Kuwait: Developing a mini-economy

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ABSTRACT

This study examines the changes that occured in the Kuwaiti economy as a result of rapid growth, and the regional economic implications of public policies of a small developing state. It is a case of rapid growth and accumulation of finance in excess of productive capacity. Affluence is derived from oil. One cannot pretend that the economic analysis emphasizing allocation of resources is satisfactory. Yet unfortunately the core of development economics has failed to present an adequate analysis of the main aspects of the development process.

The thesis can be loosely divided into two parts. The first part is concerned with the behavioural characteristics of the economy. Chapter 2, discusses the dualism of the economy as represented by its factoral imbalance. The discussion of the trends, terms, and composition of foreign trade in Chapter 3 develops the theme of the economy's levels of growth and degrees of sectoral imbalance. Chapter 4, surveys the present industrial structure in Kuwait, pointing out the importance of complementarities, and external economies. The second part of the thesis reviews Kuwait's industrialization plans given the present state of the country's economic development. Kuwait's industrialization plans take note of the present dominant characteristics of the economy and suggest industrial development along the lines of unbalanced growth (Chapter 5). Chapter 6, uses static analysis to discuss Kuwait's cooperation endeavours. The dynamics of regional integration, and the availability of elements of complementary and diversified industrial structure in an active Arab Common Market, suggest the favourable long-run implications of this market, and cooperation in general, for Kuwait's industrial development.

Statistically, it is more feasible to study long periods. However, to avoid breaks in the series or incomplete or provisional data, the period 1961 to 1973 has been used, almost exclusively. A number of statistical tables, being

only available in a fragmented form and scattered in a diversity of sources, were compiled and reorganised by the candidate. This is stated where it occurs.

PREFACE

This study was submitted as an M.A. in the academic year 1974/75. My thanks are extended to Dr. R. J. Wilson for his suggestions and criticisms throughout the course of this study. My numerous discussions with him on theoretical and practical issues have been invaluable.

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CONTENTS

List of Tables

CHAPTER 1

Introduction

1.1 The Scope of the Study

This study focuses upon the rapidly growing economy of Kuwait and its process of development. Kuwait has one of the highest percapita incomes and average propensities to save - 51 percent in 1971/72 - in the world, a rapid growth rate of the national income (about 14 percent per annum)[1], and a consistent balance of payments surplus which are all indicators of an affluent economy. The major explanation for this affluence is the state's massive resources of crude oil. Yet the course of economic development is not to be equated with specialization in the prdduction and exportation of a primary product of a favourable, strategic, and as some see it "noble" nature. Nor is the high average standard of living and of individual income - standing at about KD 1620 in 1972/73 - synonymous with oil profitability alone, but also with the low denominator: the small size of the population. It is here that the distinction between the terms short-run and long-run periods need to be introduced. This distinction is particularly important since we are concerned with the causal links of the different economic criteria in the 'process' of development. That is, through the process of rapid growth, achieved higher standards of living need to be sustained over a long period and their benefits spread.

Since the agricultural potential is weakened by the severe climatic conditions and a fairly well developed trade sector exists, the appropriate course for accelerated economic development would seem to be industrialization. In determining industrial strategies, past experiences can be

used as guidlines. The approach employed in this study places emphasis on the allocation of resources, but does not assume the availability of adequate investment opportunities for increasing the number of projects required to generate the ability to invest.[x] The balanced growth theory advocated by Nurkse, Rosenstein-Rodan, Lewis and Scitovsky, is reviewed. In addition, the unbalanced growth theory, which is advocated notably by Hirschman, is discussed. In so far as Kuwait's industrial potential and plans suggest development along the lines of one of these theories, the approach of this study identifies with the characteristics of the surplus capital economy and its factoral and sectoral imbalances. Emphasis is laid upon technical progress as a crucial factor in economic growth.

Dependence of the economy on export markets and expatriate labour has not resulted in foreign interventions nor exploitation. Dependence could be transformed into the more useful context of cooperation. It is a case of an independent 'outward looking' nation searching for means of achieving development. In this context, the study proposes a comparative approach based on the analysis of the 'size of nation and economic development' as put forward by Lloyd, MacBean, and Kuznets.[x] The appraisal of the implications of Kuwaits liberal trade policies, and the effects of specialization and vulnerability are compared with countries in the area, and other developed and developing countries, small and large.[x] Here it is necessary to briefly review the definition of size of a nation which is used throughout the study with respect to Kuwait.

1.2 Definition of Size of Nation

A preliminary theoretical consideration of this study is the size of Kuwait and the influence of this on the development of the economy. There is no standard method of defining the size of a nation for economic purposes.[x] Economists have used a number of criteria. These include

land area, population, national income and their interrelationship, to name but a few.

Geographic size in these terms refers to the relationship between land area and population size. In both these respects Kuwait is a small nation. The country's agriculturally productive land area is restricted by desert and the severe climate. On the other hand, the oil resources lying beneath such tracts are extremely productive. Other natural resources are limited by Kuwait's small geographic area. The most frequently used indicator of a country's size is population, an approach formalized by Kuznets[2]. Those possessing less than 10 million are defined as small, while those with more than 10 million are said to be large. If we adopt this dividing line, Kuwait falls within the classification of a small nation.

