9	0.6	-0.4
Real oil GDP	1.8	-6.5	2.3	-3.2	-8.0
Real non-oil GDP	5.2	2.2	1.8	3.4	5.0
Consumer price index	0.1	3.0	1.8	1.7	1.4
	(In percent of GDP; unless otherwise indicated)				
Financial variables 1/					
Total revenue, *of which:*	46.4	68.7	77.8	66.3	68.6
Oil and gas 2/	26.4	46.7	55.3	42.9	49.0
Investment income 2/	16.6	19.3	18.2	16.6	14.4
Total expenditure	48.7	39.5	39.2	44.8	43.2
Current	43.1	36.0	36.0	40.7	38.2
Capital	5.6	3.5	3.1	4.1	5.0
Overall fiscal balance	-2.3	29.3	38.7	21.5	24.6
Change in broad money supply (in percent)	-0.8	1.6	6.3	12.8	4.8
Interest rate (in percent) 3/	5.9	5.3	5.4	3.7	2.2
	(In millions of U.S. dollars; unless otherwise indicated)				
External sector					
Exports, f.o.b. *of which:*	9,616	12,225	19,476	16,246	15,365
Crude oil and refined products	8,470	11,027	18,184	14,976	14,058
Imports, c.i.f.	-7,715	-6,708	-6,451	-7,049	-8,118
Current account balance (deficit = -)	2,215	5,013	14,672	8,328	4,190
In percent of GDP	8.5	16.6	39.6	24.3	11.9
Central Bank of Kuwait's international reserves	4,034	4,928	7,170	9,997	9,256
In months of imports of goods and services	3.7	5.0	7.4	9.7	8.3
Real effective exchange rate (percent change)	3.1	0.9	4.2	5.1	-1.5

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

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

2/ Includes profits of public enterprises.

3/ Three–month Kuwaiti dinar deposits.