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IMPACTS OF FISCAL LEGAL SETTING AND INSTITUTIONS ON BUDGET OUTCOMES IN THE RENTIER STATE OF KUWAIT

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Working Paper No. 920

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Abstract

This study addresses the impact of the legislative setting, institutions, and political structure on the public budget in the State of Kuwait. This is an issue that has gained sizable attention, from both theoretical and empirical dimensions, in recent decades. In this respect, Kuwait represents a special case among her peers of rentier states in the GCC region because it is adopting a semi-democratic political structure, which simultaneously combines features of presidential and parliamentary systems. This structure is influenced by the prevailing interests and dynamic relationships between the limbs. The study focuses, systematically, on three thematic areas: legislative, institutional, and evolution of public revenues and public spending. Through this approach, the study attempts to dig out the effects and consequences of the institutional settings on the country's fiscal outcomes. The public budget and fiscal account data used for this purpose cover the period from FY 1970/71 to FY 2013/14.

JEL Classifications: P3, L4

Keywords: Fiscal Legal Settings, Budget Outcomes, Kuwait

ملخص

تتناول هذه الدراسة تأثير الإعداد التشريعي، والمؤسسات، والبنية السياسية على الموازنة العامة في دولة الكويت. وهذه قضية اكتسبت اهتماما لا بأس به، من الأبعاد النظرية والعملية على حد سـواء، في العقود الأخيرة. وفي هذا الصـدد، تمثل الكويت حالة خاصـة بين أقرانها من الدول الريعية في دول مجلس التعاون الخليجي لأنها اعتمدت الهيكل السياسي شبه الديمقراطي، الذي يجمع في وقت واحد ملامح النظامين الرئاسي والبرلماني. ويتأثر هذا الهيكل من قبل المصالح السائدة والعلاقات الديناميكية بين أطرافه. وتركز الدراسة، بشكل منهجي، على ثلاثة مجالات موضوعية هي: التشريعية والمؤسسية، وتطور الإيرادات العامة والإنفاق العام. من خلال هذا النهج، تحاول الدراسة الوصول من آثار وعواقب الأوضاع المؤسسية على النتائج المالية للبلاد. البيانات الميزانية وحساب المالية العامة المستخدمة لهذا الغرض تغطي الفترة من السنة المالية 1970-1971 إلى السنة المالية 14/2013.

1. Introduction

No one argues about the importance of the role played by public budget and fiscal policy in forming and directing the social, economic, and political development of modern societies, through their vital functions in resource allocation, income redistribution and their overall impact on macroeconomic variables.

Budget imbalances in many developed and developing nations, during the last four decades, became a subject of great concern to policymakers and researchers. Within the sizeable body of theoretical and empirical literature, a solid causality has been established between the quality of budget institutions in their broad sense (structures, rules, and procedures governing all phases of the budget cycle) and the quality of fiscal outcomes. These studies have covered countries with different levels of income, varied constitutional systems, and diverse geographical locations (Olden et al 2012, Dabla-Norris et al 2010, Alesina et al 1999). Hence, enhancement of a budgetary system and fiscal institutions becomes a necessary condition to improve fiscal accountability, effectiveness and outcomes (Poterba, J. and J. Hagen 1999).

This common conclusion, on the apparent positive linkage between the evolution degree of fiscal institutions and the fiscal outcomes, also applies to the resource-rich countries. According to several studies, these countries represent, to a certain extent, a distinctive case in this context. Various empirical studies have shown that resource-rich countries have a modest fiscal outcome when compared with their non-resource rich peers. A study that analyses the dimensions of public expenditure and financial accountability framework scores found that oil producing economies did not perform as well as non-resource-rich economies (Andrews 2011).

In general, most resource-based economies were found to have inefficient institutions (Karl 1997), less governance and more corruption (Auty & Gelb 2001, El Badawi 2012), less democracy and less stability (Micheal Ross 2011). Besides, the Dutch disease literature provides additional evidence on the opposite impact of the boom in a natural resource sector on non-resource tradable sectors (Ismail 2010).

Some studies have concluded that resource rich countries (and specifically oil exporters) have the weakest budget institutions along all dimensions (Dabla-Norris et al 2010). Other studies suggest that resource dependent countries have, on average, lower growth rates than resource-deprived countries and countries with a more diversified export structure (Ahmadov et al 2013, Collier and Goderis 2007).

The present study aims to examine the link between fiscal institutions and fiscal outcomes in Kuwait, which represents a unique case among the oil-rich Arab countries of the Gulf. Kuwait is unique in being the only Arab Gulf country with a directly and freely elected parliament (i.e., it has a quasi-democratic political system while sharing with its neighbors the peculiarity of hereditary rule). Kuwait is unique also for standing among her oil-rich peers as a case of extreme dissatisfaction in the field of diversification of economic activity. In spite of the fact that Kuwait is one of the luckiest among the Gulf nations for having oil wealth much earlier than other neighboring countries, latecomers such as the United Arab Emirates and Qatar have achieved better extent of diversification.

The study describes the evolution of Kuwaiti fiscal institutions since the inception of its budgetary system. Such description covers the budget cycle, the rules and procedures, and the structural setting in order to assess their effects on fiscal outcomes. In the course of the study, several issues and dilemmas are discussed. These include, but are not confined to, the instability of income, ineffective expenditure, inefficient macroeconomic management and inadequacy of fiscal rules that do not live up to the challenges faced by such a single-resource-based economy.

The fiscal outcomes are investigated by looking at the public budgets and fiscal accounts data over the period from FY 1970/71 to FY 2013/14. The employed data are generally actual accounts, while aggregate budget data has been used to compare between budgeted and actual revenues and expenses. The sources of data that have been utilized in this study include the Ministry of Finance, the Central Statistical Bureau, the Central Bank of Kuwait, the International Monetary Fund, and the UN Statistical office.

2. A Brief Overview of Kuwait

Kuwait is fairly small in terms of geographic area (17,818 Sq. km), with a population of nearly 4 million and an endowment of 7% of the world's conventional crude oil reserves. With a daily crude production of nearly 3 million barrels, the oil industry accounts for nearly 60% of the country's GDP and the oil revenue stands for more than 90% of public income.

Since its political independence in 1961, Kuwait became a constitutional emirate with a parliamentary system of government. According to the constitution, which combines aspects of both presidential and parliamentary systems of government, the Amir, which is a hereditary position in Al Sabah family, is the head of the State and appoints the prime minister. The Council of Ministers (i.e., the executive authority), is commonly selected by the Prime Minister and approved by the Amir.

Legislative power is vested in the Amir and the parliament (National Assembly), which has in addition to the 16 ministers, 50 members that are elected directly for a four-year term.[1] However, the National Assembly has never been a formal body, but rather discusses critical issues and pressures government for more transparency and accountability towards fiscal and financial matters, but at the same time calls for more oil rent distribution.

The Constitution allows for the establishment of political parties. Yet, until the present, no law has been enacted to regulate them. As a result, no political parties are operational in Kuwait in the formal sense. Nevertheless, several members of parliament, in addition to some political activists, identify themselves and function as de facto political parties on the basis of religious ground, social class or political belief.

Through public expenditures, oil revenues are injected back into the economic cycle. Over the years, increasing oil revenues, owing either to the expansion of the amount produced or the increase in the price (especially since the 1970s), have become the key source for funding the ever mounting public expenditures and a leading basis for economic activities.

Such ample revenues relative to the small number of native population have led to several folds of increases in the per capita income and in the share of oil industry of the GDP. Consequent remarkable growth in infrastructure, public services and other economic activities provided job opportunities to thousands of national and expatriate laborer, which led to a rapid growth in population. From 1964 until the present, the population of Kuwait grew by more than 25 fold.

With the absence of income taxation, public expenditure became the only tool of fiscal policy and the main instrument for macroeconomic management in Kuwait. The government of Kuwait, especially during periods of high oil prices, has been accustomed to respond positively to the parliamentary pressures and requests of different groups of interests to increase various types of consumer subsidies, on one hand, and to expand salaries and benefits of the employees of the public sector, which employs 80% of the national labor force, on the other hand. However, during periods of downturn in global demand for oil, or a sharp decline in the volatile prices of crude, such budgetary expansion is not sustainable.

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[1] Eligible voters are citizens of 21 years and older from Kuwaiti fathers or naturalized Kuwaiti citizens after 20 years of their naturalization. Judges, executives of the electoral commission, armed and police forces personnel are ineligible. Between 1962 and 2005, only men were eligible to vote. Only in 2006, and after a long battle against Islamic and conservative groups with unambiguous support of the Amir and government, have women have gained their right to vote and to run for election.

Overall, political disputes and unrest during recent years have been held responsible by the IMF and other observers for the State's underinvestment in capital infrastructure and overspending on public sector salaries and subsidies. The atest Kuwaiti budgets intend to calm unrest rather than to set Kuwait up for long-term growth. The IMF warned that such trends, if continued, are likely to put Kuwait's budget into deficit during 2017-2020. (Katzman, Kenneth 2014)

3. Legal Setting and Institutions

3.1 Brief background

The first State budget of Kuwait goes back to the year 1955. On December 11, 1954, the official gazette of Kuwait, "Al Kuwait Alyoum," published an issue, for the first time, calling on all government departments to prepare an estimated budget for the forthcoming year. But the 1955 budget, as well as the four subsequent budgets, had focused on the expenditure side only, in particular on salaries and wages of the employees and workers of the public sector, expenses of public services, purchases of goods, and construction of new buildings. During those years, the fiscal year was matching the Gregorian year.

Hence, the systematic data of Kuwait public accounts can be traced back to the early 1960s. From that time, a customary budget, but with limited classifications, has been produced. Starting from FY1965/66 budget, revenues and expenditures data became available with more detailed classifications. Between then and until FY 1977/78, revenues were first classified into 12 categories and then into 18, while expenditures were classified into four chapters and each chapter was divided into various sections.

Since then, the starting date of the fiscal year has been altered three times. The 1959 budget had covered 15 months due to the amendment of the beginning of the fiscal year from January to April as of FY 1960/61. Thereafter, Decree law no. 31 of 1978 has altered the start of the fiscal year to July 1. But once again, from FY 2001/02, the starting date has been adjusted to April 1, and thus the budget of that year was shortened to nine months only.

3.2 Basic budget laws and legislations

The initial rules for public budget preparation, execution, and closing account of Kuwait were set by the Amiri Decree No. 1 in the early days of 1960. The Decree contained guidelines for the estimation of public revenues and expenditures, procedures of budget acceptance and approval, and closing account. The Decree called for the allocation of specific ratio of total revenues to be added to the public reserve fund, allocation of another amount of total revenues for productive projects and construction. As per this Decree, the fiscal year had been altered to commence on 1st of April and conclude on 31st of March of the subsequent year. All government departments were instructed to complete their budget estimates by December of the preceding year (Amiri Decree No. 1, 1960).

In 1964, in compliance with the constitutional provision, law 30 on the establishment of the State Audit Bureau (hereafter referred to as SAB) was issued. The Bureau has been empowered to examine the adequacy of the regulations and methods adopted for the safeguarding of public funds and prevention of their abuse. SAB has been authorized to control all public revenues and to carry out control over expenditures before and after transactions.

In 1978, Decree No. 31 for "the Regulations for the Preparation of the Public Budget, Control of Implementation, and the Closing Account" represents a remarkable improvement in the regulation of the Kuwait's public budgeting process. It has been the first comprehensive and detailed act for the budgetary system in Kuwait. Such Decree empowers the minister of finance to determine and enforce the budget structure of all ministries, government departments, public authorities with supplementary budgets, and autonomous public institutions with independent budgets. Each of these entities must adhere to the minister's instructions when preparing its own estimates of revenues and expenditures. This Decree, which reinforce the centralization of the budget system, called for the adoption of modern budgetary measures and the observation of requirements of the socio-economic development plans when determining the budget structure. The fiscal year had been altered by this Decree to commence on July 1 and conclude on June 31 of the succeeding year. But again, from FY 2001/02 the start of budget has been re-adjusted to return to 1st April as a starting point.

In 2001, a new article was added to Decree 31 of 1978 to empower the minister of finance to appoint financial controllers and chief accountants in every ministry, department, and authority to check on its level of proficiency during the preparation of its own budget estimates (Law 55, 2001).

3.3 Budget preparation

As established by Decree law no. 31 of 1978, the first step of the budget preparation starts with the formation the **Budget Committee** by the minister of finance. The committee is chaired by the minister and comprises representatives of the Civil Service Commission (CSC) and the General Secretariat of the Supreme Council for Planning and Development (GSSCPD). The committee is entitled to define guidelines of the draft budget, specify methods for the estimate of revenues and expenses, and to determine the financial policies that should be followed by all public entities during the preparation of their respective draft budgets. The preparation process begins in June of each year with the issuance of **MOF circular** of rules and standards that must be followed during the estimation of revenues and expenses. It also includes detailed explanatory tables and necessary forms for the preparation of such estimates.

Each public entity forms its own **sub-committee**, which must include MOF representative, to prepare its draft budget. A circular is then sent to all work-centers within each public entity. Such a circular contains the ministry's instructions regarding the preparation of the draft budget and tables and forms that need to be filled up to reflect the needs of each work center classified by each chapter of expenses. The estimated expenses of each work center are then added up and grouped on chapter level and entity level. The main table and explanatory tables are then filled in and submitted along with a comprehensive explanatory memorandum on the draft budget.

3.4 Budget estimation methods

Since the early sixties, the process of estimating public revenues and public expenditures has evolved and became subject to a central authority and unified prime law and consistent procedures. However, this process is still simple and lacks certain degree of accuracy.

3.5 Estimation of public revenues

In estimating public revenues and public expenditures the MOF, in cooperation with few other relevant government institutions, has used and still is using some simple methods and techniques. Since March 1975, when the government completed its control of the oil production, estimate of oil revenues, which constitutes the bulk of public income, has been based upon the below method.

As a member of the Organization of the Petroleum Exporting Countries (OPEC), Kuwait must abide by the daily limit of crude output that is established for Kuwait by the OPEC quota system. Such daily limit is used as a base for estimating the country's level of oil production in a coming fiscal year [2] (Sandrea 2003).

[2] In response to the high oil prices of the 1970s, consuming nations took steps to reduce dependence on oil. Consequently, demand for oil dropped while oil production outside of OPEC rose. OPEC market share fell from 50% to 29%. The result was a sharp drop in the crude price, and thus OPEC agreed to establish the quota in order to combat such fall.

