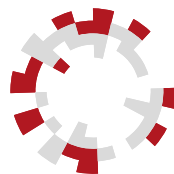




Policy Paper for the Economic Growth Pillar

Overview of Gaps, Challenges, and
Way Forward in Kuwait National
Development Plan 2015-2020



مركز الكويت للسياسات العامة
Kuwait Public Policy Center



*Empowered lives.
Resilient nations.*

Authored by Arif Mahmood for KPPC.

© 2019 Kuwait Public Policy Center

All Right Reserved.

Reproduction and distribution, in whole or in part, by non-profit, research or educational institutions for their own use is permitted with proper credit given and copyright acknowledged to “Kuwait Public Policy Center”.

Contact Details:

Kuwait Public Policy Center

kppc@scpd.gov.kw

Tel: 22452359

The Kuwait Public Policy Center

General Secretariat of the Supreme Council for Planning and Development

State of Kuwait

Table of Contents

Executive Summary	5
I. Introduction	16
II. Literature Review	18
III. Ongoing Work to Support Economic and Private-Sector Growth.....	32
IV. Economic Growth, Management and Public Finance	36
V. Private-Sector Development – Supporting and Expanding.....	47
VI. Small-and Medium-Sized Enterprises (SME).....	55
VII. Diversifying the Production Base	61
VII. Identifying Gaps and Challenges: Further Considerations	59
References	73

List of figures and tables

Figure 1: Growth rate and forecast.....	36
Figure 2: Inflow of Foreign Direct Investment (FDI).....	41
Figure 3: FDI Stock and Flow in 2016 (Million \$).....	41
Figure 4: Growth and value-added levels across subsectors.....	51
Figure 5: GDP sector percentage contribution in GCC countries – 2005 and 2015.....	63
Figure 6: Kuwait vision.....	71
Table 1: Key interactions of the Economic Pillar with other pillars.....	6
Table 2: The Economy Pillar and KNDP: Challenges, gaps and recommendations.....	14
Table 3: Literature summary.....	28
Table 4: Contributions of inputs in non-oil sector growth in Kuwait and the GCC.....	40
Table 5: Doing business ranking in 2017.....	49
Table 6: Kuwait in Competitive Industrial Performance (CIP) Index and Economic Complexity Index (ECI).....	62
Table 7: Growth in GDP by economic activity.....	64
Table 8: Logistics Performance Index.....	67
Box 1: Economic Growth: International Experience – I.....	24
Box 2: Economic Growth: International Experience – II.....	44
Box 3: Foreign Direct Investment (FDI): Marketing and Promotion.....	52
Box 4: Public Sector Procurement – SMEs and the Private Sector: The International Experience.....	59

Executive Summary



This report analyzes economic policies that will support and deliver economic growth outlined in the Kuwait National Development Plan (KNDP), which is designed to achieve the New Kuwait Vision 2035. The policies aim to develop efficient and vibrant public, non-oil and private sectors, raising Kuwait's profile in the international arena and thus transforming the country into a financial and commercial center. Overarching objectives include developing small- and medium-sized enterprises (SMEs), public-private partnerships (PPPs), and attracting foreign direct investments (FDIs).

The Kuwait Vision and ambitious KNDP are designed to build a prosperous new Kuwait, enhancing the welfare of its citizens. There are constructive activities ongoing to support this work, which include: annual plans to further develop the policies, objectives and investments; monitoring of progress; and building on experiences to further refine the plan for the New Kuwait Vision.

International performance indicators such as those presented by the World Economic Forum's global competitiveness index and the World Bank's *Doing Business* indicators show that Kuwait is not effectively supporting policies for the economic pillar.

The Global Competitiveness Index (GCI) ranked Kuwait 52 out of 137 economies for 2016¹; this ranking slipped from 38 (out of 138 economies) from the previous year. Kuwait's GCI "Technological Readiness" ranking for the year 2016 was 68. Kuwait was ranked 64th in the world out of 137 countries in terms of the overall quality of its infrastructure,

¹ in the 2017–18 report

behind Bahrain (33rd), Qatar (13th), Oman (36th), Saudi Arabia (29th) and UAE (5th). In 2015², Kuwait research and development (R&D) expenditure to gross domestic product (GDP) was 0.3%, which is low compared with Finland (3.17%), Ireland (1.52%), Singapore (2.1%, 2014), Estonia (1.44%) and UAE (0.7%).

Kuwait faces several challenges in its quest to promote economic growth, including: a high dependence on oil revenue; an underdeveloped market for supporting the private sector; the dominance of the public sector in the economy; and inefficiency³ in the public sector.

There are gaps in the plans' policies, and the links to objectives are sometimes obscure. Major policies to support economic growth include increasing productivity, ensuring regulatory support for the private business environment, and reducing the dominance of the public sector in the economy in order to increase private sector contributions.

Policies to support long-term economic growth should increase investment in the human capital sector and technology. Higher public-sector capital expenditure will ensure a stronger impact on economic growth. Removing subsidies would make the economy more efficient toward the market, and would result in better management of public finances. Ensuring the right type of infrastructure in the right places will accelerate growth.

The evidence base to support the plans' policies is not adequate. Economic rationale should be used to develop policies and programs. Government support in the form of regulation or funding will benefit Kuwait when there is an economic rationale for intervention.

There are small countries outside of those in the Gulf Cooperation Council (GCC) that have been successful in promoting economic growth and transformation, and these experiences can provide useful examples for Kuwait. Finland, Ireland and Singapore have successfully transformed their countries' economies, moving from low technology-based economies to exporters of high-tech products.⁴ They adopted growth strategies that diversified the production base in the area of exports of electronics, telecommunications, software, chemicals and pharmaceuticals. The countries benefited from identifying new products and tradable services.

A number of factors advanced the economic success of these countries, in which economic diversity toward a high-tech sector has been the key driver for success. These factors include: identifying the market for the right type of technology and innovation for commercial purposes at an early stage; openness to the outside world to trade and inviting labor with the right skill sets and ideas; allowing government to play an important role in terms of support and funding for the right sectors for growth; effective, entrepreneurial innovation; letting institutions take a leadership role; and promoting a sense of national mission and developing national consensus. The countries had a basic foundation for growth as a result of promoting education, investing in human capital, improving the government's efficiency, and investing in innovation and technology.

² World Development Indicator

³ Reported as number one problematic factor for doing business in the World Economic Forum, Executive Opinion Survey 2017

⁴ Estonia (2016 GCI rank 29, population 1.3 million) is another example of a country that regained independence from the Soviet Union (in 1991), and is recognized now as one of the most high-tech nations in the world. See web links at [The Economist](#) and [The Telegraph](#).

Policy challenges for the economic pillar when implementing the KNDP

- Accelerate economic growth and manage the economy and public finance when the price of oil is low worldwide.
- Create policy and regulatory frameworks that support the private sector to thrive within a favorable environment, ensuring a competitive market economy.
- Diversify the production base for different sectors, increase sector contribution to non-oil GDP compared to the public sector.
- Ensure that basic ingredients for economic growth are developed, for example by investing in human capital and technology.
- Develop public service, improve efficiency within public authorities, and develop the labor market to support growth.
- Expand the private sector and accelerate non-oil sector growth, including developing the manufacturing sector and SMEs to support growth and develop the export market.
- Accelerate the development of infrastructure, ensuring good quality in the right place in order to boost the economy's performance.

Policy gaps for the economic pillar when implementing the KNDP

- Prioritize investment and policies based on the economic rationale that would maximize social and economic benefit.
- In order to accelerate economic diversification, policy interactions from other pillars with the diversification of production within the economic pillar are low.
- Support specific subsectors within the economy and the private sector which can accelerate growth.
- Enhance technology and innovation development, by working closely with subsectors in the economy.

Gaps and challenges within the KNDP

- Weak evidence base overall for policy development and policy makers are not making good use of existing research that is already available.
- Economic rationale is not the main driver for public sector or government intervention in the economy in general.
- Linkages among policies, objectives and programs are not always obvious.
- A clear and an effective implementation of the national plan is lacking.
- Develop synergy between the plan and other public-sector initiatives, and foster better coordination among public authorities.
- Current plan is inadequate to achieve the UN Sustainable Development Goals.

TABLE I

Key Interactions of the Economic Pillar with other Pillars

Economy: Develop a prosperous and diversified economy to reduce the country's dependence on oil export revenues	
Economic Growth: Developing National Economy Management and Increasing Investment Rates	
Global Position: Enhance Kuwait's regional and global presence in spheres such as diplomacy, trade, culture and philanthropy.	<ul style="list-style-type: none"> • FDI Contribution
Infrastructure: Develop and modernize the national infrastructure to improve the quality of life for all citizens.	<ul style="list-style-type: none"> • Technology readiness. • Increasing private sector investments in water and electricity production. • Increasing total production capacity for water distilling plants. • Developing facilities and services at Kuwait International Airport. • Developing sea ports' services and increasing their capacity. • Adding highways and interior roads in regions. • Removing trade & transport logistics impediments.
Human Capital: Reform the education system to better prepare youth to become competitive and productive members of the workforce.	<ul style="list-style-type: none"> • Human capital economic activities on advanced technology with right type of labor, improve productivity. • Achieve excellence in education and improve Kuwait's ranking on international assessment tests. • Achieve standards of quality and excellence at institutions of higher education • Improving scientific research quality. • Embed a culture of scientific research and innovation in society. • Increasing youth creativity and innovation.
Public Administration: Reform administrative and bureaucratic practices to reinforce transparency, accountability, and efficiency in the government.	<ul style="list-style-type: none"> • Increasing capital spending out of total government spending. • Regulate government expenditures, cancel any non-essential expense, and combat waste in public spending. • Review, rationalize and restructure current subsidy practices. • Check large government project costs by putting in place an expert system. • Planning and Public Policy Making. • Legislation, tools, methodologies, and planning and follow-ups; develop standards for selecting projects.
Healthcare: Improve service quality in the public healthcare system and develop national capabilities at a reasonable cost.	<ul style="list-style-type: none"> • Healthy lifestyle
Living Environment: Ensure the availability of living accommodation through environmentally sound resources and tactics.	<ul style="list-style-type: none"> • Supply of living environment e.g. Housing construction

Supporting and Expanding the Private Sector: Increase Private Sector Share of GDP; Increase Private Sector Investments

- Technology transferred through foreign products and services
- Improving services' efficiency and performance - based on principles of commerce and competition.
- Increasing the available capacity of electric power plants.
- Involve the private sector in the water and electricity sector by establishing public joint-stock companies.
- Separating operators from regulators in the transportation sector.
- Promote and encourage competition and investment in communications and IT sectors.
- Modernizing infrastructure and technological development in the media and culture sector.
- Increase workforce contribution to private sector relative to public sector, with balance between the sectors in terms of conditions, work hours, wages, bonuses, and other benefits.
- Training programs to support need of private sector.
- Encourage and support private sector participation in the educational field.
- Increasing the capacity of institutions of higher education and correlating their output with the needs of the labor market.
- Supporting private Sector participation in higher education, meeting development needs.
- Develop the training system and community service in various fields.
- Develop the training needs necessary for the skills required so as to direct the workforce towards achieving the state's Vision.
- Reinforcing youth leadership capabilities and empowerment.

- Projects for the transition to electronic government.
- Regulate and standardize the legislative aspects of government procurement procedures.
- Administrative reform, develop public services and business services in the public sector, and expand private sector participation.
- Fight Corruption and Promote Transparency and Accountability in the Public Sector.
- Cooperation between the legislative and executive branches and all development partners.
- Expand electronic government applications & civil information systems.

- Develop a health system promoting the private sector's role.

- Provide new housing alternatives in new and advanced styles to keep pace with global changes in construction principles.

Diversifying the production base: Manufacturing; Developing the Oil sector; Financial; Commercial and Agriculture

- Trade Openness – Increase Export and encourage producing imported products domestically

- International Linkages.
- Marine and air to diversify services and access new markets.
- Connectivity.

- High skilled labor.
- Produce and absorb technology.
- Develop human capital with right type of skill set.

- Rationalize public expenditure.
- Removal of subsidies and by doing so, create a market to diversify products (e.g. alternative energy source).
- Favorable legislation.
- Reform in public sector employment.

- Promote healthy lifestyles, with participation from all sectors of society (e.g. innovation in health care, preventive medicine).

- Develop a model of housing provision through private sector participation in providing housing for citizens.
- Involving private sector in different ways in construction to housing products; Greener environment.

TABLE I - CONTINUED

Key Interactions of the Economic Pillar with other Pillars

Economy: Develop a prosperous and diversified economy to reduce the country's dependence on oil export revenues

Economic Growth: Developing National Economy Management and Increasing Investment Rates

Global Position: Enhance Kuwait's regional and global presence in spheres such as diplomacy, trade, culture and philanthropy.

• FDI Contribution

Infrastructure: Develop and modernize the national infrastructure to improve the quality of life for all citizens.

- Technology readiness.
- Increasing private sector investments in water and electricity production.
- Increasing total production capacity for water distilling plants.
- Developing facilities and services at Kuwait International Airport.
- Developing sea ports' services and increasing their capacity.
- Adding highways and interior roads in regions.
- Removing trade & transport logistics impediments.

Human Capital: Reform the education system to better prepare youth to become competitive and productive members of the workforce.

- Human capital economic activities on advanced technology with right type of labor, improve productivity.
- Achieve excellence in education and improve Kuwait's ranking on international assessment tests.
- Achieve standards of quality and excellence at institutions of higher education
- Improving scientific research quality.
- Embed a culture of scientific research and innovation in society.
- Increasing youth creativity and innovation.

Public Administration: Reform administrative and bureaucratic practices to reinforce transparency, accountability, and efficiency in the government.

- Increasing capital spending out of total government spending.
- Regulate government expenditures, cancel any non-essential expense, and combat waste in public spending.
- Review, rationalize and restructure current subsidy practices.
- Check large government project costs by putting in place an expert system.
- Planning and Public Policy Making.
- Legislation, tools, methodologies, and planning and follow-ups; develop standards for selecting projects.

High

Moderate

Low

Supporting and Expanding the Private Sector: Increase Private Sector Share of GDP; Increase Private Sector Investments

- Technology transferred through foreign products and services
- Improving services' efficiency and performance - based on principles of commerce and competition.
- Increasing the available capacity of electric power plants.
- Involve the private sector in the water and electricity sector by establishing public joint-stock companies.
- Separating operators from regulators in the transportation sector.
- Promote and encourage competition and investment in communications and IT sectors.
- Modernizing infrastructure and technological development in the media and culture sector.
- Increase workforce contribution to private sector relative to public sector, with balance between the sectors in terms of conditions, work hours, wages, bonuses, and other benefits.
- Training programs to support need of private sector.
- Encourage and support private sector participation in the educational field.
- Increasing the capacity of institutions of higher education and correlating their output with the needs of the labor market.
- Supporting private Sector participation in higher education, meeting development needs.
- Develop the training system and community service in various fields.
- Develop the training needs necessary for the skills required so as to direct the workforce towards achieving the state's Vision.
- Reinforcing youth leadership capabilities and empowerment.
- Projects for the transition to electronic government.
- Regulate and standardize the legislative aspects of government procurement procedures.
- Administrative reform, develop public services and business services in the public sector, and expand private sector participation.
- Fight Corruption and Promote Transparency and Accountability in the Public Sector.
- Cooperation between the legislative and executive branches and all development partners.
- Expand electronic government applications & civil information systems.

Diversifying the production base: Manufacturing; Developing the Oil sector; Financial; Commercial and Agriculture

- Trade Openness – Increase Export and encourage producing imported products domestically
- International Linkages.
- Marine and air to diversify services and access new markets.
- Connectivity.
- High skilled labor.
- Produce and absorb technology.
- Develop human capital with right type of skill set.
- Rationalize public expenditure.
- Removal of subsidies and by doing so, create a market to diversify products (e.g. alternative energy source).
- Favorable legislation.
- Reform in public sector employment.

Recommendations

- Develop the plan further by improving on the evidence base to support the plan and policy statements, developing research to support the key challenges and identified gaps.
- An intervention in a specific area in the economy should be based on a sound rationale. This will support policies to deliver expected results. For example, where there is an issue of market failure or a coordination problem within an industry, an intervention by the government would be the most beneficial.
- Provide additional support to high-growth businesses and private sectors that have the potential either to be sustainable within the domestic market or to be developed as an export industry.
- Develop regulatory frameworks and business environments that are favorable for the private sector, the manufacturing and international trade sectors and SMEs, including better interaction between the plan's pillars, with product diversification policies.
- Prioritize government expenditure and investments, using economic rationale. For example, investing in technology, human capital and the right type of infrastructure is expected to deliver the strongest impact on the economy, by developing the basic foundation for economic growth and by developing the private sector. Increase capital expenditure in these high-impact sectors. Protect, increase and prioritize capital spending during challenging times.
- Develop a public finance management policy for times when oil prices are low globally. Prioritize public expenditure based on the economic rationale during a low-oil price situation. Eliminate market distortions, correcting the incentive structure by removing subsidies.
- Develop different funding options for investment in innovation and technology⁵ and for funding diverse sectors, including high-risk and viable commercially-oriented projects to benefit the economy. The funding should be at an operational level, supporting the development of products and innovation, with a team on the ground working closely with potential private sectors, including SMEs. The team will proactively identify and support innovation, technology and R&D initiatives. Innovation and technology are key drivers of growth that will support the long-term well-being of the people of Kuwait.⁶
- Support SMEs by giving a higher market share to supply the public sector purchasing requirements, where each of the public authorities can have its own internal targets for public sector procurements from SMEs. In addition, SME support teams should work actively in the field, working closely with and supporting potential subsectors.

5 One example is Innovate UK, a UK innovation funding agency: <https://www.gov.uk/government/organisations/innovate-uk>. Examples from other countries – Finland, Ireland and Singapore – are in the report.

6 One current project in the technology area in Kuwait is a renewable energy project that involves the installation of rooftop solar PV panels in co-operative society car parks, supported by KFAS, KISR and NTEC.