The criterion of productive capacity, advanced by the Neoclassicists, lays stress on the ability of a nation to produce quantities of a good under complete specialization as an index of national size[3]. Kuwait's large national income derives basically from the production of one export commodity. Accordingly, Kuwait may be suitably described as a single product economy. Kuwait's national income might, therefore, be used as an estimate of the productive capacity of a single product economy. Two related points need to be made here concerning the dependence of Kuwait's economy on the production of a single export commodity vis-à-vis the concept of size. Firstly, dependence on this commodity has hindered the expansion of the production pattern. This has rendered the economy extremely vulnerable to fluctuations in demand from foreign markets. Secondly, productive capacity of an export commodity does not necessarily reflect the size of the domestic market. Export demand extends the productive capacity of Kuwait far beyond the national market level. However, it remains true that the massive oil export revenues raise the percapita income and

purchasing power of the small population to the level of developed countries. Therefore, the national consumer market is swollen beyond that which might be expected of a nation of one million, by several factors. These factors include high purchasing power, though arguably unfairly distributed, developed transport and communications facilities, and fairly homogeneous tastes. In the context of development and economic efficiency, market size is more relevant than absolute population size.

As can be seen from the brief review above, the criteria employed in a discussion of the size of a nation such as Kuwait, are to a certain degree interrelated. The isolation of any one particular factor is most probably inadequate. However, in passing, it is worth mentioning that these criteria are likely to contradict each other[4]. In the case of Kuwait, area and population give little clue to national income and productivity levels. However, those features generally ascribed to small nations are found to be true of Kuwait. That is, Kuwait has a limited geographic size, a relatively small national market, a limited range of national resources, and is dependent on one export commodity. For the purposes of this study, then, Kuwait is viewed as a small nation.

The distinction between growth and development, as noted by H. Chenery, and the status of Kuwait's dualistic economy are the subject matter of the following chapter.

Notes to Chapter 1

1. The geometric mean is used in calculating the average growth rate of national income over the period 1969/70 - 1972/73, which was 14.4 percent.

2. Kuznets, S., "Economic Growth of Small Nations" in Economic Consequences of the Size of Nations, Proceedings of a Conference held by the International Economic Association, edited by E. A. G. Robinson (London: Macmillan and Co. Ltd., 1963) p. 14.

3. Lloyd, P. J., International Trade Problems of Small Nations (Durham, North Carolina: Duke University Press, 1968) p.8.

4. For an extensive review of this question, see Vakil, C. N., and Brahmananda, P. R., "The Problems of Developing Countries", in Robinson, op. cit., pp. 133-135.

CHAPTER 2

Factoral Imbalance

This chapter is concerned with factoral imbalance of Kuwait's dualistic economy. For the purposes of discussion it is divided into three sections. Section 1 provides an introductory discussion of the dualism of the economy. Sections 2, 3, 4, and 5 review areas in which capital surplus is evidenced and the allocation of financial resources. Sections 7, 8, and 9 outline the structure of the population and the limited manpower resources. Section 10 provides the summary and conclusions to the chapter.

2.1 Introduction

The crux of Kuwait's dualistic economy is the divorce between growth and development. In some spheres growth has been achieved without development, in others development without growth. The distinction between growth and development[1] is important in the context of long-run economic planning. In the wake of the oil discovery, Kuwait had to cope with the sudden influx of wealth in extremely underdeveloped social and economic conditions. Her endowment with a favourable raw material export has propelled the remarkable expansion of her GNP. Being a small country this has allowed Kuwait to accomplish and maintain high levels of percapita income. The economy, overwhelmingly dependent on oil exploitation, has achieved little change in resource allocation as yet. This constitutes growth without development. On the other hand, the sustained accumulation of capital has permitted the diffusion of large improvements in infrastructure and education. In this respect, Kuwait has achieved development without growth.

In order to conceive of future output growth, major modifications in

resource allocation are requisite. It is notably so because oil is "a wasting asset"[2]. Consequently, the government has put a ceiling of 3 million barrels a day on oil production. However, the time discount factor shows that a 5 percent annual rate of growth would allow continued production for only the coming thirty years[3]. Oil production will sustain the growth in the economy over this period, provided other things are equal in the energy field.

The main restriction on development has, accordingly, been over-specialization[4] with one sector developing more rapidly than the rest of the economy. This means that close to two-thirds of the national income, over 90 percent of the government revenue, and about 95 percent of the export earnings (in 1972) were generated by oil production. The high incomes have been accompanied by very high propensities to save. The inability of the economy to absorb these financial resources has led to the amassing of a substantial capital surplus. As might be expected then, the economy still exhibits characteristics of underdevelopment[5]. This is manifested in the predominance of the oil sector over others in its production and exportation, and in the inadequacy of the indigenous labour force, specifically in qualitative terms.

This overspecialization and dualism of the economy is represented by the sectoral imbalance. The expansion of the oil industry raised demand for other sectors[6], but its developmental impact has been weak[7] and has not helped the attainment of comparable growth rates by the rest of the economy. In the decade ending in 1970, the annual rate of growth of the oil sector was 9 percent, whilst that of the rest of the economy did not exceed 6 percent. It could be argued that both levels of growth will be maintained; but on current levels of growth of oil revenues, dependence on the oil sector will be accelerated. In the long-run, the Kuwaiti economy could, in fact, become increasingly vulnerable to changes

in external demand, prices and production of oil.