Because it is almost impossible to accurately forecast the price of oil per barrel during a coming year, when the draft budget is prepared, the MOF supreme budget committee in collaboration with the Ministry of Oil and the Kuwait Petroleum Corporation chooses a precautious price of oil that is lower than the prevailing price in the global market. The level of such precautious price changes along with the general trend of crude oil prices in the global market. However, this price is generally determined by the value judgment of the personnel of the above mentioned committee and government departments.

It is also difficult to estimate an accurate exchange rate for the national currency (i.e., the Kuwaiti dinar (KD), against the U.S. dollar, which is the international currency for settling oil sales). In general, the value of the Kuwaiti currency is largely linked to the U.S. dollar because the KD exchange rate is based upon a basket of currency that is heavily loaded by U.S. dollars (Marzovilla & Mele 2010). The Central Bank of Kuwait usually supplies the MOF with the estimate of future exchange rate to be used in the budget draft. The product of the above three variables (output, price, and exchange rate) is then multiplied by the number of days in a Gregorian year (i.e., 365 days, except for the leap year which has 366 days).

In accordance with provisions of the Decree issued in January 1981, the cost of crude production must be deducted from the estimates of oil revenues. In FY 2005/06 budget, the total of such cost was estimated at 608.3 million KD. It is worth to note that the cost of production of Kuwait crude oil has been distinctly increasing in recent years owing to extensive boost in compensations and allowances paid to the staff of oil industry in 2011.

In general, the precautious price of oil chosen by MOF, in most of the years, was well below the actual price level in the global market. For example, in FY 2000/2001, this price was $13 per barrel although the average Brent crude price was $26.47. In FY 2004/2005, this price was $15 against $46.39. In FY 2005/2006, it was $21 against $59.83. In FY 2007/2008, it was $36 against $84.82, whereas in FY 2011/2012, it was $60 against $111.46.[3]

The estimate of non-oil revenues, on the other hand, should take into account the nature and type of each source of income. Among the other considerations, the estimate should match the actual revenue that has been realized of the same public good or service during the past three years; and should consider the growth rates of the number of transactions or number of end users of the considered public good or service. All newly imposed duties or changes in the rate of existing duties, by laws or by resolutions of the competent authority, should also be considered during the process of estimation. In addition, specific considerations that are relevant to each authority should also be taken into account.

3.6 Estimation of public expenditures

In principle, estimates of public budget expenses for a forthcoming fiscal year should take into account the country's economic and social development plan for that year. In accordance with the law, the public budget should closely match the first year of a five-year development plan. Nevertheless, Kuwait has a poor record when it comes to approval and execution of plans. Out of eight development plans, only one (the plan of 1986) was implemented and another one (2011) was approved but not executed. [4]

However, estimates of budgetary expenses should include all eminent liabilities arise from the execution of all issued laws and orders, as well as all contracts and agreements signed between

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[3] Prices of Brent crude are based on BP Statistical Review of World Energy, 2013.

[4] Most of the successive development plans in Kuwait have encountered harsh opposition from the consecutive parliaments, either because of disagreement with some of its programs, or the lack of necessary legislative bases for the implementation of such programs. The 1986 plan was implemented by the government, following the dissolution of the National Assembly and the suspension of some articles of the Constitution, as a compensation for such exceptional measures. The 2011 plan, on the other hand, was endorsed but not implemented due to the inaccuracy of the plan's preparation, political tensions, and disagreement on the mechanism of projects financing.

any state entity with suppliers of commodities or contractors for provision of services or works. They should also include expenses of new projects or services and expansion or improvement of existing services and works.

The cost of commodity requirements (known as stock materials) should also be part of the estimated expenses. The estimation of such materials should be based on and supported by public warehousing bills. Each public entity shall form a committee to prepare warehousing measurements and need. The warehousing bill should cover items with less than one-year of working life (consumable goods and materials), durable goods and materials and spare parts with more than one year of working life, non-staff food and uniforms such as meals and uniforms supplied to students and patients in hospitals and care centers, etc., and staff food and uniforms such as those provided to police, national guards, military personnel, physicians, nurses, fire fighters, municipality workers …., etc.

3.7 Accuracy of revenue estimation

During the past 45 years, actual public revenues in Kuwait have been increasing without interruption. Aside from two major fiscal contracts - one was during the 1980s following the 1986 oil price collapse and another during the late 1990s Asian crisis - estimates of revenue in Kuwait have, in most years, been falling well below the actual ones due to the highly cautionary level of the price of oil.[5]

Figures (1) and (2) show the difference between budgeted and actual public revenues, in million KD, during two periods of time. The first Figure covers FY 1970/71 until FY 1989/90 while the second Figure starts with FY 1992/93 until FY 2013/14. These two Figures mirror the highly conservative estimates of revenue during years of oil price rises and highly positive estimates during years of price contraction. This shows either lack of proper mechanism to forecast the future oil price movement, or that the government has a deliberate over-precautionary strategy during times of oil price rises and eagerness to send positive signals during times of oil price decline.

At any rate, the large divergence between actual and budget revenues is clearly related to the change in oil prices. Figure (3) illustrates the relationships between such divergence and the changes in the price of oil from FY 1972/73 to FY 2013/14.[6]

3.8 Accuracy of expenditures estimation

Every year, at the start of the budget preparation process, MOF instructs all government departments to be more careful in estimating their expenses and their funding requirements, to act in accordance with the terms and guidelines of public budget preparation, and to fully observe the past year comments and observations of SAB and the National Assembly. Nevertheless, differences between budget and actual expenditure have been always there.

In recent years, the divergence between budget and actual public expenditures has been reaching almost a ceiling of 2 billion KWD. Figure (4) shows the difference between the actual and budget expenditure in percentage and not in value in two periods of time, the first from FY 1970/71 to FY 1979/80 and the second period from FY 1980/81 to FY 2013/14. As can be observed from the Figure, during most years of the seventies decade, and due to the large increase in revenues and the subsequent fiscal expansion, actual spending has been much higher than the budgeted one. On the contrary, during the eighties, as the price of oil declined and Kuwait had experienced different setbacks, actual spending became less than the budgeted one. After 1990 and until the present, subordinate levels of spending developed as customary

[5] Note that years following the 1990 Iraqi invasion of Kuwait are not included in this analysis because of their abnormality.

[6] The time difference between the revenue data, which is recorded per fiscal year (which starts in April), and the prices of oil (which are recorded per calendar year) functions as a required time lag between these two sets of data.

practice in most government departments. In many cases, such overestimate of public expenditure is an indicator of poor public management and lack of capacity in executing plans and projects. However, various public offices claim that power overlapping between different government departments and the slow mechanism at the legislative authority are somewhat responsible for such difference between budget and actual spending.

3.9 Rules of budget execution

The budget execution starts with the notification by the minister of finance to all ministries and government departments of the budget law. Similarly, the minister notifies all subsidiary and autonomous institutions of their budget laws along with their respective specific execution rules.

During the budget execution process, public entities are requested to adhere to certain basic rules such as: cutting back and rationalization of public expenditure; elimination of wasteful spending; expansion of revenues; avoidance of allocation of public revenues for a specific type of expenditure without a law (Article 141 of the Constitution); avoidance of clearing between State revenues and expenses; and revenues must be collected on time and then transferred to the MOF account at the Central Bank of Kuwait in line with MOF instructions.

Rules to be followed on the **provisions of commitment** include: avoidance of commitments toward works, services or purchases of materials in the latter months of the fiscal year with the intention of expending the remaining balances of financial appropriations; and each budgetary appropriation not spent or decided to be spent within the fiscal year shall be void and forwarded to trust accounts.

With regards to **the contract**, the following basic rules have to be considered: (A) avoidance of contracts that result in financial liabilities extending to next fiscal year, unless the law provides for an appropriation for this purpose for more than a year. However, contracts of renting, maintenance and frequent supplies can be extended to 3 years. (B) Avoidance of importing items or recruiting contractors to carry out works without a public tender through the Central Tenders Committee if the contract amount exceeds 5000 KD, subject to other provisions of law 37 of 1964 regarding public tenders and its amendments. (C) Avoidance of any contract of value exceeding 75000 KD without the approval of the Fatwa and Legislation Department. And (D) all public tenders, binding arrangements, contracts or agreement amounting to 100,000 KD or more are subject to the prior control of State Audit Bureau.

Concerning the **expenditure by government departments,** the following rule have to be observed: (A) No appropriation may be spent for any purpose other than its respective purpose. Debit shall be made only on the respective specified program, chapter, item or kind. (B) All government bodies should strictly apply the provisions of applicable laws, orders and circulars with respect to the application of financial appropriations. (C) Each fiscal year shall be debited with its respective expenses so that the closing account would truly reflect the expenses of the designated fiscal year. And (D) no government authority may expend amounts exceeding its balance with the Central Bank of Kuwait or local or international commercial banks.

In the case of **additional or transferred appropriations:** the following rules have to be observed (A) any expenditure not included in the budget or exceeding the budgetary estimates should be made under a law. This rule also applies to the transfer of any amount from one budget’s chapter to another (Article 146 of the Constitution); (B) the maximum limit of expenditure estimates stated in the budget law and its amending laws cannot be exceeded by any means (Article 147 of the Constitution); (C) swapping between budgetary programs and items is subject to the provisions of the MOF circular no. 2 of 1992 concerning the interchange between budgetary items and programs. A government authority may interchange between items without the consent of MOF and in accordance to the said circular; and (D) the budget implementation rules include some specific rules related to different chapters of expenses, accounts, records, procurement and storage.

Additionally, **procurement and storage** are carried out (in terms of management, organization, supply, distribution, issue, control, design of stores, arrangement of assets and specification of all relevant records and papers) in accordance with the instructions and circulars issued by the MOF Storage and Procurement Affairs Sector.

3.10 Budget approval

The draft budget, once completed, is sent to the Council of Ministers to be transferred to the ministerial economic committee, which is headed by the minister of finance and comprised of ministers concerned with trade, industry, planning, development and labor affairs in addition to the governor of the Central Bank for review and examination. Subsequently, the minister of finance shall explain the bases, components, programs and projects proposed by the draft budget to the Cabinet and show them the basis of the estimation of revenues and expenditures. If approved by the Cabinet, the draft budget is then referred to the National Assembly in accordance with the constitutional time limit (i.e., two months before the end of the current fiscal year).

The Parliamentary Committee for Budgets and Closing account shall then review the draft budget and report its observations. During the process of assessment, the committee meets with MOF officials to discuss their remarks on the draft budget. The Salaries are discussed in a special meeting with officials of the Civil Service Commission, while estimates of construction and maintenance projects are discussed with officials of the General Secretariat of the Supreme Council for Planning and Development. Representatives of subsidiary and autonomous institutions along with MOF officials are usually invited to discuss issues concerning their respective budgets.

Before the vote at the National Assembly, the MPs meet to discuss the draft budget chapter by chapter. Once the draft is approved it becomes a law. Then the Cabinet is requested to present the law to the Amir for sanction thereof. Following the Amir’s endorsement, the public budget is promulgated. Similar procedures are followed with budgets of every subsidiary as well as autonomous institution.

3.11 Budget control

There are four major objectives for the budget control as follows:

1. The verification of the integrity and accuracy of financial and accounting operations from textual and calculation aspects.
2. Checking the degree of government authority’s compliance with the estimated appropriations and the extent of their application of relevant laws, regulations and financial and administrative instructions.
3. Finding out the extent of the government’s success in achieving the objectives stated in the government action plan, which had been submitted to the legislative power.
4. To review, evaluate and measure the impact of the budget implementation on the levels and trends of economic activities.

The types of budget control can be looked at on basis of the control nature (accounting, economic and administrative) as follows:

a. Accounting Control: This is done through the review and verification of the procedures and accounting directives and the accuracy of figures contained in the supplied forms and tables, the review of supporting documents of each transaction and the completion of all essential information and formalities, and the verification of accuracy of figures stated in records, books, monthly and quarterly statements, closing accounts, balances and financial reports.

b. Economic Control: The economic control is concerned with measuring the efficiency and the effectiveness of the implementation of government programs, projects and works within the specified limits and times. It is also concerned about the economic and social impacts of the budget. This, however, necessitates economic based categorization of expenses between current and capital expenses. For this purpose, a program budget method should also be applied where the budget is divided into programs of specific quantitative and measurable objectives. In application, it was too hard to implement such objectives accurately and efficiently in the case of Kuwait, and for this reason, Kuwait has abandoned an attempt to implement a proposed budget of programs and performance.
c. Administrative Control: This control is carried through continuous review of the administrative regulations and rules, introduction of necessary amendments thereto in light of decisions of Civil Service Commission and new legal, financial and economic development.

Alternatively, budget control can be looked at on basis of the time of control (pre-execution control, control throughout the fiscal year, and post execution control).

3.11.1 Pre- execution control

This type of control requires approval of respective authorities. Provisions of law no. 30 of 1964 concerning SAB provides that tenders of public works and supplies, as well as each draft commitment, contract or agreement are subject to the prior control of SAB if the value of each is equal or exceeds 100,000 KD. Decree no. 12 of 1960 concerning the Fatwa and Legislation Department (FLD) provides that any contract with value of 75,000 KD cannot be made or approved, except after referral thereof to FLD. Pre-execution control is intended to verify that any major financial act is in compliance with the budgetary objectives and goals and within the appropriation limits. Such control may include examination of payment vouchers prior to actual payment. This is performed by internal audit, as well as by the financial controller and the chief accountant that represents MOF in each public entity.

3.11.2 Control throughout fiscal year

During the fiscal year, control is exercised by the MOF Department of Public Accounting Affairs by examination of monthly and quarterly financial statements and reports received from various public entities to monitor deviations or inappropriate actions. Control is also practiced through the appointed financial comptrollers and chief accountants in every public entity. In light of practical experience, and disputes between government departments and authorities on one side and comptrollers and accountants on the other side, functions and authority of the latter have been redefined by MOF in year 2000.[7]

In order to improve their control, financial comptrollers have been authorized to verify advance commitment for ensuring that no expenditure has exceeded its budgetary allocation; verify collection and deposit of revenues in accordance with laws and instructions; review the accounting books and records for regular posting; and examine internal control regulations and their efficiency to tightly control the financial transactions.

The mechanism of financial comptrollers and chief accountants applies to all ministries, departments and subsidiary authorities. Since 2001, this mechanism has been extended to cover autonomous institutions (Law 55 of 2001).

[7] MOF revoked the ministerial decision no. 30 of 1993 and replaced it with decision no. 10 of 2000.