- Identify specific products that Kuwait can competitively develop in an international market. Based on insight from the small-country experiences, Kuwait can identify potential export markets where it can use its comparative advantage to develop export promotion to benefit the non-oil sector. However, these other countries' experiences also suggest that the basics have to be right. Further investment and development in human capital, technology and government institutions along with an efficient public sector can help Kuwait reap benefits from international trade. It is imperative that these areas are given priority, as this will create the foundation for the economy.

One potential product example could be Kuwait positioning itself as a market leader in alternative or renewable energy sources, developing its competitiveness not just by supplying energy from alternatives sources but also by supplying products to support the industry. The sector would benefit Kuwait domestically, as a subsidy is being withdrawn from the energy sector in Kuwait and there is potential in the international market. The renewable energy industry is currently booming, with high demand globally.⁷

- Develop the civil service, improving it so that it can efficiently develop, deliver and implement the National Plan. A core, high-profile civil service can lead the public sector.
- Ensure better coordination of policy development and implementation plans within public authorities. Plans to achieve the UN Sustainable Development Goals should be integrated to align with national priorities and commitments.
- The owner of a project that develops a new policy should carry out a policy and regulatory impact assessment when a new policy or regulation is introduced. This will ensure that new regulations either will not have or will minimize an adverse impact on other sectors within the economy, and that they will not conflict with any current regulations. Simplify regulatory burdens by ensuring that when one regulation is introduced, regulations that are in conflict or that are expected to deliver similar outcomes are identified and removed.⁸
- The policy lead who develops policy in public bodies should follow a policy cycle. There should be a systematic approach, including ownership of a policy, setting up options, an implementation plan, monitoring, and finally, evaluation of the policy. The cycle will work in conjunction with the objectives, finance options, strategy and programs for the Vision of Kuwait.

⁷ See a study by Lahn, G. (June 2016). Fuel, Food and Utilities Price Reforms in the GCC: A Wake-up Call for Business. London: Chatham House, The Royal Institute of International Affairs.

⁸ Recently, the Doing Business indicator has deteriorated, due to the additional burdens of new regulations, i.e. businesses have to submit papers both online and as a paper copy. Work is currently ongoing to rectify the problem.

TABLE 2

Tzzhe Economy Pillar and KNDP: Challenges, gaps and recommendations

Economy: Develop a prosperous and diversified economy to reduce the country's dependence on oil export revenues.		
	Economic Growth: Developing National Economy Management and Increasing Investment Rates	Supporting and Expanding the Private Sector: Increase Private Sector Share of GDP; Increase Private Sector Investments
Challenges	<ul style="list-style-type: none"> • High dependence on oil revenue and a large public sector. • GDP moves hand-in-hand with global oil prices. • Recently, external and fiscal accounts have been unfavorably affected to support economic growth. • Non-oil real GDP growth has slowed down. • Business environment and regulatory burdens. • The lack of a dynamic non-oil tradable sector. • The productivity contribution to growth is either low or insignificant. 	<ul style="list-style-type: none"> • Support and expand the sector, increase the private sector share of GDP and investments. • Business environment and competitiveness have worsened, as measured by most international indicators. • Develop the market, correct market failures and encourage firms to establish businesses, generating private-sector growth. • Less bureaucracy to do business.
Gaps	<ul style="list-style-type: none"> • Market failure and underdeveloped markets. • Rationalize public expenditure in favor of capital expenditure. • FDI to compete with other GCC countries to attract investments. • Non-oil sector growth with low or insignificant contribution from productivity. • Management of macroeconomic policies in a low oil price situation. • Infrastructure investment has to be focused on the right areas and types. • International trade policy. 	<ul style="list-style-type: none"> • Institutions and policy frameworks to encourage competition and investments. • A flexible capital and labor markets, ensuring labor productivity. • High-growth firms to play a key role. • Risk-mitigating measures within the policy cycle for the business environment.
Recommendations	<ul style="list-style-type: none"> • Policies to boost productivity. • Further investments on the main drivers of for growth. • Coordinated economy management policies in a low oil price scenario. • Reduce the size of the public sector to make way for the private sector. • Develop the evidence base analyzing economic growth. • Provide additional incentives for high growth and technology business. • Additional support for innovation and technology. <ul style="list-style-type: none"> • Reduce subsidies and correct distortion in the incentive structure. • Trade policy to support the economy, including enhancing product diversification. • Ensure right type and best quality infrastructure is developed. 	<ul style="list-style-type: none"> • Immediately take action on the problematic factors for doing business. • Ensure market forces are working; ensure competition and correct market failure. • Monitor the market. • Reduce ownership of public sector managed businesses. • Make market forces effective for the private sector, by removing subsidies. • Ensure land requirements and regulations are favorable to the private sector. • Priorities projects based on maximum social and economic benefit. • Incorporate risk-mitigating measures by carrying out impact assessments. • Support high-performing private businesses and ensure these firms receive favorable treatment. • Further develop investment promotion and evidence for FDIs for Kuwait. • Increase the share of SMEs in government contracts and procurements, set target.

Diversifying the production base: Manufacturing; Developing the Oil sector; Financial; Commercial and Agriculture

- Regulatory framework to ensure successful business environment for manufacturing.
- Dominant sector in the production base is the oil and oil-producing sector.
- Manufacturing in the non-oil sector contributed to just over 5% of GDP.
- Growth was negative during recent low oil prices situation.
- Public sector encourages the private sector.
- Easy and affordable access to finance.
- Agriculture and fisheries sector makes a small contribution to GDP and makes up only 3% of total national employment.

- Right type of expertise and technical knowledge, and technology.
- Agriculture sector is not focused on the agro-processing industry.
- Skill gaps to support manufacturing, such as interaction with the labor market and human capital.
- Infrastructure interacting with wider economic and commercial linkages.
- The need to stimulate growth and supply chain, e.g. construction sector.
- Trade logistics.

- Priorities infrastructure and construction projects that have high economic and social benefits.
- Additional support for high-growth potential businesses.
- Impact assessments on manufacturing, employment and environment.
- Natural resource-based products: support and identify products that can contribute additional value addition to the supply chain.
- Eliminate skill shortages within manufacturing.
- Encourage knowledge and advanced technology industries, with support at both top level and ground and operational level.
- Ensure market forces are developed to make the market competitive.
- Support for the private sector for higher investments in production and infrastructure projects, with high economic benefit.
- Separate foreign trade policy.
- Provide motivational and financial incentives for export industries.
- Develop tourism polices to support not just tourism infrastructure but also tourism products and services.
- Encourage and support the establishment of agro-processing industries.

Further Considerations

- Weak evidence base to support the plan.
- Systematic policy cycle by policy owner.
- Impact assessment by the policy owner.
- Efficient Civil Service to deliver and implement policies to achieve the national plan's objectives.
- Implementation is the biggest challenge with regards to achieving the policy objectives.

- Weak evidence base to support the plan.
- Systematic policy cycle by policy owner.
- Impact assessment by the policy owner.
- Efficient Civil Service to deliver and implement policies to achieve the national plan's objectives.
- Implementation is the biggest challenge with regards to achieving the policy objectives.

- Policy owners follow a policy cycle and carry out an impact assessment on economic growth and the private sector.
- Use a clear rationale for government intervention in a specific policy area.
- Develop the Civil Service to provide effective support delivery of the plan.
- Better coordination among public authorities for implementation.

I. Introduction



The economy of Kuwait is different in a number of ways when compared to other countries. The total land area of Kuwait is very small - approximately 18 km². It has a population of 4.4 million, more than 68% of whom are foreigners. While it is one of the smaller countries in the world, it is rich in hydrocarbon; its proven crude oil reserve of 101,500 million barrels accounts for approximately 7% of the world's total reserves.⁹ Kuwait has one of the highest per capita incomes in the world, and is classified by the World Bank as belonging to the high-income group of countries.

The government of Kuwait has been working on enhancing economic growth in order to develop a diversified, private, non-oil sector and to develop a vibrant community in the country. The medium-term development plans emanate from the New Kuwait 2035 vision.¹⁰ The current plan contains seven pillars for delivering the vision, and the economic pillar is one of these.¹¹ The KNDP's existing policies that are most significantly related to the economic growth pillar are reviewed in this paper. In national plans, the economic pillar aims to support policies that move away from oil revenue while maintaining Kuwait's prosperity, supporting jobs and income for all residents, and positioning Kuwait as a strong economy within the international arena.

This report, completed in October 2017, analyzes policies that support and deliver the national plan's economic pillar to achieve the 2035 vision for Kuwait. The aim is twofold - to identify gaps and challenges within the current economic growth policies and to recommend further developments for the policies and their evidence base. These steps will help to generate growth and employment for Kuwaitis and develop efficient and vibrant public,

9 OPEC (2017)

10 First Medium-Term Development Plan was for 2010-2014.

11 Other pillars: administration, infrastructure, living environment, health care, education and human capital, and international positioning.

non-oil, private sectors and diversify the production base. Overarching objectives includes developing SMEs and attracting FDIs. Economic growth policies are interlinked with the policies and implementation of some of the other pillars; the most important linkages are with human capital, infrastructure and public administration, i.e. the public finances.

Economic growth in this report is viewed from two perspectives. First, the longer-term economic growth is discussed within a general economic growth framework, looking from a supply-side perspective. The second is from a demand-side perspective and is based on short- and medium-term growth prospects. The analysis here is based on a review of the ongoing national plans and the current evidence base, as well as a literature review and discussions with selected focus groups and stakeholders.

Analysis here is divided into economic growth, private sector growth and diversification of production within the economic pillar. Private sector growth is further broken down into the private sector in general, and SMEs as a particular sector - due to their importance for Kuwait. Experiences and best practices from other countries are discussed throughout the paper – to set specific areas in context – and GCC countries are seen as comparators for Kuwait, due to the similar country-level and political characteristics that they share with Kuwait.

This report is organized as follows. A literature review of selected papers is presented in the next section. Policies and objectives within national plans are presented in section three in order to set the report in context. Sector-specific gaps, challenges and recommendations are presented in the following four sections covering economic growth, the private sector, SMEs and diversification of the production base. The final section presents some additional considerations that should be used to develop a national plan.

II. Literature Review



Summary

Gaps and challenges

- Bureaucracy and red tape block or distort markets, hindering competition and stifling private-sector development. The public sector dominates investment and employment to the detriment of private sector development.
- Government policies lack strategic alignment and coordination.
- Current public expenditures are not sustainable due to low oil prices and rapidly increasing public-sector expenditures to accommodate the increased demands of a growing population.
- Non-oil sectors, including technology, are not rapidly increasing their contribution to the Kuwaiti economy. Productivity gains are low.
- Private sector inefficiencies stem from potential weaknesses in the sector's institutions as well as weaknesses in the economic policy areas that support the sector.
- University researchers in Kuwait do not team with their private sector counterparts in publishing research as frequently as do professors in other countries, such as Norway and Singapore.
- University support services for connecting with industries are inadequate.

Recommendations

- Allow the private sector to lead development of targeted, local economic diversification and FDI.
- Develop further governance and regulatory reforms to support public interests and safeguard societal well-being.

- Foster an innovation-driven diversification strategy; innovation is the key factor in promoting economic diversity and competitiveness.
- Encourage the private sector to take the lead in economic development and the financing of its own projects; develop educational and labor reforms in support of the private sector; spending and subsidies programs will require rationalization to drive cost savings and promote efficiency.
- Use public money to invest effectively in order to boost capital and technology; spend more on capital budget; ensure ongoing plan progress is successful.
- Prioritize the development of a foundation to support sustainability of economic growth: healthcare, education and infrastructure.
- Improve competitiveness in the market, ensure reforms are implemented, and provide good management of public finances – particularly in a low oil price scenario.
- Provide incentives for firms so that they are encouraged to collaborate with local universities.
- Take a strategic and differentiated approach to encouraging university industry linkages by designing sector-specific policies.
- Offer guidelines to universities that delineate best practices for linkage engagements with the private sector.

Discussions about the various policies that can further support and enhance economic growth in Kuwait are nothing new. Numerous papers from the Kuwait Institute for Scientific Research (KISR, 2005) on the economy of Kuwait that endorse policies in areas including: privatization; regulation of fair competition and protection against monopolies; investment in technology; support for SMEs; management of the economy without a budget deficit; and rationalization of public expenditure improving on ways to provide subsidy to specific sectors in the economy. A review of a number of recent studies is presented here, and key points from the literature that are relevant for the economic pillar are added throughout the paper.

TICG (2016) presents a number of challenges and indicators that are hindering the progress of the economic pillar, along with other pillars within the ongoing national plan. The main barrier to change for the economy has been government dependence on oil revenue and the issues that result from low oil prices. Other barriers include bureaucracy and red tape – they are distorting the market and making the market less competitive. Economic development is further constrained by the dominance of the public sector in employment, as well as a lack of strategic alignment and coordination among government policies. The report identifies three areas in which opportunities exist to benefit the economic pillar and enhance economic growth. First, maximize oil reserve usage by improving the upstream (exploration and production) process and developing the downstream (refining and petrochemicals) activities. Second, ensure private sector diversification, covering local and foreign investments. Develop and implement priorities on strategic and comparative, advantage-focused industries for Kuwait. Third, ensure governance and regulatory reforms supporting effective use of revenue generated from the oil industry, private sector growth and labor market reform, and reinforce taxation to institutionalize economic activity that leads to positive growth and increased public revenues.

The Kuwait Foundation for the Advancement of Sciences (KFAS, 2017) reviewed a variety of pieces of evidence to identify priority sectors and suggested that these sectors could more significantly contribute to Kuwait's future economic development and employment.

A model based on the assumption that by 2030 the contribution to GDP from oil production will be reduced to 25%, is the desired scenario and economic diversification will take place, with Kuwait's economy positioned in three priority areas. These are: foundational needs, which are required to ensure that the economic growth is sustainable; priority sectors, from which the country will benefit the most based on competitive analysis; and, finally, the aspirational priority areas, which includes those sectors that cover ongoing national developments in international positioning. The report recommends that health care, education and infrastructure should be within the foundation sector, and manufacturing, real estate, financial institutes, restaurants and hotels within the critical sector. Finally, the aspirational sector includes connectivity and computing, analytics and intelligence, digital physical transformation, advanced materials, production philosophies, advanced production processes, and human-machine interfaces. The study suggests that the most promising sectors in terms of growth are manufacturing, restaurants and hotels, and also construction within the infrastructure sector. In addition, economic diversification will be effective when oil and gas contribution to GDP is no more than 30% in 2030. GDP growth rate on the current trajectory will be 2%, rising to 3% in 2030, when policies are developed, support is provided for economic diversification, and a focus is placed on the priority areas. The country has high potential for job creation within manufacturing and transport, storage and communications. High job creation in these sectors will require high investments in R&D and Science Technology and Innovation (STI); this will generate skilled personnel and executable projects for the sectors.

Asheim (2015) presents an innovation-driven economic diversification strategy for Kuwait. First, the report suggests securing optimal efficiency and productivity for oil production. Second, there is huge potential for economic diversification in renewable energy, such as solar energy, for energy production that would be supplied both locally and regionally. This would also add to the manufacturing of production equipment, such as storage capacity, which would help develop linkages within the industry. Third, diversification based on key research-oriented activities in areas of life science or health and medicine would have the potential to accommodate a rapidly-growing demand for some drugs in Kuwait and in the larger Arab and North African region, such as drugs for diseases like diabetes and obesity, or related health areas. Fourth, economic diversification in the banking and financial sectors also has the potential to nurture economic growth in Kuwait. Fifth, Kuwait also has creative sectors that could be upgraded, drawing on the symbolic knowledge base in the areas of information and communication technology (ICT), social media, and technology to support theatrical traditional expanding market commercialization for small firms or SMEs, where the threshold with respect to capital and competence is probably lower in these sectors.

This study proposes policy reforms in the following areas. First, the private sector should take the lead in economic development in order to contribute to projects that are independently financed. Educational and labor reforms are essential to pave the way for more nationals to successfully steer the country's private sector. Second, spending and subsidies programs will require rationalization to ensure that the intended beneficiaries actually do benefit, and to support utilities to drive cost savings and promote efficiency. Finally, there needs to be more of a focus on a "look east" policy by exporting more oil and related products to Eastern countries. This would minimize uncertainty to some extent, in partic-

ular where Western countries seek to obtain more of their fuel from shale oil. A broader innovation policy, in addition to the current ongoing R&D capacity development activities in key national organizations focusing on and identifying the priority innovation sectors, will be a realistic way to achieve a successful, diversified specialization. The report also recommends the development of human capital, which can absorb the increased capacity, as well as institutional reforms and cultural changes in governance systems and institutions, including a reformed legal framework to create more openness to improve the business climate, thereby contributing to economic development.

The International Monetary Fund (IMF, 2017) provides analysis on macroeconomic and fiscal policies, and there are a number of studies on Kuwait available. One of IMF's most recent reports presents discussions on the economy of Kuwait, and how the country can shape policies to make the economy more active and manage public finance more efficiently. Public finance in the state of Kuwait is largely dependent on oil prices, and IMF staff project that this will increase very gradually over the medium term on the assumption of oil prices being at US\$60 by 2021. In the near future, the fiscal position will improve, but pressure on public expenditure will continue. There are initiatives for fiscal reforms to reduce this pressure, in particular the partial removal of fuel and electricity subsidies. Taking on board ongoing economic reform activities in Kuwait and the oil market scenario, IMF staff estimate that the deficit in the budget will continue to persist and in 2020/21 will be around 13% of GDP over the medium term.¹²

The IMF study, accounting for the costs and risks for funding from own assets or a draw-down buffer,¹³ suggests that budget gaps in public expenditures can be funded through income generated by using financial instruments, such as issuing government bonds and developing domestic capital markets. In addition, borrowing from global markets on favorable terms could be beneficial.

