Taking the short view and the long view on Kuwait's budgetary challenges

Rating downgrades, government liquidity crises and a parliament that is more interested in political point scoring than addressing the country's financial and social challenges – those are the stories that have been written about Kuwait over the past year. But is Kuwait really heading for a financial and economic crisis?

Arab Banker's Editor, Andrew Cunningham, takes a longer view, and finds some grounds for optimism.

When I first started studying the Middle East in 1980, Kuwait was seen as the wealthiest of the Gulf states and also the most dynamic. That view was based on the huge wealth that the small emirate had amassed since it began exporting oil in 1946, and the very visible presence of Kuwaiti money – both institutional and personal – in London.

A Kuwait Investment Board began operations in London – based in the Bank of England – in 1953; Kuwaiti commercial banks clubbed together to found United Bank of Kuwait in London in 1966; and in 1974, the Kuwait Investment Office (as the Board had become), became a major player in the London property market through its acquisition of St Martins Real Estate Group. More visibly, Kuwaiti citizens could be seen on the streets of Knightsbridge and Mayfair, and in the clinics on Harley Street.

Kuwaiti financial markets were leading the way in the Middle East, with innovative bond issues, a dynamic stock exchange and a domestic real-estate market that produced some of the first iconic buildings in the Gulf.

So, what happened next? Why are we not still talking about the innovation and dynamism of Kuwait and its financial markets?

In 1982, Kuwait's stock market crashed, devasting the domestic economy. Banks had extended loans to enable citizens to speculate on the official and the unofficial exchanges, so when prices collapsed, thousands of Kuwaitis were left with debts they could not pay, and all but one of the banks had non-performing loans that overwhelmed their balance sheets. The mass of indebtedness stretched to the highest levels of Kuwaiti society, making the problem a political issue as well as a financial one.

The Kuwaiti economy was beginning to revive when Saddam Husain's tanks rolled into Kuwait on the morning of 2 August 1990, beginning an occupation that ended only when US-led forces expelled the invaders six months later. Despite the destruction wreaked by the departing Iraqi forces, oil production quickly resumed. Kuwait's huge financial reserves had been ring-fenced by the international community to prevent Saddam's government stealing them. Bank head offices and branches had been left relatively unscathed during the occupation. When one CEO returned to his office after the liberation, he found his reading glasses in his desk drawer, just where he had placed them when he hurriedly left the bank six months earlier.

The stock exchange crash and the Iraqi invasion still resonate in the Kuwaiti financial landscape today, even if both are now more than 30 years in the past. Since then, many of the challenges to Kuwait's financial dynamism have been external rather than internal. Dubai emerged during the 1990s as a major commercial hub with an offshore financial centre; Saudi Arabia gradually made it easier for foreign bankers to do business inside the Kingdom, rather than from outside; and Qatar's development of its gas reserves enabled it to assume the mantle of the new and fabulously rich Gulf state, much as Kuwait had done so many years before.

The economic challenges facing Kuwait today are similar to those of its neighbours: an over-reliance on earnings from oil and gas, the prices of which are volatile; and spending commitments that are inflexible and large.

Kuwait's current budget foresees oil and gas revenues accounting for 84% of total revenues, while spending on government salaries and subsidies comprises 72% of expenditure. The vast gap between revenues and expenditures means that spending on government salaries alone exceeds projected oil revenues by some margin. (See table, 'The Short View'.)

The Short View: Kuwaiti budgets 21/22 and 20/21

$ mn unless otherwise stated	Year to 31/3/22	Year to 31/3/21
Revenues	**36,272**	**24,898**
oil revenues	30,291	18,679
Expenditure	**76,493**	**71,538**
salaries and related government costs	41,794	40,112
subsidies	12,997	11,875
Deficit	**40,221**	**46,640**
Oill revenues % total revenues	84	75
Salaries and subsidies % total expenditure	72	73

Source: Ministry of Finance. Original figures in Kuwaiti Dinars converted to dollars at KD1 = US$ 3.31886