The extremity of this dualistic situation is further shown by the capital to labour ratios. The oil industry, is characterized by high capital intensity and can employ a very limited labour force. In 1970, it employed a mere 2.5 percent of the labour force while producing over 60 percent of the gross domestic product[8]. The rest of the economy, by contrast, has a much lower capital to labour ratio and a lower productivity[9]. This explains the widespread underemployment and disguised unemployment, particularly in the public and services sector. Thus labour wastage drains the small labour force, more than three quarters of which is imported, causing labour shortage in the rapidly growing economy. Labour shortage couples with the accumulated capital surplus to produce factoral imbalance[10]. Low domestic interest rates and the constraints of the dualistic economy have lowered the capital absorptive capacity of the economy. Thus with no more than half of the country's substantial national savings invested at home, Kuwait is exhausting the relatively small oil resources to build up an excessive surplus. The balance of payments reflects the capital surplus condition. This is also evidenced in government finance and budgetary surplus, and in the capital available for investment.

2.2 Balance of Payments

The overall balance of payments has shown consistent surpluses, estimated at approximately KD 252 million and KD 166 million in 1971/72 and 1972/73, respectively. This surplus has been maintained despite massive leakages from the economy. Most of the debit on current account is visible imports of goods and services. Since the development of domestic manufacturing has only recently begun to gather momentum, and agriculture is virtually non-existent, Kuwait is heavily dependent on

imported commodities. Dr. Khoja, has estimated that imported commodities accounted for close to 80 percent of any increase in private consumption and investment expenditure, in the 1960s.

The current account surplus, however, remains substantial and enables the government to continue her aid programme and portfolio investments abroad. The other main capital leakage is from the private sector. This has been overwhelmingly towards investment and short-term deposits in the west. Kuwait's investment pattern is discussed below.

It is the increasing foreign exchange earnings through rising oil exports which maintains the balance of payments surplus. The breakdown of the balance of payments for the years 1971/72 and 1972/73, given in Table 2.a. highlights the dominant role of the oil sector in the economy. Total receipts from this sector, in the form of tax payments, royalties, and local purchases of goods and services by the oil companies, accounted for 73 to 77 percent of current account receipts. A further 8 to 10 percent represented receipts from visible exports and re-exports, and services. Income from public and private investments abroad constituted the remaining 16 to 17 percent. Given the rising oil revenues and the encouraging outlook for development of the industrial sector, it is likely that the balance of payments will show even more substantial surpluses.

2.3 Government Revenue

Government revenue is made up almost exclusively from oil revenue. Its rapid increase has stimulated the emergence of the public sector as pre-eminent in the transformation of the desert economy into a welfare-state. Over the period 1969/70 to 1972/73 oil revenues approximately doubled as a result of agreements in the 70s and price rises. Between 1972/73 and 1973/74 an increase of 273 to 400 percent, that is KD 1383 million to KD 2027 million, was expected[12]. In 1975 this is estimated at a massive KD 2117 million[13].

Table 2.a.

Balance of Payments of Kuwait, 1971/72 & 1972/73
(in millions of Kuwaiti Dinars)

	1971/72	1972/73
Current Account		
Current receipts	688.97	750.29
Oil Revenues[a]	527.91	548.53
Exports & Re-exports of goods[b] fob	37.80	53.30
Exports of services[c]	14.58	23.00
Investment Income	108.68	125.46
Current payments	-268.22	-301.52
Imports of goods (Cif)	-241.23	-266.63
Imports of services	- 26.99	- 34.89
Net current account	420.75	448.77
Capital Account		
Government transfers	- 37.75	- 46.27
Government loans (net)	7.36	- 6.11
KFAED loans	- 4.29	- 3.54
KFAED portfolio	- 3.08	- 13.50
Private capital flows (including errors and ommissions)[d]	-131.46	-213.47
Net capital account	-169.22	-282.89
Overall Balance of Payments	251.53	165.88
Changes in Foreign Assets		
Commercial banks (net)	- 34.71	18.95
Central Bank	- 30.62	- 27.23
Government (including adjustment to currency realignment)[e]	-186.60	-157.60
Net changes in assets	-251.93	-165.88

Source: The breakdown of the balance of payment has been made by the author from Al-Kitab Al-Sanawi, 1973 (The 1973 Year Book) published by the Ministry of Information (Kuwait: Government Printing Press, 1973) pp.64-66; Al-Takrir Al-Sanawi Al-Thaleth, 1972 (The Third Annual Report, 1972) Central Bank of Kuwait (Kuwait: Government Printing Press, 1972) pp.179-183.

a. Includes receipts from Kuwait National Petroleum Company's products exports and sales of bunker and airplane fuels, and its payments towards credit installments and interest to Gulf and BP companies.

b. Includes shrimp exported outside the territorial waters. The last three months of 1972/73 are estimates.

c. Includes the net current account of the Kuwait Tankers Company.

d. Includes current and capital transfers through the 'unofficial free market'; returns on investments transferred to the country; unregistered imports of the ministry of defence; and payments of ministries for invisible accounts, such as foreign services of technical consultancy. These items are entitled 'errors and omissions' accounting for massive payments of KD 66.02 million and KD 142.29 million in 1971/72 and 1972/73, respectively.

e. Includes losses accruing to the ministry of Finance & Petroleum, commercial banks, KFAED, and other Kuwaiti companies, resulting from the devaluations of the dollar, and changes of the exchange rates of other currencies. This item represented losses of KD 22.5 million & KD 57.05 million in 1971/72 and 1972/73, respectively.