There are opportunities to develop the domestic capital market and benefit from domestic borrowing. Banks in Kuwait now hold a small proportion of their assets in short-term CBK¹⁴ bonds and government treasury bonds. Private debt sectors can benefit from a developed, long-term government bonds market when there is a risk-free government yield curve - which would also help develop the private debt market. The domestic bonds would enhance investment and asset diversification in the financial sector, creating new opportunities. Managing excessive domestic borrowing from the government sector and ensuring that the private sector loan market develops at the same time would help private sector development and economic growth. Kuwait has a very strong credit rating - currently (AA) - and can possibly benefit from the global financing environment. Taking examples from other countries with similar ratings, such as Qatar and UAE, accessing international markets could be carried out at better terms than domestic borrowing. In 2015, the use of a buffer in other GCC countries covered about 80% of the financing needs, while the rest was secured through borrowing.

12 Taking on board that the budget balance excludes the 10% of total revenue, which by law must be transferred to the Future Generations Fund (FGF) as well as investment income and profits from state enterprises.

13 Future Generations Fund (FGF) and General Reserves Fund (GRF).

14 Central Bank of Kuwait (CBK)

Growth is expected to recover in 2018/19 in wider regions, covering the GCC and other countries in the Middle East and North Africa,¹⁵ as oil prices increase in the international market. The higher oil prices will provide support to expansionary fiscal spending and rising deposits will increase funding capacity for banks, enabling better lending possibilities to the non-oil sector of those economies where there is a high level of dependency on oil revenue. As a result, the oil exporting economies in the region are expected to modestly recover in 2017 from the weak position seen in 2016. Despite expected improvements in fiscal and bank lending positions, the country's ability to leverage improvements in conditions will require strengthening private sector participation in the economy and the governance framework for investors and corporations. There are, however, risks regarding the growth outlook in the wider region around Kuwait, i.e. the GCC and neighboring countries in the Arab world. These risks result from geopolitical conflicts, oil prices increasing at a lower rate than expected, and political and social obstacles in these countries (World Bank, 2017).

An academic working paper by Burney et al. (2017) presents an empirical analysis of Kuwait's economic growth. The paper uses quarterly data for 1979 (Q2) to 2013 (Q1) when presenting its empirical analysis, and investigates the long-term role of oil income in the economic development of Kuwait, examining how real output in the long run is shaped by oil revenue through its impact on capital accumulation and technological transfers through foreign output.

The paper concludes that the real domestic output in the long run in Kuwait is influenced by oil revenues and foreign output that act as a proxy for technological progress. It also finds that, while both oil revenues and foreign output drive growth in the public sector, technological progress is the main and only driver for private sector real growth. The paper recommends further research to understand the drivers of growth in the private sector, with a more detailed disaggregated analysis, as these fall beyond the scope of the model used in the paper. There are potential inefficiencies that may result when developing the private sector, emanating potentially from both the institutions and economic policy areas that support the sector.

Details on the midterm KNDP are available in GSSCPD (2015, 2015a), where objectives and policies for different areas linking to the national vision are presented. Earlier plans detailing missed targets and lessons are also presented in brief. In earlier plans, objectives and strategies were not clearly delineated, key performance indicators (KPIs) were not tied to specific plan objectives, and legislative requirements did not clearly connect to specific projects or goals. The economic pillar is described as a tool to broaden Kuwait's development, gradually reducing the country's dependency on oil export revenues. This will be done by stimulating competition and innovation in the private sector, improving the labor market so it is conducive to growth, encouraging FDI investments and stimulating the SME activities in the economy. A list of projects is presented, and there are no estimated cost-benefit figures.

The United Nations Development Programme (UNDP, 2011) presents an analysis of the challenges for SMEs in Kuwait that are preventing the sector from becoming a major player in terms of economic development and recommends ways to tackle structural imbalances in the role of SMEs in the private sector. The report recommends finding a commonly-accepted definition of SMEs and collecting appropriate statistical information

¹⁵ 16 economies covering oil exporters and importers grouped into three sub-regions where one is the Gulf Cooperation Council (GCC) countries of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

solely for the sector. The report further recommends drafting a development strategy for the sector to offer institutional support, develop entrepreneurial drive, simplify business registration and streamline licensing procedures. It also recommends: making easy and cost-effective access to debt and equity finance for SMEs; broadening use of ICT; and, most importantly for SMEs, widening the market to create more opportunities through broader access to public procurement; and reducing the government's share in the market so that SMEs have better access to these opportunities.

IBS (2016) discusses how to develop the banking sector for SMEs in Kuwait by expanding and enhancing their businesses, both for their commercial benefit and also to better meet the needs of SME customers. Commercial banks can help SMEs develop their services, as well, by establishing a separate SME division, expanding a range of financing options for SMEs and providing additional transaction and advisory services for the sector. The study also suggests that the central bank should set up a regulatory field that is favorable for SMEs, and the banks should work closely with the national fund for SMEs.

There have been a number of lessons from Kuwait's first medium-term development plan (2010/2011– 2013/2014), where policies did not produce expected outcomes and objectives were not fully attained (GSSCPD 2017). A clear, "holistic" approach has been lacking to integrate cross-cutting strategic objectives across government departments and addressing flaws in the policy-making process. Policy-making was not based on a best-practice, evidence-based approach; it should have included regulatory and policy impact assessments at the initial stage. Furthermore, program evaluations at a later stage can contribute to an understanding of how successful the policies have been, thereby setting future directions; however, there was no clear evaluation included in the plan. National plans would benefit from a consultation with stakeholders and experts before new policies are formulated. A good-practice economic appraisal would greatly contribute to identifying and prioritizing policies with a high level of impact.

Stern et al. (2017) studied university and industry linkages in R&D for Kuwait and the UAE, and they mention that policy makers recognize the importance of strengthening science and technology (S&T) to boost competitiveness and economic development. However, there are challenges for the university- industry linkages in these countries. The study suggests there should be favorable policies to support the linkages from both national and university policy-level perspectives. The main recommendations from the study are as follows:

- Provide incentives for firms collaborating with local universities.
- Have university administrators encourage science and engineering faculties to engage with industry partners.
- Direct university administrators to engage business and industry technical leaders in the design of engineering and related curricula to support student preparation and training to fill the industry-needs gap.
- Take a strategic and differentiated approach to encourage university-industry linkages, including collaborative research, co-publication, student employment, conferences and consulting. This should be individualized for each industrial sector through the design of sector-specific policies.
- University administrators encourage collaboration of specific departments so that the projects fit within the scientific discipline of a particular department while also matching the R&D needs of local firms. This can range from allowing faculty time for

- consulting to providing sabbaticals to faculty for starting research-related enterprises.
- Offer guidelines to universities that delineate best practices for these types of linkage engagements, including possible increases in funding for incubators and the exchange of venues – e.g. science parks – to enhance the establishment of linkages.
- Suggest university administrators create specific, mediating offices to increase opportunities for collaboration by improving communication and reducing administrative delays.

Country examples

There are a number of small countries outside the GCC that have made significant economic progress from a low level of economic performance. For example, Singapore, Finland and Ireland, among others, have gone through significant transformation. There are some lessons discussed in World Bank (2012) and NESTA (2014) reports, based on the experience of these countries.

Looking at the small-country experience between 1985 and 2005, Singapore, Finland, and Ireland improved the quality of learning and achieved technological catch-up, developing manufacturing capabilities of the first rank and increasing their ability to innovate. The population in 1985 (per capita GDP for the year in parenthesis) ranged from 2.76 million in Singapore (US\$6,485) to 3.54 million in Ireland (US\$5,826) and 4.9 million in Finland (per capita GDP US\$11,253). In 2016, 16 per capita GDPs for Singapore (3), Ireland (24) and Finland (10) were US\$52,961, US\$62,562 and US\$43,169, respectively.

Good strategy to identify product market

During the upswing in global integration apparent in the early 1980s, Finland, Ireland and Singapore were able to catch two important economic waves: the electronics and information technology (IT) revolutions and globalization. This was achieved by adopting growth strategies that diversified the production base in the areas of exports of electronics, telecommunications, software, chemicals and pharmaceuticals. The countries benefited from identifying new products and tradable services. The countries encouraged technological assimilation and innovation to support profitable new products and tradable services. The economic growth strategies of the countries thrived on the development of education and training. During this time, the countries continued to sustain competitiveness in a number of traditional industries.

Human capital

The countries augmented human capital and intangible assets, e.g. soft infrastructure. They were building up human capital by developing their education and training projects. In the early stages, they focused on good primary and secondary education (including vocational education) to cater to expanding industrial sectors. From the late 1990s, as the three countries began approaching technology frontiers, tertiary education began receiving equal attention.

R&D and technology and innovation

For all three countries, expenditure in this sector played a dominant role in enhancing growth. For example, Finland invests heavily in R&D, with over 3% of GDP invested in innovation, which has been increasingly placed at the heart of government policy, with active coordination among the key players taking place at the highest level.

FDI and access to the international market

FDI was the key driver for diversifying the product base and exports in Ireland and Singapore. The countries benefited from the growth of regional and US markets. Access to the market in the European Union (EU) benefited Ireland and Finland. Singapore benefited from being a part of the fastest-growing region of East Asia.

Government institutions

Government institutions in the three countries had developed into mature and well-functioning organizations before the 1980s, which helped strengthen the organizational capabilities of the state. With a deep knowledge base and extensive human capital, the Funding Agency for Technology and Innovation (Tekes) in Finland, the Industrial Development Agency (IDA) in Ireland, and the Economic Development Board (EDB) in Singapore played a pivotal role in planning and implementing effective strategies for spurring economic growth.

Leadership and national consensus

The leaders in each of the three countries forged a consensus with the key players in the economy and the private sector on economic objectives and the means for achieving them. In the case of Singapore, the country's first prime minister - Lee Kuan Yew - was the driving force. In the case of Finland and Ireland, there was support from political institutions and organizations. In Finland, the prime minister chairs Tekes, and the organization works closely with government agencies such as the Academy of Finland, which promotes basic research, as well as with Sitra (the Finnish Innovation Fund) along with universities, firms and private financiers.

Product and export diversification

All three countries diversified their product base. Nine of Finland's top 10 export commodities in 1970 were products from the wood subsector and the pulp and paper subsector; the only export commodity that was not resource-based was ships. After 30 years, telecommunications equipment had displaced lumber as the leading export. Ireland's main exports were food products, such as meat and butter. Now, high-tech products (electronics and telecommunication equipment) and pharmaceutical compounds and products dominate the list. Currently, high-tech products such as electronics and telecommunication equipment are also at the top of Singapore's export list.

BOX I

Economic Growth: International Experience – I

Productivity is the main driver of economic growth during high and sustained growth episodes.

Source of Real GDP Growth: 1970 -2015 (51 countries)	GDP Growth	Contributions		Total Factor Productivity(TFP)
		Labor	Capital	
Advanced, Emerging and Developing Economies				
High Growth Episodes	7.0	1.6	1.9	3.3
Non-High Growth Episodes	2.9	1.1	0.6	0.5
Differences (High/non-high)	4.1	0.4	1.3	2.8
Advanced Economics				
High Growth Episodes	8.1	1.4	2.1	4.3
Non-High Growth Episodes	3.5	0.6	0.9	1.1
Differences (High/non-high)	4.6	0.8	1.2	3.1
Emerging and Developing Economies				
High Growth Episodes	6.9	1.6	1.9	3.0
Non-High Growth Episodes	2.8	1.2	0.6	0.4
Differences (High/non-high)	4.1	0.4	1.3	2.6

High Growth: Annual GDP Growth Over 4 percent for at least five consecutive years. Source: IMF (2016).

KFAS (2017) discusses the successful experiences of a number of countries, including Malaysia and South Korea. Malaysia has been enjoying a favorable geographical location in the international trade sector and, as a result of trade openness and its international position, it has been encouraging export-oriented industrialization, promoting regional integration within an open environment of trade and investment, and also facilitating manufacturing growth, higher employment and productivity. Following the 1997-98 Asian financial crisis, the country strengthened its macro-prudential policies and its financial sector. It also developed its financial markets, such as local currency bond markets. South Korea had higher spending on industrial infrastructure and on designing R&D, carrying out a structural reform that spurred industrial development and growth.

TABLE 3

Literature summary

Paper	Policy Paper	Challenges
TICG (2016) – OBJECTIVE ONE: ARTICULATION OF KUWAIT 2035 VISION AND CORRESPONDING OPPORTUNITIES, 25TH SEPTEMBER, 2016	Discussion on 2nd KNDP covering all pillars; Key points on economic pillar	<ul style="list-style-type: none"> • Dependency of government revenue from oil production; low oil prices. • Bureaucracy and red tapes block or distort markets, hindering competition and stifling private sector development. • Dominance of public sector in investment and employment. • Lack of strategic alignment and uncoordinated among government policies.
Asheim, Bjørn T. (2015). An Innovation driven Economic Diversification Strategy for Kuwait. Kuwait Foundation for the Advancement of Sciences	Economic diversification; innovation	<ul style="list-style-type: none"> • Unsustainable future on current trajectory despite Kuwait's very high accumulated national wealth and could last for another 20-40 years of use of capital on current level. • Low oil price, rapidly increasing public sector expenditures to accommodate increased demand to support a growing population, lack of sustainability in the current situation on public expenditure.
IMF (2017). Kuwait – Selected issues. IMF Country Report No. 17/16. International Monetary Fund, Washington DC, January 2017	Economic Growth; Institutional and Macro-Fiscal linkage, debt market, financial market	<ul style="list-style-type: none"> • Public finance largely dependent on oil prices; will increase very gradually over the medium term, on assumption of oil prices at US\$60 by 2021; Kuwait will have to borrow from domestic or international market. • Deficit in the budget will continue to persist and it will be around 13 percent of the GDP over the medium term in 2020/21. • Domestic debt markets have remained underdeveloped. • Non-Oil Growth - Labor has been the main driver of nonoil growth during the last 25 years, regardless of whether oil prices have been relatively high or low. Next follows TFP growth and capital accumulation.
KFAS (2017). Identifying Priority Sectors in Kuwait, Kuwait Foundation for the Advancement of Sciences and Marmore MENA Intelligence Ltd	Priority sectors for growth; Private sector	An urgent need to diversify its economy and increase non-oil sector income and employment; private sector enterprises are still underdeveloped

Recommendations

- Optimize utilization of oil reserves by improved up-stream (exploration & production) process and developed down-stream (refining & petrochemicals) activities.
- Targeted and private sector-led local economy diversification and FDI.
- Develop further governance and regulatory reforms to supporting public interests and safeguarding societal well-being

- Diversify the economy; enhance the value creation capacity of the economy beyond the oil and gas economy; knowledge based and global competitive economy
- Entrepreneurship and innovation for transformation to diversify
- An innovation driven diversification strategy is proposed: innovation is the key factor in promoting economic diversity and competitiveness
- Policy reforms: private sector to take lead in economic development, finance its own projects; educational and labor reforms to support the private sector; spending and subsidies programme will require rationalization to drive cost savings and promote efficiency.

- Develop the domestic capital and debt market to benefit from domestic borrowing.
- Kuwait has a very strong credit rating (AA) currently and can benefit from the global financing environment. Other neighboring countries benefitted from accessing international markets.
- Use public money to invest effectively to boost capital and technology, spend more on capital budget, ensure ongoing plan progress successfully.

Three priority areas:

- **Foundation** - for sustainability of economic growth: Healthcare, educational and infrastructure
- **Critical** - benefit the most based on competitive analysis: manufacturing, real estate, financial institutes, resultants and hotels
- **Aspirational** - sectors to ongoing national and international developments i.e. due to growth in digital and internet: Connectivity & Computing, Analytics & Intelligence, Digital Physical Transformation, Advanced Materials, Production Philosophies, Advanced Production Process and Human-Machine Interface"

Other Comments

From other studies: (McKinsey, Monitor, Tony Blair)

- Lift restrictions on foreign investors & promote FDI
- Diversify government income through taxes & fees
- Increase labor market flexibility
- Expanding & empowering the energy sector into the premier regional energy hub for northern Gulf
- Optimize the usage of oil reserves & entering the petrochemicals industry
- Expand & modernize Kuwaiti refining capacity
- Develop a financial hub by empowering capital markets
- Develop a commercial hub with upgraded logistics infrastructure

A broader innovation policy, in addition to the current ongoing R&D capacity development activities in key national organizations focusing on and identifying the priority sectors to innovation will be a realistic option to achieve a successful diversified specialization. The report also recommends development of human capital which can absorb the increased capacity, and institutional reforms and cultural change in governance system and institutions, including a reformed legal framework to create more openness to improve the business climate, contributing to economic development.

By 2030, higher economic and employment growth; high potentials in manufacturing and transport, storage and communications with high investments in R&D and STI should generate skilled personnel and projects

TABLE 3 - CONTINUED

Literature summary

Paper	Policy Paper	Challenges
World Bank (2017) Global Economic Prospects: A Fragile Recovery	Growth and public finance	Geopolitical tensions and conflicts, a lower-than-expected rise in oil prices, and challenges that may delay implementation of key structural reforms.
UNDP (2011) Challenges to SME Development in Kuwait	SME	There are structural imbalances related to the labor market and the role of the private sector. The SMEs are minority players in the economy and their role in economic development and employment is low in Kuwait.
IBS (2016). Taking Stock of SME Banking in Kuwait, Consultancy and Research Department, Institute of Banking Studies Research	SME Finance	SME Credit is low in Kuwait; represents only 7 percent of total bank lending and financing in Kuwait, versus an average of 13 percent in developed countries and 26 percent in developing countries
Burney and et al (2017)	Economic Growth	There are potential inefficiencies to develop the private sector emanating potentially from both the institutions and economic policies areas to support the sector.
Stern, R, A Siddiqi, L D Anadon, V Narayanamurti (2017). University-Industry Collaboration in Science and Technology in Kuwait and the United Arab Emirates: Current State and Future Opportunities. Harvard University Kennedy School	R&D; University - Private, Industry linkage	<ul style="list-style-type: none"> • Faculty who collaborate with firms have greater publications output than their colleagues who do not collaborate. • University authors in Kuwait (and the UAE) publish articles with co-authors in the private sector less frequently than do university authors in Norway and Singapore. • The links between university and industry vary by discipline and type of collaboration. • University support services for connecting with industry are inadequate.

