

NEW IDEAS FOR KUWAIT

Incentives and structures for a brighter future

By Ali Al-Salim, October 2020

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FOREWORD

With Kuwait now running regular budget deficits and a sanguine outlook for oil demand, quiet panic has emerged amongst its technocrats, stoking debate around the ability to maintain the status quo. With income looking weaker but expenditures growing, budget figures simply do not balance; shortfalls are set to become larger, more frequent and with that, the certainty of disruption. This paper explores a novel proposal that may help improve the balance and sustainability of Kuwait's economy. Kuwait's volatile domestic political environment, antagonised by pervasive corruption allegations, requires solutions to be simple, transparent, and relatively easy to implement. Emphasis is therefore put on a possible solution that may be adopted with minimal legislative hurdles, averting both political headwinds and further bureaucracy.

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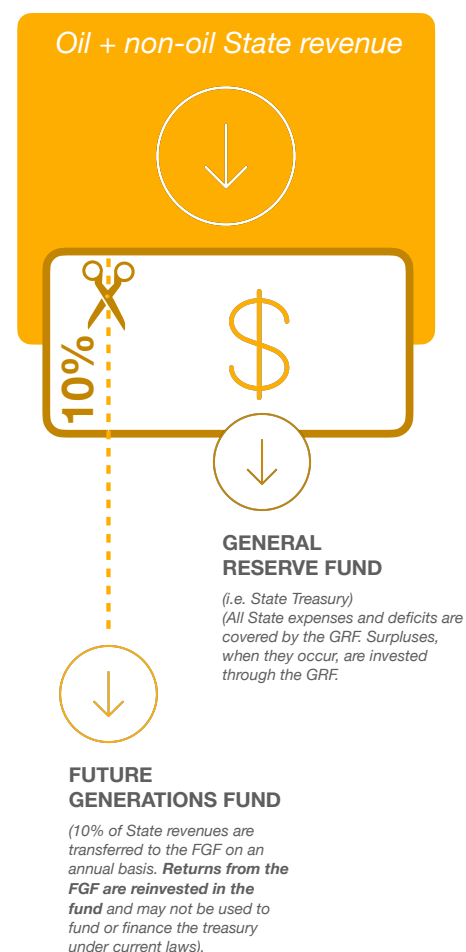
INTRODUCTION

THE FIRST QUARTER OF 2020 DELIVERED KUWAIT THE DOUBLE BLOW OF A PANDEMIC-INDUCED LOCKDOWN AND A RELATED COLLAPSE IN OIL PRICES. THESE EVENTS SWIFTLY DEGRADED THE FINANCIAL POSITIONS OF BOTH PRIVATE AND PUBLIC SECTORS, QUESTIONING —ONCE AGAIN— THE COUNTRY'S ECONOMIC SUSTAINABILITY.

So far this century, Kuwait's economic development has been stagnant with state spending, primarily through salaries and wages of public sector employment, continuing to drive the economy.¹ This was possible in the two decades that followed 2000 because of buoyant oil prices. Significant budget surpluses bestowed Kuwait with a financial cushion that it has significantly depended upon.²

Kuwait's oil revenues flow through the Ministry of Finance, which oversees two pools of sovereign capital, each ultimately managed by the Kuwait Investment Authority. The first is the General Reserve Fund (GRF), which is used to finance the budget. The second, established in 1976 and invested with a longer-term horizon, is known as the Future Generations Fund (FGF) and is regarded as the national savings vehicle.³ Every year, the law stipulates that 10% of all oil revenues are seamlessly transferred to the FGF.⁴ Consecutive budget deficits since 2014 have now entirely eroded the value of the GRF, with pressure now mounting to enact laws allowing debt issuance, or the FGF, to make up the shortfall.

CHART A. SIMPLIFIED FLOW AND DISTRIBUTION OF STATE REVENUE



¹ The World Bank, Kuwait's Economic Updated April 2020, <https://www.worldbank.org/en/country/gcc/publication/kuwait-economic-update-april-2020> (accessed 27 June 2020)

² CEIC, Kuwait's Government Surplus/Deficit from 1989 to 2018, <https://www.ceicdata.com/en/kuwait/government-revenue-and-expenditure-annual/government-surplusdeficit> (accessed 27 June 2020)

³ Kuwait Investment Authority, <https://kia.gov.kw/investments/> (accessed 11 July 2020)

⁴ Law was amended on 19 August 2020 for the transfer to be conditional only if the budget registers a surplus in that year.

In a publication for the London School of Economics Kuwait Programme, Dr. Al-Ojayan clearly describes the problem:

“While Kuwait has the financial power to maintain government spending for a considerable period, it may not be sustainable in the longer term. The government remains heavily dependent on oil exports, having failed to build an entrepreneurial system that can alleviate the burden of demographic drag on the fiscal budget.”⁵

Whilst Kuwait has a vibrant community of entrepreneurs, current legislation creates barriers for private enterprise to achieve its full potential and incentivises citizens to refrain from pursuing such endeavours.

The lack of economic progress is often attributed to an increasingly toxic political environment where progressive policy has become almost impossible to implement. The situation is perpetuated by politicking policymakers and their influencers, including the cabinet, parliament, merchant-class, and tribal factions.⁶

However, there is one thing everyone can agree on, and that is Kuwait upholds policies, reinforced by its constitution, to largely spend the rents it receives from oil exports on its citizens.

Beginning in the 1940s, Kuwait’s nascent welfare system went on to deliver immeasurable value to its once stricken citizens. It has provided every conceivable item of infrastructure from roads, schools and hospitals to lifelong jobs paying generous salaries. Social benefits were extended in the 1970s to include one of the world’s lowest-age retirements on a —now few remaining— defined-benefit pension.⁷

Today, Kuwait is home to 16 Ministries, more than 35 different Bureaus, Commissions, Councils and Public Authorities and around 25 other government-owned institutions and companies. Kuwait also counts no fewer than 38 types of state allowances in its annual budget, a convoluted document publicly available on the Ministry of Finance website.⁸

70%

OF THE BUDGET IS CONSUMED BY SALARIES, ALLOWANCES, AND SUBSIDIES

80%

OF CITIZENS ARE EMPLOYED BY THE STATE IN +66 GOVERNMENT BODIES

4.5%

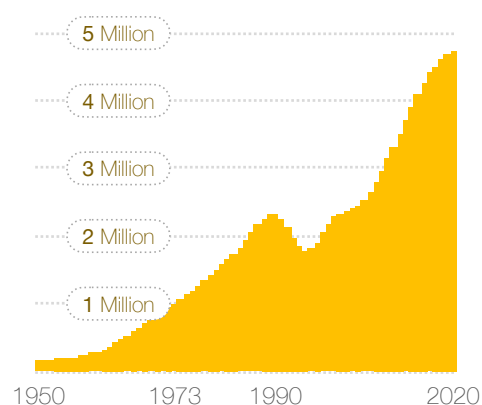
ANNUAL GROWTH RATE OF CITIZENS EMPLOYED IN THE PUBLIC SECTOR (FROM 2014 TO 2019)