3.11.3 Post-execution control

In case of revenues, post-execution control intends to ensure that revenues are collected in accordance with the provisions of laws and instructions and deposited into the treasury or bank. In case of expenses, this control intends to verify that payment was made in line with the related instructions and within the stipulated appropriation limits and that all supporting payment documents are valid. Post-execution control is a detector of actual errors or violations. It is performed by SAB through its inspectors in all State ministries, departments, subsidiary and autonomous institutions, and companies with 25% or higher of government possession.[8]

3.12 Closing account

In line with provisions of Decree law no. 31 of 1978; the MOF sets the rules for the preparation of the closing account by each government entity. The reported revenues and expenses in closing account are confined to the actual amounts collected or spent during the fiscal year. Actual expenditure shall virtually include the dues payable for all completed work or delivered materials during the fiscal year, even if the payment procedure is not completed by the end of that year. Prior to closing, unpaid dues or liabilities must be forwarded to a trust account.

Adjustments to any budget, such as swapping between items and programs, transferring from supplementary appropriation, or adding extra appropriations must be executed before the end of fiscal year, in accordance with the laws, rules and regulatory instructions. Budget appropriations, stated in computerized closing account, must be reviewed and checked to ensure compliance with the approved budget.

Closing account must include inventories of cash in hand; fiscal stamps; postal stamps; magnetic cards; and checks in the process of collection. Cash balances of respective authority's accounts with the Central Bank of Kuwait or commercial banks must also be stated. Similarly, the closing account must include all cash assets of stores, goods and materials in custody, transports, as well as real estate (lands and buildings).

Along with the closing account, a comprehensive explanatory memo must be prepared. Such memo contains realized and non-realized objectives (with respective causes), new developments that occurred after the approval of the budget and the impact thereof on budget execution. It should also include reasons of increase or decrease in comparison with the previous fiscal year, as well as reasons for the difference between budget and actual revenues and expenses.

Every closing account must be examined and reviewed by the respective MOF technical representative, and approved either by the head of the respective authority or his lieutenant, in addition to the financial controller and chief accountant. All closing Accounts must be forwarded to MOF within forty days of the fiscal year end.

Subsequently, the minister of finance is responsible for the preparation of the closing account of the State's finance administration along with a report that reflects the true fiscal position of the State during the expired fiscal year. The closing account, along with the report, is then submitted to the Cabinet and next to the National Assembly, within the four months constitutional period.

4. The Political Structure

Reform of budgetary legal setting and institutions is closely related to the development of political and economic institutions.[9] Thus, it is highly important to examine the role of the political and economic institutional structures that affect the fiscal system and hence the fiscal

[8] Source: Law no. 30 of 1964 and its amendment by law no. 1 of 1993 regarding the protection of public funds.

[9] Allen, R. (2009) refers to these institutions as described by North, Wallis, and Weingast (2006), drawing on the seminal work of North (1991).

outcomes. The structure of political and economic institutions, especially in a small country with semi-democratic system, such as Kuwait, would be certainly influenced by the nature of its social relationships and societal structure. Consequently, the impact of the political structure on the state's fiscal policy reflects, in turn, the effect of the society structure as well.

Besides, the public administration in Kuwait, as in many other developing countries, is in need of expertise and guidance of international organizations such as the IMF and the World Bank to develop their emerging public finance system. This represents an additional source of effect in this course of fiscal system evolution. Based on these grounds, the present section considers the role of the following effective political and economic organizations in the budgetary system of Kuwait: the Council of Ministers, the National Assembly, the State Audit Bureau, the Kuwait Investment Authority, and last but not least the IMF and the World Bank.

4.1 Council of Ministers

To a large extent, the formation of the Council of Ministers in Kuwait reflects an apparent pattern of distribution of power between the ruling family and the financially powerful merchants who are seen as historical allies to the former. Besides the prime minister position, the ruling family holds the sovereign ministries (foreign affairs, defense, and interior). However, over the years, influential components of the relatively powerful parliament (liberals, Islamists and tribes) have affected this formation. Non-ruling family members have been appointed to effective ministerial positions, which had been previously perceived as sovereign positions, such as finance, media, and labor. During the past four decades, Cabinet members have been chosen to reflect the unstable balance of power within the society. Yet, with the outstanding authority, which remains in the hand of the ruling family and influential business community, it is not expected to experience a drastic change in the pattern of wealth or rent distribution away from its historical course.

Through policies, plans, resolutions, regulations, and enforcement of laws, the Council of Ministers plays an effective key role in directing the public budget towards expansion or contraction. Like many other developing countries, where transparency and accountability are weak, it is not easy to control or to prevent every minister from exploiting his position for his own interests. Each minister has some room to influence Cabinet decisions or to campaign for a specific resolution, which may require additional funding.

Usually, ministers are authorized to appoint new staff, determine compensation and bonuses, select members of delegations, and spend on non-recurrent activities. Over the years, a number of ministers' irregularities have been published in local media, including cases of unlawful promotions of staff, employment of relatives or close links, and illegal allowances. Some MPs exercise pressure on ministers to approve their electors' transactions and requests. In some cases, ministers were blackmailed through threats of interrogation.

The Council of Ministers is, constitutionally, empowered to introduce and approve necessary key adjustments in the draft budget whenever national public interest requires such interference. For example, on September 2007, the government augmented expenditures estimated for the fifth chapter, namely "Miscellaneous Expenses and Transfer Payments" in FY 2008/09 draft budget by nearly 6.3 billion KD (i.e., 137.3% more than the appropriations of the preceding year) in order to pay, over a period of two years, the actuarial deficit in the third chapter fund for social security payments which was estimated at 10.9 billion KD.

When the draft budget is received by the government, the ministerial financial and economic committee, which is headed by the minister of finance and comprised of all ministries of economic affairs (trade, planning, and labor), in addition to the CBK governor examines the draft budget on behalf of the Cabinet. Thereafter, the minister of finance presents and explains the draft's components and basis to the Council of Ministers, showing all works and projects proposed for execution in the new fiscal year and the estimated balance (deficit or surplus). The Cabinet has the right to approve or disapprove the draft. If approved, the draft budget is referred to the National Assembly for review and endorsement, in accordance with article 140 of the Constitution, at least two months before the fiscal year end.

4.2 The National Assembly

The National Assembly exercises a significant role in the budget cycle through its supervision and control of budget implementation to specifically make sure that no amount is transferred from one chapter to another without a law, and that each expense that is non-budgetary or exceeds the relevant estimates shall be under a law as per Article 146 of the Constitution .

As well, the National Assembly members practice their control on budget execution by raising pertinent questions to ministers, and by discussing the closing account of the State finance administration as well as the closing accounts of supplementary and autonomous authorities prior to the approval of the closing account by a law.

The National Assembly committee of budget and closing account regularly reviews and reports its observations and proposes amendments to the draft law. As regards the ministries and government authorities' budgets, the committee invites MOF officials to discuss observations on the draft budget. In addition, officials of Civil Service Commission are also invited to discuss comments concerning the first chapter of the public budget, "Salaries and Wages," and officials of the Supreme discuss estimates of construction and maintenance projects. No other government authorities are invited for this purpose except when necessary. However, during the review process of draft budgets of supplementary and autonomous institutions, the committee usually invites MOF officials as well as officials of respective institutions.

As called for by Article 141 of the Constitution, the National Assembly shall then discuss the budget draft on a chapter-by-chapter basis. After discussion, the National Assembly votes on each budget's chapter for approval before voting on the budget as a whole. Upon the National Assembly approval of the budget law, the Council of Ministers is addressed to present the law to the Amir for endorsement thereof. Following the Amir's endorsement, the public budget is promulgated. The same procedures are applicable to the budgets of supplementary and independent institutions, as well as when requesting extra fund or transferring a fiscal appropriation from one chapter to another.

If the budget law has not been promulgated before the start of the fiscal year, the previous budget shall apply until the promulgation of the new budget. Nevertheless, in accordance with Article 145 of the Constitution and Article 16 of Decree law 31 of 1978, if the National Assembly has already approved some of the budget's chapters, such chapters become executable.

Furthermore, the National Assembly exercises a significant role in the budget cycle through its supervision and control on budget execution to specifically make sure that no amount is transferred from one chapter to another without a law, and that each expense that is non-budgetary or exceeds the relevant estimates shall be under a law as per Article 146 of the Constitution.

As well, the National Assembly members practice their control on budget implementation by raising pertinent questions to ministers, and by discussing the closing account of the State finance administration as well as the closing accounts of subsidiary and independent authorities prior to the approval of the closing account by a law.

The active role played, over many years, by members of the National Assembly through political interrogations of ministers as regards administrative and financial corruption allegations helped in improving the degree of transparency and control over contracting and spending of public fund. Different ministers of finance along with other ministers have been interrogated on claims related to mishandling of budget allocations, misplacement of public funds and financial corruption in general. Interrogation of Cabinet ministers can lead to their impeachment in a no confidence vote. In many previous cases, the government had managed to avoid such votes by cabinet resignation, reshuffling or as a result of dissolving the parliament.

Over the years, the parliament has played a prominent and critical role in the development of the country's public finances, which has affected the growth rates of both public revenues and public expenditures. During the sixties, when the National Assembly was under an apparent influence of the merchant class, four vigorous members of well-known merchant families had been elected to chair the parliament. All the four heads of the National Assembly during the sixties were prominent members in the Kuwait Chamber of Commerce and Industry. These four were Abdullatif Mohammed Thunayan Al-Ghanim (1962-1963), Abdulaziz Hamad Al-Sager (1963-1965), Saud Abdulaziz Al-Abdulrazzaq (1965-1967), and Ahmed Zaid Al-Serhan (1967-1971).[10] Much of approved legislation during that period of time has led to the widening of the channels of the oil rent distribution, and thus led to enormous fiscal expansion. Among the laws that issued in the sixties are those that provided the business community with their needs of state land at nominal prices, credits at low interest rates, cheap power, fuel and water, low custom duties, tax exemption, and a protection shield from foreign competition.

In 1971, during the third parliament, the nationalist-leftist bloc that was comprised of six MPs led by Ahmed Al Khatib, one of the founding leaders of the Arab Nationalist Movement[11], has campaigned against the deal reached between the Saudi oil minister, on behalf of the Gulf oil producers, and the foreign oil companies. The deal provides the Gulf governments a 25% share in their oil production. This share was supposed to rise steadily by 5% per year until it reaches 51% in 1981. The bloc succeeded in getting the parliament support to reject this deal.

The bloc won again in early 1974 when they convinced the parliament to turn down the new participation agreement, which stipulated the sale of 60% of the Kuwait Oil Company (owned then by BP and the American Gulf Oil) to the Kuwaiti government. They demanded that the State should control all the company immediately. This goal had been achieved on March 1975 after long and hostile negotiation between the government and KOC (Hiro 1982; Marcel & Mitchell 2006).

In the early seventies, BP and Gulf Oil had appeared as being interested in rapid production of Kuwaiti crude oil. They used to pump crude oil at increasing rates. BP has estimated the Kuwaiti crude peak production in 1972 at 3.34 million barrels a day, while KOC believe that this figure has reached as high as 3.7 million barrels a day (BP Statistical Review of World Energy 2014). This had occurred at a time when the parliament was playing a crucial role in influencing government economic and political decisions. Hence, after the 1973 quadruple increase in the oil price, and because of the country's limited absorptive capacity, the parliamentary nationalist bloc has succeeded in passing a proposal to cut the Kuwaiti crude oil production to half, and thus reducing the public revenues as well as the potential additions to the general reserve fund.

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[10] Al-Ghanim was managing his family trade since 1932. Al-Sager was a top merchant of dates since the 1930s and had contributed to the establishment of many large companies in Kuwait during the 1950s including the National Bank, Kuwait Airways, Cinema Co., and the Oil Tankers. He was among the founders of the Chamber of Commerce and Industry in 1959 which he chaired for a period of 36 years. Saud Al-Abdulrazzaq belongs to an active merchant family. Ahmed Zaid Al-Serhan was, since the 1940s a merchant, in the trade of gold, clothing, and food.

[11] The Arab Nationalist Movement has been a revolutionary pan-Arabist youth society. It placed emphasis on the formation of a nationally conscious intellectual elite, which would play a vanguard role in a revolution of Arab consciousness, leading to Arab unity and social progress. Ideologically, it was committed to socialism and secularism, and was thus hostile to Western hegemony.

In recent years, the active parliamentary opposition bloc that is comprised of Islamists group in alignment with tribal opposition and in collaboration with various groups of interests outside the parliament have managed to pressure the government to provide significant increases in salaries, fringe benefits, additional social support and subsidies. The result was a massive increase in current public spending on salaries as well as on transfer payments and subsidies, which represent the bulk of the fifth chapter components of the budget expenditures.

On different junctures, increasing tensions between the legislative and executive authorities led to the parliament's dissolution and in two occasions to partial suspension of the constitution. In 1976, the parliament, along with some constitutional articles, was suspended and new elections were held only in 1981. Once again, the 1985 parliament was suspended in 1986. Following weekly large protests, the parliament was replaced in 1990 by an unconstitutional "National Council."[12] Most previous MPs and Kuwaiti active groups rejected the new council and boycotted the elections. During the seven months of the Iraqi invasion of Kuwait, the government promised to restore the constitutional order and hence an election for a new National Assembly was held in 1992. However, on May 4, 1999, the National Assembly has been dissolved, but this time as well as in subsequent times through constitutional means.

For eight consequent years, from 2006 to 2013, the government's confrontation with the parliament, which was pushing for greater power, led to six early parliamentary elections and eight cabinet formations. The opposition, which was benefiting from the electoral law of four votes per voter, has gained more seats in the parliament. On May 2013, the Amir issued the decree of "one-person one-vote". The change has been protested by the opposition and the July 2013 election witnessed a large boycott by the Islamists along with other political factions and some tribal leaders, who dominate two out of the five electoral districts. The biggest winners in this election were the independent middle class, liberals, and some marginalized tribe[13] (Katzman and Kenneth 2013).

4.3 State Audit Bureau (SAB)

The State Audit Bureau (SAB) exercises another significant role in the process of budget control. This Bureau has been established on July 7, 1964, in compliance with article 151 of the Constitution. SAB is an independent authority, even though it is subordinated to the National Assembly.[14] However, the Bureau subordination to the parliament is related to its broad role in the public fund protection area. SAB also supports the government in controlling public revenues collection and payment of expenditures within the budgetary limits.

SAB is headed by a president appointed by Amiri Decree upon nomination by the Speaker of the National Assembly and approval of the Assembly in a secret session, along with the backing of the Council of Ministers. The President of SAB cannot be ousted except by the approval of the majority of the National Assembly members or by the order of the competent disciplinary authorities.