Recommendations

Improve competitiveness in the market, ensure reforms are implemented and manage public finances well, most importantly in a low oil price scenario.

The report recommends finding a commonly accepted definition of SMEs and collecting appropriate statistical information solely for the sector. It further recommends drafting a development strategy for the sector and offer institutional support, developing entrepreneurial drive, simplified business registration and streamlined licensing procedures, easy and cost effective access to debt and equity finance, broader use of information and communication technology (ICT) and most importantly, widening of the market to create more opportunities through broader access to public procurement and reducing the government's share in the market.

Commercial banks should establish separate SME divisions, expand range of financing options, transaction and advisory services, and central bank should set up the regulatory field favorable for the SMEs. The study also suggests the banks to work closely with the national fund for SMEs.

Further research to understand drivers of growth in the private sector with more detailed disaggregated analysis

Other Comments

The paper concludes that the real domestic output in the long run in Kuwait is influenced by oil revenues and foreign output that acts as a proxy for technological progress. It also finds that while both oil revenues and foreign output drive growth in the public sector, technological progress is the main and only driver for private sector real growth.

- Provide incentives for firms collaborating with local universities.
- University administrators encourage science and engineering faculty to engage with industry partners.
- University administrators engage business and industry technical leaders in the design of engineering and related curricula to support student preparation and training to fill in the industry needs gap.
- Take strategic and differentiated approach to encouraging university industry linkages, including collaborative research, co-publication, student employment, conferences, consulting. This should be divided in each industrial sector by designing sector-specific policies.
- University administrators encourage collaboration types that fit with the scientific discipline and match the R&D needs of local firms. This can range from giving time to faculty for consulting to providing sabbaticals to faculty for starting research related enterprises.
- Offer guidelines to universities that delineate best practices for these types of linkage engagements by possible increase funding for incubators and exchange venues e.g. science parks to enhance establishment of the linkage.
- University administrators have specific mediating offices to increase opportunities to collaborate in the linkage opportunities by improving communication and reducing administrative delays.

III. Ongoing Work to Support Economic and Private-Sector Growth



Summary

- The Kuwait National Development Plan (KNDP) 2015/2016–2019/2020 was approved in 2015 to help the country achieve its goal of becoming a financial and commercial hub, attractive to investment, and reclaiming its pioneering regional role in finance and commerce.
- In addition to the ongoing implementation of the mid-term plan and annual plan, there have been a number of reform initiatives. In early 2016, the government approved a comprehensive, six-point reform strategy.

Plans and “Reform”

The KNDP 2015/2016–2019/2020 was approved in 2015 to help the country achieve its goals of becoming a financial and commercial hub, attracting investment, and reclaiming its pioneering regional role in finance and commerce.¹⁷ There are a number of reforms in the plan that will enhance growth in Kuwait. The ongoing and second KNDP was intended to implement ambitious investment projects in core infrastructure, utilities, housing and oil and gas. This plan would also pursue major economic reforms to support private sector development, diversifying economic activities. The current KNDP includes seven pillars to

help achieve its objectives, one of which is the economic pillar; other key pillars include infrastructure and education, which will contribute to the plan's outcome. The KNDP will make significant investment in the real economy in order to boost public infrastructure while also involving the private sector in these activities, which would invigorate economic growth. Investment in key priorities has been envisaged, and this will finance investment projects worth US\$27.6 billion – 24% of GDP – in PPPs. Examples of large projects in the KNDP include a new metro rail network for Kuwait City, a rail network to connect the country with other GCC members, and the extension of the Kuwait Airport; all of these projects are expected to provide an economic boost. Total investment in the plan will be significant, at KD34.15 billion or US\$11.7 billion – or 103% of GDP. The ongoing KNDP plan includes over 421 projects from the first development plan – which was not fully implemented – and adds an additional 92 new projects.¹⁸

In addition to the ongoing implementation of the mid-term plan and annual plan, there have been a number of reform initiatives. In early 2016, the government approved a comprehensive six-point reform strategy to ensure fiscal adjustments such as implementing subsidy reform, encouraging private sector growth and diversification, ensuring citizen participation such as partnerships with PPPs, making the public sector efficient, and creating additional employment opportunities, thereby increasing the efficiency of the labor market. Legislative and institutional reforms here would ensure a better business environment for the private sector and increase the efficiency of the public sector.

The six reform strategies include reforms to reduce the budget deficit over the medium term by rationalizing government expenditure and increasing non-oil revenue, including introducing a VAT; modernizing the role of the state by ensuring a favorable regulatory and business environment and encouraging market forces; promoting private sector development by enhancing the use of public-sector partnerships with the private sector; and supporting SMEs. It also includes encouragement for the participation of citizens in privatized enterprises, making the labor market and civil service more efficient, and promoting legislative and institutional reforms to enhance public-sector effective management of the economy.

Existing policies in Kuwait national plans

The ongoing, second mid-term KNDP aims to kick-start “human development and the sustainable economy for Kuwait,”¹⁹ and follows a two-pronged approach to achieve its objectives; by contrast, the first plan focused on current developmental challenges and deficiencies. Supporting the endeavor of fulfilling Kuwait's future vision is considered in the second set of the work stream. The plan presents five objectives: covering increases in GDP and the well-being of citizens; developing the private sector; supporting human and societal development; improving housing provision; and increasing the effectiveness of the government. The KNDP contains a number of policies in each area of economic development, human and societal development, administrative development and legislative requirements. Objectives and targets within the plan are translated into specific policies within four areas, including 116 Economic Development Policies, 175 Human and Societal Development Policies, 51 Administrative Development Policies, and 46 Legislative Requirements.²⁰

18

IMF

19

There are some discussions on the developmental performance evaluation and challenges of the first development plan, 2010/2011–2013/2014.

20

GSSCPD (2015), page 11.

As the plan is further developed and detailed, the policies have been organized differently into seven defined pillars. The Annual Development Plan of 2017/2018 distributes the policies into seven concrete pillars with specific programs - amounting to 28 development programs - with homogenous projects in each (GSSCPD 2016). It also presents targets and charts on KPIs over the plan period. Overall for the pillars, the annual plan presents 28 programs, 20 international charts linked to the pillars, 58 indicators, 214 policies and 160 projects. All of these are linked to the KNDP 2015/2016–2019/2020. The annual plan refines the overall policies, with a total of 342 policies - which equals 128 policies to be completed during the development plan years, plus 214 policies that will be activated up to the end of the 2017/2018 plan. The “Sustainable Diversified Economy” – or the Economic Pillar – within the annual plan covers four programs: a business environment preparation program for the private sector; diversification of the production base and increasing investment rate; a national tourism development program; a state financial and economic reform program; and a knowledge economics program.

Progress and update

The economic growth rate in Kuwait improved in 2016, and is estimated at 3% by the World Bank. This has been attributed to higher oil production and fiscal stimulus from the implementation of major infrastructure projects initiated within the ongoing development plan. However, the recent IMF report released in October 2017, forecasts a negative growth (- 2.1%) for 2017 and a positive growth (4.1%) for 2018.

Rising oil output from 2018 onward, successful passage and implementation of reforms, and the development plan and massive public-sector investment in the oil sector over the next five years will boost oil output. The oil sector will continue to drive growth, and the national growth forecast is expected to near 3% in 2019, as reported by the World Bank.

Energy subsidies in Kuwait have been estimated at ranging from 1.3% of GDP to 5.7% of GDP and are a burden on public finances. Kuwait has partially deregulated fuel prices, and work on reforming electricity and water subsidies is ongoing.

Kuwait is enhancing its investments, increasing capital spending and implementing relevant projects such as boosting investment in infrastructure. These projects will be among the major drivers of growth.

On fiscal policy, it is expected that there will be a gradual implementation of public spending and revenue reforms, including a VAT in 2018.

Kuwait has used the international debt market to manage finances, and has issued an inaugural US\$10 billion international bond, which is one of the 10 largest emerging bond market sales from 1995–2017, according to the World Bank.

There has been a modest surplus on the balance of trade in goods and services, which improved in the second half of 2016. This was due to higher oil prices. Import of capital goods to support the level of investment in the economy has remained high relative to other imports. The forecast for Kuwait is that the current account balance will return to surplus in 2017 and is expected to become equivalent to 2.1% of GDP.

The Capital Markets Authority law was amended in mid-2015, and this strengthened investor protection. This allowed greater foreign ownership and increased transparency, and also brought regulations more in line with international standards. Internally, FDIs that fulfill set requirements can receive approval to own 100% equity.

PPPs account for around 20% of the KD30 billion invested in projects under the KNDP. These projects are expected to ease pressure on fiscal expenditure and encourage inward and domestic investment, accelerating economic growth. The Kuwait Authority for Partnership Projects (KAPP) is the official PPP governing body and is working on a number of projects. It has been reported that there are currently four major PPP projects, worth a total of KD1.9 billion, that are going through the under-evaluation process, which includes the second phase of the Az-Zour North Independent Water and Power Project, a school development program, a solid waste project and a project to develop highway rest stops (NBK 2017).

IV. Economic Growth, Management and Public Finance (Gaps, Challenges and Recommendations)



Summary

Gaps

- Market failure and underdeveloped markets.
- Rationalize public expenditure in favor of capital expenditure.
- FDI to compete with other GCC countries to attract investments.
- Non-oil sector growth with low or insignificant contribution from productivity, if any.
- Management of macroeconomic policies, the budget and investments in a low oil price situation.
- Infrastructure investment has to be focused on the right areas and types.
- International trade policy is inadequate to support the private sector.

Challenges

- High dependence on oil revenue and a large public sector.
- Kuwait's per capita income moves hand-in-hand with global oil prices.

- With collapsed global oil prices, external and fiscal accounts have been unfavorably affected to support economic growth.
- Non-oil real GDP growth has slowed.
- Business environment and regulatory burdens. As an example, Kuwait ranks toward the end on the World Bank Ease of Doing Business score.
- The lack of a dynamic, non-oil tradable sector.
- The productivity contribution to growth is either low or insignificant.

Recommendations

- Policies to boost productivity and ensure that ongoing activities are implemented.
- Further investments on basic ingredients for growth; business environment and competitiveness; favorable labor market; human capital; R&D and STI activities.
- Coordinated economy management policies in a low-oil price scenario.
- Reduce the size of the public sector to make way for the private sector.
- Develop the evidence base analyzing economic growth.
- Provide additional incentives for high growth and FDI with technology potential.
- Support for innovation and technology, including increased funding to support these initiatives in all sectors of the economy.
- Reduce subsidies and correct distortion in the incentive structure.
- Trade policy to support the economy, including enhancing product diversification.
- Ensure development of the right type and best quality of infrastructure.

Policy summary

To improve on national economy management and increase investment rates. To enhance economic reform, develop Kuwait's northern region, increase the size of government investments, diversify the economy for the private sector, and attract foreign investments and develop financial markets and institutions.²¹ To enhance non-oil sector growth and increase contribution to the GDP. To increase capital spending within total government spending, to rectify flaws and loopholes in state finances, and to raise the capacity of the executive apparatus for state finance.

Current scenario: gaps and challenges

Kuwait's per capita income over the years moved hand-in-hand with global oil prices. The hydrocarbon sector in Kuwait accounted for 60% of real economic activity in 2015, and oil revenues as a percentage to total government revenue was 68% in 2015/16.²² When the oil price is high in the international market, public expenditure – as a result of higher revenue – allows the government to support growth by encouraging spending in the economy and absorbing the national labor force in larger, active economic sectors. During a high oil price situation, the government can accumulate a larger oil revenue due to high oil prices and can use it to increase fiscal spending. Since 2014, with the collapse in global oil prices, Kuwait's external and fiscal accounts have been unfavorably affected to support economic growth, and non-oil real GDP growth has slowed.²³

21 GSSCPD (2015)

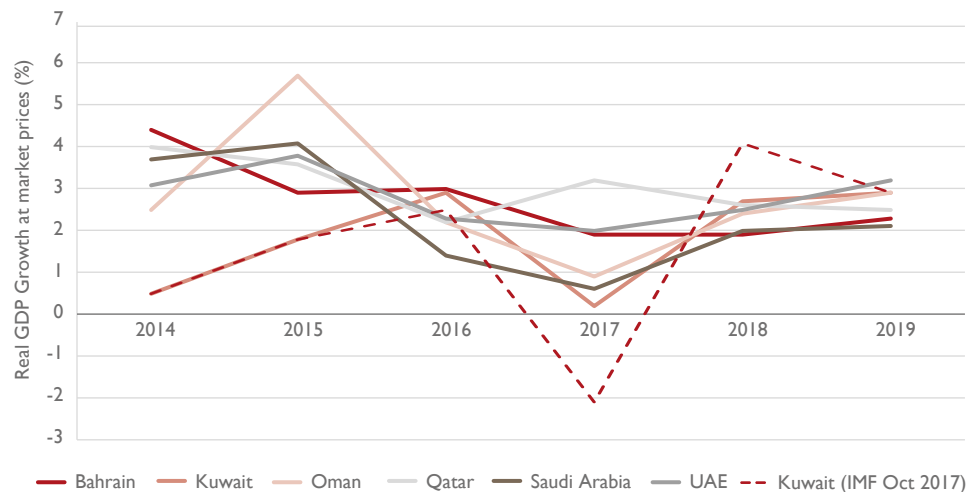
22 Central Statistical Bureau, Kuwait

23 IMF (2017)

Kuwait's nominal GDP was estimated at US\$108 billion in 2016, and this is expected to increase to US\$126 billion²⁴ in 2017. Real GDP at market rate was estimated at 2.9% for 2016 and growth forecast is 0.2% for 2017 (see figure below). Real GDP sector growth in the hydrocarbon sector (oil sector) was negative at -1.7% in 2015 and was estimated to be at 3.5% in 2016. Non-hydrocarbon sector growth has been at 1.3% and 1.9% respectively for the past two years. Growth in the non-hydrocarbon sector has slowed down from previous years, when it ranged from its highest at 4.8%, to its lowest at 3.4%, for the 2011–2014 period.

FIGURE I

Growth rate and forecast



Source: Based on data from World Bank (2017) Global Economic Prospects: A Fragile Recovery; and IMF Oct 2017.

Short-term and medium-term growth

Fiscal expansion or government expenditure creates new demand in the economy, leading to further spending and income creation, which can be captured by the multiplier effect. The fiscal multiplier measures the effect of a change in spending or tax revenue on the level of GDP and gives a measure for short- and medium-term impact. Fiscal multipliers are normally lower in emerging and low-income economies compared to advanced economies. One reason for the lower impact is inefficiencies in government spending.²⁵ For GCC countries, the IMF estimates fiscal multipliers to be larger for capital than for current spending. Current fiscal expenditure only affects economic activity in the short-term, lasting for a year, and the medium-term impact of capital spending is larger, lasting for three years. The current spending multiplier is estimated at 0.3 and capital spending multipliers are estimated at 0.4 for short-term and 1.6 for medium-term impact.²⁶

²⁴ World Bank (2017a). Sustaining Fiscal Reforms in the Long-term. Gulf Economic Monitor Issue 1, June 2017

²⁵ Another example is from greater leakages through imports (that is demand created in the country is supplied by other countries) in smaller and more open economies

²⁶ IMF (2017)

Long-term growth

Longer-term growth can be viewed using a simple model of output or economic growth:

$$Y = F(A, K, L)$$

The diagram shows the equation $Y = F(A, K, L)$. Below the equation, four labels are connected to the variables by arrows: 'Real GDP' points to Y, 'Function of Productivity' points to F, 'Capital Stock' points to K, and 'Labour' points to L.

Economic growth (Y) from the supply side relies on capital (K), labor (L) and productivity (A), that, in turn, depends on the quantity and quality of the inputs and the efficiency with which these inputs are put to use, i.e. total or multi-factor productivity (TFP). Higher productivity and physical capital help absorb the growing labor force into productive economic activities and contribute to long-term economic growth. Investing in both physical capital, notably infrastructure, and in human capital such as education and training, and in technology – i.e. innovation and R&D – is important for growth.

Improvements in the overall business environment and lower regulatory burdens can provide incentives and confidence to invest in the economy and increase productivity of firms through a number of factors. Well-established business regulatory frameworks, favorable macroeconomic conditions – in particular low and stable inflation – and well-developed financial markets are important ingredients for growth, by increasing business confidence in investing and encouraging innovation activity.

The main issue with economic growth in Kuwait and other GCC countries is the lack of a dynamic, non-oil tradable sector. Market failure, rather than government failure, is slowing diversification toward a dynamic non-oil sector; by the unfavorable incentive structure in the economy. The incentive structure of the economy needs to be changed to manage this failure so that it encourages individuals to work in the private sector and private-sector firms can look beyond domestic markets for their products (IMF, 2014 a, b).

Average real growth in Kuwait over the period from 2011–16 was 3.8%, whereas oil sector growth was 4% and non-oil 3.2%.²⁷ Oil sector growth ranged from -1.7% in 2015 to 15.6% in 2011. Non-oil growth ranged from 1.6% in 2015 to 3.4% in 2011. Over the last quarter-century in Kuwait, labor as an input in production played a dominant role in non-oil sector growth, contributing 3.3% of the 5.6% growth for 1991 to 2014, where contributions from capital and productivity were low²⁸ (see table). Contribution from capital has been at 0.9% to real growth in Kuwait, compared to GCC average contribution from capital at 2.2% to total 6.6% growth for these countries.²⁹ Overall, the total factor productivity contribution to growth has been low. The contribution is higher in Kuwait during high oil price episodes, as government spending is higher on projects, such as infrastructure investments, and this benefits and reduces operation costs for the non-oil sector.

27 Calculated from the World Bank (2017a)

28 IMF (2017) calculated TFP contribution to be 1.4 over the period, while World Bank (2017a) calculated that the TFP to potential growth for Kuwait has been negative for the period.