-0.3%

TOTAL DECLINE RATE OF CITIZENS EMPLOYED IN THE PRIVATE SECTOR (FROM 2014 TO 2019)

CHART 1. KUWAIT TOTAL POPULATION, 1950-2019 (MILLIONS)

UN Department of Economic and Social Affairs



⁵ LSE Kuwait Programme Paper Series, Treating the oil addiction in Kuwait: proposals for economic reform, <http://eprints.lse.ac.uk/67888/> (accessed 27 June 2020)

⁶ Encyclopaedia Britannica, Kuwait: Political Conflict and reform in the early 21st Century, <https://www.britannica.com/place/Kuwait/The-Persian-Gulf-War-and-its-aftermath#ref282002> (accessed 27 June 2020)

⁷ The National, GCC Pension funds are ripe for reform, <https://www.thenational.ae/business/money/the-gcc-s-pension-systems-are-ripe-for-reform-1.793926> (accessed 27 June 2020)

⁸ Kuwait Ministry of Finance, The Final Account, <https://mof.gov.kw/MofBudget/MofBudgetDetail.aspx#mofClosingAcc1>, (accessed 5 July 2020)

Although the welfare system began with good intentions, over its near 100-year existence it has slowly morphed into a sprawling costly giant, riddled with inefficiency. Evidence from studies show it has an increasing risk of doing more damage than good.⁹ Already some 80% of Kuwaitis work for the state, with salaries, allowances and subsidies consuming over 70% of the total budget.¹⁰

International consulting bodies specialised in economic development and fiscal prudence, including the World Bank and the IMF, continue reciting prescriptions for reform that include cutting subsidies, introducing taxes and other measures to encourage private sector growth. Whilst acknowledged by Kuwait's technocrats, few suggestions are implemented.

Considering the depicted backdrop, this document proposes that Kuwait should explore new ideas - *grounded in reasoning and framed by local constraints* - that can help contribute to securing a fiscally sustainable future. At the heart of this document is one such proposal to help Kuwait reduce inefficiencies and support the rebalancing of its economy in a manner that is politically feasible today.

⁹ The London School of Economics, Anatomy of an oil-based welfare state: rent distribution in Kuwait. Kuwait Programme on Development, Governance and Globalisation in the Gulf States research papers, <https://eprints.lse.ac.uk/55663/> (accessed 27 June 2020)

¹⁰ Arab Times, End of economic reforms as Kuwait sets 71% of budget for salaries and subsidies, <http://www.arabtimesonline.com/news/end-of-economic-reforms-as-kuwait-sets-71-of-budget-for-salaries-and-subsidies/> (accessed 4 July 2020)

THE PROBLEM

MANY OF KUWAIT'S PROBLEMS STEM FROM A BLOATED PUBLIC SECTOR THAT IS OBLIGED BY THE CONSTITUTION TO CONTINUE HIRING CITIZENS FAR BEYOND ITS NEED FOR THEM.

The growth of Kuwait's population over its modern history is staggering. From a little more than 150,000 at the start of the 1950s, Kuwait's population has increased rapidly to more than 4.7 million today, a multiple of 25 times. The only evident aberration in the trend (Chart 1) was a temporary decrease starting in 1990 from primarily expatriate departures during and after the Iraqi invasion, and the ensuing first Gulf War.

In the 1950s, the population was quite homogenous. Today, however, Kuwaiti citizens are a minority estimated to number around 1.34 million or just 30% of the 4.42 million total population.¹¹ The overwhelming majority of the population is expatriates, primarily South East Asian and other Arab nationalities.

Although expats resident in Kuwait benefit from most state subsidies, their residency is typically connected to employment, and subject to renewal. Kuwaiti citizens, however, are effectively the only permanent residents in the country that are explicitly entitled to the state's resources. Over the last five years, the Kuwaiti citizen population alone has been growing at an average annual rate of 2.6%, rising from 1.15 million at the start of 2014 to 1.34 million by 2019.

Employment Growth

The working-age population of a country includes those of an age eligible to join the labour force. For this exercise we have set it as between the age 20 and 59 to coincide with age-brackets of government statistics. Chart 2 shows the Kuwaiti citizen working-age population has grown in line with the overall Kuwaiti citizen population, at an average rate of 2.6% annually over the same period, from around 559,000 at the start of 2014 to 653,000 by 2019.

CHART 1. KUWAIT TOTAL POPULATION, 1950-2019 (MILLIONS)
UN Department of Economic and Social Affairs

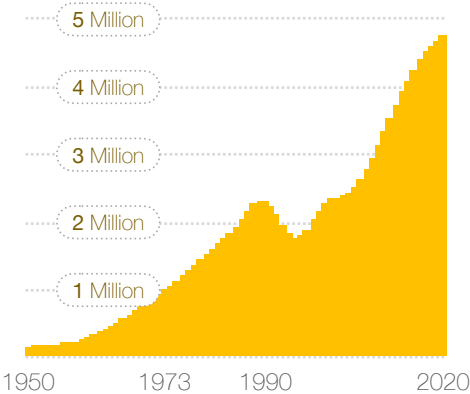
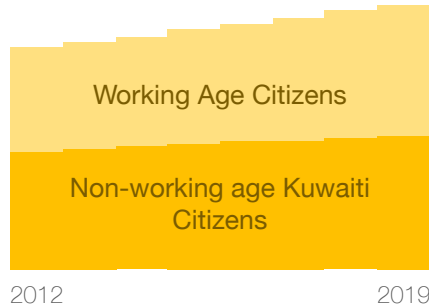


CHART 2. KUWAITIS: WORKING AND NON-WORKING AGE POPULATION, 2012-2019
Kuwait Central Statistical Bureau



¹¹ Central Statistical Bureau, 2018, https://csb.gov.kw/Pages/Statistics_en?ID=67&ParentCatID=1 (accessed 14 June 2020)

As the number of working-age Kuwaitis increases, so too does the demand for jobs. Kuwait’s government, however, has been the sole job-creator, whilst practically no employment has been generated by the country’s private sector.

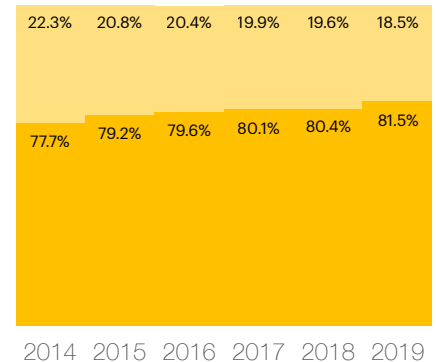
From 2014 to 2019 the number of Kuwaitis employed in the public sector has grown from around 259,000 to 322,000, or on average 4.5% annually. These numbers are understated, as they exclude all those in the Military and National Guard whose numbers are not publicly disclosed.