The Bureau is entitled to exercise its control before and after expenditures in all government and public entities. Companies and enterprises in which the State or any other public legal entity hold a share of not less than 50% of their capital or guarantees them a minimum profit are also subject to the financial control of SAB.

[12] The National Council elections were held in Kuwait on June 10, 1990. The Council (which only half of its members were elected) was created by the Amir in an attempt to calm down protestors.

[13] In the July 2013 election, the Shia sect, who tend to support the government, had gained eight seats while the Salaf, which is a fundamentalist Islamists group, but smaller and less confrontational than the Muslim Brotherhood movement, won three seats.

[14] During periods of parliamentary suspension, SAB shall be subordinated to the Council of Ministers, according to the constitution.

SAB prepares an annual report on the closing accounts of all public entities subject to its financial control showing all violations, observations, and points of disagreement between the Bureau and these entities. At the beginning of each ordinary session of the National Assembly, this report is presented to the Amir, National Assembly, Council of Ministers and MOF. During the year, SAB may present other reports on specific financial matters that SAB, the parliament or the Council of Ministers believes of its significance and serious urgency.

SAB is also entitled to examine methods of the State funds investment, check the accounts of such investments and make any observations in this respect. In addition, tenders of supplies and public works with value of 100,000 KD or higher are subject to prior control by SAB. No public entity is allowed to contract or offer commitment to suppliers or contractors without a prior permission of SAB.

In the case of State's secret expenditures, it shall be sufficient for the minister concerned to sign a declaration, every three months, containing a statement of the amount spent during such period of time and the purposes it was allocated for. Such confidential declaration is submitted to SAB president within ten days from the end of the period covered by the declaration and shall be kept by SAB president.

SAP annual reports are commonly overflowed by hundreds of violations and abuses carried out by various government and public entities. Usually, the National Assembly assigns issues of irregularities or abuses to its respective committees or forms an ad-hoc committee to investigate these violations or request correction of errors by respective entities. In certain cases, the parliament transfers the violations to the public prosecution office. For instance, the 2011 violations in abroad medical treatment by three ministries (health, interior, and defense) had been transferred to prosecution.[15] An example of recent concern in a SAB report is the delay in executing development projects that were declared by previous budgets and its negative impact on the country's economic objectives.[16]

Most observations of SAB concerning the irregularities and violations of public final accounts are not presented for a systematic extensive discussion in the National Assembly. Further, the concerned ministers are not questioned or held accountable for such violations in the presence of SAB representatives, despite the fact that Article 84 of Law no 30 of 1964 regarding SAB formation allows the parliament to invite the Bureau to clarify and discuss irregularities documented in the report. Besides, the lack of clear and effective mechanism of disciplinary trials of employees responsible for violations has led to continuous repetition of same financial irregularities year after year.

4.4 Kuwait Investment Authority (KIA)

The Kuwait Investment Authority (KIA) has an indispensable budgetary linkage through its employment and control of the nation's public reserves. KIA has been created by Law no. 47 in 1982 to be responsible for the management of the Country's General Reserve Fund (GRF), Future Generations Fund (FGF), as well as all other funds entrusted to it by the Minister of Finance for and on behalf of the State.

Prior to KIA founding, unspent oil revenues used to be managed by the Kuwait Investment Office (KIO), which was established and based in London since 1952. KIO was staffed with experienced British investment counselors who guided the government's placement of funds. As a result of the vastly expanded oil revenues of the 1970s, Kuwait's overseas investment program grew tremendously. In 1976 the government launched FGF with 50% of the GRF

[15] AlAnbaa Daily, 12 June 2011.

[16] A press release by SAP Chairman Abdulaziz Al-Adsani on SAP annual report regarding the FY 2013-2014 public budgets of government and public authorities, Kuna, 25 October, 2014.

balance. In addition, 10% of all State revenues, including 10% of the net income of GRF, are transferred to the FGF annually.[17]

The GRF consists of investments in Kuwait and other MENA countries as well as hard currencies held by KIA on behalf of the government. The GRF also holds other government assets, including the State contribution in domestic public enterprises, multilateral and international organizations. Investments of FGF, on the other hand, are outside of Kuwait and MENA region. FGF investments are allocated among various asset classes and varied types of fixed Income assets in different regions of the world. According to some estimates, the bulk of FGF is invested in the United States, Germany, the United Kingdom, France, Japan, and South East Asia. In order of importance, foreign assets are believed to consist of stocks, bonds, fixed yield instruments (mostly short term), and real estate. According to KIA, the balanced distribution is skewed due to certain core holdings, as with the KIA's investments in BP and Daimler AG.

Besides, to meet any unexpected short fall in oil revenues, due to oil price volatility, GRF has created two specific portfolios to meet any unexpected shortfalls: Liquidity Fund Portfolio and Stabilization Fund Portfolio.

During the period of the Iraqi invasion (August 1990 – February 1991), all international assets of Kuwait were frozen. Thus, KIO became the only source of funds for the government in exile. It had organized a transfer of funds to all Kuwaiti embassies throughout the world, and to the exiled Kuwaiti government in Al-Taif of Saudi Arabia, which enabled the government to provide monthly payments for thousands of Kuwaiti families in exile to maintain suitable house rents, standard of livings and medical insurance. After the country's liberation on February 26, 1991 and for months, KIO has continued to play a significant role in releasing funds for reconstruction.

By the late 1980s, and during the years of oil price decline, Kuwait's earning from overseas investments has exceeded its revenues from oil sales. Independent analysts estimate the value of Kuwait overseas reserves at about $400 billion.[18] However, accurate estimates of KIA asset, investment allocations cannot be obtained from outside sources due to the confidentiality nature of their business. The law prohibits any disclosure of such data to the public, but requires the KIA to present a detailed classified report to the government on the assets under management. KIA also makes annual closed door presentations to the Council of Ministers, as well as to the National Assembly, on the funds under its management, its strategic asset allocation, benchmarks and rates of return.

KIA's management reports to the Board of Directors, which consists of five external members from the private sector chosen by the Cabinet and appointed by an Amiri Decree and four ex-officio members (the Minister of Finance, who chairs the Board, the Minister of Energy, the Governor of the Central Bank, and the Undersecretary of the Ministry of Finance). The Board selects one of its external members to be a Director General, appoints an international independent Auditor to assess the FGF and GRF, and another auditor to review the other funds managed by KIA.[19]

KIA accounts are subject to SAB auditing on a constant basis. SAB remarks and comments are annually presented to the National Assembly where various committees, such as the Finance and Economic Committee, Budget Committee, Closing Accounts Committee, and others

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[17] Following the country's record budget surplus during the past decade, the government agreed to increase contribution into FGF from 10% to 25% starting from the 2012/3 budget.

[18] This estimate was published in Moody's credit analysis report (Government of Kuwait) on October 2, 2013.

[19] Besides the external auditors, KIA has an internal audit office that reports directly to the Chair of the Board. There is also a Higher Audit Committee comprising of two private sector Board members and chaired by the Minister of Finance.

summon KIA to discuss these comments. Additionally, KIA makes annual closed door presentations to both the Council of Ministers as well as to the National Assembly on funds under its management. The presentations cover KIA’s strategic asset allocation and benchmarks and rates of return. However, KIA’s assets distribution, transactions and policies have always been subject to parliamentary questions and allegations.

Yet, between 1989 and 1992, KIO was the victim of stolen, misappropriated, and embezzled money. In that renowned case of fraud at KIO, Kuwait lost $5 billion from its investments in Spain, and KIO reported losses of $3.8 billion as a result of a criminal conspiracy, including, but not limited to, bad investments, redemption of share prices as a result of the issuing of new shares, and the misappropriation or mishandling of such investments by some of the top management officials.

4.5 IMF and the World Bank

A lot of the improvement in Kuwaiti public finance in general, and the public budget in particular is attributed to the vital efforts and follow-up made by regular IMF missions to Kuwait. Such efforts can be traced through the Fund’s periodic country reports.

Article IV of the IMF agreement calls each member to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability. Like with all members, to ensure this target, the fund holds bilateral negotiations, on an annual basis, with the Kuwaiti authorities about the progress achieved in their policies or in requested reforms.

The process is initiated with a visit to the country by a staff team, which collects economic and financial information and discusses with officials the country’s economic development and policies. Based on this, the staff prepares a report, which forms the basis for discussion by the executive board. At the conclusion of the discussion, the IMF managing director, as chairman of the board, summarizes the views of executive directors, and this summary is transmitted to the country’s authorities for response or actions (IMF, Kuwait, 2001 Article IV Consultation-Staff Report 2001).

Since it became an IMF member in 1962, Kuwait is contributing constantly and effectively to the IMF budget, and in return receives technical assistance and guidance by the fund experts. But Kuwait is not obliged to comply with the fund's directives and propositions as are the low-income countries that are indebted to IMF or WB, and which thus have to comply with their directives and instructions. For many years, the IMF has repeatedly advised the Kuwaiti authorities to contain the growth of public expenditure, and to cut spending on subsidies and transfer payments. In return, year after year the IMF missions receive official assurances that the future fiscal policy will be tighter and budget management will be more efficient. However, due either to the hike of oil price or effective parliamentary pressure or to the psychological impact for the availability of easy source of rentier income, outcomes of such assurances become modest or intangible.

On several occasions, the IMF expressed observations concerning the non-availability of some data on important items of the public budget. Since 1987, Kuwait has not reported major components of its extra-budgetary revenues (investment income and transfers of profits of public institutions), extra-budgetary expenditures (interest on foreign debt and treasury papers) and financing operations conducted by the two reserve funds (GRF and FRF). According to the IMF, data on investment income, and interest on foreign debt and treasury papers, however, are usually provided to Article IV consultation missions (IMF, Kuwait, 2001 Article IV Consultation-Staff Report 2001).

While some progress in fiscal data presentation was achieved in 2000/01 budget, according to the IMF, the lack of a suitable classification of data on the execution of budget remained a constraint on monitoring effectively fiscal developments during the year. Moreover, data on the operations of the Public Institution for Social Security (PISS) had not been made available. Much of the weakness in the fiscal accounts stems from the limitations on the sharing of information between various government agencies. IMF had indicated to the Kuwaiti 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). The authorities had also been briefed on the IMFs 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 (IMF, Kuwait 2001 Article IV Consultation-Staff report 2001).

Prior to the global crisis of 2008, IMF Kuwait reports were reaffirming that Kuwait had remained committed to fiscal prudence, in spite of the favorable fiscal position due to escalating price of oil. The 2006 report states that such commitment was evidenced by the steady decline in both current and total expenditures in relation to GDP, from 39.3 percent and 43.9 percent in 2001/02 to 30.7 percent and 35.2 percent, respectively, in 2004/05. The composition of spending, according to the same report, also improved with the share of wages and salaries as well as subsidies and transfers in total expenditures declining over the same period. The prudent fiscal stance had allowed the government to accumulate substantial foreign assets, with two-thirds of the increase in hydrocarbon revenues estimated to have been saved in 2004/05.

The report also states that the authorities would like to reiterate their commitment to moderate increases in the general level of wages in the economy and to stricter rules for additional recruitment in the public sector. The authorities were also said to be intending to implement a budgetary reform, which include the introduction of a three-year rolling budget, the consolidation of the budgetary process, and the adoption of budget classifications in line with international accounting standards.

IMF executive directors welcomed these commitments and urged the authorities to seize this opportunity of favorable fiscal position due to escalating price of oil to further improve the structure of the budget by gradually increasing capital expenditure, rationalizing subsidies, and achieving a better balance between productive expenditure and fiscal savings. The directors noted that efficient management of the rapidly growing public sector savings will be crucial to Kuwait's long-term fiscal viability. The directors also supported the authorities' plan to build up the reserves of the FGF and to use a part of the fiscal surplus to recapitalize the social security system (IMF, Kuwait 2006 Article IV Consultation-Staff report 2006).

However, rapid growth of current public spending, during the past five years, proved to be a setback to such progress. In 2012, the IMF Board of directors was again anxious about the recurrent nature of expenditure growth in Kuwait. They believe that such growth increases the rigidity of the budget and complicates short-term fiscal management. They warned the authorities that inflation risk is on the upside and the authorities should be ready with a strategy for fiscal adjustment if inflationary pressures build up. Further, they noted that "rising public sector wage and pension costs and rapid population growth are expected to exert pressures on public finances in the medium term." They encouraged the authorities to contain the growth of the public sector wage bill, avoid a further buildup of the pension system's unfunded liabilities, and avoid new measures that would further increase current expenditures. They added that "if Kuwait is to preserve wealth equally for its future generations, fiscal consolidation will be needed in the medium term" (IMF, Kuwait 2012 Article IV Consultation-Staff report 2012).

In FY 2010/11, the World Bank (WB) completed an assessment of public expenditure and financial accountability in Kuwait. The project represented a careful examination of the country's public financial management practices through monitoring the quality of the public fiscal management. The project also supported a significant capacity building effort so that future exercises could be conducted by Kuwaiti consultants, academics, and non-governmental organizations (IMF, Kuwait 2010 Article IV Consultation-Staff Report 2010).

The WB undertook an analytical review of the major components of public spending in Kuwait. In March 2010, the full report on such review, which used various data resources and references[20] was presented and discussed with the MOF (IMF, Kuwait 2010 Article IV Consultation-Staff Report 2010).

In recent years, the IMF advised the Kuwaiti fiscal administration to establish a fiscal policy framework. This would entail developing a medium-term macroeconomic framework, which would provide multiyear projections of key economic variables, a medium-term (3 years for example) fiscal framework (MTFF), which would provide multiyear targets or ceilings on aggregate fiscal variables; and a medium-term expenditure framework, which would translate the overall budget envelope into a set of multiyear expenditure ceilings and policies for the main spending ministries. This will lay a strong foundation for the reform of the public finance management underway with the help of the World Bank. According to IMF, the MOF - not too long established - macro-fiscal unit can play an important role in this process (IMF, Kuwait 2010 Article IV Consultation-Staff Report 2010).

In order to achieve this goal, the IMF provided technical assistance to Kuwait to build and enhance its capacity in this respect. However, among major obstacles that slowdown the progress of this objective is the lack of proficient skills and expertise in this unit (IMF, Kuwait 2014 Article IV Consultation-Staff Report 2014).

