On October 16 2016, Kuwait's Emir Sheikh Sabah al-Ahmed al-Sabah dissolved Parliament, citing concerns about security and finances in an era of reduced oil revenue.

Market Watch Blog AGSIW | Karen E. Young | Oct 18, 2016

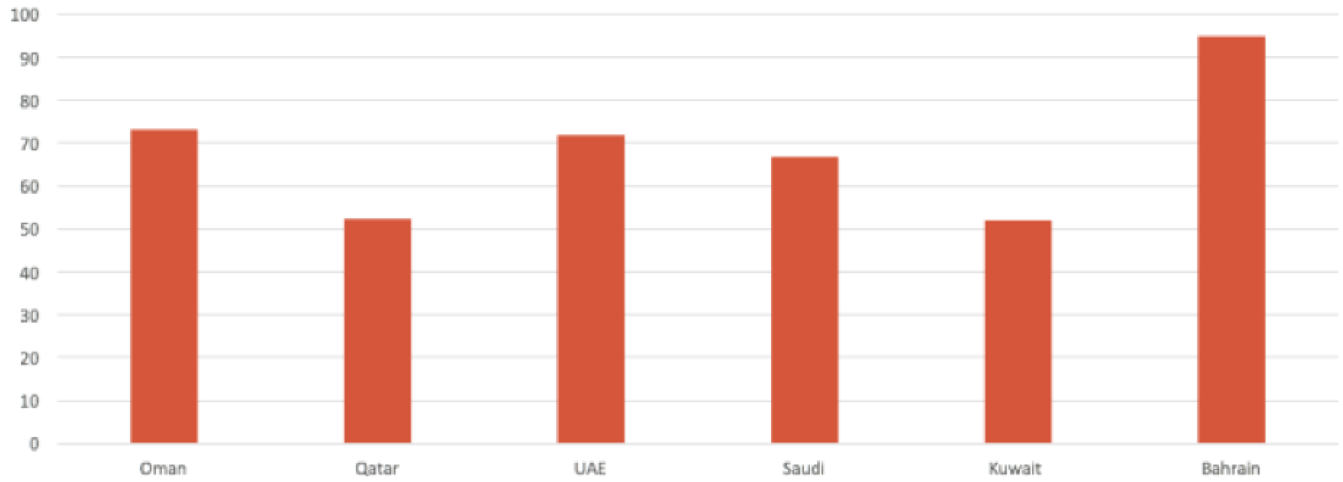
On October 16, Kuwait's Emir Sheikh Sabah al-Ahmed al-Sabah dissolved Parliament, citing concerns about security and finances in an era of reduced oil revenue. There are a number of ironies in this latest political development in Kuwait.

First, the Parliament was widely perceived to be more business friendly than was the case in previous electoral cycles (not always a given in domestic politics) and generally amenable to the regime's political agenda. Recent changes in electoral lawshad largely sidelined major opposition. New elections were expected in June 2017 but now have been scheduled for November 26.

Second, Kuwait, like all Gulf Cooperation Council states, is struggling to meet fiscal outlays with a reduced oil revenue stream, but it is better positioned to do so than many of its neighbors. Kuwait has a lower break-even price for oil, partly because the geology of Kuwait's oil makes it easily accessible, but more so because the state has traditionally spent less domestically on infrastructure and large development projects and because it has directed much of its savings over the last decade toward its sovereign wealth funds.