The private sector on the other hand went from employing 74,400 Kuwaitis in 2014 to just 73,200 at the end of 2019, reflecting an average annual decline of -0.3%.

Public sector employment of Kuwaitis has grown by 63,000 over the period whilst private sector employment was stagnant and fell slightly. This means that on a relative basis, public sector employment has continued to grow as a percentage of total Kuwaiti citizen employment. Today, over 80% of all employed Kuwaitis work in the public sector, one of the world’s highest ratios compared to the OECD average of less than 20%.¹²

CHART 3. KUWAITIS: PUBLIC VS. PRIVATE EMPLOYMENT, 2014-2019

Kuwait Central Statistical Bureau



¹² OECD, Government at a Glance 2017, https://www.oecd-ilibrary.org/governance/government-at-a-glance-2017/employment-in-general-government_gov_glance-2017-24-en (accessed 12 July 2020)

Public Sector Saturation

Several problems arise from this development, particularly as the public sector does not need more employees. The overwhelming majority of the jobs created are administrative and clerical. Kuwait has long passed its point of needing more administrative capacity. Existing roles are already unproductive, and in many cases counterproductive, as they create frictions to an already highly bureaucratic economy.

Independent assessments, such as the World Bank's Ease of Doing Business 2020 study show, despite its small size, Kuwait ranks 83 out of 190.¹³ Digitising and streamlining bureaucratic procedures have managed to help it slowly climb the rankings, however, by definition, these improvements do not require additional hiring.

Although the marginal employee added to the public sector fails to add value to the economy, the Kuwaiti constitution requires the state to provide a job to every citizen.¹⁴ Bearing in mind the constitution was written in 1962, a time when the population was small, demands were elementary, and the cost of doing so was manageable. Today the state is caught in a malicious cycle, fabricating unproductive employment openings just to remain constitutionally compliant.

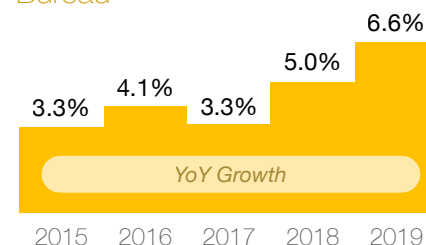
The problem is magnified further by demographics, as Kuwait expects a record number of citizens to enter the labour force over the next few years. In March 2020, the IMF reported:

“Given the fiscal challenges, scope for public sector employment growth will be limited. This makes the private sector crucial in absorbing most of 100 thousand Kuwaiti nationals (22 percent of the current Kuwaiti labour force) expected to enter the job market in the next 5 years.”¹⁵

Should this materialise, as is likely the case, the current system's inefficiencies will be magnified. Chart 4 shows the growth in public sector employment has already begun accelerating.

CHART 4. PUBLIC SECTOR EMPLOYMENT GROWTH IS ACCELERATING, 2015 - 2019

Kuwait Central Statistical Bureau



¹³ The World Bank, 2019, Doing Business 2020, <https://www.worldbank.org/en/news/press-release/2019/10/24/doing-business-2020-kuwait-ranking-improves-from-97-to-83-joins-the-top-10-improvers-in-the-world> (accessed 14 June 2020)

¹⁴ Kuwait National Assembly, The Constitution of Kuwait, Article 41, <http://www.kna.kw/ctt-html5/run.asp?id=2024> (accessed 14 June 2020)

¹⁵ IMF, Kuwait: 2020 Article IV Consultation-Press Release ; Staff Report; and Staff Supplement <https://www.imf.org/en/Publications/CR/Issues/2020/03/27/Kuwait-2020-Article-IV-Consultation-Press-Release-Staff-Report-and-Staff-Supplement-49294> (accessed 23 June 2020)

Public Sector Salaries

It is subsequently no surprise that the largest single item in Kuwait's annual budget is salaries and wages. Public sector wages are high, both relative to the private sector and internationally, as evidenced by Chart 5. Higher wages, guaranteed employment, and shorter working hours combine to form a powerful incentive for Kuwaitis to choose public over private sector employment.

Although public sector salaries and other employee compensation, including social benefits, are disclosed in the national final accounts, the total value disbursed to employees is difficult to extract because of public finance accounting procedures and inter-ministry arrangements. However, several Ministry of Finance presentations provide a total figure, as shown by annual salaries in Chart 6.¹⁶

Between 2015 and 2017, actual salaries and employee compensation averaged 73% of the country's total revenue. A growing cohort of working age Kuwaiti citizens, at a time when payroll to revenue ratios are already at record highs, paints an untenable future for continued public sector employment.

Public Sector Outcomes

The single biggest employer of Kuwaiti citizens in the country is the Ministry of Education, with approximately 83,000 Kuwaiti staff.

In the Final Accounts of the 2018-2019 financial year, Kuwait's Ministry of Education was the third largest item of total public spending, costing the state around KWD 2.1 billion (USD 6.7 billion). Kuwait's score in terms of years of schooling and performance in maths and science however has not been commensurate as shown in Chart 8 below.

Considering the headcount and the budget amount allocated to the Ministry of Education it is surprising that education quality lags those of neighbouring states, most of which have lower GDPs per capita.

CHART 5. PUBLIC WAGE PREMIUM, 2005 TO 2016 AVERAGE (%)

IMF

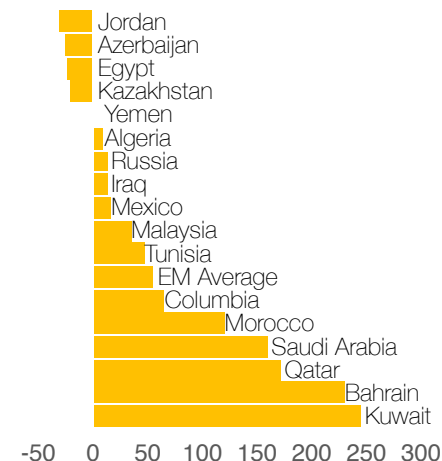


CHART 6. KUWAIT STATE REVENUES, SALARIES AND WAGES (KWD BILLIONS)