On the other hand, for years, the World Bank (IBRD) has been providing Kuwait with technical assistance in different areas. The relation between Kuwait and the World Bank goes back to the early sixties. In 1961, IBRD's representatives along with other UN organizations have visited Kuwait to advise the government on further economic development. In 1962, Kuwait became the 81st member of the Bank. Since then different IBRD missions have been visiting Kuwait to provide technical assistance in different economic issues and policies.[21]

During the past 25 years, in support of the declared national development objectives, the World Bank provided technical assistance to the government of Kuwait. Privatization was one of the early significant issues tackled by the Bank during the nineties. Besides the 1993 study, the Bank assisted delegations of the National Assembly and KIA in studying worldwide experience in the execution of privatization (1994-97); and provided assistance on the draft and privatization law[22] (World Bank, Kuwait: A Privatization Strategy 1993).

In 1995, the Bank had focused on fiscal policies and public saving; welfare and subsidization; and the labor market and employment policies. In 2001, a study on "Energizing the Private Sector" has been carried out in collaboration with Kuwait's Higher Planning Council, and Kuwait University. In 2002, the World Bank has carried out various missions on land policy, power sector reform, telecommunications, transportation, and tourism to identify areas where technical assistance might be needed.

Enhancements of 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 have also been part of the IBRD endeavor. To develop the Transparency and Anti

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[20] Among the resources used in this review: the budget final accounts data for six fiscal years (2003/04 – 2008/09 inclusive); IMF staff reports and their papers on relevant selected issues; previous WB technical assistance reports on five spending effectiveness studies on the education and health sectors in Kuwait; the World Development Indicators database; and the WB's report on education in the Middle East North Africa region.

[21] In 1968, Kuwait approved the issuance of $42 million of Kuwaiti dinar bonds as the first public marketing World Bank bonds to be issued in the Middle East to assist the Bank in its growing lending operations.

[22] The World Bank has been also advising KIA on the divestiture phase of the privatization program.

Corruption Strategy, at the request of the Kuwaiti government, a scoping mission was conducted in September 2002. The central objective of the mission was to develop the Terms of Reference and identify the key institutions to be involved.

In addition, the World Bank has provided technical assistance, which has led to the establishment of the Kuwait Small Projects Development Company (KSPDC). In partnership with KISR, a study on labor market has been carried out, and some recommendations of this study have been proposed by the government for legislative approval. Several other studies were also carried out on education expenditure, health sector, telecommunications, and power and water strategy etc.

5. The Budget

To better understand the effect of the above explained fiscal legal setting and institutions of Kuwait on the country's public budget, the development of this budget figures and data will be presented and investigated in this section.

5.1 Over-reliance on oil revenues

Over the fairly long period of time covered by the present study, the share of actual oil revenue has averaged at 91.3% of total public revenues. However, this share has been unstable due to the volatility of the world's oil price. To illustrate this lack of stability, the period covered is divided into four decades. During the Seventies, the average ratio of the oil revenue was 93.6% before it turned down to nearly 90% during the decade of the oil price decline in the 1980s. Through the third decade (FY 1994/95-FY 2003/04), the ratio went further down to 88.3% before moving up to 93.3% during the most recent decade (FY 2004/05- FY 2013/14).[23]

In fact, Kuwait has been the only GCC country where the contribution of non-oil sectors has declined throughout the years of the last two decades. Indeed, during the past three decades, Kuwait did not execute any major development project. Table (1) shows the oil and non-oil public revenues over the considered four decades, and Figure (5) represents the above noted fluctuations in the oil revenues over the same period of time.

The Change in oil revenues and thus total public revenues are closely related to the change in global oil prices. Figure (6) presents the percent changes in oil prices and percent changes in total revenues over those four decades (excluding the abnormal values). The Figure signifies the direct linkage between these two variables and hence indicates the extreme reliance of the Kuwaiti public revenues and hence the Kuwaiti economy on an exogenous volatile factor. Such high volatility in income weakens the state's ability of strategic and medium term planning. It has become obvious that government back away from development plans and programs that are initiated during periods of oil price decline once this price begins to improve. By and large, enhancement of oil price usually leads to a new phase of expansion of current spending and distribution of rents.

It must be noted that Kuwait has been keen to invest part of its public revenue in foreign assets since the early fifties. In 2007, the Kuwaiti finance minister declared that the sovereign assets had reached $213 billion. More recently, independent sources estimate the value at $400 billion.[24] This provides an additional significant source of public income. However, such sizable returns are not reflected in the public budget. The disparity between the GNI and GDP of Kuwait, which can be seen in Figure (7), is a good reflection of the importance of such returns especially at the time of the oil price decline. The gap between GNI and GDP is more

[23] The unusual 4 years between FY 1990/91 and FY 1993/94, which have witnessed a sharp decline in the country's oil production following the 1990 Iraqi invasion, are excluded from this period of time.

[24] Bahgat, Gawdat, Sovereign Wealth Funds in the Gulf: An Assessment Research Paper, Kuwait Program on Development, Governance and Globalization in the Gulf States, LSE, No. 16, July 2011.

apparent in the middle chart of Figure (7), which shows the data of the 1980s decade. Actually, income from Kuwait's foreign investment has exceeded its oil revenues in 1986.

The persistent dominance of the share of oil revenue in the budget on one hand, and in the country's GDP on the other hand, indicates that over the past seven decades, Kuwait has not been able to direct its wealth to achieve a satisfactory level of domestic economic diversification. In this respect, Kuwait is distinguished by having the least ratio of non-oil economic activities in comparison to the other members of the GCC bloc.

However, for the Kuwaiti economy, diversification endeavors can be considered from two different perspectives: diversification of sources of public income and diversification of domestic base of economic activity. Certainly, the latter would produce not just a change in the macroeconomic setting of the country but also diversification of its sources of public income but over an extended period of time. The first perspective is the short-term focal and direct concern of both the fiscal policy and the budgetary system. The success of effort on this ground can be straightforwardly measured using the change in the share of non-oil public revenues to total public revenues.

Over the four decades covered by the current study (with the exception of the four abnormal years between 1990 and 1994), the average share of non-oil revenues to total public revenues was 8.7%. If periods of major oil price collapse are excluded, this share will be slightly less than 7.4%. Throughout these decades, average share of non-oil revenues has been ranging between its two lowest values of 3.1% in 1974/75 and 3.3% in 1979/80, on one hand, and its highest value of 19.5% in 1998/99, on the other hand.

This wide range of variation between the lowest and the highest share of non-oil revenues is caused primarily by the volatility of the price of oil. The 3.1% share was recorded after the 1973/74 quadruple rise in the crude oil price, while the 3.3% was the result of more than a 100% rise in this price through the Iranian revolution. The highest value of 19.5%, on the other hand, is attributed to the 1997 Asian crunch and its consequent collapse of crude prices.

Figure (8) illustrates this negative relationship between the price of oil and the share of non-oil revenues in Kuwait. Natural logarithms of the value of both variables were used to reduce the scale of differences between the two values and clearly depict the apparent opposite relationship between the two variables.

In general, over the period from FY 1979/80 to FY 2013/14 (where detailed data on non-oil revenue is available), the distribution of non-oil revenues between their different components indicate that revenues generated by public enterprises are the largest with an average share of 49.5%. This share continues to grow more rapidly than any other non-oil revenue. This item is followed by the tax revenue, which represents about 25.4%. Such taxes include direct excise on net income of foreign companies, fees on trade of properties, rents of public land, entry and registration Fees, and custom duties and fees on international trade and transactions. Revenues from sale of government properties are insignificant and on average have not exceeded 2.26% of total non-oil revenues during the considered period of time. Figure (9) demonstrates the trends of these shares during the specified period.

However, components of non-oil revenue over the past three decades, as can be noticed in Figure (9), do not signify any persistent pattern of growth and thus do not reflect any clear-cut objective policy towards diversification of income.[25]

[25] The main rationale behind the establishment of most of the state-owned business enterprises in Kuwait is related to the lack of the financial capacity of the local private sector to establish large-scale ventures. The state enterprises benefit from generous subsidies, are shielded from competition and bankruptcy, and benefit from a right to monopolize the local market. Since the mid-seventies, the state gained, gradually, the full ownership of all upstream and downstream oil enterprises. Since the early 1960s, the state established several non-oil based activities such as the National Industries Company (NIC), which

5.2 Direct taxation

Between 1955 and 2008, Kuwait was distinguished by its hostile taxation of foreign businesses. The rate of such an unfriendly tax was 55% on a relatively modest level of income of 375 thousand KD and beyond. Such a high rate of taxes, along with other unconstructive factors, has made Kuwait one of the least attractive countries to foreign investors. During the period 2003-2013, the share of Kuwait of total inflows of foreign direct investment (FDI) to the six countries of the Gulf Cooperation Council (GCC) was the lowest. Table (2) shows the annual shares of the GCC countries of FDI inflows between 2003 and 2013.

The noticeable increase in Kuwait's FDI inflow share during the last three years in the table is due to a string of acquisitions of Kuwaiti assets by mainly GCC based corporations. The most high profile of these was Qatar Telecom's purchase of Wataniya, the country's second mobile provider, in 2012 for $1.8 billion. The government, on its part, unveiled an update to its FDI law of 2001 in order to ease the FDI approvals process and expand the list of eligible investments.[26]

Only in December 2007 was the critical 1955 income tax act replaced by a new law with a flat rate of 15%. However, national corporations remain exempt from any direct taxation.

At different junctures, the government has revealed its intention to introduce direct taxes on Kuwaiti corporations and, in some cases, on individuals. For one reason or another, such schemes have never been completed. The majority of the public in Kuwait, along with the parliament, stand firmly against the idea of personal income taxation because the government has possession of the oil revenue. While corporate taxation could be an acceptable option by MPs, the government had failed to introduce such taxes at the appropriate phase of the economic cycle.

In 1981, ex-Minister of Finance Abdulatif al-Hamad pushed for a new corporate income tax law to be applicable to all firms. However, the 1982 fall of the secondary oil market, which was followed by the resignation of al-Hamad, has put an end to this initiative.

In 2005, in a recurring endeavor to introduce a comprehensive income tax system in Kuwait, the fiscal authority had adopted a plan placed by the International Bureau of Fiscal Documentation (IBFD), a provider of tax expertise based in Amsterdam to provide technical assistance for tax reform in Kuwait[27] (IBFD, 2005). On May 2011, based on the IBFD recommendation, the Fatwa and Legislation Department (FLD), which is empowered to review and revise public laws and contracts drafted the new income tax law.

Different factors played a role in suspending the endorsement of such an unpopular bill. Besides the impact of the 2008 global financial crisis, there has been mounting political tension between the government and the parliamentary opposition groups on one hand, and the "Arab Spring" political turmoil in different neighboring countries, on the other hand.

However, an intellectual minority in Kuwait believes that a personal income tax is needed in Kuwait as a fiscal policy tool, both to reduce income inequality between citizens and to

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was established to set up large-scale building materials projects that could not, at the time, have been undertaken by the private sector. Similarly, Kuwait Flour Mills Company (KFMC) and Livestock Trading & Transport Company (LTTC) were also established in the 1960s to provide subsidized food products. The list also includes Kuwait Airways, Kuwait Ports Authority (KPA), and Kuwait Public Transport Company (KPTC). In 1977, to bail out stock holders during the first crisis of the local stock market, the government bought shares of various listed companies, resulting in wide-scale state ownership in banking, insurance, real estate, services and manufacturing sectors. For more details on the state enterprises in Kuwait see Sartawi, Mithqal, "State-owned enterprises in Kuwait: history and recent developments", OECD, 2012.

[26] NBK Economic Update, 5 August 2014.

[27] The author has participated in reviewing the IBFD study in his capacity as a seconded expert from Kuwait University to the MOF Taxation Department throughout 2005 and 2006.

encourage people to call for more efficient government and better services rather than just complain.

During the past two decades, other plans to reduce the heavily subsidized public goods have been on the government's list of thoughts, but none has ever been carried out. Only in early 2015, did the government eliminate the subsidy to diesel in order to stop its smuggling problem. Even this decision faced intense resistance as it affected different domestic activities and was brought about during time of a sharply declining price of crude oil. Other plans to reduce the gasoline and power subsidies remain under consideration.

5.3 Economic diversification

Since the early 1960s, diversification of economic activities, so as to reduce risks associated with the reliance on a quasi single source of income, has been repeatedly declared by every Kuwaiti government as a priority development objective. However, until the present, Kuwait still lacks an apparent feasible plan for achieving confident strides toward this goal.

During the Seventies, Kuwait had managed to achieve some degree of economic diversification. But, this was immediately followed by the 1980s multi-dimensional shrinking of the domestic economy due to the following:

1- Decline of oil demand, price, and revenue;
2- The horrible collapse of the secondary stock market;
3- The eight-year Iran-Iraq war which had resulted in a number of negative effects, including the elimination of Kuwait's active transit trade.

The GDP shares of non-oil sectors have significantly declined after the mid 1980s. Soon after that, the economy has suffered the harsh consequences of the Iraqi invasion of 1990 where several business firms, either lost their markets or chose to relocate to other GCC countries.

Between 1995 and 2006, Kuwait had largely used the "Build-Operate-Transfer" approach (BOT) to encourage private entrepreneurs to build different commercial projects on public plots of land. About one hundred BOT projects have been realized. Among these projects there was a waste water treatment plant, real estate development, a 30 million KD waterfront shopping mall, the country's fifth Waterfront Development Project, which includes 50 million KD Marina, a hotel and mega mall, along with diverse sports areas.

In 2006, a report by the State Audit Bureau (SAB) accused a number of BOT projects of mishandling. As a result, several BOT contracts were abolished, and the National Assembly called for a new set of regulations. The subsequent BOT act (law No.7 of 2008) proved to be too rigid to attract more private investors to the scheme.

On the other hand, abundant capital has led to the flourishing of the financial services and in particular the banking activity. The Kuwaiti banking industry is among the strongest in the region in terms of funding, where banks rely mainly on private deposits. Besides, the long track record shows that government has always been standing ready to back banks whether individually or the whole banking system at times of stress.

The four largest local banks (out of 12) control more than 70% of the system's assets and their market share has been relatively stable over the past decade. Competition from foreign banks and credit generation from non-bank financial institutions is very limited. Moreover, the use of complex and risky products is limited, and banks typically operate with adequate earnings.[28]

5.4 Public expenditures

Public expenditures in Kuwait are classified, as stated earlier, under five major chapters: The first chapter provides wages and salaries of government employees, the second chapter includes

[28] Standard and Poor's Report: Banking Industry Country Risk Assessment: Kuwait, 17 December 2012

purchases of goods and services while the third chapter covers spending on means of transport and equipment. The fourth chapter is devoted for expenditure on construction and acquisition of land, whereas the fifth chapter is devoted to transfer payments (domestic and external) plus other miscellaneous items. Domestic transfers incorporate all type of public subsidies and constitute the bulk of this chapter.