29 IMF (2017)

TABLE 4

Contributions of inputs in non-oil sector growth in Kuwait and the GCC

	Average annual non-oil growth, %	Average contribution to growth, % points			Fraction of non-oil growth accounted by labor and capital	Non-oil* growth
		Labor	Capital	TFP		
Full period: 1991-2014						2015
Kuwait	5.60	3.30	0.90	1.40	0.75	1.30
GCC Av	6.40	3.50	2.20	0.60	0.90	4.90
Lower Oil Prices: 1991-2002						
Kuwait	4.90	4.00	0.00	0.80	0.83	
GCC Av	4.30	2.60	1.40	0.20	0.95	
Higher Oil prices: 2003-2014						
Kuwait	6.30	2.70	1.70	1.90	0.69	
GCC Av	8.40	4.40	3.00	1.10	0.87	

Source: IMF (2017) and * from World Bank (2017a).

Foreign Direct Investment (FDI)

In Kuwait in recent years, FDI has slowed. In 2016, the FDI was US\$275 million, FDI inflow stock was US\$14,260 million, and the inflow in that year contributed 1% of the gross capital formation in the country.³⁰ UAE is attracting more FDIs compared to other countries in the region. UAE has good domestic growth potential. The UAE government has been supportive of expanding infrastructure and logistics, including improving the business climate and regulations to attract foreign investments. For example, the World Bank Ease of Doing Business ranking for the UAE is 26, with the country's distance to frontier (DTF)³¹ score 76.89, while the ranking and score for Kuwait are 102 and 59.55 respectively.

30

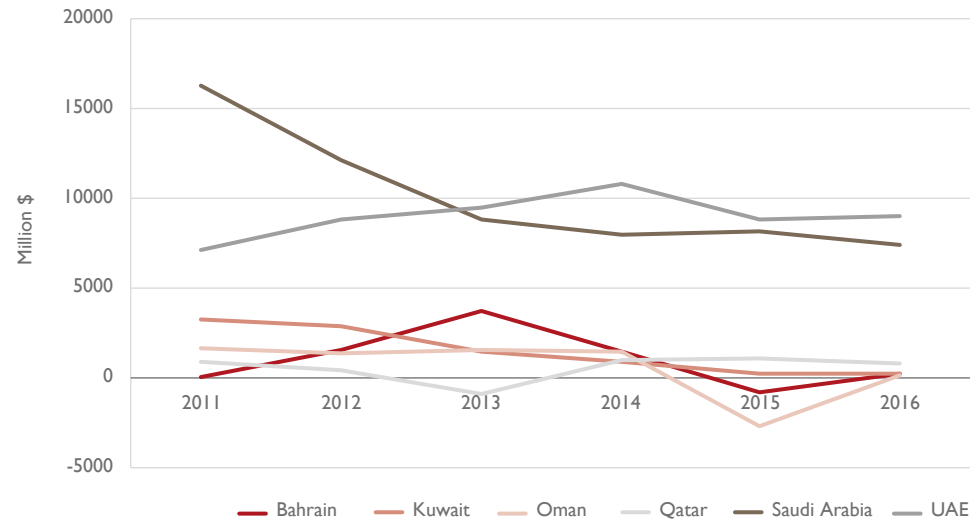
UNCTAD Kuwait country fact sheet

31

DTF captures the gap between an economy's performance and a measure of best practice across the entire sample of 41 indicators for 10 Doing Business topics.

FIGURE 2

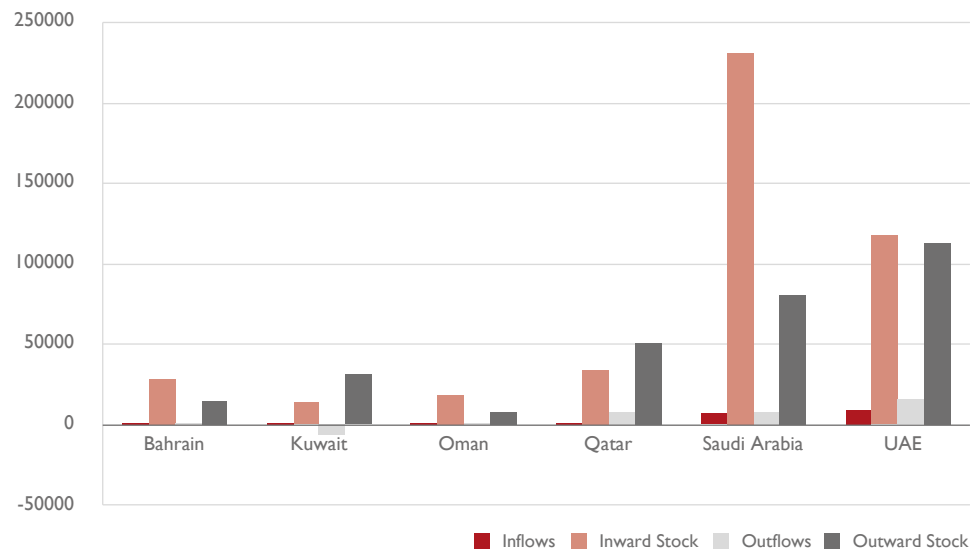
Inflow of Foreign Direct Investment (FDI)



Source: Based on data from Annex Tables, World Investment Report 2017; UNCTAD.

FIGURE 3

FDI Stock and Flow in 2016 (Million \$)



Source: Based on data from Annex Tables, World Investment Report 2017; UNCTAD.

Promotion of Kuwait as a business hub and initiatives for attracting FDI and PPP business opportunities are still developing. Inward foreign investment in Kuwait must be viewed within a regional context within GCC countries, as the countries share similar characteristics and are competing to attract these inward investments. Investors would look at offers from each of the countries, decide what is on offer and then take their investments to their country of choice. Kuwait has to compete with other GCC countries to attract investments. In the past, Saudi Arabia has attracted most of the inflow while recently, the UAE has become an attractive place for investors. Kuwait's inward foreign investments have always been low among the GCC countries (see figure), and have been gradually decreasing.

Focus areas

Economic growth in the non-oil sector in Kuwait, as in other GCC countries, has been generated by factor accumulation, both labor and capital. There was no improvement in productivity.

Empirical studies suggest that the total factor productivity is the most important driver of high and sustained economic growth.

High dependence on oil revenue and a large public sector

The economy of Kuwait is largely dependent on revenue from the oil sector and as such, economic growth is dependent on favorable international oil prices. Macroeconomic management covers a number of areas, most importantly inflation (monetary policy), public finance (fiscal policy) and external sectors (international trade and finance). Effective coordination of delivery of policies, and most importantly how to manage the economy during a low-oil-price scenario, should be the prime objectives for managing the economy of Kuwait effectively. It is challenging to forecast oil prices and sensitivity analyses in the evidence base would benefit from effective management of public finance under alternative oil price scenarios, when the prices on the international market do not increase as expected.³² In addition, another challenge here is that the public sector dominates the economy and private-sector business activities largely rely on activities related to public investments and procurements. The public sector can take the initiative to reduce its size in the economy and identify those areas where there is a comparative advantage for the private sector.

Growth framework for analysis and the major drivers of economic growth

Accumulation of capital, the growth and quality of the labor force and the contribution of the growth of total factor productivity (TFP) are the most important drivers of growth. A framework for analyzing economic growth and how this disaggregates into short- and long-term growth will provide a direction for policy formulation specific to economic growth. There are mentions of a macro model that drive some of the figures used in the plan, and a short description has been provided of the assumptions behind the evidence base.³³ However, the assumptions used to run the model or details of the model components were not clear. The challenge here is to provide a fit-for-purpose analytical and structural growth and policy framework that would underpin the national plan. In addition, the macro model should provide details of and describe how it is relevant to the economy of Kuwait and how it is fit for purpose, supporting growth from both short-term and long-term planning and delivery perspectives.

32 The midterm plan uses oil price assumptions as follows: US\$70.5 in 2016/2017; US\$80.4 in 2017/2018; US\$89.3 in 2018/2019; and US\$97.3 in 2019/2020.

33 (GSSCPD 2015), Pg. 35

Public expenditure – capital and current

Capital spending in the plan will increase over the plan period, from 9.2% of total government spending in the base year 2013/2014, to 12.2% in 2019/2020 (GSSCPD 2015). The annual plan will increase the percentage of capital spending to 23.5% in 2017/2018 (GSS-CPD 2016).³⁴ In 2015/16, capital spending was 12.5% of total public expenditure. Capital spending has a higher impact, as discussed above, and the challenge is to reduce current spending. A big part of government spending goes into subsidies, and reducing subsidies within government budgets, based upon economic rationale, would make public financial management more efficient. Current expenditure can be further reduced by employing cost-cutting measures across the public sector.

Better management of macroeconomic policies, the government budget and investments during a low-oil price situation

Manage budget deficit and increase capital expenditure for innovation capacity, higher education and training, and on skills to develop an efficient labor market.

Macroeconomic policy issues

challenges for increased borrowing from domestic markets.³⁵ Kuwait is highly dependent on domestic financing compared to external borrowing or drawing down buffers, and has the potential to put upward pressure on domestic interest rates, lower aggregate demand and increase inflationary pressures. Policy options could include measures to support banks' liquidity, for instance through shifting some of the public enterprises' financial investments abroad to the domestic banking system and, over the medium term, through financial reforms, thus increasing financial deepening. In contrast, drawing down buffers and external borrowing will have similar, direct macroeconomic implications to those of oil revenue inflow. The peg of the dinar to a basket of currencies is well-established and the external borrowing is not expected to create nominal exchange rates or inflationary pressures and will lead to real exchange rate appreciation.

FDI

From January 2015 to September 2017, the Kuwait Direct Investment Promotion Authority (KDIPA) approved 25 foreign investments worth US\$2.37 billion, potentially creating over 1,000 jobs in the economy. In addition to the activities of the KDIPA, other public authorities have their own incentive structure to support FDIs. It is important to have a list of incentives that is on offer across different public bodies in a coordinated way, ensuring efficient use of public resources. There is also competition across the GCC to attract FDIs and massive initiatives are ongoing in those countries to achieve their targets.

34 Recent Central Statistical Bureau of Kuwait shows the capital expenditure to be 14% in 2013/14. Calculated from Government Finance Statistics 2011/2012–2015/2016, Table 1, capital expenditure KD2,284.65mill/total expenditure KD15,831.71mill. In 2015/16, the capital expenditure is 18% of the total government expenditure.

35 IMF 2017

BOX 2

Economic Growth: International Experience – II

A literature review by the IMF shows that structural reforms can help support sustained non-oil growth.

The GCC countries, along with many other countries, have recognized that structural reforms are essential for ensuring sustainable growth.

Additional structural reform is required to overcome economic slowdown in the GCC in order to support growth, boost Total Factor Productivity (TFP), enhance private investment, and create high-paying, private-sector jobs.

There is a large body of empirical analysis that supports the existence of a positive relationship between a number of structural reforms and drivers of economic growth.

There is a need for price stability. This allows a better assessment of relative prices to support better investment decisions. In addition, there is a need for openness to competition from abroad, to facilitate international transfer of better technologies and create incentives for efficiency.

Contributions from capital, labor and productivity gains can be augmented by developing a competitive business environment and improving labor market efficiencies and public infrastructure. In addition, improving investment efficiency in the GCC has the potential to drive growth in these countries.

Higher quality of institutions, such as public governance, as well as legal systems and property rights, are associated with more efficient allocation of resources. This would, in turn, boost aggregate productivity and can also build confidence in the economy and stimulate investment and employment in the private sector.

Ref. IMF (2016).

Infrastructure

Infrastructure does not necessarily translate into higher long-term growth, and the challenge is that infrastructure investment must be in areas that will boost the supply potential of Kuwait's economy, enhancing long-term growth. Having the right type and high quality of infrastructure allows economic activities in a country to be more efficient; this, in turn, improves productivity and increases economic growth, improving the welfare of the country's citizens. There are a number of projects within the ongoing, annual national plan. Clarity on the assumptions and criterion for the prioritization of projects, by carrying out economic appraisals for each, would underpin policies for the sector. International infrastructure rankings by the World Economic Forum provide a way of comparing the performance of Kuwait's infrastructure with that of other countries. Kuwait was ranked 64th in the world out of 137 countries in terms of the overall quality of its infrastructure in 2017–18, behind Bahrain (33rd), Qatar (13th) Oman (36th), Saudi Arabia (29th) and UAE (5th).

Recommendations

Further develop policies to boost productivity and ensure that they are working as the key driver of growth in Kuwait and establish a sustainable economy. Ensure implementation of ongoing, structural market-oriented reform activities.

Policies for growth should include the following: first, improve the business environment and competitiveness by enhancing regulatory frameworks for the private sector; reducing trade barriers and developing a favorable environment for international trade. Second, reform the labor market to reduce public-sector dominance and combine reform, ensuring it covers both the public and private sectors within the labor market. Ensure that the private sector can absorb higher employment and that employees have the right skill set to be more productive. Third, improve Kuwait's human capital in a number of ways, such as: enhance the skills of low-skilled workers and fill in skill gaps; identify the economy's needs within the country; develop the education sector and allocate more funding to the primary, secondary and higher education systems; and improve on R&D and STI activities and ensure that funding is available where there is high potential and an economic rationale.

Develop coordinated economy management policies for economic growth under a low-oil price scenario. Reduce the size of the public sector to make way for the private sector.

Develop economy management policies based on alternative oil price scenarios, including actions during a time of low oil prices in the international market. Reduce the size of the public sector in the economy, covering both activities and employment. The government can increase investments in those areas where investment has been massive and/or where there has been a market failure and government intervention would benefit the country. This can work within a PPP framework to support the private sector.

Further develop the evidence base on frameworks for analyzing economic growth and understanding how this will translate to planned impacts. Develop a plan with longer-term growth prospects.

Growth and development of the non-oil sector is the prime objective for Kuwait. This will diversify the economy and develop private-sector growth to GDP contribution.

FDI adding to capital accumulation and technological progress

Provide additional incentives to high-growth and technology-intensive FDIs. Identify and list all incentives and activities to attract FDIs across public bodies to coordinate and effectively deliver the objectives and minimize public-sector resources. Periodically carry out a comparative analysis on investment promotion initiatives across the GCC countries and the wider region, which are the main competitors when it comes to attracting regional FDIs to their respective countries.

Enhance support for innovation and technology, including funding to support these initiatives in all sectors of the economy

Funding support will have its own entity and attract funding applications from a diverse range of areas in the economy where the funding will be approved based on set criteria, including areas where the impact on the economy will be high.

Manage public finance by reducing subsidies, underpinning remaining subsidy measures using the economic rationale and making cost-cutting measures across public bodies to make public finance more efficient. Clearly distinguish current and capital spending. Protect, increase and prioritize capital spending.

The plan should include the development of fiscal and spending policies that prioritize public expenditures that will have a high impact on the economy. Public expenditure on capital spending has a higher impact than current spending. Within current expenditure, identify areas to reduce expenditure in each of the public expenditure areas. Capital expenditure will enhance growth and this will have a higher impact, contributing to growth when spending is prioritized by identifying high-impact areas. During times when there are budgetary problems, such as in periods of low oil prices, government revenue will be reduced; therefore, protecting and prioritizing capital expenditures would benefit the economy of Kuwait.

Ensure that the right type and best quality infrastructure is developed where there is a lack of supply in specific infrastructure, which potentially hinders economic growth prospects at national and regional levels.

Prioritize projects based on the economic rationale and the economic appraisal of the individual project, ensuring that each will impact economic growth.

V. Private-Sector Development – Supporting and Expanding (Gaps, Challenges and Recommendations)



Summary

Gaps

- Institutions and policy frameworks to encourage competition and investments. Flexible capital and labor markets to ensure labor productivity.
- High-growth firms to play a key role.
- Risk-mitigating measures within the policy cycle for the business environment.

Challenges

- Support and expand the sector, increase the private sector share of GDP and investments.
- Reverse the declines in competitiveness and the business environment, drops that have been measured by most international indicators.

- Develop the market, correct market failures and encourage firms to establish businesses, generating private-sector growth.
- Decrease the bureaucracy required to do business.

Recommendations

- Take action immediately on the problematic factors for doing business.
- Ensure market forces are working; ensure competition and correct market failure.
- Monitor the market.
- Reduce ownership of public sector-managed businesses.
- Make market forces effective for the private sector by removing subsidies.
- Ensure land requirements and regulations are favorable to the private sector.
- Prioritize projects based on maximum social benefits and an economic rationale.
- Create a single window, in one platform, of services for the private sector, and integrate with the work of public authorities.
- Incorporate risk-mitigating measures by carrying out impact assessments.
- Support high-performing private businesses and ensure these firms receive favorable treatment.
- Further develop investment promotion and evidence for FDIs for Kuwait.

Policy summary

To increase the private sector's share in GDP and investment. To develop partnerships between the public and private sectors in a number of areas, including infrastructure projects. To expand the legislative structure to support private sector economic activity, increase market competitiveness and promote the market's role. To speed up implementation of privatization programs, benefit from the work of high-performing domestic banks to finance the private sector, and minimize documentation and procedures that are a burden for the sector.

Current scenario: gaps and challenges

The objective of developing the private sector in Kuwait is to support and expand the sector by increasing the private-sector share of GDP and attracting investments. This would increase the contribution of the private sector as part of GDP from a 26.6% average in 2010/13 to 41.9% by the end of the plan in 2019/20. The plan discusses developing and working on long-term partnerships and increasing public and private sector investments in large industries and infrastructure. There is government support for expanding a wide range of private sector areas, including SMEs and FDIs on one side of the spectrum to financial, health and hydro-carbon sectors on the other.

The private business environment in Kuwait has always been challenging, and international indicators show that it is worsening. In the World Bank's Doing Business 2016 index,³⁶ Kuwait ranked low- at 98 - and a year later dropped even further - to 102 out of 190 countries. The business environment enhances market forces and ensures that the private sector is effectively contributing to the economic activities of a country.

³⁶ Doing Business provides an aggregate ranking on the ease of doing business, based on indicator sets that measure and benchmark regulations applying to domestic small- to medium-sized businesses through their life cycle. Economies are ranked from 1 to 190 on the ease of doing business. Doing Business presents results for two aggregate measures: the distance to frontier score and the ease of doing business ranking. The ranking of economies is determined by sorting the aggregate distance to frontier scores, rounded to two decimals. An economy's distance to frontier score is indicated on a scale from 0 to 100, where 0 represents the worst performance and 100 the frontier.