Kuwait Ministry of Finance

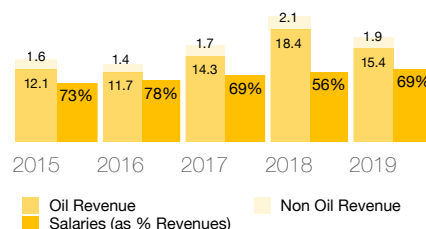


CHART 7. KUWAITI EMPLOYMENT BY STATE ENTITY - TOP 10

Kuwait Central Statistical Bureau

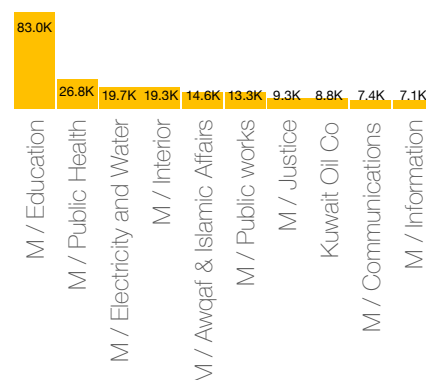
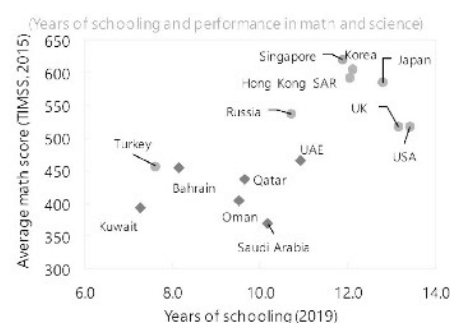


CHART 8. LENGTH AND QUALITY OF EDUCATION

IMF



¹⁶ Kuwait Ministry of Finance, Annual Accounts 2017-2018, <https://mof.gov.kw/FinancialData/PeriodRwReport/PDF/FinalAccountPDF/closingaccount17-18.pdf>, (accessed 15 June 2020)

Other —even broader— measures of human development also support this observation. The United Nations Development Programme’s Human Development Index (HDI)¹⁷ is:

“... a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and have a decent standard of living.”¹⁸

Chart 9 shows, over 10 years, Kuwait has consistently stayed at the bottom of the ranking of all GCC countries.

The large scale of resource inputs and low-quality corresponding outputs strongly suggest the education system as it stands is, at best, inefficient, and at worse, ineffective.

Public Sector Revenues

It is critical to understand how Kuwait’s public services are funded. State oil revenues continue to dominate Kuwait’s economy, averaging around 90% of total revenues over the past decade as shown in Chart 10. This makes Kuwait’s economy hugely sensitive to the price of a single commodity, crude oil.

Brent crude approximates the price of oil exported by Kuwait and as evidenced by Chart 11, has a volatile price history. The historical annualised volatility of Brent Crude over the past 30 years is 33%.

Revenue volatility complicates government budgeting as state revenues can greatly fluctuate from one period to the next. At the same time, government spending is under pressure to be kept relatively stable, as a large component of the budget is salaries and wages. At times when revenues do not cover expenses, other sources of funds must be used to cover shortfalls. In recent history Kuwait has resorted to drawing down on surpluses built up during the oil bull market years between 2005 and 2014, to cover revenue shortfalls.

CHART 9. HDI TRENDS FOR KUWAIT, UNITED ARAB EMIRATES AND SAUDI ARABIA, 1990-2018

The UNDP, Human Development Reports ¹⁶

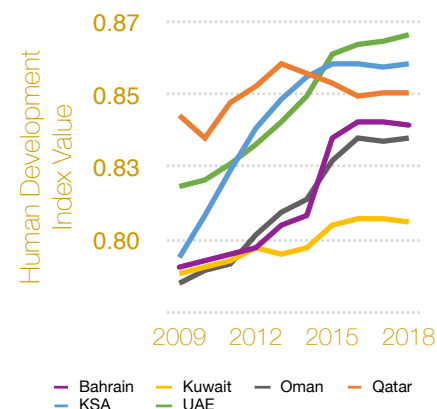


CHART 10. OIL REVENUE AS % OF TOTAL REVENUE

Kuwait Ministry of Finance

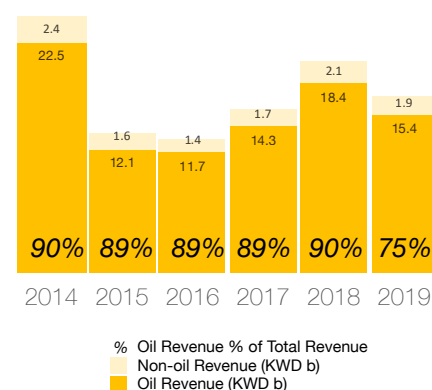


CHART 11. BRENT CRUDE OIL PRICE (USD)

IMF, St Louis Fed



¹⁷ The UNDP, Human Development Reports, <http://hdr.undp.org/en/data#> (accessed 27 June 2020)

¹⁸ The UNDP, Human Development Index, <http://hdr.undp.org/en/content/human-development-index-hdi> (accessed 12 July 2020)

Today, these surpluses have been exhausted and Kuwait faces a limited number of options, not all of which are within its control, including:

- 1) Draw down on the FGF, which would require new legislation.
- 2) Receive a higher oil income through increased production volumes or higher prices.
- 3) Increase non-oil revenues via taxes.
- 4) Make significant cuts to the national budget.
- 5) Increase national borrowing to finance the deficit.¹⁹

Each of these options are either uncertain, unacceptable, or unsustainable long-term paths to take.

Political Inertia and Constraints

Although Kuwait's current Prime Minister has outlined a desire to cut subsidies by 20%,²⁰ if history is our guide, the likelihood of Kuwait developing a more balanced and sustainable economy through its current policymaking-lens is improbable. Kuwait's representatives, democratically elected to the National Assembly, have 4-year terms. As per the constitution, the Assembly can be dissolved at any time by decree from the Amir. At the time of writing this document, the current Assembly was just months away from completing its first full, uninterrupted term in 17 years. Frequent dissolutions have meant Kuwait has gone through no less than six general elections in the decade following the 2008 global financial crisis, impeding new legislation at a critical time. All the reform plans in the world are pointless if the political consensus to pass them into law does not exist.

The other constraint is the constitution, a document sacred to the Gulf's most democratic state that is also a Pandora's box, should it be open to revision. The scope for abuse — should it be amended — implicitly restricts Kuwait to policies that are compatible with its founding text. Considering these points, highly politicised solutions to Kuwait's economic challenges are unlikely to succeed.

“ALL THE REFORM PLANS IN THE WORLD ARE POINTLESS IF THE POLITICAL CONSENSUS TO PASS THEM INTO LAW DOES NOT EXIST.”