5.5 Current versus capital expenditure

Over the past three decades, the share of current expenditure has been constantly growing, while capital expenditure has been getting a modest allocation. To separate between current and capital spending of the budget, official sources add up the first two chapters to stand for current expenditures and chapters 3 and 4 to stand for capital expenditures. Figure (11) illustrates the increasing spread out between the value of Kuwait current (chapters 1, 2) and capital expenditures (chapters 3 and 4) during the past four decades. Yet, the fifth chapter is seen as a detached chapter from those types of expenditure. No distinction is available between current and capital components of chapter 5. Although, since this chapter is burdened by different types of consumer subsidies, the author believe that it can be added to the first two chapters to stand for the actual total of current expenses.

The relative limitation of capital spending led to a visible shortage in the supply of basic public services, such as health care and education; a recurrent interruption in power and water supply, especially at peak times during the hot months of summer; an escalating problem of traffic congestion; and to the deterioration in the quality of some roads and public facilities.

The most remarkable expansion in public capital spending had occurred during the Seventies, subsequent to the 1973 quadruple increase in the price of crude oil. During the 1970s, capital spending had increased by almost 7-fold, while transfer payments had increased by 5.8 times and spending on salaries as well as spending on goods and services had each increased by 4.8 times. Figure (12) shows the importance of such capital spending compared to other chapters of expenditure during the 1970s.

Among the Seventies' massive investment projects there were motor highways, roads, ports, newly improved residential areas, hospitals, schools, social care units, power and water desalination plants, manufacturing plants, and sport and recreation facilities. Besides, government also expanded its list of consumer and producer subsidies, eased its licensing procedures, and provided soft credits to industry, real estate and farming activities. The boost up in public subsidy and support is reflected by the significant increase in the value of the fifth chapter (the miscellaneous and transfer payments). However, the growing oil revenues were much greater than the absorption capacity of the Kuwaiti economy, hence, the Parliament decided to cut the country's crude oil production by 50%.

Nevertheless, Kuwait could not sustain the remarkable growth of the 1970s during the following decade. In next to no time, the economy became victim to the triple shock of a long eight-year war between the two powerful neighbors of Iraq and Iran, the 1982 crash of securities trade, and the mid-1980s collapse of oil prices. The rundown in capital expenditures, particularly after the oil price collapse of 1986, has been clear.

However, the 1990s began with the Iraqi invasion. The Kuwaiti Government-in-exile depended upon the state's overseas investments during the seven months of the occupation. On the eve of the Iraqi troop withdrawal in February 1991, the Iraqi forces set ablaze or damaged 749 oil wells which have reduced Kuwait capacity to produce oil. The pre-war capacity was restored in 1994. As soon as the country started to get back to normal by 1996/97, the economy was hit further by the 1997 Asian crisis, which was followed by a sharp decline in the price of oil.

The Iraqi invasion had resulted in a full scale decline in all types of public expense except the transfer payments (chapter 5) which have increased 4.5 times in FY 1990/91 and 3.2 times in

FY 1991/92 from its level of the preceding year. Subsequent to those two years, there were noticeable and uninterrupted increases in current spending on salaries and purchase of goods and services (chapters 1 and 2). Higher salaries came out as gratitude to citizens who stood firmly against the aggression and more purchase of goods were needed to substitute for the enormous losses incurred by the invasion. In contrast, there has been no significant increase in capital spending during those years.

5.6 The transfer payments

The sharp increase in the fifth chapter (transfer payments) allotment has been one of the most evident features of the 2000s public expenditures. The government settlement of the actuarial deficit in the public pension fund (PPF) is accountable for part of this increase, especially in FY 2006/07 and from FY 2008/09 until FY 2014/2015.

Such actuarial deficit has been accumulating because of the serious structural imbalance suffered by PPF due to its generous pension payments in exchange for relatively low contributions by employees. Since 2001, the IMF had been warning the government that funds of the public pension system would be depleted within 15 to 25 years if no corrective measures were taken. The cumulative actuarial deficit has increased from 5.5 billion KD in 1998 to nearly 7 billion in 2004.[29] In FY 2006/07, a 2 billion KD has been transferred to cover part of this deficit, resulting in a record increase of 84% in the value of the fifth chapter. In FY 2008/09, such value has increased by 158% reflecting the transfer of 5.5 billion KD for the same purpose. Between FY 2010/11 and FY 2014/15, further transfer of 1.094 billion KD per year has also been directed toward this item. Increases in salaries, fringe benefits and subsidies to government employees along with the settlement of the PPF actuarial deficit have enlarged the size of the fifth chapter of FY 2014/15 by six-fold its value of FY 2000/01. After the settlement of PPF imbursement, chapter 5 allocation remains equal to more than five times its value in FY 2000/01. Table (3) shows the share of chapter 5 of total public expenditure and its growth rate between FY 2006/07 and FY 2013/14.

Above and beyond, domestic subsidy is the primary bulk of the fifth chapter. Table (4) presents the value and share of various items of domestic subsidies in FY 2014/15 where it is noticeable that funding of fuel for power generation plants constitutes about 44% of total subsidies. This is followed by funding of refined oil products and liquefied gas (12%).

When one considers the value of current expenditures on public services, the electricity and water sector accounts for the largest value of this spending. Expenditures on defense, security and justice come next. During more recent years, spending on public health as well as education services has been gradually increasing. Growth in spending on the latter sectors is mainly attributed to the increase in number of staff along with the rise in their compensation and does not necessarily signal an improvement in the level of these services. The steady increase in population and hence the ever-growing demand for services has led to enormous pressures on public utilities, health and education services, resulting in deterioration of their adequacy and quality. It became usual for citizens to resort to treatment at private hospitals and clinics and to enroll their children in private schools and institutes. Figure (14) illustrates changes in the public spending allocations to these public services between FY 2000/01 and FY 2012/13.

6. Concluding Remarks and Recommendations

Various theoretical and empirical studies, which are labeled in the literature under the name of resource curse or the paradox of plenty, have shown that resource-based economies possess inefficient institutions, weak governance, more corruption, less democracy, and less stability.

[29] IMF Country Report No. 6/132, Kuwait: 2006 Article IV Consultation—Staff Report, April 2006.

The Dutch disease literature provides additional evidence of adverse impact of the boom in a natural resource sector on non-resource tradable sectors.

Along with these findings, some studies have concluded that resource-rich countries, and specifically oil exporters, have the weakest budget institutions. Effects of fiscal institutions on fiscal outcomes became a central and significant issue for research and discussion during the past few decades. The present study examines the link between fiscal institutions and fiscal outcomes in Kuwait, which represents a unique case among the oil-rich Arab countries of the Gulf. While sharing with its neighbors the peculiarity of the hereditary ruling, Kuwait is unique in being the only GCC country with a directly and freely elected parliament. Further, Kuwait is unique for standing, among her oil-rich peers, as a case of maximum failure in the diversification of economic activity.

The study shows that Kuwait, after seven decades of its oil production and exports, remains heavily reliant on this exhaustible resource as its main source of income. The study also shows that the Kuwaiti government has been unable to transfer an effective bulk of its oil revenues into non-oil income-generating assets within its borders. However, it did achieve success in this respect during the decade of the Seventies. Kuwait has also succeeded in building a rich foreign portfolio of investments, but returns on this portfolio involve a risk factor that may not be less hazardous than the oil price fluctuations. In fact, the course of volatility in returns on foreign investments does not differ from the course of volatility in the price of oil. The drop in oil prices coincides usually with the slowdown of economic activity in energy-consuming leading countries, which are usually the countries where the Kuwaiti sovereign investments are concentrated.

It is also clear from the study that Kuwait has been a center for throbbing crises and unrest during the eighties and nineties. The most notable five of these crises are the Iran-Iraq war, which lasted eight devastating years, the collapse of the Kuwaiti stock exchange, the decline of demand for oil, the Iraqi invasion of Kuwait, and the Asian crisis and its damaging repercussions in the late nineties. The Kuwaiti public finance was burdened by the negative consequences and massive losses of those events, and has been obliged, over the years, to pay costs, generous compensations and subsidies to address such effects.

A sequence of such extraordinary events would require highly competent fiscal management and well-tailored macroeconomic policies to adequately deal with them. Unluckily, Kuwait has not been sufficiently privileged to have this type of management or policies. The IMF mission's frequent advice to the Kuwaiti authorities and their constant call for reform, which is recurrent year after another, is an obvious symbol of this reality. The current shortage of facilities and infrastructure and deterioration in quality of public services comprise additional evidence of the inappropriate macroeconomic and fiscal management that has prevailed in the country.

Despite the availability of clear and well-designed fiscal laws and procedures as described in section, the execution has been weak and inaccurate. This represents an additional indication of the lack of proficient macroeconomic and fiscal management. The roots of the management weakness and the lack of proficiency can be partially found in the traditional social relations and connections between the ruling family, prominent business community and tribal leaders. The historical legacy of the evolution of such relationships has led to the selection of officials based on their family kinship, business links, or tribal support and not on the basis of their qualifications or performance. On the other hand, this weakness might be due to the effects of the rent distribution and the concept of citizenship entitlements.

Above and beyond, as the holder of oil wealth, on behalf of the community, the government has been using various channels for the distribution of oil rents to nationals. Such channels include the provision of undemanding public jobs with attractive compensations and generous fringe benefits, free health and free education services, fuel, electricity and fresh water at nominal prices, housing, soft loans, support to building materials, subsidized basic food items, foreign scholarships and medical treatment abroad.

A great deal of public spending commitments has been caused by popular resolutions issued under the pressure of parliament members who want to appease their constituents. Similar resolutions have been passed by the government to procure political support of various interest groups or by demands of trade unions and civil society. As a result, compensations of employees, fringe benefits, pensions and transfer payments have increased fivefold in less than two decades.

In addition to its considerable inaccuracy, estimates of budget oil revenue are very conservative during years of oil price rises and highly positive during years of price contraction. Besides, the IMF points to unreported budgetary items and the dearth of relevant data. The IMF also points to constraints that hinder the effective monitoring of budget executions. Among these is the lack of a suitable classification of data on the execution of budget. For years, data on the operations of the pension institution had not been made available to IMF missions. The IMF repeatedly requested to classify the data on the operations of the two respective funds (GRF and FRF) as part of government, as they perform activities for public policy purposes (management of debt and assets and financing of the budget). Moreover, a weakness in the fiscal accounts stems from limitations on the sharing of information between various government agencies.

The divergence between budget and actual public spending is another sign of inaccuracies. Such divergence has been mounting in recent years. During the Seventies, and due to the sudden large increase in revenues and subsequent fiscal expansion, actual spending has been much higher than the budgeted one. On the contrary, during the Eighties, as the price of oil declined and Kuwait had experienced different setbacks, actual spending became less than the budgeted speeding. After 1990 and until the present, overestimates of budgetary spending developed as a customary practice in most government departments. In many cases, such overestimates are an indicator of poor public management and a lack of capacity in executing plans and projects. Fiscal management needs to spend more effort to reduce the growing gap between budget and actual spending.

For many years, the IMF has been advising the Kuwaiti fiscal authorities to establish a fiscal policy framework. This would entail developing a medium-term macroeconomic framework, which would provide multiyear projections of key economic variables; a medium-term fiscal framework, which would provide multiyear targets or ceilings on aggregate fiscal variables; and a medium-term expenditure framework, which would translate the overall budget envelope into a set of multiyear expenditure ceilings and policies for the main spending ministries. According to the IMF, this will lay a strong foundation for the reform of public finance management underway with the help of the World Bank. According to the IMF, a recent macro-fiscal unit at the Ministry of Finance can play an important role in this process. However, the main problem remains to be the lack of qualified and proficient skills that are able to carry out this task.

The political institutions and structures in Kuwait, along with the nature of the societal relationships and historical developments that have created and shaped these structures, are still hindering the willingness and capability of executive authorities from taking brave decisions and actions that are necessary to start an economic and fiscal reform process in Kuwait. Without a real evolution in these institutions and structures, the authorities will continue to defer the much needed reforms.

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Abbreviations

CBK	Central Bank of Kuwait
CSC	Civil Service Commission
FLD	Fatwa and Legislation Department
GSSCPD	General Secretariat of the Supreme Council for Planning and Development
IBFD	International Bureau of Fiscal Documentation
KD	Kuwaiti dinar is the national currency of Kuwait. Each KD = 3.25 - 3.5 U.S. Dollars
KFMC	Kuwait Flour Mills Company
KIA	Kuwait Investment Authority
KISR	Kuwait Institute for Scientific Research
KPA	Kuwait Ports Authority
KPC	Kuwait Petroleum Corporation
KPTC	Kuwait Public Transport Company
KSPDC	Kuwait Small Projects Development Company
LTTC	Livestock Trading & Transport Company
MOF	Ministry of Finance
MTFF	Medium-Term Fiscal Framework
NIC	National Industries Company
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PISS	Public Institution for Social Security
SAB	State Audit Bureau