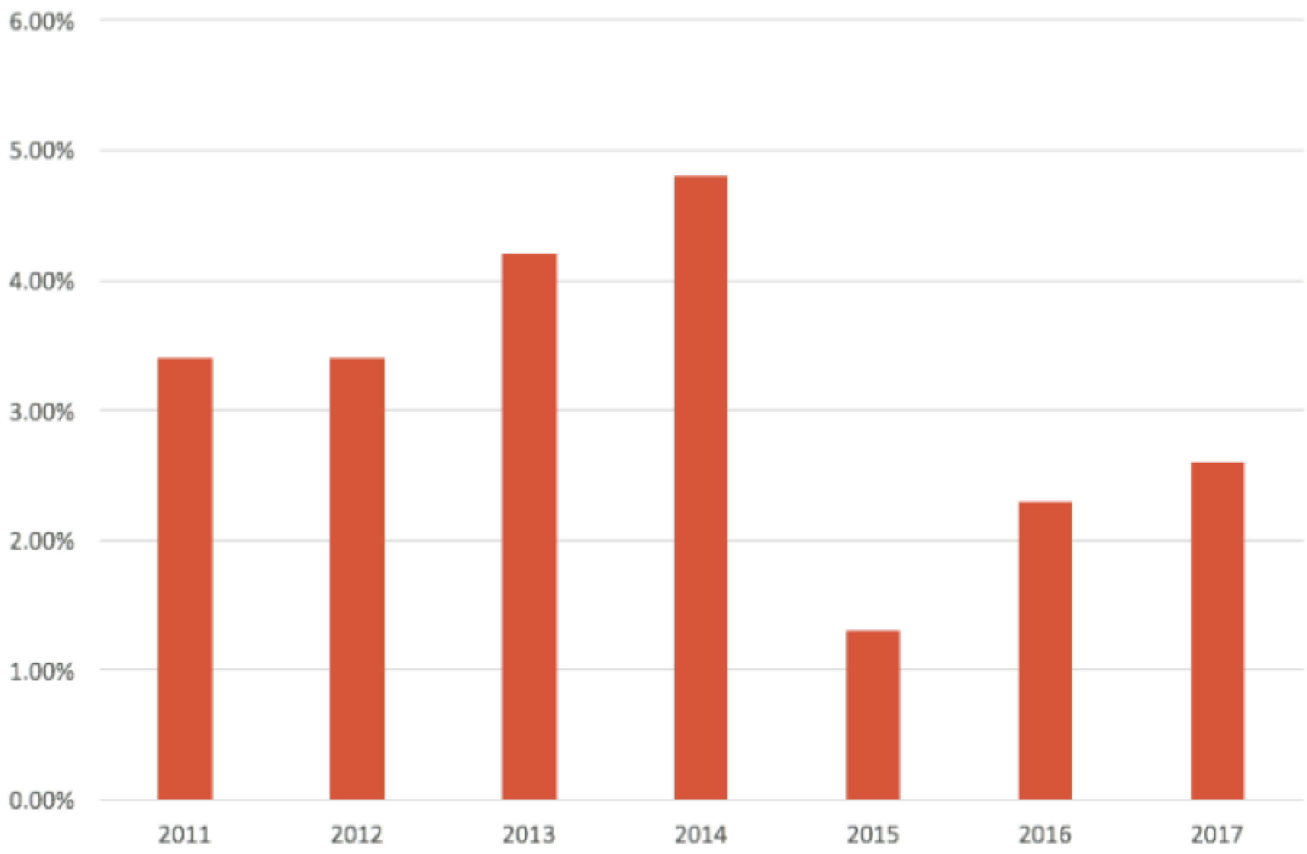
Kuwait isn't necessarily a nicer place to live in the Gulf. As investors have lamentedand the World Bank "Ease of Doing Business" reports have tracked, Kuwait has been a difficult place to see growth. On my own visit to Kuwait last week, I saw firsthand the problems with crowded and dated roadways and inefficient waste management. However, the failure to spend on public works might also be viewed in a time of fiscal austerity as prudent. In fact, it was poor timing in that as oil revenue dropped in 2015, government spending commitments increased to remedy the lag in infrastructure development. Furthermore, Kuwait has been on track since 2011 to increase its other sources of revenue, though the decline in oil prices since 2015 seems to have dampened the economy as a whole and diminished the diversification effort.

Fiscal Break-Even Oil Price (U.S. dollars per barrel)



Source: IMF

Annual Growth Rates of Non-Oil GDP for Kuwait



Source: Central Statistic Bureau – Kuwait

Despite popular resistance to cuts in fuel subsidies and a lackluster public responseto reforms, Kuwait is actually making broader institutional and regulatory changes to its investment climate that are far beyond what other GCC states have proposed, in terms of the distribution of wealth to citizens that privatization and liberalization plans might bring. The irony is that Kuwait's contentious politics are remaking the investment framework very much in the favor of citizens, while other Gulf states are plunging full speed ahead with little provision of how the savings and sell-offs of today will be shared among their populations tomorrow. It is the intervention of Parliament and concerns for the retraction of public benefits that motivate the government to make concessions, including concessions on how foreign investment and liberalization will serve constituents.