¹⁹ Reuters, Kuwait scrambles to boost coffers with up to \$16 billion debt plan, <https://www.reuters.com/article/us-kuwait-economy-debt-exclusive/exclusive-kuwait-scrambles-to-boost-coffers-with-up-to-16-billion-debt-plan-idUSKCN24K0EO> (accessed 20 July 2020)

²⁰ Reuters, Kuwait to cut government entities' budget for fiscal year 2020-2021 by at least 20% <https://www.reuters.com/article/us-kuwait-budget-cuts/kuwait-to-cut-government-entities-budget-for-fiscal-year-2020-2021-by-at-least-20-idUSKBN23B2YA> (accessed 17 June 2020)

The Problem: Summary

Many of Kuwait's problems today arise from a bloated public sector *obliged* to continue hiring citizens. The public sector does not need more staff to operate; additional hiring instead goes to magnify problems by producing additional bureaucracy and slowing down economic dynamism, particularly that of the private sector. The attraction of Kuwaitis to the public sector also creates a domestic brain-drain, where young, educated citizens are funnelled into underproductive careers compared to their true potential. Aside from the economic impact, this also has significant well-being and social implications for the population.²¹

The onset of the COVID-19 pandemic resulted in a government-mandated economic shut-down. However, the delayed reaction by the government to introduce an adequate private sector stimulus plan may further damage Kuwait's private sector.^{22,23} This behaviour risks compromising the capacity of the private sector to create opportunities for Kuwaitis, and seeds doubt around job security for those considering private sector employment.

Considering the constraints of the constitution and complex political and social dynamics, the most feasible assistance that can positively shape Kuwait's economic future must emerge from the current body of legislation.

Desperate times call for equally desperate measures, so we propose a solution that may sound radical at the outset, but upon closer examination holds up exceptionally well to rational cross-examination. The solution enhances transparency, reduces corruption, delivers accountability, imposes responsibility and gently ushers in sustainability. The surprising aspect you will discover, is that Kuwait is somewhat already on its path to reform, needing only a handful of changes to drive the desired outcomes.

²¹ WHO, Mental Health in the workplace, https://www.who.int/mental_health/in_the_workplace/en/ (accessed 20 July 2020)

²² BloombergQuint, Fiscal Nightmare Ties Up Kuwait's Stimulus With 40% Deficit, <https://www.bloombergquint.com/politics/fiscal-nightmare-ties-up-kuwait-crisis-stimulus-with-40-deficit> (accessed 23 June 2020)

²³ Bensiri Public Relations, Kuwait COVID-19 Business Impact Survey, <https://www.pnewswire.com/news-releases/kuwait-covid-19-business-impact-survey-finds-45-of-businesses-have-shut-down-since-february-301060491.html> (accessed 5 July 2020)

A PROPOSED SOLUTION

AN EFFECTIVE AND FEASIBLE SOLUTION FOR KUWAIT IS TO STREAMLINE THE OIL-REVENUE DISTRIBUTION MECHANISM. TODAY, KUWAIT CONTENDS WITH LAYERS OF INEFFICIENCIES THAT HAVE DEVELOPED OVER DECADES IN THE PROCESS OF ENSURING NATIONAL WEALTH IS DISTRIBUTED TO CITIZENS.

An example of a large and very tangible inefficiency is the stock of physical infrastructure that has been created, and continues to be built, to deliver on the notion of “a job for every Kuwaiti”. In the 2018-2019 financial year, over USD 330 million was spent in constructing and maintaining government office buildings.²⁴ Less obvious economic costs also emerge, including those associated with cooling said buildings, providing them with water and electricity,

24 Kuwait Ministry of Finance, Final Accounts 2018-2019, <https://mof.gov.kw/FinancialData/PeriodRwReport/PDF/FinalAccountPDF/Total2018-2019.pdf> (accessed 5 July 2020)

office supplies, road and transport infrastructure and the consumption of petrol to facilitate daily commutes. These all greatly increase the volume of misallocated resources because of an oversized public sector workforce.

There are two schemes that form the pillars to this proposal. The first scheme is titled **New Incentives** and draws Kuwait's citizens toward more optimal methods of receiving incomes promised by the state. The second scheme is **New Structures**, which maximises the efficacy of the **New Incentives** by pushing ahead with many existing reform plans whilst mitigating political friction.

The Solution: New Incentives

There is an alternative to creating fictitious jobs and more bureaucracy. We propose the adoption of the radical yet logical policy of giving Kuwaitis the option not to work, but still receive a state salary. At the same time, whilst receiving their state salaries, citizens would also be allowed to freely participate in the private sector at their discretion.

The proposed solution has the potential of offering significant immediate and long-term positive effects on the country's operating and capital expenditures, infrastructure, politics, economic diversification and the environment, that are explored below.

Immediate Benefits

Political

- 1) Less pressure on the government to create job openings within an already overwhelmed and convoluted public sector.
- 2) Greater government budget transparency with extremely limited room for corruption, through an easy to understand, uniform, universal payment scheme.
- 3) Less demand on the government to provide public services at the level of quality expected from today's modern society.
- 4) Reduction in amount of time spent by policy makers on corruption issues.
- 5) Complies with the constraints of Kuwait's Constitution, with minimal new laws to be enacted.

Economic

- 1) Lower demand for physical office infrastructure and demand for utilities such as electricity and water to accommodate new employees.
- 2) Immediate capital and operating expense savings.
- 3) Allows the government to focus on a reduced core portfolio of services.
- 4) Smaller public sector bureaucracy improves the capacity to streamline administrative processes, helping the private sector.
- 5) Easier path to digitising government services, which increase efficiency and limit corruption.
- 6) Greater scope for private sector to deliver superior quality services incentivised by the profit motive.

Social & Environmental

- 1) Introduces freedom for Kuwaiti citizens to pursue alternative, more optimal activities of choice, nudging citizens toward productive employment.
- 2) Greater scope for adult members of a family to spend time with their children, elder family members, or work from home. Improves family unity, increases parent-child time, and potentially reduces the overall number of domestic support staff required.
- 3) Traffic congestion is likely to decrease due to a reduction in numbers commuting to and from offices, improving quality of life and the environment.
- 4) Smaller footprint of public buildings means lower electricity demand, resulting in lower fossil fuel energy consumption.

Implementation Mechanism

This proposal suggests Kuwait implements the changes in the most direct and politically feasible way. To achieve this, the proposal makes use of as many existing laws as possible and considers the constraints imposed by the Kuwait Constitution. Correctly implemented, Kuwait can radically reform the country's problematic incentive structures and unlock greater economic dynamism in a politically viable manner.

Kuwait's General Authority for Manpower (GAM) is home to a scheme named "Da'am Al A'amala" (DA) that started over a decade ago to provide a government-administered stipend to Kuwaitis that chose to work exclusively in the

"THE PROPOSED SOLUTION HAS THE POTENTIAL OF OFFERING SIGNIFICANT IMMEDIATE AND LONG-TERM POLITICAL, ECONOMIC, AND SOCIAL BENEFITS."

private sector. Although partially funded by taxing the profits of publicly listed private sector companies, the state is responsible for contributing the balance. The stipend is offered in addition to basic pay received from a private employer. DA's aim was to create an economic incentive to pursue employment outside of the already bloated public sector. In many ways it resembles what economists call Universal Basic Income (UBI).