TABLE 5

Doing business ranking in 2017

Economy	Ease of Doing Business Rank	Starting a Business
United Arab Emirates	26	53
Bahrain	63	73
Oman	66	32
Qatar	83	91
Saudi Arabia	94	147
Kuwait	102	173

Source: World Bank (2017b).

Kuwait's Doing Business 2017 score for distance to frontier (DTF) was 59.55, and this has been reduced from a DTF of 60.12 in 2017 – a change in of -0.57.

The GCI ranked Kuwait at 52 out of 137 economies in 2017–18; this rank slipped from 38 (out of 138 economies) during the previous year, 2016–7.³⁷ The drop is primarily due to deterioration in the macroeconomic environment as a result of the budget deficit resulting from low oil prices, where the budget is highly dependent on oil revenue. This has been further influenced by a revision in the technological readiness indicators by the International Telecommunication Union (ITU). The top three most problematic factors for doing business are inefficient government bureaucracy, corruption and restrictive labor regulations.

There are a number of ongoing initiatives to implement the plan. The 2017/18 annual plan develops ambitious targets for delivering economic projects in areas that will generate growth in the private sector, non-oil sector, tourism and infrastructure, among numerous sectors that are interlinked with each of the pillars, including different priority areas of the economy pillar other areas. Recently, Kuwait has been supporting PPP projects, and there are policies to support this within both the mid-term and annual plans.

The KDIPA³⁸ and its sub-site Tahseen³⁹ are working to develop the business environment. The Kuwait Business Center⁴⁰ has started to improve the regulatory environment and procedures for doing business for entrepreneurs in Kuwait, and the work is evolving in order to achieve the national plan's objectives.

37 <http://reports.weforum.org/global-competitiveness-index-2017-2018/>

38 <https://kdipa.gov.kw/en/>

39 <https://tahseen.kdipa.gov.kw/en/home-2/>

40 <http://www.kbc.gov.kw/>

Focus areas

The aim of business regulations and of developing a business environment is to develop the market, correct market failures, and encourage firms to establish businesses that generate private-sector growth. Decreasing the bureaucracy around business creation, operation and development can foster economic growth and generate higher profits.

The World Bank (2017b) carried out research covering 172 economies in the period from 2006 to 2010, where each additional business regulatory reform was associated with an average increase of 0.15% in economic growth. Starting a business has been difficult, as the time required to register a business has increased, with firms required to submit original documents both online and by sending a representative to appear in person (World Bank, 2017b). For starting a business within the country, as of 2019, Kuwait ranks low at 133⁴¹, while the ranking has improved within 190 countries compared to the previous year, Kuwait needs to do more to improve its rank further.

Institutions and policy frameworks encourage competition and ensure that firms receive good returns on investments. Flexible capital and labor markets ensure labor productivity, and the diffusion of innovation drives growth. Moreover, there is evidence from other countries that high-growth firms⁴² can play a key role in driving growth in their respective countries.

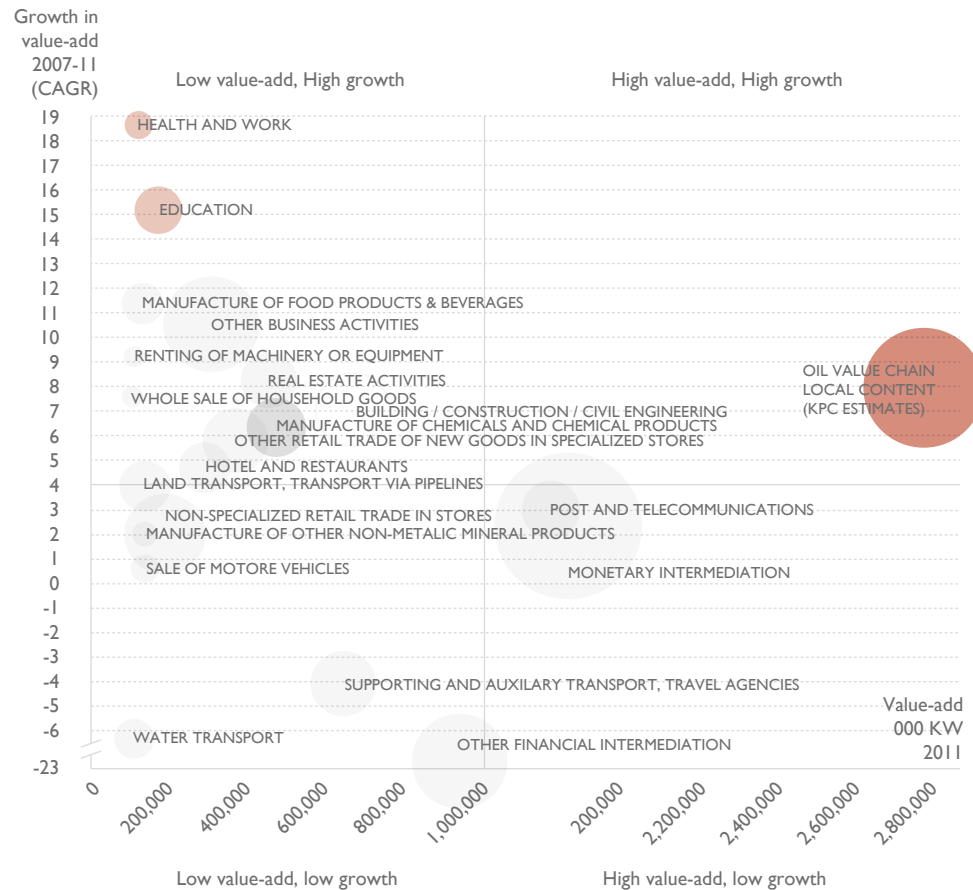
There is a growing demand for services in the high-growth service sector. In Kuwait, these sectors are concentrated in the areas of education, health care, and ICT. Despite the potential for high market growth in these sectors, there is a lack of supply attributed to a limited amount of skilled employment and entrepreneurship. Small- and medium-sized businesses encounter difficulties in reaping entrepreneurship opportunities within these sectors, as they face challenges and competition from larger firms.

41 Doing Business 2019: Training for Reform: The World Bank

42 High-growth firms here: Those that achieve annual growth rates in turnover or number of employees of over 20% for three consecutive years.

FIGURE 4

Growth and value-added levels across subsectors



Source: Kuwait Central Statistical Bureau, World Bank Team Analysis – National Fund (2015)

Note: Shows the value-added and growth levels of the subsectors and the bubble size is Kuwaiti employment in those subsectors in 2011.

Governmental policies and regulations can adversely impact the business environment and other, related business indicators. Adverse impacts on business are taken seriously by the government. One example to support this is how the government has created initiatives to facilitate improvements in the business environment and eliminate procedures that influence the negative impact on business, as generated in the World Bank report.⁴³

The challenge is to ensure that mitigating measures within the policy cycle eliminate or minimize the risk of a negative impact. To increase the likelihood of such an outcome, a best-practices approach should be followed, which means that a thorough and systematic policy and regulatory impact assessment should be undertaken. Impact assessments can be applied to an array of different areas, from the impact on small businesses to the impact on the environment. In developed countries such as the UK, this is a common best-practice in policy formulation.

43

See <https://tahseen.kdipa.gov.kw/en/record-2/>

A good investment promotion strategy on what is on offer is important to attract FDIs. Dubai and Saudi Arabia offer details on what is available with regard to investments in market reports and informative websites.⁴⁴ Kuwait's investment and business promotion websites, i.e. business information services, are evolving, and are expected to develop further in the future.

BOX 3

Foreign Direct Investment (FDI): Marketing and Promotion

At the end of 2011, inward FDI stock in Saudi Arabia amounted to US\$187 billion, which is equivalent to 34% of the country's GDP. Outward investment of the country has been modest, and the country's outward FDI stock was equivalent to only 5% of its GDP at the end of 2011. Historically, Saudi Arabian FDI stock has been targeted toward the services sector (70% in 2010), followed by manufacturing and processing activities. There also has been small investment in the primary sector (3%). The country attracted FDIs in business activities, construction, petrochemicals, finance and refining.

Saudi Arabian General Investment Authority (SAGA) (<https://www.sag.gov.sa/>) promotes inward investments in the country. The website presents details of opportunities and how the agency can support establishing businesses in the country. **Dubai FDI** (<http://www.dubaifdi.gov.ae/>) attracts inward investments in Dubai and "guides, advises and provides practical help on all aspects of business decisions and management, from determining the best legal structures to identifying investment opportunities and introducing a vast network of government and private sector contacts." Both of the organizations present themselves as professional and less bureaucratic, facilitating and supporting inward businesses into the countries.

⁴⁴ See <http://www.dubaifdi.gov.ae/english/Pages/default.aspx> for Dubai and <https://www.sag.gov.sa/en/Pages/default.aspx> for Saudi Arabia. For Kuwait see <https://kdipa.gov.kw/en/> and <http://www.kbc.gov.kw/Default.aspx>.

Recommendations

Identify weaknesses immediately and take improvement measures as soon as the issue is identified, covering – most importantly – improvements regarding problematic factors for doing business.

Ensure that market forces are working, ensure competition and measures are taken to correct market failure

Create an action plan to reduce monopolistic power in the market and ensure that there is competition. Monitor and evaluate ongoing, competition-related policies and ensure that regulations make the market competitive for the private sector.

Monitor the market

Set up a competition team within a public body, with a clear remit for monitoring competition in the market; this will work in close conjunction with the anti-corruption authority. With public bodies, establish procedure-monitoring corruption and ensure actions are taken by senior management to curb corruption before it escalates further.

Reduce ownership of public-sector managed businesses in Kuwait and effectively transfer these to the private sector and PPPs

Establish a clear transfer procedure and ensure everyone within the Kuwait private sector has the opportunity to receive a share of these publicly-owned businesses. Public bodies can create a collective action plan based on how much can be transferred to the private sector and how this can be delivered.

Make market forces effective for the private sector by applying an economic rationale to determine which subsidies should be removed

Eliminate subsidies in those areas where an economic rationale is absent; this will reduce pressure on government budgets and make the market forces effective. Each public body can take the lead to identify subsidies lacking a sound economic rationale and collectively report to the funding authority, thereby ensuring efficient resource use.

Ensure land requirements and regulations are favorable to the private sector, both for SMEs and others such as PPPs and large private sector companies, and that any costs associated with the implementation of these requirements are minimized.

Ensure lands are not released in those areas where there could be an adverse impact on the local population and the environment, e.g. marine flora and fauna. Support SMEs when there are any potential negative impacts of land requirements, e.g. costs and regulations.

Prioritize projects based on maximum economic returns and when a government intervention is required in a market failure situation

Ensure impact assessments are undertaken for the projects to prioritize them and prioritize areas of potential adverse impacts, such as on SMEs and the environment. Ensure adverse impacts are accounted for by the mitigating measures.

Develop a single window, in one platform, of business development services from the government for the private sector and integrate with the work of public entities involving stakeholders and target groups.⁴⁵

Work in collaboration with high-performing domestic banks on economic feasibility studies of various projects and private sector enterprises to identify the best financing options. Ensure there is no conflict of interest in availing public agency services in support of the private sector.

Incorporate risk-mitigating measures by ensuring that public bodies include impact assessments within the policy cycle for any primary legislation - and any other regulations in which there is a potential for an adverse impact on the doing business environment.

Public bodies should actively develop a business environment that is conducive to supporting a thriving private sector in Kuwait. This should be done in conjunction with Kuwait's Vision 2035 and should use indicators that describe the business environment in Kuwait, e.g. the World Bank's Doing Business indicators.

Identify high-performing private businesses and ensure that these firms receive favorable treatment in order to effectively contribute to growth and employment generation.

Further develop investment promotion and evidence for FDIs in Kuwait, including enhancing internet-based information and services. Integrate the work of different public authorities and enhance coordination in attracting investment.

45

Initiative for a one-stop service is currently ongoing. See example: <http://www.kbc.gov.kw/Default.aspx>.

VI. Small- and Medium-Sized Enterprises (SME)(Gaps, Challenges and Recommendations)



Summary

Gaps

- Clear definition of SMEs and of the evidence base.
- Business environment hindrances include labor regulations, regulatory uncertainty and administrative inefficiencies.
- International and domestic markets opportunities are limited.
- [Similar to the private sector development gaps].

Challenges

- Contribution to GDP is low, despite the fact that the number of SMEs exceeds 30,000.
- Credit in the financial sector is 7% of total bank lending, compared to an average of 13% in developed countries and 26% in developing countries.
- [Similar to the private sector development challenges].

Recommendations

- Write a consistent definition for SMEs.
- Create a database for SMEs, including periodic surveys, and ensure it is consistent and comprehensive.
- Develop regulatory and policy impact assessments of new regulations on SMEs.
- Identify and support rapidly-expanding SMEs, e.g. high-growth SMEs.
- Increase the share of SMEs in government contracts and procurements.
- Allow public entities to devise their own targets for SMEs' share and develop an internal monitoring system to ensure the targets are achieved.
- Establish linkages with national-level innovation initiatives.
- Make funding available for high-risk and high-reward technology innovation projects for projects undertaken by SMEs.
- Work closely with SMEs in the field to provide support and advice, customized to SMEs' need for targeting subsectors.

Policy Summary

To provide comprehensive service support, boost SMEs' presence in the private sector, promote public investment spending rates, and amend the state structural plan for SME project land requirements. To promote SMEs' role in and share of manufacturing activities through the building of competitive capabilities and the fostering of ties with national and foreign institutions. To reinforce the role of SMEs and increase the growth rate in private-sector activities by supporting the work of the National Fund and giving preferential treatment to benefits provided by government tenders.

Current scenario: Gaps and challenges

The SME economy in Kuwait is small, and one estimate shows it to be under 10% of GDP compared to an average of around 40% for the world.⁴⁶ The World Bank staff estimates the contributions of SMEs to be 3%, while SMEs in Kuwait employ around 23% of the country's total workforce.⁴⁷ Anecdotal evidence suggests that the number of SMEs in Kuwait exceeds 30,000, which represents 90% of registered companies; 85% seem to be owned by families and individuals.⁴⁸ In comparison, SMEs play an important role in Organisation for Economic Co-operation and Development (OECD) member countries, where they account for 60–70% of jobs in most of these countries. The share is larger in Italy and Japan, while the US has a relatively small share.

In Kuwait, the SME credit in the financial sector is 7% of total bank lending, compared to an average of 13% in developed countries and 26% in developing countries.⁴⁹

There are ongoing projects to support SMEs in Kuwait, such as the establishment of incubators for small- and medium-sized projects in the 2017/18 annual plan period. The establishment of industrial zones for small- and medium-sized enterprises will be included in the 2018/19 annual plan.

46 IBS (2016). Taking Stock of SME Banking in Kuwait. Consultancy and Research Department, Institute of Banking Studies Research. <http://www.worldbank.org/en/news/feature/2016/03/01/building-kuwait-future-one-small-enterprise-at-a-time>

48 UNDP (2011).

49 IBS (2016).

Focus areas

The World Bank carried out a survey in 2014 in order to understand key barriers to SME business growth, surveying 502 SMEs in Kuwait. The survey revealed that more than 35% of respondents saw business licensing and permits as the main factor impeding their growth. Other reasons for hindrance include labor regulations, regulatory uncertainty and administrative corruption.⁵⁰

Analytics

The plan neither clearly defines nor provides analytical evidence for the value of SMEs in the plan. Comprehensive statistics on SMEs also are lacking. Clear definitions and solid data feed into and contribute to a number of areas within a plan. Developing a good evidence base for policy and effective monitoring and evaluation are just two examples where good and consistent data sets are beneficial. Another specific area includes better understanding of the cost and complexity of regulations by firm size and growth (e.g. high performing). There is evidence from other countries that high-growth firms can play a key role in driving growth in their respective countries - the UK is one such example. In an economy, a small group of high-growth SMEs can make important contributions to job creation and productivity growth.

Finance

Funding sources for SMEs in Kuwait include the National Fund for SMEs, commercial banking loans and private financing. Each funding source may have its own way of defining SMEs. The National Fund, which became operational as a result of government law 98/2013, broadly defines SMEs as enterprises that employ one to 50 Kuwaiti workers and that have financing requirements of less than KD500,000⁵¹ for business investment funding. By contrast, the Central Bank of Kuwait defines an SME as an unlisted company or an unincorporated enterprise, and expects each bank to develop its own definition for offering services to SMEs.⁵²

Access to financing and funding allows SMEs to protect their cash flow and increases the potential for business growth. The public sector plays a supporting role by reducing the risk and cost of private equity finance for SMEs. This will complement and at the same time encourage the development of the private capital industry in favor of SMEs. Financial constraints are more pressing for SMEs than for big firms. Financing is important to establish and thrive in business and, most importantly, to acquire and absorb new technologies in order to become competitive.

The National Fund offers services to manage access to financing for SMEs, and the national plan supports the fund's efforts and initiatives. However, the plan falls short of developing the financial market in favor of SMEs. A subsidized favorable interest rate working through a traditional commercial banking system would be beneficial to co-finance SMEs' investment. Financial infrastructure and regulations can be streamlined to deliver in favor of the SMEs.⁵³

50 <http://www.worldbank.org/en/news/feature/2016/03/01/building-kuwait-future-one-small-enterprise-at-a-time>
 51 National Fund (2017): Annual report 2015/16.
 52 IBSR (2016)
 53 Market failure

The challenge here is to create pathways for SMEs to access financing from the commercial banking sector and for that sector to develop new financial products best suited to assist SMEs. The services' National Fund will complement the products from commercial banking. It is necessary to develop SME credit within the overall financial system, from a low percent within total credit in commercial bank lending to increasing it to a higher level of total investment of the SMEs.

In addition to access to finance through traditional banking channels, other forms of finance, such as financial lease agreements, can benefit small- and medium-sized enterprises, as they have difficulties in raising money directly from the capital markets.