Figure 1: Budget vs. Actual Revenue in Million KD 1970/71 – 1989/90

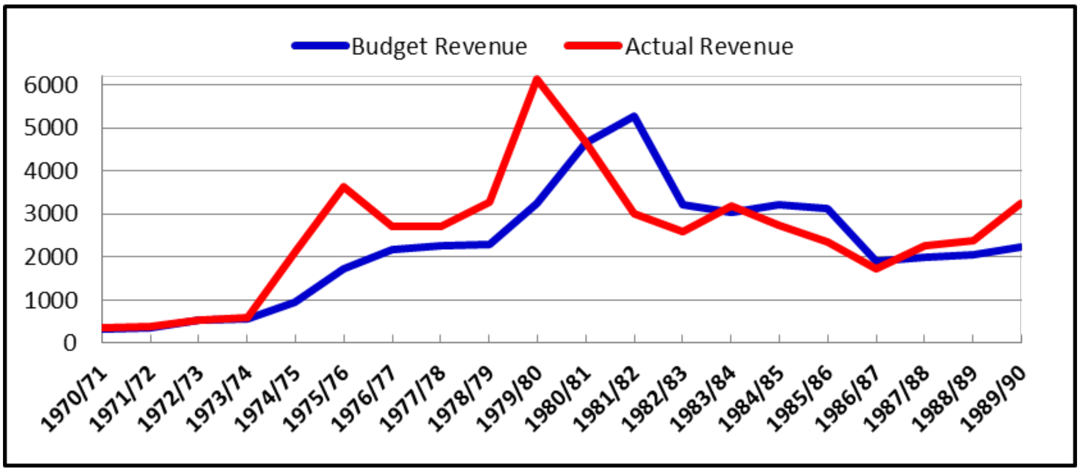


Figure 2: Budget vs. Actual Revenue in Million KD 1992/93 – 2013/14

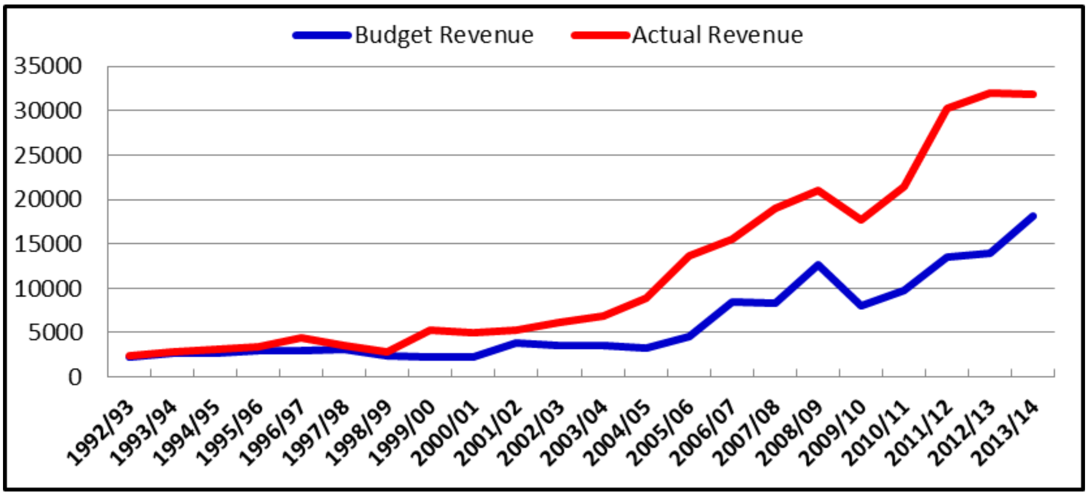


Figure 3: Changes in Price of Oil (—) vs. Divergence (- - -) between Budget and Actual Revenues FY 1972/73 – 2013/14

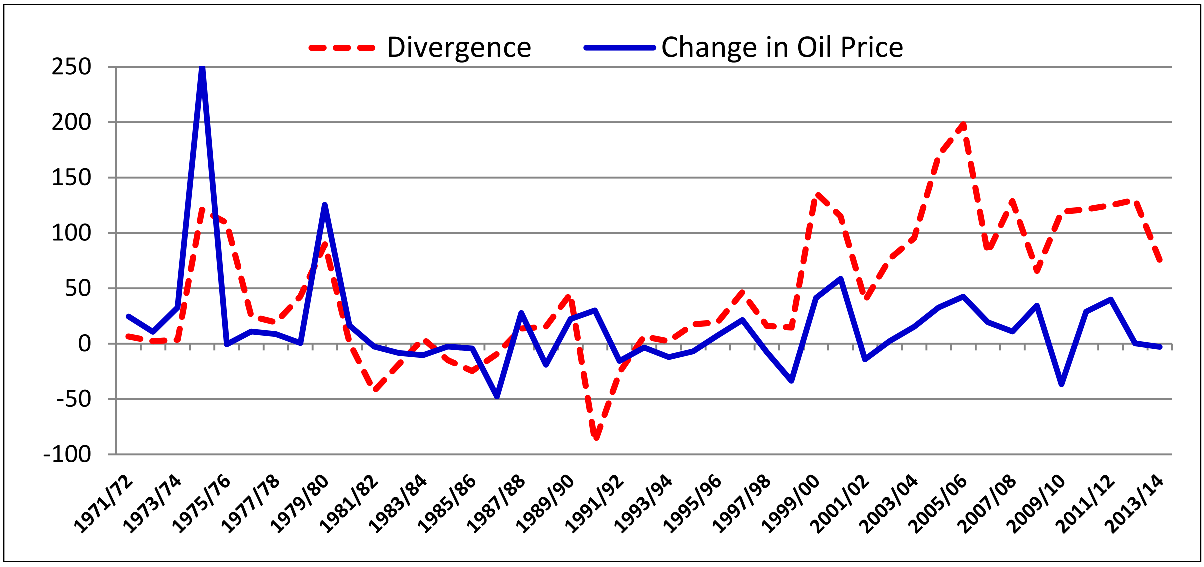
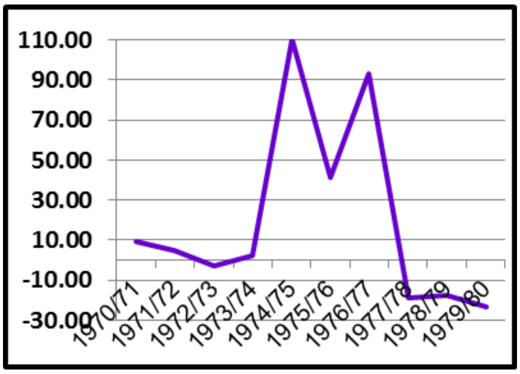
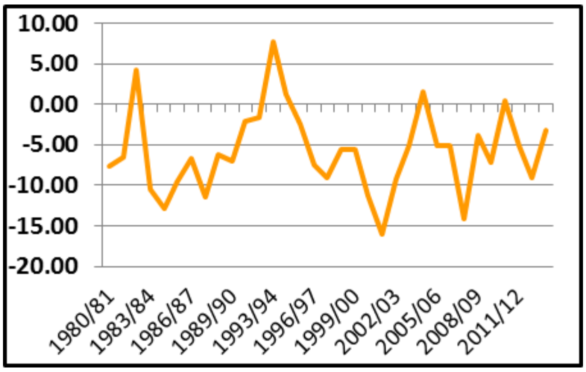


Figure 4: Percentage Difference of Actual Compared to Budget Expenditure in Million in Two Periods KD 1970/71 – 1979/80 and 1980/81- 2013/14





Note: Ratios of the 1970s range between minus 30 and 110%, while from 1980/81 to 2012/13 they range between minus 20 and 10% only.

Figure 5: Ratios of Actual Oil Revenues to Total Revenues FY 1970/71-2013/14

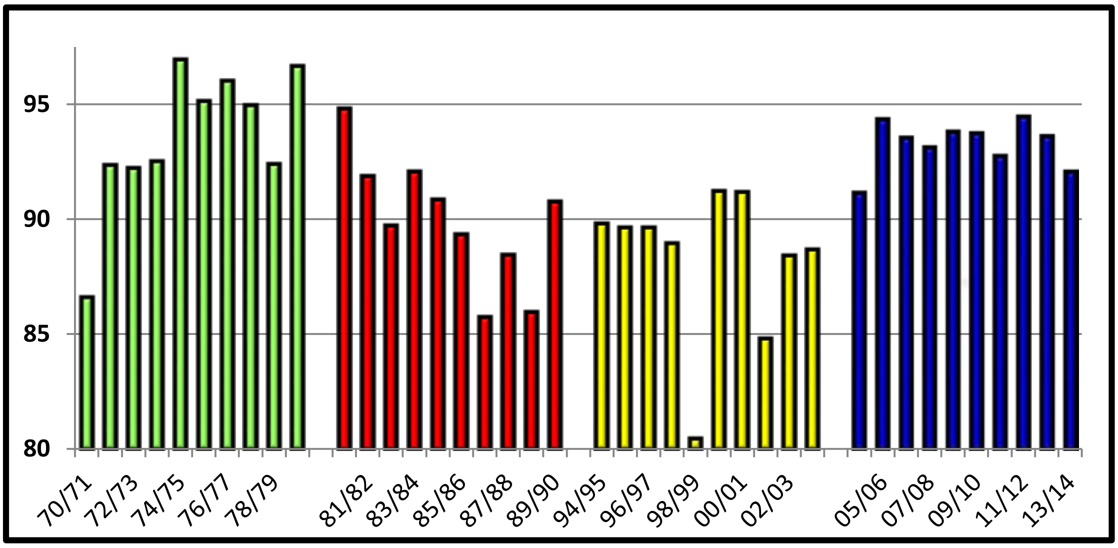


Figure 6: Change in Oil Prices versus Change in Total Revenues in Percent FY 1972/73-2013/14

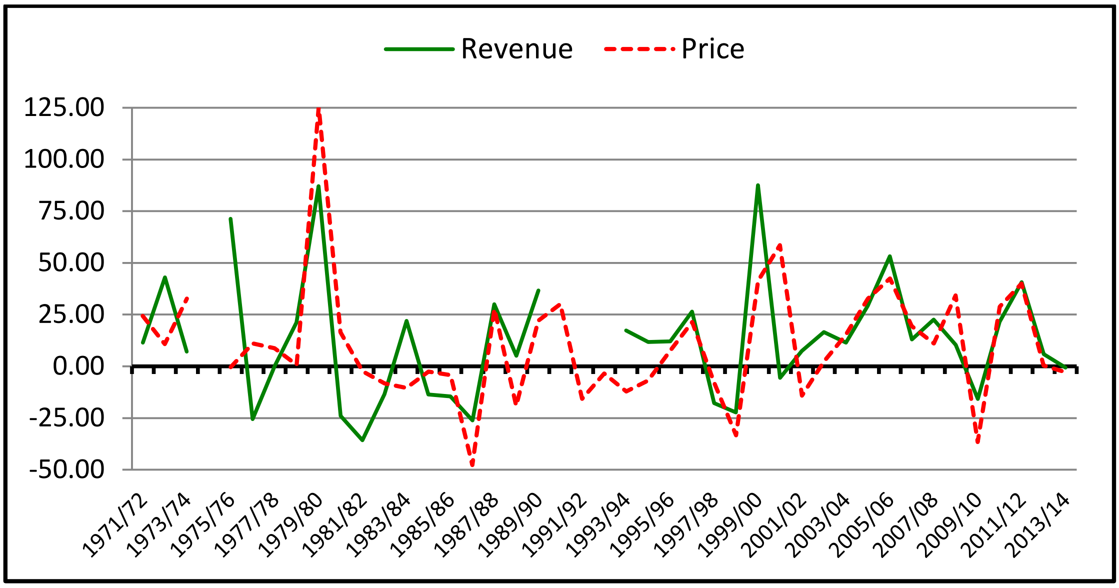
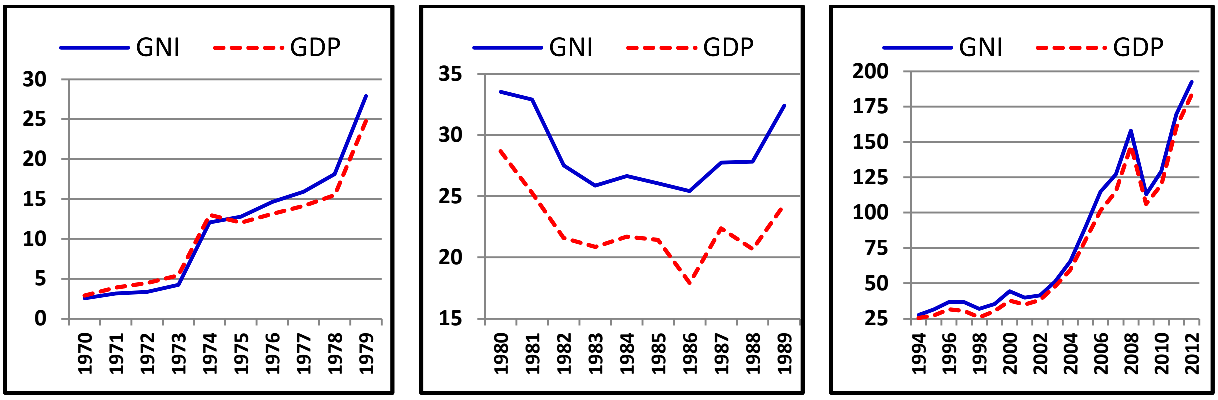


Figure 7: Kuwait GNI versus GDP in Current Billions of U.S. Dollars 1970s, 1980s and 1994 - 2012



Sources: the World Bank and the UN National Accounts Database.

Figure 8: Shares of Non-Oil Revenue vs. the Price of Oil 1970/71-2013/14

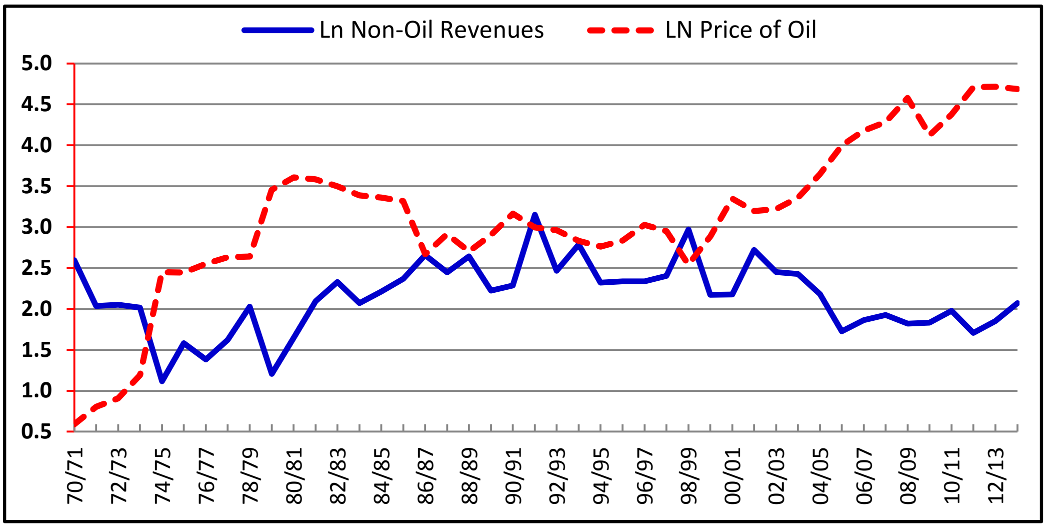
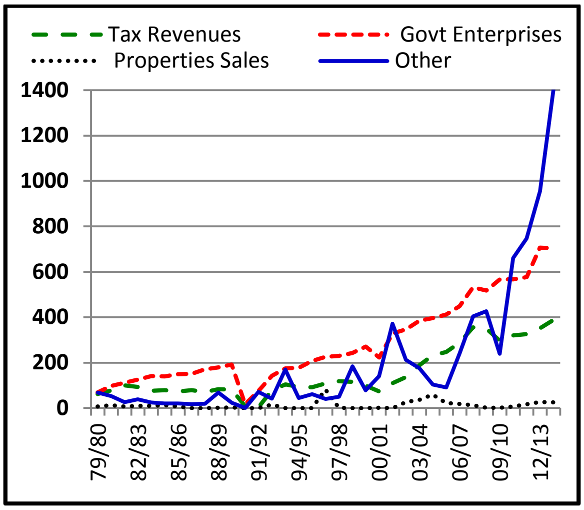