DA would become the central mechanism for delivering the **New Incentives** scheme.

Qualification

The current value of the DA stipend is based on the level of education but should instead be simplified and made equal for all Kuwaiti citizens of working age. DA is also currently only available to full-time employees of the private sector. Our implementation requires that all working age citizens should be able to apply for, and receive, DA.

Employment

DA should no longer be paid as a stipend, but as a salary for 'working' at GAM. The organisation would have its capacity to hire effectively uncapped, allowing as many eligible citizens to join or transfer to its payroll as required. Employees of GAM would also be allowed to participate in the private sector - *either as employees or as business owners* - at their own discretion.

A job at GAM, would not require its employees to attend a physical workplace, nor would it require any tasks to be performed. This allows GAM employees receiving DA to pursue other ventures whilst receiving a substantial basic income.

Stipend Value

Kuwait's government and public sector shelters citizens from the volatility of oil prices and thus state revenues, as illustrated by Chart 6. Fixed wages that only increase over time are obviously untenable. If oil revenues were to stay lower for longer, as previously emphasised that Kuwait would have to sell down FGF assets to finance the shortfall, or resort to significant borrowing through debt issuance. Neither of these two paths are sustainable. A more realistic approach is to pass on the volatility of oil prices to Kuwaiti citizens.

The aggregate value of DA should be linked directly to a percentage of Kuwait's oil revenue. This achieves two

“CORRECTLY IMPLEMENTED, KUWAIT CAN RADICALLY REFORM THE COUNTRY'S PROBLEMATIC INCENTIVE STRUCTURES AND UNLOCK GREATER ECONOMIC DYNAMISM IN A POLITICALLY VIABLE MANNER.”

things. It introduces the notion of variability to incomes which has a significant psychological impact. Kuwait already has the lowest savings rate in the Gulf because public sector salaries are implicitly guaranteed.²⁵ A variable income is likely to result in a higher savings rate, and greater capital formation that can be used more productively. It also defines a fixed ratio of direct oil-income sharing between the state and its citizens, allowing government spending on core services to continue without being crowded out by fixed public sector salaries and wages when oil revenues are low.

The total salary figures shown in Chart 6 from Kuwait's Ministry of Finance presentation average around 70% of total revenues. We propose that the percentage could be allowed to grow to a similar range, with the precise figure becoming the central focus of political discourse and the legislative process. Care should be taken to ensure today's value of DA per participating citizen is calibrated to provide an adequate incentive to switch from the public sector.

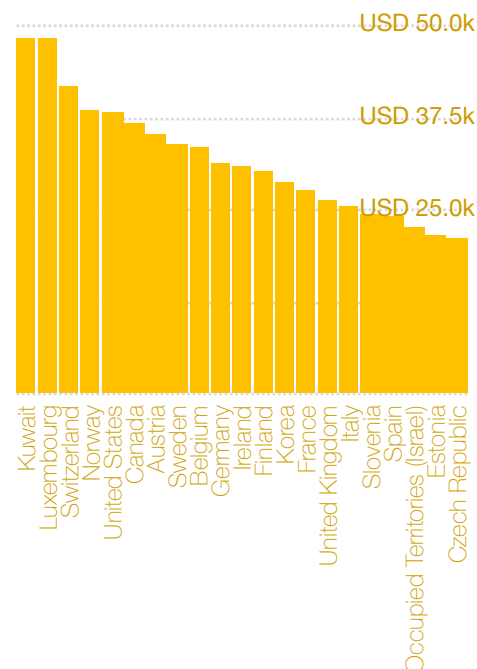
As of 2019, the average Kuwaiti public and private sector salaries were KWD 1,510 and 1,191, respectively²⁶ Setting DA today at KWD 1,250 per month, for example, would equate to a very generous tax-free income for no time commitment.

Chart 12 illustrates how such an amount would secure a globally unprecedented purchasing power and standard of living for every participating Kuwait citizen. On a PPP adjusted basis (using the largest international data set available from 2017) this would have equated to an annual income of over USD 50,000 per Kuwaiti adult. This is the equivalent of over USD 100,000 annually, tax-free, for a household of two adults. By contrast, the median household income in the United States is less than USD 65,000.²⁷

Linking DA to oil revenues means that were oil prices to increase, then DA would too. This could see DA cross above KWD 2,000 in some years, which would serve to increase the incentive to enroll in the programme.

CHART 12. MEDIAN DISPOSABLE INCOME PER WORKING AGE POPULATION, 2017

OECD, World Bank, author calculations



²⁵ Arab Times, Kuwait Records Lowest Rate of Savings in the Gulf Region, <https://www.arabtimesonline.com/news/kuwait-records-lowest-rate-of-savings-in-the-gulf-region/> (accessed 22 July 2020)

²⁶ Labor Market Information System, https://www.lmis.csb.gov.kw/En/integrateddata_graphview.aspx?graph_id=2029, (accessed 25 July 2020)

²⁷ United States Census Bureau, U.S. Median Household Income up in 2018 from 2017, <https://www.census.gov/library/stories/2019/09/us-median-household-income-up-in-2018-from-2017.html> (accessed 25 July 2020)

The Solution: New Structures

This proposal requires the government also conducts several reform measures that have been repeatedly prescribed, including broad deregulation and privatisation. Whilst not new ideas, they may be easier to implement with the proposed **New Incentives** in place.

Privatisations

In parallel to the redesigned DA scheme, the government must carry out further privatisations. Focus should be on state utilities, such as water and electricity, but additionally education and healthcare.

To overcome popular resistance, privatisations would see public utilities put into companies whose shares would be distributed on a pro-bono *and* pro-rata basis to every citizen. The gas-powered electricity and water plant, Shamal Az-zour, is a successful recent example, although citizens were required to pay for subscribed shares.²⁸ This wealth distribution would allay fears that a sale by the government would result in financial proceeds that could be misused by the state.

In return for freely distributed privatisations, Kuwaiti citizens would forfeit subsidies (*see Overnight Subsidy Reform below*). If citizens receive DA they can easily afford all their basic needs and pay prices dictated by a free market. Furthermore, efforts must be made to educate citizens that any profits made by the utility company could be distributed back to citizens as dividends.

This is a key part of the solution, that of a free market that lets demand and supply meet at a consensually determined price, and where Kuwaiti citizens can participate in the efficiency gains.

