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Kuwait’s economy gains temporary breathing space

Hassan Jivraj | 31/03/2023 8:56 am



Strong recovery: Kuwait’s economic growth rebounded to 18.7% in 2022, according to the IMF

While a spike in oil revenues is predicted to return government finances to a surplus for the first time since 2014, vital economic reforms appear as far off as ever, writes Hassan Jivraj.

After a lacklustre performance since 2019, due to the Covid-19 pandemic and depressed global oil prices, Kuwait’s economy grew strongly in 2022 on the back of a rebound in both prices and production. After contracting by 8.9% in 2020 — the biggest decrease in the Arabian Gulf — the country’s economic growth rebounded to 1.3% in 2021 and 8.7% in 2022, according to International Monetary Fund (IMF) data.

Growth is likely to be slower in 2023, however, reflecting slowing external demand and oil production cuts under the agreement with OPEC+ (a group comprising the Organization of the Petroleum Exporting Countries, along with 10 other major oil producing countries), with gross domestic product (GDP) set to increase by just 2.6% — lower than the average forecast for the region (see graphic on page 60).

Now, 85 years after the drilling of the country's first commercial well in the Al-Burqan field, Kuwait's economic fortunes remain intertwined with the vagaries of the international oil market. The country holds around 7% of the world's reserves, with oil revenues accounting for around half of Kuwait's GDP and approximately 90% of government export revenue, with attempts to diversify its economy bearing little fruit in comparison with neighbouring countries.

In particular, Kuwait has struggled for several years with an increasingly unsustainable public sector wage bill that has stifled productivity in both its private and public sectors. In addition, the ongoing political impasse between the country's parliament and the government has prevented effective policy-making, especially with regards to key economic reforms.

"There has been limited diversification, either in terms of GDP or Kuwait's fiscal position," says Monica Malik, chief economist at Abu Dhabi Commercial Bank, warning that the strained political backdrop and the limited ability to progress with reforms and diversification plans remain key risks for Kuwait.

"Nevertheless, we expect the still strong oil price forecast to result in healthy fiscal and current account surpluses, albeit moderating from 2022."

Kuwait and Middle East GDP growth

%

Kuwait Middle East

Budget deficit

As a generator of high oil revenues yet home to a population of under five million (of which only about 1.5 million are Kuwaiti citizens), the government has for several decades been content to distribute oil revenue to its people via the provision of public sector employment and generous subsidies.

Yet, with diversification efforts having largely stalled and a parliament that has proven resistant to significant reform, the country's expenditure on its citizenry has ballooned to consume the majority of government spending, with the government consistently running budget deficits.

THERE HAS BEEN LIMITED DIVERSIFICATION, EITHER IN TERMS OF GDP OR KUWAIT'S FISCAL POSITION

Monica Malik, Abu Dhabi Commercial Bank

While the surge in oil prices in the wake of Russia's invasion of Ukraine may result in a surplus for the first time in nine years, a reduction in prices is set to lead to a deficit for the coming year.

The government's preliminary 2023/24 draft budget (for the year ending March 31, 2024) projects revenues of Kd19.5bn ($63.4bn), and expenditures of KD26.3bn.

While 88% of government income for the year is set to come from oil, 80% of spending has been earmarked for public sector salaries and subsidies.

"Spending on salaries, subsidies and transfers is huge, and has been crowding out project and development spending for years," says Steffen Hertog, associate professor of comparative politics at the London School of Economics and Political Science.

"There is continued pressure for highly inefficient and often socially regressive patronage spending from parliament."

Complicated political system

While Kuwait's over-reliance on oil revenues and the need to tackle its ever-larger wage and subsidies bill has been apparent for decades, the country's domestic politics have continued to hinder economic progress and development.

Unlike its Gulf neighbours, Kuwait's political system is not an absolute monarchy, but rather consists of a mixture of presidential and parliamentary systems, complicating the passage of key reforms.

"They don't have the top-down decision-making processes that their neighbours enjoy," says Robert Mogielnicki, senior resident scholar at the Arab Gulf States Institute in Washington.

"Kuwait also hasn't passed the leadership to a younger generation with a greater urgency and tolerance for changes to the economic landscape. We see this happening in Saudi Arabia, the UAE, Qatar and even Oman, [but] not so much in Kuwait."

Although the country's emir heads the executive, the country's 50-seat national assembly is elected and responsible for legislative, political and financial affairs, which include ratifications of public budgets as well as key legislative bills.

Since 2006, Kuwait has been subject to frequent political stalemates, a high turnover of government officials and cabinets, and frequent dissolutions of parliament.

"The underlying political economy leading to this stalemate is that parliament represents the citizen middle class, who depend on government employment and transfers. This middle class has almost no organic link to the private sector, which pays in taxes and employs only very few Kuwaitis," says Mr Hertog.

"So, the economic diversification agenda that would benefit the private sector is sidelined."

At the most recent parliamentary elections in September 2022, opposition candidates made considerable gains with 16 first-time parliamentarians. The breakdown in relations between

parliament and the government came swiftly, with a standoff between the two groups over a proposed debt relief law that would see the state buy up billions of dinars worth of personal debts accrued by Kuwaiti citizens, as well as the questioning of two ministers. The row prompted the resignation of the cabinet in January 2023 — the fifth in just over two years.