Several factors have coalesced to alter the nature of Kuwait's income tax with respect to oil. Previously Kuwait's main tax was an income tax of fifty percent levied on foreign participation in local business where net income exceeded KD 350,000 a year[14]. The object of this levy was to tax equity income of foreign oil companies. Only KD 150,000 income revenue was collected from the non-oil sector in 1973/74. Part of the income tax on the foreign oil companies was the royalty item. This consisted of 12.5 percent of total company revenue. Factors which have contributed to the change are the Tehran and Geneva agreements in 1971 and 1972 respectively; the state's 60 percent participation in the Kuwait Oil Company (KOC), effective from 1st January 1974; and more recently, the state's take-over of the remaining 40 percent of KOC, previously shared equally by Gulf and British Petroleum[15].

Since 1974/75 government budgetary figures are provisional, the following discussion is based on 1973/74 figures. Income tax oil revenue, as a consequence of the Tehran agreement, was recorded as KD 530.9 million. Of this figure, KD 128.3 million was royalty as Table 2.b shows. Non-oil government revenues represent only an infinitesimal portion of the total. They can be broadly divided into domestic income and returns on external investments. In 1973/74 funds from domestic income constituted less than 8 percent of total government receipts[16]. They consisted mainly of customs and taxes on consumption and production of the oil companies which amounted to KD 9.5 million; the provision of public utilities which amounted to about KD 23.5 million, mainly from communication and transport; and KD 11.8 million from the independent budgetary institutions[17].

The return on government investments abroad, carried out through such agencies as the Investment Board in London, have been growing steadily in absolute importance (refer to Table 2.c). This is a reflection of the

Table 2.b.

Government Revenue Estimates for the Fiscal Year 1973/74[a]

	Million KD	Percentage
Income Tax	531.0	92.0%
Oil	402.6	
Royalties	128.3	
Non-Oil Sector	0.15	
Domestic Income	48.8	8.0%
Taxes & Duties (Tariff)	9.5	
Public Utilities	23.5	
Public Land Sales	1.6	
Income of Independent Budget Institutions[b]	11.8	
Other Income	2.4	
Total[c]	576.8	100.0%

Source: Kuwait Chamber of Commerce & Industry Magazine (in Arabic), October 1974, Vol. XV, No.140, pp.29-34.

a. Authors calculations based on Kuwait Chamber Magazine estimates.

b. Includes oil products, therefore, figures do not add up to the estimated totals, as there is an element of double counting with oil revenue.

c. Total revenue does not include return on external investment.

Nb. Figures are rounded off.

rapid cumulative process of government investment abroad, and is a consequence of successive budget surpluses. Thus in 1973/74 it was estimated to have reached KD 65 million, almost double that of 1970/71.

2.4 Government Expenditure

The government's role in economic activity is significant both as an employer and as a spender. Government expenditure as a share of GNP averaged at 38 percent (unweighted) over the fiscal decade ending in 1972/73. The major portion of budgetary expenditure has gone to government institutes and administration in the form of wages and salaries. In 1970 over 70 thousand, or 30 percent of the employed population, were on the government's payroll. In 1972/73 and 1973/74 wages and salaries absorbed about half the total current expenditure.(Table 2.d)

Other government outlays, in the form of money injections and services, operate to stimulate the growth of the productive capacity of the economy. In other words, these budgetary outlays channel funds from the oil to the non-oil sector. They consist of social overhead and infrastructural expenditure, and land purchase.

In the last two decades the government has been in the process of building a welfare state. Welfare state schemes entail two outstanding outlays, the social overhead and infrastructural expenditure, that is developmental expenditure. The social overhead capital embodies public services in the form of communication, transport, water supply and electric power, health and education services and other social and religious services. The provision of the social overhead capital overlaps with developmental expenditure and is described by Kuwait as the social services sector. The expenditure on the social services sector during this period averaged 34 percent annually[18] of the total current expenditure between 1971/72 and 1974/75. Over the same period current expenditure increased

Table 2.c.

Government Budgets for the Fiscal Years 1970/71, 1971/72, 1972/73, & 1973/74, in Million KD

Outlay, Income	1970/71	1971/72	1972/73	1973/74
Current Expenditure	240.4	264.8	311.6	335.9
Development Expenditure	47.9	60.3	79.0	91.2
Land Purchase	24.4	29.7	25.5	26.5
Other	7.9	8.9	12.6	20.8
Total Expenditure	320.6	363.7	428.7	474.4
Oil Revenue	293.0	354.1	506.6	530.9
Returns on External Investment	37.0	39.6e	60.4e	65.0e
Domestic Income	26.4	29.3	29.6	48.8
Total Revenue	356.4	423.0	596.6	644.7
Surplus	35.8	59.3	167.9	170.3

Source: Calculated and compiled from: The Arab Economist, Supplement Kuwait, May 1974, No. 64, p.29; Central Statistical Office, The Planning Board, Statistical Abstract 1973 (Kuwait, 1973); Kuwait Chamber of Commerce and Industry Magazine (in Arabic), October 1974, Vol. XV, No. 140, pp. 29-34; Quarterly Economic Review Special 18, pp. 44-45; Central Bank of Kuwait, Third Annual Report, 1972, Table 25, 29, pp. 80 and 85.