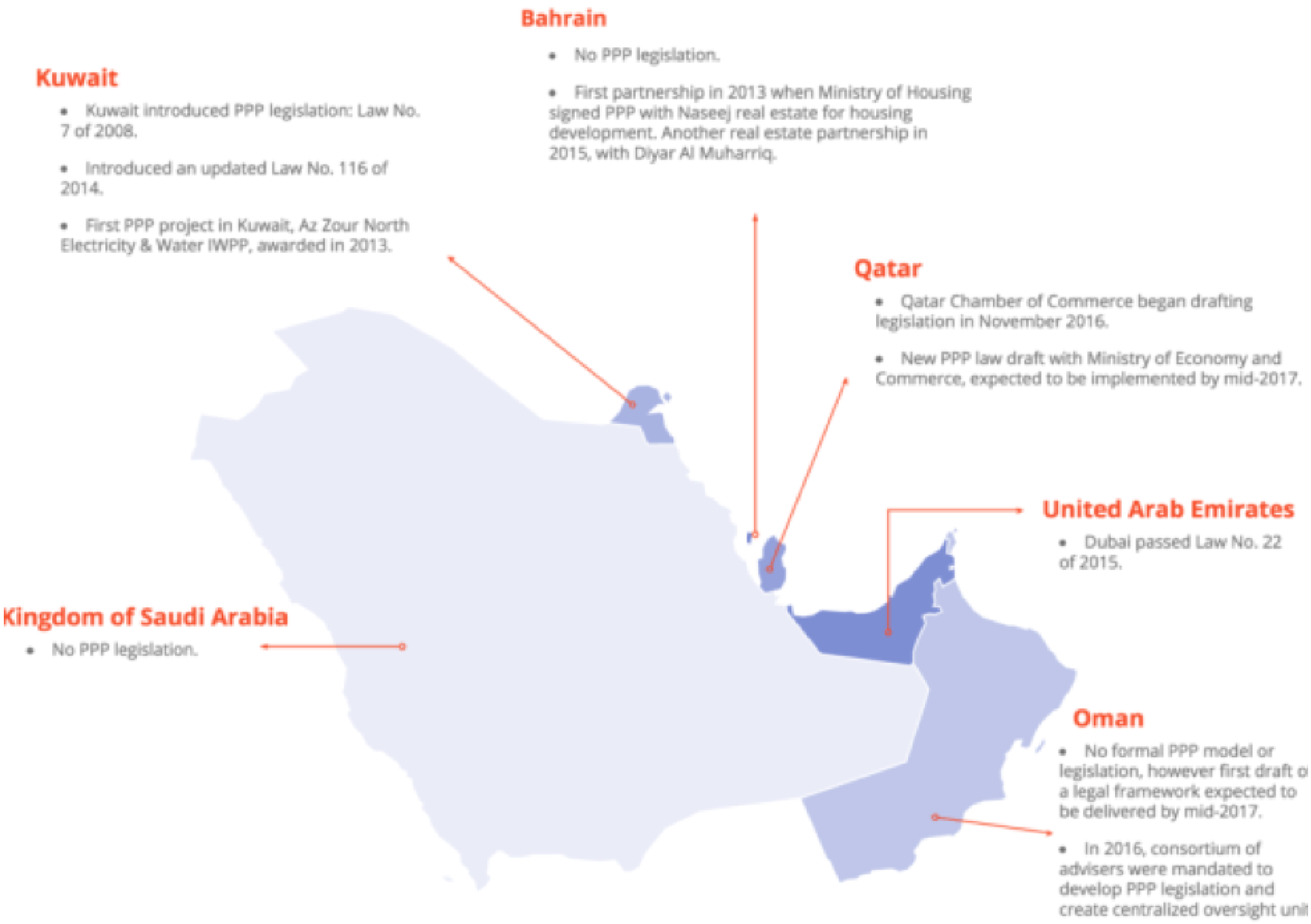
Most telling is Kuwait's advanced Public-Private-Partnership (PPP) law in 2014, which placed stringent rules on foreign ownership of shared ventures. The Kuwait Authority for Public Partnerships was set up to formalize government policy, while also making it clear to outside investors how profit sharing can take place. Article 13 of Law 116 of the 2014 PPP regulations requires that the equity of a public joint stock project be divided carefully between public authorities, winning investors, and public subscription offers to Kuwaiti citizens. Any project of more than 60 million Kuwaiti dinars (approximately $150 million) must offer 50 percent of shares to Kuwaiti citizens in a public offering. The public authority is limited to no more than 24 percent of an entity in a sell-off via PPP and the investor must take on at least 26 percent of shares. In this regulation, Kuwait has drawn two important lines in the sand in its liberalization and efforts to attract foreign investment. First, it has prioritized and reserved opportunities for its citizens to benefit from the profit of sales of state assets. For example, if a utility is to be built under this scheme, the new company created would be more than 75 percent investor owned, with the largest portion made up of citizen investors. The government has been careful to sideline its own potential gains (as well as the risks) of these large investments.

In comparison, frameworks for PPP investments are not nearly as developed in other parts of the GCC.

Qatar – Qatar allows 100 percent foreign ownership of corporate entities, but land rights are an issue. For utility providers, there is little competition, as the state-owned utility (KAHRAMAA) dominates the market and controls grid access.
Saudi Arabia – There is no PPP law. It is not clear yet from the National Transformation Program or

Vision 2030 how PPPs might move forward, or how privatizations will be managed of parts or assets of the Saudi Electricity Company, for example. There has been some success with Independent Power Producers, but always with a 50 percent share by the Saudi Electricity Company.

United Arab Emirates – The UAE company law stands with a requirement of at least 51 percent ownership by the state or a UAE national for any corporate entity, unless in a free zone. The UAE has implemented many Independent Power Producer models for its electricity plants as well as contracts for design and operation of large utilities but not outright ownership.



Kuwait's one step forward, two steps back progress on economic reforms may be an asset in its long-term development. As GCC states make difficult choices about how to raise revenue now for spending commitments long entrenched for citizens, the process and institutionalization of revenue sharing may be a strong indicator of regime stability.

This article was originally published by the Arab Gulf States Institute in Washington (AGSIW) https://agsiw.org/smarter-money-in-the-gulf/.

Dr Karen E Young is a former senior resident scholar at the AGSIW. She is a resident scholar at the American Enterprise Institute in Washington and a senior advisor at Castlereagh Associates.