Health Insurance

Kuwait has a chronic public health problem that is rooted in lifestyle choices. Cardiovascular disease accounts for 46% of all mortality in Kuwait according to the World Health Organisation,

“... obesity, diabetes, dyslipidaemia and physical inactivity show an alarmingly high prevalence and are emerging as major risk factors, demanding a shift from curative to preventive medicine.”²⁹

**“DA WOULD
BECOME THE
CENTRAL
MECHANISM FOR
DELIVERING THE
NEW INCENTIVES
SCHEME.”**

²⁸ Shamal Azzour, <https://aznoula.com/en/> (accessed 13 July 2020)

²⁹ WHO Country Cooperation Strategy 2012-2016, http://apps.who.int/iris/bitstream/10665/113231/1/CCS_Kuwait_2014_EN_15234.pdf (accessed 23 June 2020)

A portion of DA would be mandated to be spent on newly introduced health insurance for every citizen. This would incentivise citizens to take better care of their own health, something that is lacking today.

Mandatory health insurance creates another desirable incentive for Kuwaiti citizens. The desire for a longer and better-quality life aside, economically speaking, the less of one's DA salary spent on insurance premiums, the more discretionary income available to the individual.

Lower premiums for healthier individuals is a strong incentive that, combined with competitive private healthcare, will drive a greater emphasis on preventative measures. Putting the responsibility for the delivery of healthcare services into the hands of profit-motivated private sector operators increases choice and competition, leading to a better service that is more efficient.

Market Liberalisation

The government must further liberalise parts of the local economy under its direct control, allowing more independent operators within utilities, healthcare, education and other tightly controlled sectors. Kuwait's successful reforms in the telecommunications sector have resulted in more competition, lower prices and better service for consumers. It is no coincidence that Kuwait has gone on to achieve a world-leading position in 5G adoption, having achieved one of the most comprehensive deployments globally.³⁰ This was accomplished without explicit government financing, and was greatly facilitated by economic liberalisation and a competitive market environment.

Increasing competition is good in that it reduces inefficiencies, lowers prices and rewards excellence, resulting in better outcomes for consumers. Today, Kuwait is far from competitive, meaning its output and performance suffers in many sectors due to state monopolies or excessive red tape.

Overnight Subsidy Reform

High incomes distributed directly to every citizen via DA mean subsidies are no longer needed. The removal of subsidies simplifies policy by eliminating the timeless challenge of assessing claims and directing support to only those that need it most. Kuwait's current subsidies across

“TO OVERCOME POPULAR RESISTANCE, PRIVATISATIONS WOULD SEE PUBLIC UTILITIES PUT INTO COMPANIES WHOSE SHARES WOULD BE DISTRIBUTED ON A PRO-BONO AND PRO-RATA BASIS TO EVERY CITIZEN.”

³⁰ Telecoms.com, Omdia crowns South Korea as global 5G leader, <https://telecoms.com/504802/omdia-crowns-south-korea-as-global-5g-leader/> (accessed 4 July 2020)

fuel, electricity, healthcare, and food are blanket subsidies, offered to both those that genuinely need them and an overwhelming majority that do not. They are hugely inefficient, wasteful, and increasingly costly policies to run. There is also growing public debate and tension related to the amount of subsidy benefits that accrue to the majority expatriate population. Broadly offered DA eliminates this entire topic of contention from public discourse in one fell swoop, as citizens could afford to pay market determined rates.

Filling the Void Left by Government

When Kuwait needs new infrastructure, such as a port or a train-line, then those with the demand or idea must be free to establish companies to design and build it.

Companies may raise capital from the country's citizens, meaning infrastructure projects create domestic investment opportunities for those with excess capital, while reducing the amount leaving the country. Government-led projects have been notoriously slow undertakings and almost always faced punitive cost overruns.³¹ Kuwait's current Foreign Direct Investment (FDI) level is by far the lowest in the Gulf.³² Viable projects with proven local operators that are profit-seeking are much likelier to attract FDI.

By allowing infrastructure to be delivered by the private sector and citizens' savings, greater accountability is demanded of those in charge of delivering. Project sponsors with poor performance and weak track records will ultimately not continue to attract funding.

This process also transforms the notion of knowledge-transfer from an attempt at a "nice to have", to something critically important, as the true cost of hiring expensive foreign consultants is now borne by profit-seeking entities. It will incentivise technical expertise to be rapidly developed in-house and retained for future benefit.

A revised DA would also mean fewer state tenders to compete for, as much of the infrastructure, healthcare and education systems would be privatised. The financial impact of corruption associated with government-awarded contracts would therefore reduce.

“BY ALLOWING INFRASTRUCTURE TO BE DELIVERED BY THE PRIVATE SECTOR AND CITIZENS’ SAVINGS, GREATER ACCOUNTABILITY IS DEMANDED OF THOSE IN CHARGE OF DELIVERING.”

“IT IS NO COINCIDENCE THAT KUWAIT HAS GONE ON TO ACHIEVE A WORLD-LEADING POSITION IN 5G ADOPTION ... WITHOUT EXPLICIT GOVERNMENT FINANCING, ... GREATLY FACILITATED BY ECONOMIC LIBERALISATION.”

31 The Times, Project Delays hurting Kuwait development, <https://www.timeskuwait.com/news/project-delays-hurting-kuwait-development/> (accessed 13 July 2020)

32 CEIC, Kuwait Foreign Direction Investment <https://www.ceicdata.com/en/indicator/kuwait/foreign-direct-investment> (accessed 23 June 2020)

If prices charged by private operators of these services rise too high, a deregulated market means competitors can enter, introducing new supply, and prices would adjust lower. Kuwait's infrastructure is effectively already delivered by the private sector, as consultants and contractors tasked with projects from airports to train lines are private sector businesses hired by the state.

Long Term Benefits

The direct link of DA to oil revenues achieves several structural changes that help Kuwait rebalance its economy.

In a scenario where oil revenues increase, higher DA payments will entice more individuals to leave the wider public sector employment and join GAM to receive DA. We have already discussed the broad benefits that this brings.

The variability in income through linking DA to oil revenue will also, over time, incentivise individuals to appreciate uncertainty, adopt more reasonable approaches to financial planning and force them to accumulate financial buffers appropriate for their circumstances. As articulated by Nassim Taleb in the book, *The Black Swan*,

“A turkey is fed for 1,000 days by a butcher, and every day confirms to the turkey and the turkey's economic department and the turkey's analytical department that the butcher loves turkeys, and every day brings more confidence to the statement. But on day 1,001 there will be a surprise for the turkey.”³³

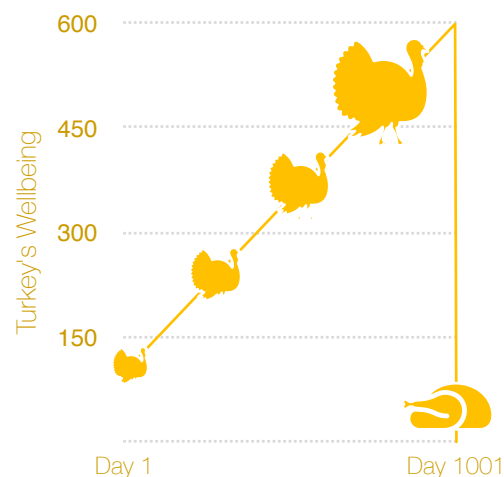
As oil prices decline over time, DA incomes will also decline. In our base case scenario, a gradual decline for both gives time for Kuwaiti citizens to both realise the importance of, and decide to acquire, a supplemental private sector income.