Developing the business environment

In a regulatory environment, business environments for SMEs can improve when new regulations and their implementation have gone through efficient and careful scrutiny of the impact they will have on SMEs. Some regulations can deter entry of SMEs into the market and they can also increase costs for them.

Facilitating easy access to information about the business environment for SMEs will reduce their administrative and regulatory burdens and will eventually develop the overall business environment. In countries where SMEs have been successful economic players in the economy, e.g. in OECD countries, respective governments reduced red tape and simplified administrative procedures. In the UK for example, there are impact assessments for new regulations where one of the sections would cover the impact of all regulatory and cost burdens on small businesses.

Innovation and technology

Higher costs for R&D and technology development would exclude smaller firms from benefiting from new technologies, as this would become expensive for SMEs. From an economic growth perspective, usage of better and improved technologies would benefit SMEs and economic growth. In contrast to larger enterprises, SMEs often more quickly seek and adopt new opportunities due to their size, which helps them to adjust their operations quickly.

SMEs can benefit from environments that are conducive to R&D and technology diffusion for SMEs by ensuring simplified procedures are in place without unnecessarily costly and unfavorable regulations. Examples of this include supporting SMEs to work as a group and ensure economies of scale within higher technology development and usage. Technology and innovation include not only technology embedded in machinery but also much broader aspects, such as innovation in management and market development for a product.

Management capabilities

Human capital and effective management in SMEs are, importantly, linked to their competitiveness. These are influenced by a combination of formal education, training and experiential learning. Management training and access to advisory and consultancy services would benefit the management capabilities of SMEs. Furthermore, providing entrepreneurship skill development opportunities for people at a young age in the Kuwaiti educational system will ensure that they acquire the basic, relevant skills to develop their commercial expertise and personal qualities in order to become future managers.

Access to markets opportunities

Enabling factors that ease access to markets, both international and domestic, will allow SMEs to rely more heavily on those markets - rather than government-sponsored initiatives - to develop their businesses. The high costs of marketing SME products overseas might be a barrier to making SME products competitive in the international market. A well-organized strategic plan, identifying potential SME products for the international market, would be an option. In the domestic market, where the public sector is the dominant player, public procurement can offer market opportunities for SMEs in areas in which they can assume a reasonable share for their businesses.

BOX 4

Public Sector Procurement – SMEs and the Private Sector: The International Experience

An IT-based e-procurement portal, when working as a one-stop shop for SMEs to access all public procurement opportunities and associated information, can increase SMEs' participation in government tenders. In addition to support for SMEs, this is also beneficial for the wider private sector.

Benefits of e-procurement: Lowers the risk of fraud and corruption; simplifies processes and adds transparency by collecting and disseminating public procurement information; and improves service quality by facilitating entry for good suppliers and minimizing delays to public works projects.

Example from Chile: Within 10 years of implementation of the ChileCompra portal, the share of contracts awarded to SMEs had risen from 24% to 44%.

Example from Korea: Korea ON-line E-Procurement System (KONEPS), the e-procurement portal, acted as a driver for investment and economic growth by enhancing efficiency, effectiveness and integrity of the public procurement system. It saves significant transaction costs and increases productivity. KONEPS has been benchmarked by more than 60 countries and MOUs have been signed with 17 nations on e-procurement cooperation.

Example from the UK: The UK Government set a target that by 2015, 25% of government spending would go to small-and medium-sized enterprises (SMEs). In 2014–15, 27% (£12.1 billion) of the government's procurement spending had reached SMEs so in August 2015, the target was increased to 33% by 2020.

Ref.

World Bank (2017). Doing Business 2017: Equal Opportunity for All. Washington, DC: World Bank. DOI: 10.1596/978-1-4648-0948-4.

OECD: Country case: Integrated e-procurement system KONEPS in Korea

UK: UK House of Commons Committee of Public Accounts Government spending with small and medium-sized enterprises

Recommendations

- Develop and agree on a consistent definition for SMEs across public bodies.
- Develop a consistent and comprehensive database for SMEs, including periodic surveys on opportunities and challenges facing them.
- Introduce regulatory and policy impact assessments of new regulations in Kuwait as a part of the overall impact of the regulations on the economy.
- Identify and support rapidly expanding SMEs. Develop an evidence base for high performing SMEs that can foster economic growth.
- Increase the share of SME firms in government contracts and procurements. Each public entity will come up with its own targets for the share given to SMEs and will develop an internal monitoring system to ensure the targets are achieved.
- Establish linkages with national-level innovation initiatives.
- Make funding available for high-risk and high-reward technology innovation projects that are undertaken by the SMEs.
- Set up a team either within an existing public authority or as a new one to work closely with SMEs in the field to provide support and advice, customized to SMEs' need to target subsectors.

VII. Diversify the Production Base (Gaps, Challenges and Recommendations)



Summary

Gaps

- Right type of expertise and technical knowledge, and technology.
- Agriculture sector is not focused on the agro-processing industry.
- Skill gaps to support manufacturing, such as interaction with the labor market and human capital.
- Infrastructure interacting with wider economic and commercial linkages.
- The need to stimulate growth and supply chain, e.g. construction sector.
- Ranking in World Bank Logistics Performance Index (LPI) is low.

Challenges

- Develop a regulatory framework to ensure a successful business environment for manufacturing.
- Reduce dominance in the production base of the oil and oil-producing sector.

- Boost manufacturing in the non-oil sector, which currently contributes just over 5% of GDP.
- Growth was negative by 11% in the manufacturing sector in 2015 compared to the previous year, which was characterized by a period of low oil prices.
- Encourage the private sector, not the public sector, to take a leading role.
- Foster easy and affordable access to finance.
- Increase the contribution of the agriculture and fisheries sector, which currently makes a small contribution to GDP and makes up only 3% of total national employment.

Recommendations

- Prioritize infrastructure and construction projects that have high economic and social benefits.
- Increase support for high-growth potential businesses.
- Perform regulatory and policy impact assessments on manufacturing, employment and environment.
- Establish a separate platform to support investments for manufacturing.
- Support and identify natural resource-based products that can contribute additional value to the supply chain.
- Eliminate skill shortages within manufacturing.
- Encourage knowledge and advanced technology industries, and market them to the industrial sector by offering innovation funds at the operational level, where anyone can apply for developing technology/innovation (e.g. physical, managerial) support at both top level and ground level.
- Ensure market forces are developed to make the market competitive.
- Support the private sector in increasing investments in production and infrastructure projects that have high economic benefit.
- Separate foreign trade policy.
- Provide motivational and financial incentives for export industries.
- Coordinate with public bodies; roles and responsibilities of financial regulatory authorities should be clear.
- Develop tourism policies to support not just tourism infrastructure but also tourism products and services.
- Encourage and support the establishment of agro-processing industries.

Policy summary – diversifying the production base

To increase industrial-sector growth rates to become an important contributor to increasing national income: restructure and improve the competency of the sector; incentivize and encourage the domestic private sector to invest in manufacturing; promote the role of small enterprises and increase their share of industrial activity; protect domestic industrial producers from harmful foreign competition and support producers by all means possible; and develop industrial non-oil exports and diversify their structure.

To develop the oil sector: increase oil production rates, develop oil reserves and diversify by promoting downstream oil industries; involve the private sector in some oil activities;

improve domestic capabilities in oil industry-related scientific research and development; improve the maritime transport fleet and increase its numbers.

To develop the financial sector: develop the current structure of the banking and financial sector and insurance activities; expand activity in the securities market; promote the Central Bank of Kuwait's role in monitoring and supervising the sector and monetary policy.

To develop the commercial sector: increase commercial and tourism sector growth rates resulting in increased contributions to national income; improve efficiency of commercial activity; restructure the foreign commerce sector and reinforce links with other countries; strengthen the importance of the private sector; allocate land in new residential areas for private sector commercial activity; protect consumers' rights.

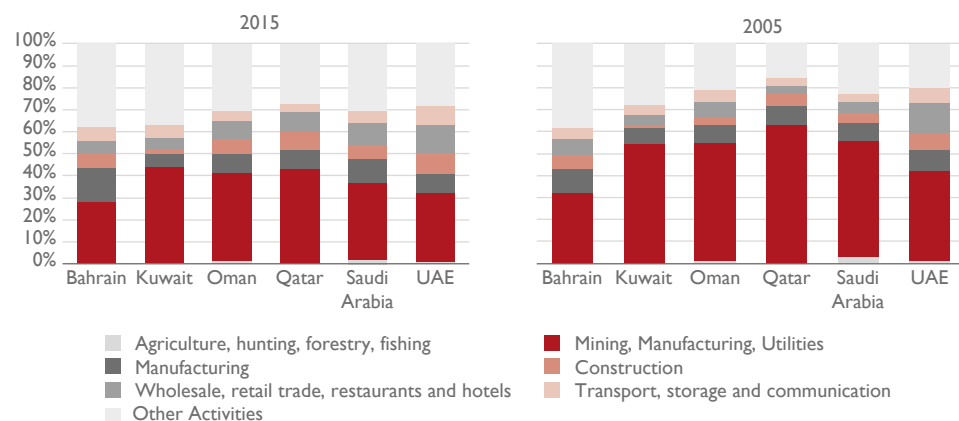
To develop the agriculture sector: strengthen the agriculture sector's role in the economy as an important sector; introduce modern techniques improving efficiency of environmentally-friendly production; improve water-resource management, conservation and maintenance.

Current situation: gaps and challenges

The dominant sector in the production base in Kuwait is the oil and oil-producing sector, which contributed 59% to GDP in 2015. Manufacturing in the non-oil sector contributed to just over 5% of GDP for the year 2015 and the contribution of agriculture was less than 1%. The following figures show how the contributions of different sectors to GDP in Kuwait compare with other GCC countries.

FIGURE 5

GDP sector percentage contribution in GCC countries – 2005 and 2015



Source: Based on data from <https://unstats.un.org/>

Focus areas

Diversifying the production base has been at the core of policy formulations to support the non-oil sector in Kuwait and other GCC countries. Economic diversification will minimize the adverse impact of oil price fluctuations, reducing the risk of a negative impact on government revenue and making the economy of Kuwait more stable, enhancing the capacity to create jobs and developing the non-oil sector's contribution to economic growth. The KNDP has stressed the importance of diversifying the production base along with promoting entrepreneurship within the private sector. There is evidence from figures above that since 2005, there have been some changes in the contribution to GDP over the last 10 years in Kuwait and other GCC countries. However, the oil sector is still the dominant sector in Kuwait, and there are linkages to other sectors that are dependent on this sector's activities.

Long-term, sustainable growth has a high dependence on the competitiveness of the manufacturing industry, which is also an indicator of the competitive capacity of a country. The Competitive Industrial Performance (CIP) index by the United Nations Industrial Development Organization (UNIDO, 2016) is a way of assessing how Kuwait is performing in the manufacturing sector in comparison to other countries. In addition, the Economic Complexity Index (ECI) is an indication of the production structure in the country. With regards to both these indicators, Kuwait ranks low within GCC countries and in the world (see table).

TABLE 6

Kuwait in Competitive Industrial Performance (CIP) Index and Economic Complexity Index (ECI)⁵³

Country	CIP Ranking	CIP Index 2013	Country	ECI 2015
(141 countries)				
Top Five Countries				
Germany	1	0.579	Japan	2.34767
Japan	2	0.466	Switzerland	2.12416
South Korea	3	0.442	South Korea	1.97403
United States	4	0.442	Germany	1.91906
China	5	0.366	Singapore	1.72081
GCC Countries				
Saudi Arabia	36	0.108	UAE	-0.251409
Bahrain	44	0.080	Saudi Arabia	-0.355486
Kuwait	47	0.073	Qatar	-0.525304
Qatar	48	0.073	Oman	-0.671414
UAE	54	0.066	Kuwait	-0.789111
Oman	62	0.047		

Source: CIP – United Nations Industrial Development Organization, 2015. Industrial Development Report 2016. The Role of Technology and Innovation in Inclusive and Sustainable Industrial Development. Vienna; ECI – The Economic Complexity Observatory and AJG Simoes, CA Hidalgo: An Analytical Tool for Understanding the Dynamics of Economic Development.

53 The Competitive Industrial Performance (CIP) index by UNIDO (2016) is a way to see how Kuwait is performing in the manufacturing sector in comparison to other countries. The CIP index is a performance indicator based on outcome of manufacturing activities and not a potential of what would happen for competitiveness process indicator. It focuses on industrial competitiveness and structural economic variables e.g. technological learning. Economic Complexity Index (ECI) is the number of products made by an economy, controlling for the likelihood that the same product is also made by others in the calculating the index. The index relies on trade data and the assumption here is that countries will export those products that are of high quality. In the table, Germany and Japan have high scores. This is because their manufacturing sector is diversified in relation to that of other countries, and this is reflected in the trade data from those countries.

During 2014–15, growth was negative – 11% – in the manufacturing sector (see table below), which can be attributed to low oil prices. The average growth between 2011–13 was positive - at 17%⁵⁴ - during a relatively higher oil price regime. However, some of the subsectors within manufacturing reported positive growth when the overall growth in manufacturing was negative during the low-oil price period. There is a potential for manufacturing growth for these subsectors, which are less vulnerable within a lower-oil price situation. In addition, this can be further developed for subsectors with strong backward and forward linkages to prospective manufacturing. High-performing firms in subsectors can contribute to higher growth in the manufacturing sector.

TABLE 7

Growth in GDP by economic activity

Economic activity	Growth rate average 2014-2015
Electricity, gas and water	28.7%
Hotels and restaurants	7.5%
Agriculture & fishing	5.8%
Construction	4.4%
Financial intermediation & insurance	4.4%
Wholesale and retail trade	4.2%
Community, social & personal services	3.5%
Non-oil sector	3.1%
Transport, storage and communications	1.8%
Extraction of crude petroleum and natural gas and service activities incidental to oil and gas	-1.0%
Oil and oil-products sector	-1.9%
Real estate, renting and business services	-2.0%
Manufacturing	-11.1%
GDP at market's values	1.2%

Note: At constant price, 2010 = 100

Source: Analysis based on table 5, National Accounts, Central Statistical Bureau, State of Kuwait.

The manufacturing sector can benefit from the involvement of potential subsectors within natural resources - which can work as inputs and which can provide innovative ways to enhance productivity using these natural resources – of which Kuwait has plenty.

Spatial strategy within planning for the manufacturing sector, covering regional distribution of land available for private, non-oil sector businesses and offering easy access of lands through a one-window initiative, can help develop business conglomerates in regions outside cities. In the demarcated land areas, infrastructure will be required to support manufacturing activities. Challenges include ensuring that demarcated land is suitable for the purpose and that relevant public bodies work together, including relevant agencies that are responsible for infrastructure development.

Manufacturing requires the right type of expertise and technical knowledge to carry out technology-focused work. Technology can be embodied within the production process, i.e. by investing in superior technological advanced machinery, or technology can also be disembodied in the production process, i.e. by increasing productivity by using the same level of inputs. In either case, there are skill gaps within the sector.

The public sector should work in a supportive role, and not as a competitor, in order to create favorable market conditions for the private manufacturing sector alongside unfavorable competition from international trade. The challenge here is that the public sector should not take a leading role and should encourage the private sector to develop and thrive in manufacturing.

Private-sector growth has a critical relationship with easy and affordable access to finance. Developing the financial sector would reduce credit costs and risks for both borrowers and financial intermediaries. Providing details on products that will develop the sector will help the development of the Kuwait national plan. Islamic finance in the international market has true potential and requires Kuwait to place additional emphasis on how it can reap the benefits of additional linkages to the global Islamic financial market.

Infrastructure that effectively contributes to economic growth has been discussed previously in the section on economic growth. Within infrastructure and the interactions with wider economic and commercial linkages, construction work stimulates growth by attracting big investments and supporting the supply chain. This investment in the sector generates capital formation and contributes to growth. The construction industry is responsible for 6% of global GDP⁵⁵ If policies are implemented to develop Kuwait's construction sector, such as streamlining procedures and improving coordination among different public bodies, the sector could have a strong impact on growth,

Trade logistics have an impact on costs for business and commerce, and cost reduction would impact productivity and growth. Kuwait is at the bottom of GCC countries in the World Bank's LPI, which is based on a survey of logistics professionals who are questioned about the foreign countries in which they operate.

TABLE 8

Logistics Performance Index

	overall LPI score	overall LPI rank
Country	Score	Rank (out of 160)
Top performer		
Germany	4.23	1
Luxembourg	4.22	2
Sweden	4.20	3
Netherlands	4.19	4
Singapore	4.14	5
GCC Country ranking		
UAE	3.94	13
Qatar	3.60	30
Bahrain	3.31	44
Oman	3.23	48
Saudi Arabia	3.16	52
Kuwait	3.15	53

Source: World Bank. Connecting to Compete 2016 – Trade Logistics in the Global Economy.

The agriculture and fisheries sector makes a small contribution to Kuwait's GDP and represents 3% of total national employment.⁵⁶ The potential exists for the sector to domestically produce within the country and reduce imports, using improved technology to boost production in the sector. Some regions in Kuwait might have relative advantages over other regions when it comes to achieving production objectives. Developing the agriculture sector further into agro-processing of selected agriculture sector production and making it more agribusiness-oriented, and developing the value chain and linking it effectively to the market will enhance the sector's development.

Top agencies in the technology and innovation sector in Kuwait are the Kuwait Foundation for Advancement of Sciences (KFAS),⁵⁷ the Kuwait Institute for Scientific Research (KISR) and the National Technology Enterprises Company (NTEC). One of the ongoing projects undertaken by these agencies in the technology area that would help diversify production in the energy sector is a renewable energy project that involves installation of Rooftop Solar PV Panels in co-operative society car parks, which contributes to the national energy supply.⁵⁸

⁵⁶ LFS 2015, CSB.