Kuwait's crown prince Sheikh Meshal al-Ahmad al-Sabah reappointed Sheikh Ahmad Nawaf al-Sabah as prime minister on March 5 and asked him to form a government.

Public debt law

Of the many key pieces of legislation that have been stymied by Kuwait's long-running political stasis, a new public debt law is perhaps the most glaring, with the country unable to raise debt via international markets over the past five years.

Kuwait sold its first and only Eurobond — an $8bn dual-tranche deal consisting of a $3.5bn 2.8% 2022 note and a longer-dated $4.5bn 3.6% 2027 piece — in March 2017. The issuance received orders amounting to $20bn.

While the deal was welcomed by international bond investors because of Kuwait's high sovereign credit rating, domestically it received strong criticism from segments of Kuwait's political and business class over corruption and wastefulness.

Following the expiration of public debt legislation in 2017, successive parliaments have failed to pass a permanent law, despite past government efforts.

"The passage of [a new] debt law might aid the country to raise finance from the capital market during periods of low oil revenues," says MR Raghu, CEO of Marmore Mena Intelligence, a subsidiary of Kuwaiti asset management firm Markaz. "This would help fund capital expenditure and prevent the erosion of Kuwait's reserves."

In the absence of a public debt law, Kuwait has relied on the General Reserve Fund, one of the main repositories of all of Kuwait's oil revenues, to make up its budget shortfalls in recent years. While such actions have seen the value of the fund — which receives 10% of state revenue every year (an arrangement paused in 2020 at the start of the Covid crisis) — depleted significantly, higher oil prices over the past year are expected to restore its fortunes somewhat.

A public debt law would provide the government with a fiscal anchor, reduce fiscal risks and improve its ability to manage adverse financial shocks, according to the IMF. In addition, the law would set a debt ceiling, improve financial transparency and clarify the borrowing of state-owned entities.

But Issam Altawari, managing partner at Newbury Economic Consulting, a Kuwait-based debt advisory firm, is sceptical that the debt law will be passed anytime soon, especially in light of higher oil prices.

"The Ukraine war has been a blessing in disguise for the oil market, it has helped to narrow the [government's] deficit gap, which means there is less fiscal need to borrow in international markets," he says. "However, as current expenditure is historically high, they will [eventually] need to borrow. They have to reinstate the government and see whether it can collaborate with the parliament and reach a common ground."

Calls for reforms

A new public debt law is just one of a series of reforms called for by international institutions such as the IMF, in order to prepare its economy and society for a post-oil future.

"Kuwait needs to meaningfully start with the diversification of its economy and fiscal position away from oil," says Ms Malik. "While Kuwait is [currently] benefiting from the stronger oil price, it will remain vulnerable to any reductions in prices and the global transition away from oil."

Mr Mogielnicki says reforming expenditures on government wages and other subsidies, which remain precariously high, should also be a priority for a state that remains hooked on proceeds from energy exports. "Kuwait has a tremendous amount of work to do to encourage genuine economic diversification, especially in terms of its public sector revenues," he says.

The country has not kept pace with the fiscal reforms of its neighbours, particularly in the area of taxation. In 2017, Kuwait agreed, along with its co-members of the Gulf Co-operation Council, to introduce value-added tax, but has yet to implement it or announce a formal date for doing so. The IMF has also encouraged Kuwait to introduce taxation like excise duties, expanding corporate tax to domestic firms and implementing property tax.

"We need reforms with regards to the constitution, the education system, economy, as well as introducing measures to curb corruption," says Mr Altawari. "There needs to be leadership with a clear vision — without [it], nothing will take place."

An increasingly urgent priority is the country's response to climate change. Kuwait faces acute risks relating to its impact on liveability, with summer temperatures regularly exceeding 50°C. A recent Harvard University study found that by mid-century, the average temperature in Kuwait is predicted to increase by between 1.8-2.6°C.

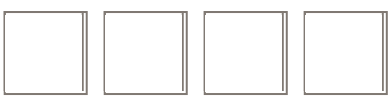
"The physical risks from heat impact people's day-to-day lives and will lead to more heat-related deaths as well as other adverse health impacts," says Blake Goud, CEO of the RFI Foundation. "The rise in temperatures also affects the oceans. The Arabian Gulf is warming faster than other oceans, presenting risk to fisheries and increasing reliance on imported food."

Kuwait's foreign minister, Salem al-Sabah, announced at the COP27 climate summit in November that the country was committed to becoming carbon-neutral in its oil and gas sector by 2050, and in the whole country a decade after that.

To support government climate commitments, entities including the Kuwait Investment Authority and National Bank of Kuwait (NBK) have made climate and sustainability a key part of their strategy. NBK has developed targets to reduce gross operational emissions by 25% by 2025 and aims to achieve net-zero operational greenhouse gas emissions by 2035.

"Initiatives are being taken to expand green financing solutions across a broad range of asset classes to tackle climate change challenges, setting up carbon funds and fund custody, expansion of paperless/digital business operations," says Mr Raghu.

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