Nb. Figures are rounded off; e = estimates.

Table 2.d.

Distribution of Government Expenditures for the Fiscal Years 1972/73, 1973/74, 1974/75[e]

Outlay	1972/73	Percent of Current Expenditure	1973/74	Percent of Current Expenditure	1974/75	Percent of Current Expenditure
Current Expenditure	311.6	100.0	335.9	100.0	387.1	100.0
Of which Wages & Salaries	151.0	48.5	163.0	48.5	174.0	44.9
" " General	30.0	9.6	30.9	9.2	41.0	10.6
" " Non-Classified & Transfer Payments	130.6	41.9	142.0	42.3	172.1	44.5
Land Purchase	25.5		26.5		35.0	
Development Expenditure	79.0		91.2		104.6	
Other[a]	12.6		20.8		58.3	
Grand Total	428.7		474.4		585.0	

Source: Kuwait Chamber of Commerce and Industry Magazine (in Arabic) October, 1974, Vol. XV, No. 140, pp. 29-34; The Arab Economist Supplement Kuwait, May 1974, No. 64, p.29.

[a] Includes attached budgets' outlays.

Nb. Figures are rounded off; e = estimates, the difference between 1974/75 expenditure estimates and 1973/74 expenditure, indicate the high projected revenue for this year.

at an average rate of 14 percent per annum. The population growth, including immigration, was around the 10 percent mark annually. This expenditure, therefore, seems sufficient to maintain the development of the social services sector in the 1970s at the same impressive levels achieved in the 1960s.

On the other hand, domestic development expenditure in real terms, has been running at modest levels in the 1970s. In 1972/73 domestic development expenditure increased by KD 29 million to KD 79 million over the previous year, and KD 91.2 million was allocated for the purpose in 1973/74. These increases, however, were attributed by planners to the rising costs of large development projects resulting from world and domestic inflation[19]. Booming trade, however, has produced supply bottlenecks which require more roads, ports and other works. Public works' capital expenditure has in consequence more than doubled between 1971/72 and 1973/74, from KD 24.2 million to KD 49.7 million. Of planned development expenditure in 1973/74, about 55 percent went to public works. The other main development expenditure was water supplies and electric power which accounted for KD 33.1 million or just over 36 percent of planned development expenditure.

Due importance in this welfare state is given to housing every Kuwaiti in a modern residence. To this purpose between 1972 and 1973 about KD 52 million (part of the unclassified items) was spent on low-income housing. Moreover, the private housing sector is also booming. Plans include new public schools and clinics; four new hospitals, costing around KD 30 million to KD 35 million; a new parliament and government buildings, at KD 15 million; and Kuwait's second earth satellite station costing KD 3 million. Other large expenditure included in the unclassified and transfer item are comprised of food subsidies, which cost around KD 10 million in 1973/74[20]; research; and Kuwaiti

educational missions[21]. The mid-sixties question 'when to stop spending' on these spectacular projects reverberates with increasing strength. However, as in the past, it is expected that "real expenditure is likely to fall short of allocations due to overambitious targets and bureaucratic bottlenecks"[22].

The land purchase and construction schemes were intended to redistribute wealth. This fund distribution was initiated in the early 1950s in the wake of the boom in the construction of the social and economic infrastructure. The land purchased, mainly in Kuwait city and to a lesser extent in other population concentrations, was in excess of the requirements of public projects. Later, the surplus was sold back to the citizens at an estimated 4 to 6 percent of the original price[23]. This buying and reselling process has led to the amassing of some enormous private fortunes and a "real estate craze"[24]. Government capital expenditure on land purchase throws light on the volume of these fortunes and the scale of the real estate speculation. It ran close to $840 million[25] between 1957 and 1962, KD 300 million between 1964/65 and 1968/69, and dropped to KD 114 million in the five years ending in 1973/74. During this latter period public outlays for land purchases were drastically reduced, from KD 95 million in 1966/67 to KD 26.5 million in 1973/74, since the private, as well as the public sectors' demand "on new construction is not insatiable"[26]. The reduction of this form of money injection into the economy was also designed to check the grave inflationary spiral and speculation in real estate.

The tribal character of the Kuwaiti community means that merchants involved in land investment are also members of the higher echelon of the socio-political hierarchy. Their political influence has impelled the continuation of the land purchase schemes, albeit at a reduced level.

They argue that without the continuance of this scheme bankruptcies could follow since substantial bank credit has been undertaken. The truth or falsity of this claim is hard to substantiate. The statistics of the Central Bank of Kuwait indicate that banking advances to trade in the year ending March 1972 amounted to KD 106.3 million. In Kuwait most bank credit is used to finance the importation of visible goods. The whole of the amount advanced in 1971/72 would barely have covered 41 percent of total visible imports for this period. This hardly seems to support the merchants' claim.