The Solution: Summary

At the heart of **New Incentives** and **New Structures** are several understandings. Principally, that people are fit to make their own expenditure decisions, optimal for their own circumstances. This is illustrated by the example of public education. Whilst it is provided for free to citizens a growing number of Kuwaitis are choosing to pay for their children to attend private schools. What schools need is competition and what we have is a monopoly. Like all

**“INCENTIVISE
CITIZENS TO TAKE
BETTER CARE OF
THEIR OWN
HEALTH.”**

**CHART 13. A TURKEY'S
WELLBEING**
The Black Swan



³³ The Black Swan, Nassim Taleb, 2007

monopolies, the ultimate outcome is a low-quality product at a high cost.

Excessive regulation continues to limit the supply of university level education in Kuwait. As a result, the country continues to offer costly scholarships to send swathes of its population overseas. Deregulating will increase the supply of critical services, and let individual Kuwaitis decide where they wish to educate their children or which hospital they prefer. Over time, the best service providers are rewarded at the expense of the worst. A government stipend to enable Kuwaitis to procure the education and health services fit for them, is effectively an outsourced method of providing the services, and honours the country's constitution.

The **New Incentives** and **New Structures** would see the Kuwaiti government privatise all but a core handful of services, and likely retaining ownership and control over an important portfolio such as the police force, judiciary and defence. With a lighter burden to create unproductive clerical jobs, it alleviates the pressure on the government to absorb citizens into ministries already suffocating from bureaucracy.

A clearer and simpler government budget greatly reduces the scope for corruption, as revenues flow directly to the citizen's pocket. This begs the question whether Kuwaiti citizens would find themselves incentivised to simply sit at home and do nothing but collect monthly stipends. This would unlikely be the case, nor would it be problematic. Those happy with the value of their stipend certainly have the choice to be unproductive, however the stipend will almost certainly decrease over time as the ratio of oil revenue to working-age population falls.

Anyone with ambition or a desire to receive an income over and above their ultimately shrinking stipend will resort to either private sector employment or start a private business. Many Kuwaitis with government jobs already have private businesses that are held in the names of a spouse or relative, contravening the spirit of the law. If anything, this shows a penchant for entrepreneurship exists, despite generous government salaries.

Kuwait has plenty of examples of already-affluent individuals continuing to seek out entrepreneurial ventures be it in technology, retail, food & beverage, or business services.

“CLEARER AND SIMPLER GOVERNMENT BUDGET GREATLY REDUCES THE SCOPE FOR CORRUPTION, AS REVENUES FLOW DIRECTLY TO THE CITIZEN’S POCKET.”

CONCLUSION

AT THE CENTRE OF KUWAIT'S CHALLENGE IS BOTH A PERPETUAL DISAGREEMENT ABOUT HOW TO DIVIDE THE PIE, AND AN EXTREMELY INEFFICIENT APPARATUS RESPONSIBLE FOR DOING SO.

In the interim it continues a path on autopilot, committing young graduates brimming with potential, to life-sentences in aimless administrative jobs that neither challenge their abilities nor give them a sense of purpose.

Many of Kuwait's problems today stem from state spending excessively tied up in the political process. This bottleneck continues creating inefficiency, bureaucracy, and corruption. At the same time, because the state is responsible for the overwhelming majority of spending, growing demands are being made by Kuwaiti citizens of a government that cannot be reasonably expected to deliver what its people want and need.

This proposal rests upon a purer expression of wealth distribution that respects Kuwait's current system and constitution but will optimise the process and will gently

lead us to develop a more capitalistic, dynamic, and sustainable economy.

Streamlining oil-revenue sharing with citizens increases transparency, whilst reducing waste and corruption. Releasing citizens from unproductive government employment frees them up to pursue more productive private endeavours. A subsequent reduction in clerical jobs eliminates government bureaucracy and reduces the cost to the state of building and maintain office infrastructure. Privatisations and deregulation create strong incentives for more effective private sector operators to deliver better services at a lower overall cost to the economy. A smaller portfolio allows the government to focus its efforts on a core set of public services, increasing its probability of success.

Today, Kuwait holds an enviable position owning large quantities of a natural resource still regarded at its most valuable compared to long-term history. However, the dawn of the electric vehicle has arrived, and with it potential for major disruption to global energy markets, in which Kuwait finds itself at the centre. The time for an evolution in thinking is upon us and it begins with accepting certain truths. We cannot deny that we have become a rentier economy. We must also accept that recent strategies to change it — in demanding austere reforms — have led us nowhere for decades. We must instead seek new solutions that use our constraints to our advantage.

Instead of going against the grain, let us radically amplify what we currently have, on the condition that greater financial responsibility is put in the hands of each Kuwaiti citizen and in doing so, we eliminate structural problems accumulated over a century that now threaten to drown us.

There are many talented and hardworking individuals in Kuwait's government. For the most part they are not at fault, but the system in which they are operating is flawed. Current policies prohibit Kuwait from utilising its most important asset, its people.

Legislating through consensus is notoriously challenging, as Kuwait has learnt since its independence. But if an individual is given the freedom to pursue his or her own priorities, the burden on central planning is drastically lifted, and the outcome considerably more optimised.

Article 7 of Kuwait's constitution says, ***“Justice, freedom and equality are the pillars of society;”***. What could be more *just*, than giving each citizen an *equal* share in the nation's wealth and the *freedom* and *responsibility* to choose what to do with it.

“INSTEAD OF GOING AGAINST THE GRAIN, LET US RADICALLY AMPLIFY WHAT WE CURRENTLY HAVE, ON THE CONDITION THAT GREATER FINANCIAL RESPONSIBILITY IS PUT IN THE HANDS OF EACH KUWAITI CITIZEN AND IN DOING SO, WE ELIMINATE STRUCTURAL PROBLEMS ACCUMULATED OVER A CENTURY THAT NOW THREATEN TO DROWN US.”

NEW IDEAS FOR KUWAIT

Incentives and structures for a brighter future

By Ali Al-Salim, October 2020

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