The Long View: Kuwaiti budget deficits, oil production and oil prices

	To 31/3/22	To 31/3/21	To 31/3/20	To 31/3/19	To 31/3/18	To 31/3/17	To 31/3/16	To 31/3/15
Revenues ($bn)	36.2	25.6	57.1	68.0	53.1	43.5	45.1	82.6
Expenditure ($bn)	76.3	71.4	70.0	72.4	66.0	58.7	60.4	71.0
Surplus/deficit ($ bn)	-40.2	-45.8	-12.9	-4.3	-12.9	-15.3	-15.3	11.6
	IH 2021	Year 2020	Year 2019	Year 2018	Year 2017	Year 2016	Year 2015	Year 2014
Crude oil production (000 b/d)	2,341	2,432	2,687	2,745	2,708	2,853	2,764	2,779
Price of Brent crude oil (Brent) ($/b)	66.2	43.2	64.2	71.7	54.7	43.6	52.3	99.0

Kuwaiti budgets run to 31 March, but statistics on crude oil production and prices are most easily accessible as averages for years to 31 December. This table aligns full year figures for production and prices with the budgetary year in which the first nine months of that year fall.
Sources: Kuwait Ministry of Finance, OPEC Monthly Oil Report (for production figures), Middle East Economic Survey (for prices).

The budget assumes an oil price of $30/b, which now looks pessimistic. ICE Brent averaged $66.2/b in the first seven months of 2021. But for the budget to break even, Kuwait would need a price of $90/b, according to a Ministry of Finance presentation.

The last time Kuwait reported a budget surplus was in the year to March 2015, when oil prices were around $100/b. Since then, the cumulative deficit, if we include the current year's budget and last year's, has been $147 bn. (See table, 'The Long View'.) Most of that deficit is assumed to occur this year and last and, as already noted, the projected deficit this year looks overly pessimistic. Annual deficits of around $12 bn–$15 bn appear to be the norm, given oil prices of around $60/b–$70/b.

Plugging those annual revenue gaps of around $15 bn is easily sustainable for Kuwait over the medium term, but deficits of $40 bn are not. Furthermore, the larger-than-normal deficits of this year and last have, for the first time, made financial management a significant issue for Kuwait.

By September 2020, Kuwait's General Reserve Fund was entirely depleted, according to the Ministry of Finance. This was the fund that held Kuwait's more liquid assets. The Fund for Future Generations held assets of around $500 bn in mid-2020, but many of its investments were illiquid.

The obvious short-term solution for a country that, at that time, held ratings in the double-A range, is to borrow, especially given historically low international interest rates. But Kuwait's parliament has been blocking a debt law that would enable the government to raise modest amounts of money, under strict conditions.

Kuwait's apparent inability to change the structure of its budget or to introduce more flexible deficit financing tools led all three international rating agencies to downgrade its sovereign rating to A+ over the past 18 months. (The most recent was S&P's downgrade on 16 July.)

Ironically, Kuwait's feisty political system has proved to be an impediment to reform, rather than a catalyst. Alone among the GCC states, Kuwait has a parliament that challenges the government (which is appointed by the hereditary Emir) and seeks to hold ministers to account. Yet all too often, the parliament blocks and obstructs, rather than leading change and pushing ideas.

The parliament's frustration with the political system is understandable. In recent decades Kuwait has not followed the trend of some of its neighbours in allowing power to fall to a new and sometimes more youthful generation. The current Emir, who took the throne in September 2020, is 83 years old, and his two predecessors were in their mid-70s when they assumed theirs.

Kuwait has the tools it needs to make its fiscal and budgetary positions more sustainable. The government's financial reserves, though illiquid, are huge. Despite the rating downgrades, well-managed sovereign bond issues, backed by high single-A ratings, would be eagerly subscribed by international investors. There is a level of public debate on economic and social issues which is far more open than in neighbouring countries that face similar financial challenges. If these resources can be marshalled correctly, Kuwait will easily be able to confront the challenges ahead. ■