This scheme has failed to realize its targets. Firstly, it has failed to achieve a fair distribution of income and only a part has accrued to the masses, the larger part going to a minority of citizens. In fact, income disparities have widened rather than narrowed. Secondly, the diffusion of public expenditure amongst citizens, intended to broaden the economic basis, has failed to materialize, and most of this private wealth was remitted abroad.

In summary, as a small nation it is uneconomic for Kuwait to bear the cost of equiping herself with adequate economic and political institutions. For instance, defence expenditure[28] is very high in relation to the size of the nation. However, such spending is perhaps to be expected in an area of political disputes, as is excessive expenditure and policies designed to stamp political nationhood. The weakness of Kuwait's planning institutions is reflected in the economic depressions of 1961, 1965 and 1969/70. This weakness has led to fluctuations in budgetary expenditure as determined by trading conditions. Furthermore, government control instruments are limited, and whilst budgetary expenditure pumps substantial purchasing power into the economy, it absorbs only a tiny portion from it. Taxes and duties, other than from oil, represented only 6.5 percent of

total government revenue in 1973/74. It follows, therefore, that spectacular construction projects and such schemes as land acquisition aggravate the inflationary spiral. The nature of the Kuwaiti socio-political structure and the lack of governmental regulatory mechanisms and limited pump-priming instruments have led to increasing income disparities. However, external economies brought about by developmental and social overhead expenditure can be expected to aid productive investments. Finally, it should be noted that efficient allocation of public resources has been particularly handicapped by the sector's endowment with unproductive surplus capital.

2.5 Government Budget Surplus

Even before the recent increases in the price of oil, government revenue exceeded expenditure and the surplus was mounting. In 1967/68 it stood at KD 16 million. By 1973/74 it was over KD 170 million (see Table 2.c). The main budgetary item allocated to the state general reserve, or the budgetary surplus, in the fiscal years 1972/73 and 1973/74 was the royalty element of oil revenues. This surplus topped KD 890 million in December 1973, rising by approximately 23.5 percent in a year. Between 1962/63 and 1969/70 the rise in current expenditure was less than 60 percent, on average, of the rise in governmental oil revenues and return on external investment. This percentage dropped to 40 percent between 1970/71 and 1973/74. With rapid increases in oil revenue, particularly since the October 1973 oil price rises, it is likely to continue to drop in relative terms. This is substantiated by the government's realization of the inflationary consequences of conspicuous expenditure. In other words, the rate of accumulation of general financial reserves has gathered momentum substantially as a result of rising unspent funds. This will undoubtedly be accelerated with prolonged increases in oil revenue.

Some estimates claim that these reserves stood at KD 2 billion (approximately $7 billion) by the end of 1974.

In order to slow down the vicious inflationary spiral the government ought to consider reducing its exorbitant expenditure. In general, government expenditure increases the private sector's volume of revenue (by a multiplier effect) without improving the performance of domestic investment. The inevitable discrepancy between domestic investment and government expenditure has widened the gap between "the country's productive capacity and the demand made upon it"[29]. One solution would be to invest in the productive capacity. This is the subject of Chapter 5.

2.6 Investing Capital Surplus

The expanded oil revenues strengthen the balance of payments and sustain growth in capital surplus and savings. The piling up of excessive surpluses has been an ever-present feature in the post-oil era and results from the inability of the country to utilize its financial resources at home. Increases in the volume of private revenue, through public expenditure, has increased domestic investment only marginally. Most of the savings continue to be remitted abroad and reduce the national income multiplier. Capital leakages are the outcome of high propensities to import and save, accompanied by a low level of domestic investment. While the marginal propensity to save for the period 1962/63 to 1969/70 was 50 percent of national income, it is estimated that the marginal propensity to invest was a strikingly low 40 percent of the marginal propensity to save[30]. Dr. Khoja, estimated that the national multiplier for this period was only 1.48[31]. In other words, income increases 1.48 dinars for every dinar increase in investment or public expenditure. It can be seen that the high propensity to save and the low propensity to invest

domestically are two important characteristics of the Kuwaiti economy.

The low level of domestic investment can be attributed to several factors. The 7 percent ceiling on domestic interests has encouraged the flow of funds towards higher-yeilding investments abroad. At the same time Kuwait has suffered from underdeveloped conditions in such spheres as smallness of domestic market, lack of know-how and technical expertise, and administrative impediments. These difficulties have created bottlenecks and hampered efforts to diversify productive capacity. In this respect Kuwait's inability to utilize her oil revenue at home, or her limited absorptive capacity have been the main impediments to Kuwait's "investment for future"[32]. For instance, the government has invested domestically a meagre 30.9 percent or KD 275.1 million of the state reserve. The rest was remitted abroad in the form of portfolio investments and aid.