Figure 9: Distribution of Non-Oil Revenues Value in Million KD (Left) and Percentage (Right)



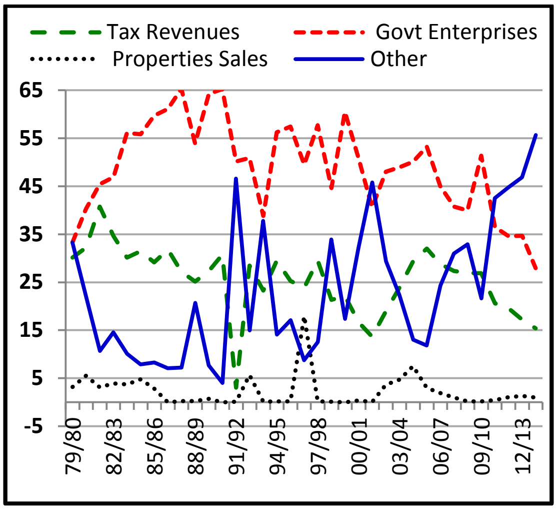


Figure 10: Percentage Distribution of FDI Inflow to GCC Countries 2003 – 2013

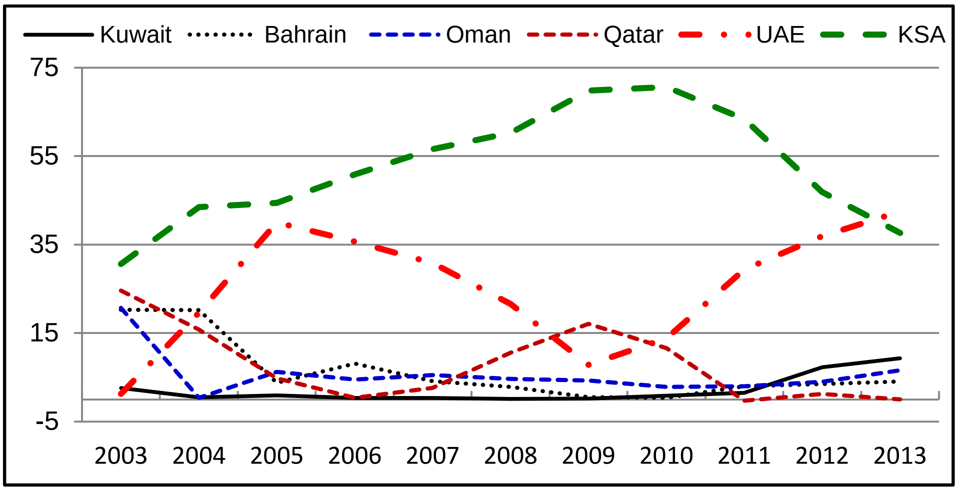


Figure 11: Current vs. Capital Expenditures FY 1970/71 – 2013/14 in Million KD

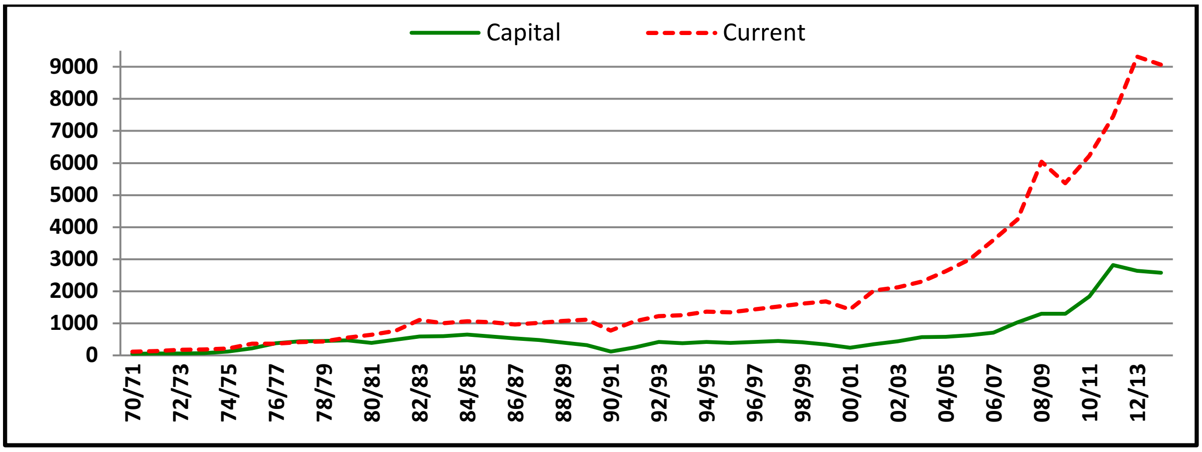


Figure 12: Expenditure by Chapters FY 1970/71 – 1979/80 in Million KD

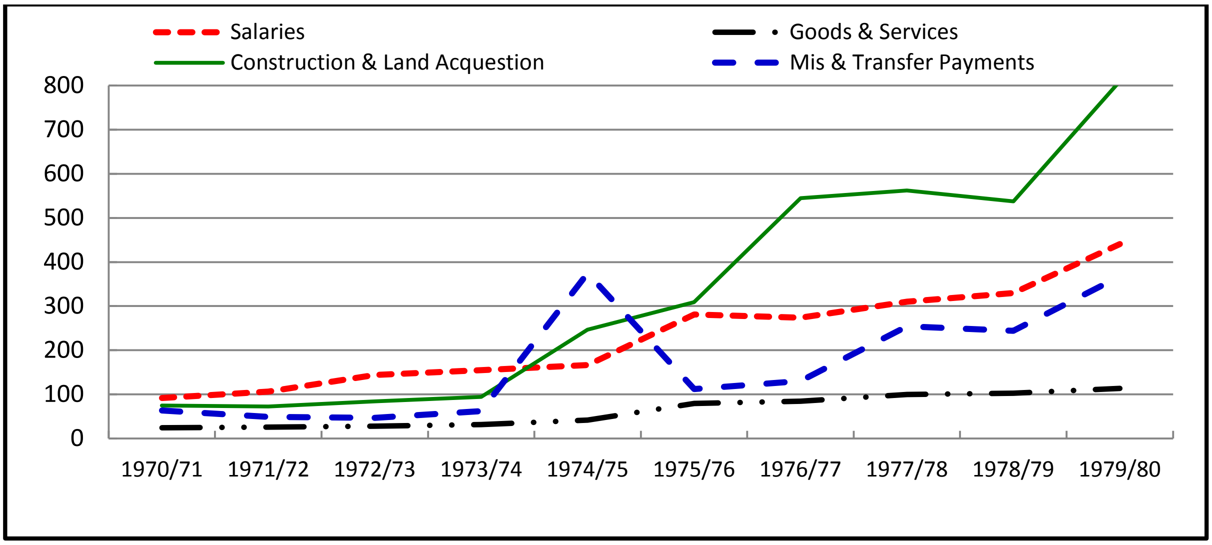


Figure 13: Key Domestic Subsidies FY 2014/15 Budget in Million KD

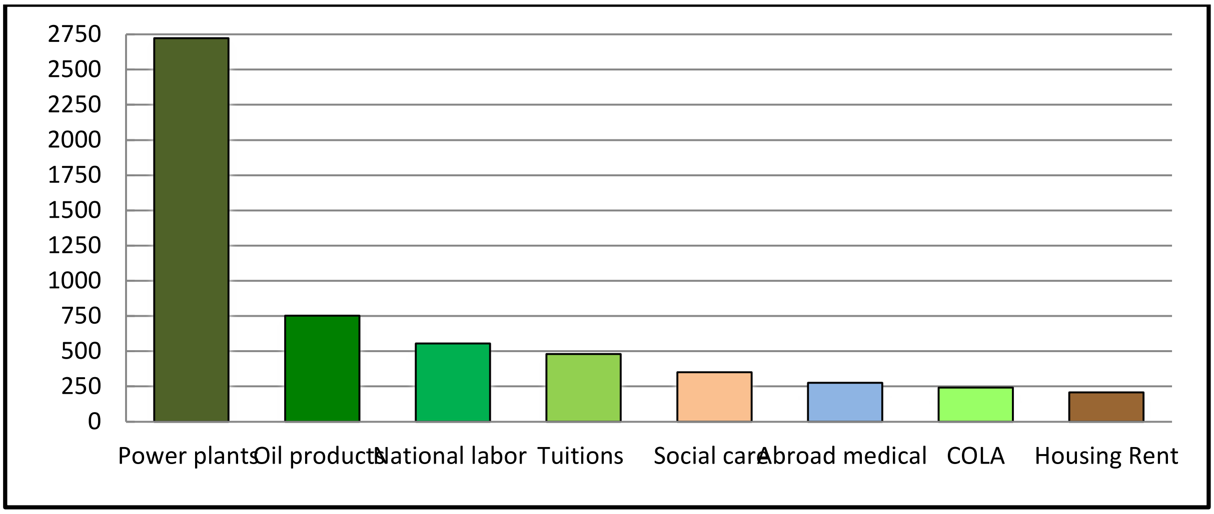


Figure 14: Expenditures on Services FY 2000/01 - 2012/13 in Million KD

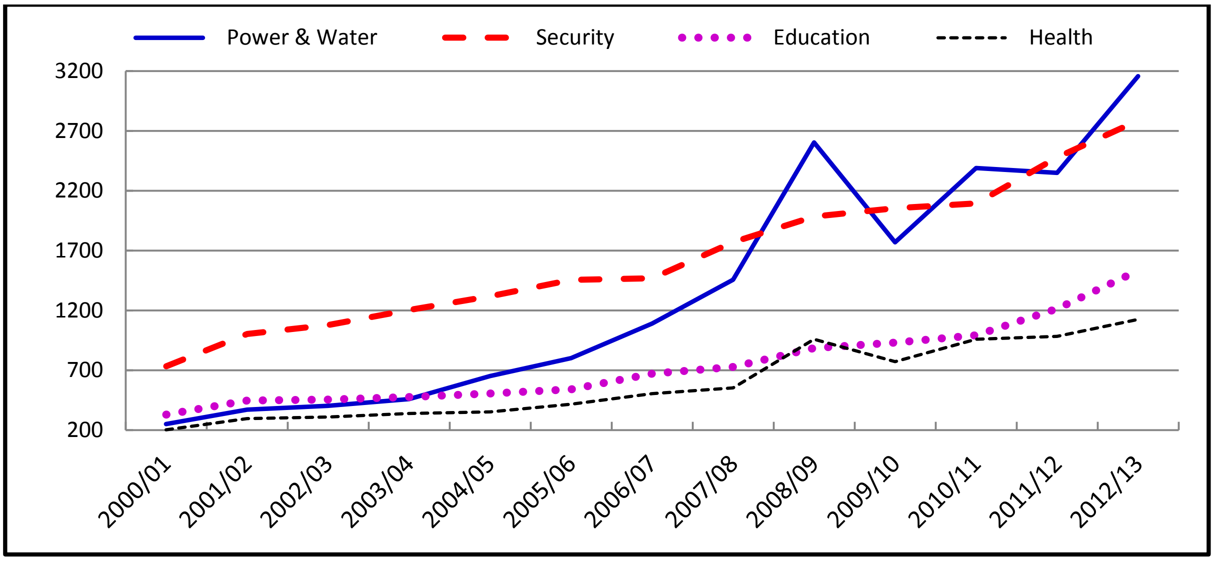


Table 1: Ratios of Actual Oil and Non-Oil Revenues FY 1970/71-2013/14

Decades	Oil Revenues	Non-Oil Revenues
1970s	93.58	6.42
1980s	89.95	10.05
1994/95 - 2003/04	88.28	11.72
2004/05 - 2013/14	93.28	6.72
Average	91.27	8.73

Table 2: Percentage Distribution of FDI Inflow to GCC Countries 2003 – 2013

Country	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Kuwait	2.6	0.5	0.9	0.3	0.3	0.1	0.2	0.8	1.5	7.3	9.3
Bahrain	20.3	20.2	3.8	8.1	4.1	2.8	0.5	0.4	3.0	3.5	4.0
Oman	20.7	0.4	6.2	4.5	5.5	4.6	4.3	2.8	3.0	4.0	6.6
Qatar	24.6	15.8	4.8	0.4	2.6	10.6	17.1	11.6	-0.3	1.3	0.0
UAE	1.2	19.6	40.0	35.7	30.8	21.6	7.8	13.8	29.4	36.9	42.5
KSA	30.6	43.5	44.4	50.9	56.6	60.3	69.8	70.6	63.4	46.9	37.7

Source: UNCTAD World Investment Report.

Table 3: Shares of Chapter 5 of the Total Public Expenditure and its Growth Rates 2006/07 – 2013/14

Year	Miscellaneous & Transfer Payments	% of Public Expenditures	Growth Rate
2006/07	5641.5	54.74	84.12
2007/08	4157	42.86	-26.31
2008/09	10741.4	58.82	158.39
2009/10	4576.5	40.68	-57.39
2010/11	8164.9	50.34	78.41
2011/12	8345.1	49.07	2.21
2012/13	9024.8	46.74	8.14
2013/14	9361.8	44.57	3.73

Table 4: Domestic Subsides in FY 2014/15 Budget

Items in 2014/15 Budget	M. KD	Share
Funding fuel for power generation plants	2723.4	43.655
Funding refined oil products and liquefied gas	751.9	12.053
Support of national labor working in the private sector	554.7	8.892
Private universities students' tuition, fees and rewards	480.9	7.709
Support of social care programs	351.8	5.639
Abroad medical treatment	276.2	4.427
Allowance for reducing cost of living	242	3.879
Other subsidies	224.5	3.599
Rent compensations for citizens awaiting housing care	208	3.334
Disabled allowances	98.2	1.574
Cancellation of real estate loans	70.8	1.135
Interest on real estates' loans	67.5	1.082
Central Bank of Kuwait (money market operations)	60	0.962
Support of sport clubs and other local activities	56.9	0.912
Subsidy to farmers and fishermen	30.7	0.492
Subsidy to fuel prices	16	0.256
Marriage grants	14.8	0.237
Funding fuels of Kuwait Airways	5.1	0.082
Support of labor unions and civil societies	2.9	0.046
Funding the House of Islamic Charity (Bait al-Zakat)	1.5	0.024
Support of local newspapers	0.5	0.008
Summer and Spring students training	0.1	0.002
Total	6238.4	100.000

Source: Committee of Budge Affairs, the National Assembly, July 2014