⁵⁷ KFAS centers that are supporting R&D, technology and innovation include: Sabah Al Ahmad Center for Giftedness Creativity, to discover and nurture the most outstanding talent in Kuwait; Jaber Al Ahmed, a scientifically-distinct institution with highly advanced clinical and academic credentials; Dasman Diabetes Institute for research and patient treatment; the Scientific Center, which includes an IMAX movie theatre, aquarium, animal kingdom, Discovery Place and gift shop, as well as interactive attractions and innovative educational programs.

⁵⁸ <http://www.ntec.com.kw/#projects>.

Recommendations

Prioritize infrastructure and construction projects according to which projects provide the greatest benefit, and based on a systematic economic appraisal of a wider economic and social perspective for Kuwait.

Streamline procedures and support the construction sector. Improve coordination among the various agencies involved in the process.

Identify and provide additional support to high-growth potential businesses and industries.

Approve and prioritize investments and projects based on the highest returns to the investment fund, prioritizing those that have the potential to generate high employment in the economy. Support projects that contain innovation and cutting-edge technologies suitable for use in Kuwait, with minimum adverse impact on the environment at the national level and that are in line with international obligations.

A joint committee comprising relevant public bodies should initiate impact assessments on manufacturing, employment and the environment, for any release of selected land for manufacturing.

Simplify land management from the perspective of both public authorities and private users, e.g. management and implementation. The Public Authority for Industry and the Public Authority for the Environment can work closely with the team for the 4th Kuwait Master Plan 2040, exchanging evidence and working on suitable land that can be released for manufacturing.

Establish a platform separately to support investments for manufacturing.

This can also be done within a single window to support expansion of private-sector growth. In any case, clearly define and agree on the role and responsibilities of the public bodies that will contribute to achieving successful promotion of manufacturing.

Support industries that are based on natural resources by setting up a team within a public authority to support and identify products that can contribute additional value to the production chain.

Enhance collaborative efforts to work together with established institutions within Kuwait. Make funding available for high-risk and/or high-return innovation and technology projects that would benefit manufacturing and the country.

Develop policies based on evidence of skill shortages within manufacturing.

An evidence base can be developed through a need-and-skill survey for manufacturing. This has potential linkages to human resources and the education pillar.

Encourage knowledge and advanced technology industries, and market them to the industrial sector by offering innovation funds at an operational level, where anyone can apply for developing technology/innovation (e.g. physical, managerial) support at both the top level and ground level.

Products based on knowledge and advanced technology should be demand-driven projects from the market, and the projects should have potential for technology advancement. Provide additional support to high-performing firms in the high-growth sector.

Approve projects and licenses based on a clear, pre-defined criterion.

These should include those projects that have the highest returns, e.g. the highest benefit compared to costs. In addition, the set criterion for approval should be clearly delineated, covering a defined minimum-production capacity, employment or investment required for a project to be approved.

Ensure market forces are developed to make the market competitive and link this to the recommendations on competition in the previous section on expanding the private sector.

Develop an evidence base for backward and forward linkages for the policy area.

Share information on forward and backward linkages by delivering annual conferences along with marketing fairs for large and small companies within the industry. In addition, provide support to small firms that have potential but which are having difficulties competing in order to establish linkages.

Provide support for the private sector for higher investments in production and infrastructure projects. Alongside government spending, support these with PPP and FDI frameworks, providing institutional and regulatory support.

Develop a stand-alone foreign trade policy separately rather than part of another policy, ensuring an anti-dumping policy framework is established and provide incentives for export promotion industries.

Provide motivational and financial incentives for export industries where there is an economic rationale and where the supporting industries can benefit the economy. In addition, support in the form of any type of subsidy should be minimized. The supported industry should show potential for sustainability in the longer term, without any form of government support, in order to minimize pressure on public finances.

Coordination with public bodies and the role and responsibilities of financial regulatory authorities should be clear.

Capital market authorities should have their own master plan within current regulations on how to develop the market, working alongside stakeholders. The Central Bank's function as a financial regulator and manager of monetary policy should enhance its role in developing the sector. Develop products for the international market in collaboration with the international financial sector, e.g. Islamic finance.

Develop tourism policies to support not just tourism infrastructure but also tourism products and services, such as sea cruises, ensuring the industry does not harm the marine environment.

Encourage and support the establishment of agro-based industries to generate value addition by the private sector in the supply chain

Encourage processing of agriculture and fisheries products, including linkage to export markets for processed products. Provide incentives to establish joint venture industries in the agro-processing sector. Develop and source innovation and suitable technologies (e.g. international) to develop the sector. Develop policies to establish linkage between agro-producers and the perishable items market. Implement a project on agro-based industries to develop value addition in the chain. Train and introduce farmers to new technology and market information. Provide technical support to businesses that have the potential to develop the agribusiness sector.

VIII. Identifying Gaps and Challenges: Further considerations



Summary

Gaps and Challenges

- Weak evidence base to support the plan.
- Systematic policy cycle by policy owner.
- Impact assessment by policy owner.
- Efficient Civil Service to deliver and implement policies to achieve the national plan's objectives.
- Implementation is the biggest challenge with regards to achieving the policy objectives.

Recommendations

- Encourage policy owners to follow a policy cycle and carry out an impact assessment on economic growth and the private sector.
- Use a clear rationale for government intervention in a specific policy area.
- Develop the Civil Service to provide effective support delivery of the plan.
- Improve coordination among public authorities for implementation.

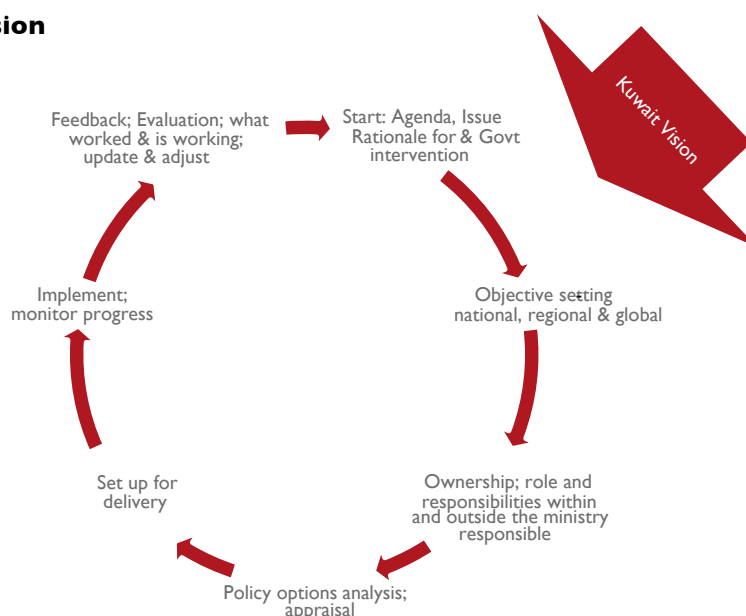
Policy development process and the national plan

The policy development process should follow a systematic policy cycle, with interaction with set objectives, e.g. KPIs, the financial means to deliver the policy, and a strategy to achieve the objectives. There should also be details on performance indicators for the public sector in Kuwait, as the public sector is the largest sector in the economy.

The national plan should have a coherent policy framework for developing a policy. A policy cycle is presented in the next chart. Setting an agenda and identifying a policy for Kuwait would start from the New Kuwait Vision, and would be developed further by the public authority, which is responsible for delivering a specific policy.

FIGURE 6

Kuwait Vision



In the cycle, developing policy options for a specific policy will require an impact assessment as part of the policy evidence base. From an economic growth perspective, the assessment should systematically analyze the impact on economic growth and private businesses. Policy design should also consider not adding any additional regulatory burdens and cross-checking current regulations in the area in order to minimize an adverse impact on the business regulatory environment.

Recommendation

Public authorities that own a policy should follow a policy cycle and carry out impact assessments on economic growth and the private sector, as those policies have considerable potential to have a negative impact on the economy. Monitoring and evaluation of policies should be an integral part of the national plan.

Rationale for government involvement or intervention

One primary area of the plan's focus is developing markets in the Kuwait economy. Developing financial markets and organizations in the financial sector and improving the capabilities of financial firms by ensuring competition for both local and foreign firms, thereby strengthening financial services, are all discussed in the plan. Currently, there is a capital markets authority in Kuwait that regulates the capital market. Promoting and expanding both the market role and mechanisms that will help implement privatization programs and economic activities to assist with either partial or full transfer to the private sector also are discussed in the plan.

The prime objective of the government is to develop and correct market forces. Prioritizing a specific area to achieve an objective, by introducing or reforming a policy or regulation and spending public money, can be beneficial by facilitating discussion of what the government's role in that area is. Government intervention in the economy when the market is not delivering an efficient outcome⁵⁹ will achieve economic efficiency. In addition, there should be enough evidence that the intervention will make an improvement, which will depend on the ability of the public sector to plan, design and implement an effective intervention.

The main rationales for the government's intervention in the economy are as follows. There are legal requirements, such as an international obligation to deliver. Equity or redistribution is another area where public intervention is justified, where the market would not provide a more equitable distribution of benefits than the market simply working on its own. One example of this is supporting targeted youth groups in a remote area of Kuwait to help with employment. The rationale here is that without this support, the market is producing unacceptable distributional impacts from economic, social or political perspectives. Finally, market failure is the most common reason for the market not working effectively, producing inefficiencies in the use of resources and in the resultant outcomes.

Examples of market failure

When consumers and producers (agents) bear the full costs and benefits of their activities, markets can deliver an efficient quantity of goods and services. A situation in which an activity from either or both of the agents imposes a cost or benefit on the other, but the second agent is not charged or compensated, can lead to the market not working efficiently, as an agent would look only at his own private costs and benefits, and his decisions would not be optimal for society or for Kuwait's economy as a whole. This situation, where the actions of one agent impose a cost or benefit on third parties with no compensation, is said to be an externality.⁶⁰ In a case of a positive externality, all benefits are not included and the market will under-supply. In case of a negative externality, all of the costs are not included in the decision-making, and the market will provide too much of the activity.

59

Market failure

60

Other reasons for market failure include: information failure, public good and market power or imperfect competition. Public good is non-excludable and non-rival in consumption: non-rival if the consumption by one person does not diminish the ability of others to consume it, non-excludable if a person cannot be excluded from consuming that good, if it is pure public goods with both characteristics (e.g. a landscape, a beach) are pure public goods.

- Pollution is an example of negative externality. When people buy cars, they care more about their private costs and benefits than they do about overall social costs and benefits; they prefer to buy a big or attractive car, rather than a small car that would cause less pollution to the environment.
- Coordination failure is another type of market failure. Simultaneous investing in related industries by a group of firms in a given industry can potentially benefit all the firms. Developing localized business areas in selected, local areas in Kuwait would overcome coordination problems, such as the private sector being unable to manage the provision of goods. Positive externalities would arise from interlinking with the group's supply chain, infrastructure development, and retail, leisure and service businesses. A single, private business will provide a lower investment on developing business opportunities in the local area, such as supporting infrastructure and facilities, including those required for industrial areas or shopping and tourism. Government intervention can facilitate benefits from positive externalities, supporting coordination among firms by placing mechanisms and regulations that enable private businesses to recognize a return on their investment.
- A private-sector firm investing in technology and innovation-intensive manufacturing will benefit the economy from a growth perspective, and the use of new technology would also increase innovation and productivity within the economy of Kuwait as a whole. There is a positive externality here. However, the firm might decide not to invest in this area as there could be uncertainty with regard to the return on the investment. It might prefer to invest in an area where there is low risk but the same level of profit, due to the subsidy or oil revenue lead incentives available. This may lead to them investing in a low-technology-based service sector. This would result in the firm not receiving the benefit of high technology and increased productivity in manufacturing. The policy objective here should be to change the incentive structure in order to correct the market failure so that firms invest in the high-tech manufacturing sector.

Recommendations

- Identify the most appropriate sector response and prioritize effectively. Identify barriers that need to be removed to make the market work more effectively and efficiently by targeting an intervention with a clear rationale. The achievement of a successful, targeted intervention would mean that the public sector's role would no longer be required in the future, and the private sector can take the leading role. An unclear or poorly-defined rationale might not produce the desired outcome and could result in the market delivering without the intervention,⁶¹ and will not be a good use of public money. The clear reason for intervention here is that the private sector will not take advantage of these opportunities on its own, given the barriers.
- Use a clear rationale for government intervention in a specific policy area. Develop and introduce economic policies that have an economic argument behind them.

Efficient civil service

The issue of inefficiency in the public sector has been reported in a number of papers and surveys (e.g. the GCI survey), highlighting that it is a hindrance to the delivery and implementation of policies to achieve the objectives of the national plan. A professional civil service can help in this regard.

Recommendation

Develop the Kuwait Civil Service to support effective delivery of the plan. This can take the form of developing a core Civil Service, which will be high-performing and which will be made up of leaders and high-performing managers within the Civil Service. They will be selected based on merit and by using competitive exams, and will be provided with better incentives. The core group can comprise different groups, such as generalists, engineers and economists. The other group can be the wider Civil Service, for which a moderate but competitive recruitment process can be employed.

The Kuwait Civil Service should follow a clear performance management system and a competency framework in which there will be a defined skill base for each group, e.g. leadership skills.

Implementation

Implementation is the biggest challenge for achieving the policy objectives. Past experience with the national plan suggests that this has been an ongoing issue.

Recommendations

- Improve coordination among public authorities.
- Monitor performance against objectives and key indicators effectively and annually.
- Eliminate risk of not achieving a policy objective by undertaking immediate action.
- Ensure effective interaction with stakeholders, civil society and target groups.

References

Asheim, Bjørn T. (2015). *An Innovation Driven Economic Diversification Strategy for Kuwait*. Kuwait Foundation for the Advancement of Sciences (KFAS), Kuwait

BMI (2017). *Middle East Monitor*: September 2017 Vol 27 Issue 9 BMI research

Burneya, Nadeem A., Kamiar Mohaddesb, Ahmad Alawadhia, and Marwa Al-Musallama (2017). *The Dynamics and Determinants of Kuwait's Long-Run Economic Growth*. Kuwait Institute for Scientific Research, Kuwait and University of Cambridge. Working paper, University of Cambridge. June 26, 2017

GSSCPD (2015). *Draft development plan: 15/16 – 19/20 Kick starting human development and the sustainable economy*. The State of Kuwait. General Secretariat of the Supreme Council for Planning and Development. January 2015

GSSCPD (2015a). *KUWAIT Mid-Range Development Plan 2015/2016 – 2019/2020* MAY 2015

GSSCPD (2016) *Annual Development Plan 2017/2018*, GSSCPD. The State of Kuwait June 2016

GSSCPD (2017). *UNDP project document for the Institutional and Technical support for the establishment of Kuwait Public Policy Centre*. I February 2017

IBS (2016). *Taking Stock of SME Banking in Kuwait*, Consultancy and Research Department, Institute of Banking Studies Research September

IMF (2014a). *Soaring of the Gulf Falcons: Diversification in the GCC Oil Exporters in Seven Propositions*. Prepared by Reda Cherif and Fuad Hasanov, WP/14/177 September 2014

IMF (2014b) *Economic Diversification in the GCC: The Past, the Present, and the Future*, by Tim Callen, Reda Cherif, Fuad Hasanov, Amgad Hegazy, and Padamja Khandelwal, IMF Discussion Note, SDN/14/12 December 2014

IMF (2016). *More Bang for the Buck in the GCC: Structural Reform Priorities to Power Growth in a Low Oil Price Environment*. Annual Meeting of Ministers of Finance and Central Bank Governors October 26, 2016 Riyadh, Saudi Arabia

IMF (2017). *Kuwait – Selected issues*. IMF Country Report No. 17/16. International Monetary Fund, Washington DC, January 2017

KFAS (2017). *Identifying Priority Sectors in Kuwait*, Kuwait Foundation for the Advancement of Sciences and Marmore MENA Intelligence Ltd, Kuwait

KISR (2005). *Challenges of Economic Development for the Development for the GCC Countries*. Kuwait Institute for Scientific Research (KISR), State of Kuwait

Nesta (2014). *When Small is Beautiful*, National Endowment for Science, Technology and the Arts (NESTA), London, UK

UNDP (2011). *Challenges to SME Development in Kuwait*. By Dr. Ernest Koch, November.

National Fund (2017). *Annual report 2015/16*. The National Fund for Small and Medium Enterprise Development, Kuwait

National Fund (2015) *Annual Report for Fiscal Year 2014/2015*. Kuwait National Fund for SME Development

NBK (2017). *Economic Update*, the National Bank of Kuwait (NBK), 20 March 2017

OPEC (2017). *Organization of the Petroleum Exporting Countries Annual Statistical Bulletin*

Stern, R, A Siddiqi, L D Anadon, V Narayanamurti (2017). *University-Industry Collaboration in Science and Technology in Kuwait and the United Arab Emirates: Current State and Future Opportunities*. Belfer Center for Science and International Affairs / STPP/ENRP Policy Brief March 2017, Harvard University Kennedy School

TICG (2016) – OBJECTIVE ONE: ARTICULATION OF KUWAIT 2035 VISION AND CORRESPONDING OPPORTUNITIES, 25TH SEPTEMBER, 2016. UNDP AND GS-SCPD; TICG; Kuwait Investment Authority, Kuwait Fund For Arab Economic Development & Oliver Wyman Joint Company. 2nd Deliverables

TICG (2016a). *Developing and advancing the implementation strategy of Kuwait national Development Plan – inception report*. TICG GSSCPD & UNDP - Kuwait Investment Authority, Kuwait Fund for Arab Economic Development & Oliver Wyman joint company. Objective one: Articulation of Kuwait 2035 vision and corresponding opportunities. 25th September 2016, UNDP and GS-SCPD

World Bank (2012). *Some Countries do it Better*, Washington

World Bank (2017). *Global Economic Prospects: A Fragile Recovery*. The World Bank Group, Washington DC. June 2017

World Bank (2017a). *Gulf Economic Monitor*, Issue 1, June 2017: Sustaining Fiscal Reforms in the Long-term. June 2017

World Bank (2017b). *Doing Business 2017: Equal Opportunity for All*. Washington, DC: World Bank. DOI: 10.1596/978-1-4648-0948-4.



مركز الكويت للسياسات العامة
Kuwait Public Policy Center