The higher return on investments abroad has been an important factor in this capital outflow. It might be said that the political instability in the area is also a contributing factor. The balance of payments indicates the increasing importance of returns on investment abroad by both the public and private sectors. It increased by 15 percent to KD 125.5 million between 1971/72 and 1972/73. Investment in foreign assets was initiated in the early 1950s, when the local money market was not developed enough to cope with the large increases in oil production and revenue. The capital exodus has continued and until recently was mainly transmitted to or by way of Beirut. The government has tended to maximize her foreign high-yield portfolio investment. It is thought that government portfolio investment constituted a quarter of proceeds from oil production annually since the 1950s. It was estimated at KD 425.6 million in 1973. The growing importance of these

revenues can be seen in the remarkable 50 percent yield increase in 1972/73 over 1971/72, to KD 60.4 million[33]. Private portfolio investment is thought to be far in excess of the government's.

This general trend of investment in fixed security assets encounters considerable potential risks and difficulties. The instability of the international monetary system creates problems for Kuwaiti investors. For instance, in 1971 as a result of the exchange instability on the international money markets, and the fluctuations in interest rates, the Central Bank of Kuwait reported a significant capital inflow. By the end of 1971 this movement was reversed due to the revaluation of the dollar and the reduction of competition in money markets[34]. The balance of payments shows losses incurred by the Ministry of Finance and Petroleum and the private sector because of devaluations of the dollar and changes in the exchange rates of other currencies. These losses ran at KD 22.5 million and KD 57.1 million in 1971/72 and 1972/73, respectively. It is argued that capital outflow relaxes the inflationary pressures in Kuwait. But the oil producing countries in general tend to increase the liquidity of the international monetary system by spending reserves and "to fuel inflationary tendencies"[35]. Therefore, another form of risk-taking is world inflation and a possible world recession. This would deflate their assets and bring about higher prices for Kuwait's imports and may reduce demand for oil[36]. There is also the risk of default on bonds and possible economic and political countermeasures by host countries, which may end in confiscating equities and real estate[37]. Further risk is involved since large sums of capital investments are being handled by private institutions, without international intermediations. The collapse of Intra Bank of Beirut in 1966, which used to handle part of these investments, is reminiscent of these dangers. A final difficulty facing investment is

the barrier placed on the movement of foreign capital and legal limitations on the maximum holdings in any company which are imposed by some countries.

Realizing these potential risks, and in order to stamp political nationhood and establish an identity in the financial world, Kuwait has expanded financial activities beyond fund placing abroad. For instance, the government's aid and cheap loans programme for developing countries provides a channel for part of the country's excessive surpluses. In this way Kuwait has assisted international liquidity. The country's emphasis on aid, notably to the Arab countries without oil revenues, is evidenced in the cheap loans on government-to-government bases and through the Kuwait Fund for Arab Economic Development (KFAED). In March 1974, Kuwait announced that the capital resources of the KFAED was to be increased from KD 200 million to KD 1,000 million, partly by drawing on the general reserve, and partly by allocating portions of future oil revenues. Since its inception in 1961 the KFAED has made loans totalling KD 126 million, on a commercial basis[38]. To assist international liquidity, Kuwait is recycling more of the oil revenues through multilateral agencies. Kuwait's grants to the World Bank by November 1973 amounted to some KD 200 million. Kuwait also intends to contribute £30 million to the Arab-African Development Bank's £200 million funds. Further the government holds part of the reserves, in the form of short-term deposits, in Arab and other foreign banks.

Finally, Kuwait has used the general reserve and other sources to secure the country's independence and to support the Arab cause. Thus after the October 1973 war, Kuwait contributed KD 100 million to Arab countries directly engaged in the war with Israel.

The multiplicity of these financial operations have helped develop

the Kuwaiti banking system. In the late 1960s and early 1970s, the expansion of the financial institutions has been remarkable. An important development in this direction was the establishment of the Central Bank in 1969 to take over from the Kuwait Currency Board the handling of money issuing and the monitoring of the activities of the five national commercial banks. These commercial banks have expanded rapidly. Between 1963 and 1972 their foreign assets increased from KD 138 million to KD 434 million. Time and savings deposits increased from KD 81 million to KD 362 million, whereas demand deposits rose only KD 34 million, from KD 65 million to KD 99 million. These figures indicate the expansion of the operations of the private banks through utilizing the high propensity to save[39]. Recently many specialized financial institutions have been established. The major institutions of this type include the Savings and Credit Bank; Kuwait Foreign Trading Company; Kuwait Investment Company; Kuwait Industrial Development Bank; Contracting and Investment Company; Kuwait Real Estate Bank, and Kuwait International Investment Company[40]. The paid-up capital of these institutions is either furnished by the government, or the government is the major subscriber.

Kuwait could, therefore, develop into an important financial centre, and perhaps become capable of attracting and handling the financial resources of other oil producers in the area. This could compensate for the economy's lagging sectors in the long-run. Supporting the development of this sector would entail extensive training of personnel and a more aggressive entrepreneurial attitude. Moreover, to command the use of money, financial institutions, other than investment and merchant banks, must be established and developed. These include brokerage firms, insurance and re-insurance houses, and trust units[41]. Finally, the

commercial laws governing non-Kuwaiti ownership of companies ought to be slackened.[42]

To conclude, Kuwait has been remitting most of the substantial savings abroad. Although investments abroad have been lucrative, the potential risk taking is considerable, and Kuwait is unable to utilize financial resources at home. In these circumstances, the government might find it advisable to implement and consciously expand a set of policies designed to circumvent the asset preference trap of the surplus economy. Such a set of policies might include, firstly, a review of the ceiling placed on oil production to ensure that it is at an optimum point of production. This optimum ceiling could be prolonged since energy substitutes are unlikely to emerge before the exhaustion of oil reserves. Conservationists have advocated reduction of oil production. However, though this may not affect revenues drastically, it could lead to retaliation by the oil consumers. Secondly, grants to underdeveloped countries, particularly to Arab countries, might instead be channelled as loans. These loans could be at lower rates of interest than those charged by international institutions like the World Bank[43]. Thirdly, the productive capacity of the economy should be expanded. The growth potential of the economy has not yet been exploited. Fourthly, the above measures, if carried out, would reduce overseas investment. Moreover, by making long-term investments and investments in "inflation-proof assets"[44] investment risks may be circumvented to a certain degree.

2.7 Population and Manpower

As far back as 1765 a tourist from Denmark had estimated the population of Kuwait at 10,000 persons. In the year preceding the discovery of oil, 1937, the population was crudely estimated at around 75,000 persons. A distinctive feature of development in Kuwait in the

oil era has been the phenomenal population increase. With the urban explosion of the 1950s the wall surrounding the old city of Kuwait was demolished, and a radical redevelopment process for the city undertaken. In 1970, Kuwait, which has become one of the more modern cities of the world, with 29.4 percent of the country's population, was the main population concentration centre in the state. In addition, 80.4 percent of the total population lived in centres of more than 20,000 people. Overall, the 1970 census shows that Kuwait is one of the most highly urbanized countries of the world, perhaps on equal footing with Hong Kong[45]. This has been brought about mainly by the continuous influx of immigrants. It is, therefore, of dual significance, for this massive rise in population has also resulted in a notable change in the composition of the population.

The oil boom expanded employment opportunities in the construction sector, government services and service areas in general. It increased wage differentials between Kuwait and other Middle Eastern countries. Furthermore, securities in the form of education and health, as well as relative political stability, attracted the Palestinians after the 1948 Palestinian war, and after 1967 war; and Iranians after the Iran Mussadak crisis of 1952. Both skilled and unskilled labour has been attracted by these considerations from many nations, but mainly from the Arab world. By 1957, this influx of immigrants had swollen the total population to 206,473. The immigrant proportion was then 45 percent of the population. This population figure more than quadrupled between 1957 and 1972, rising to 858,300. The non-Kuwaiti portion rose to 57.1 percent of the total, unrestricted by a government policy on immigration. The 1970 census[46] showed the distribution by nationality of the 738,662 population (Table 2.e) to be 347,396 persons or 47.0 percent Kuwaitis and 42.4

Table 2.e.

Population by Sex and Percentage Distribution by Nationality (1970 Census)

Nationality	Males Number	Females Number	Total Number	Percentage
Kuwaitis	175,513	171,883	347,396	47.0
Arab Nationalities:	184,729	128,120	312,849	42.4
Of which Jordan & Palestine	79,934	67,762	147,696	20.0
" " Iraq	23,583	15,483	39,066	5.3
" " Egypt	17,392	13,029	30,421	4.1
" " Syria	17,180	10,037	27,217	3.7
" " Lebanon	14,145	11,242	25,387	3.4
" " Other	32,495	10,567	43,062	5.9
Non-Arab Nationalities:	59,587	18,754	78,341	10.6
Of which Iran	35,498	3,631	39,129	5.3
" " India	10,510	6,826	17,336	2.4
" " Pakistan	9,438	5,274	14,712	2.0
" " Other	4,141	3,023	7,164	0.9
Grand Total[a]	419,881	318,781	738,662	100.0

Source: Statistical Abstract 1973, Section Two, pp.20-21.

a. Includes 'not-stated' nationalities.

percent non-Kuwaiti Arabs. The remaining 10.6 percent were non-Arabs. The largest 'single'[47] non-Kuwaiti national group was the Palestinians and Jordanians', with 147,696 or 20.0 percent of the total. The other main groups were Iraqis, Iranians, Egyptians, Syrians, Lebanese and Indians in that order.

The Kuwaiti portion registered an average annual increase of 11.6 percent from 1961 to 1972. This increment is a function of the natural rate of growth and the balance of migration into and out of the country. The balance of migration is that of bedouins wandering between the Iraqi, Saudi Arabian and Kuwaiti deserts, who have been naturalized. The annual natural rate of growth of the Kuwaiti portion averaged 4.3 percent between 1965 and 1972. This high natural rate of growth is demographically normal in situations where health services and public utilities have been very rapidly developed, making an immediate and strong impact on the mortality rate. For instance, foetal deaths per thousand live births decreased from a low 15 in 1965 to 13 in 1972. The mortality rate amongst the Kuwaitis dropped from 7.4 per thousand in 1965 to 6.9 per thousand in 1972. Another crucial factor in the demographic equation is fertility. In the early 1970s the average birth rate in the underdeveloped world as a whole is estimated at 38 per thousand[48]. This can be compared with the high birth rates of 54 per thousand in 1965 and 52 per thousand in 1972 in the case of Kuwait. In this case the level of development would seem to be neither a necessary nor sufficient condition for achieving low fertility. An inverse relation between the level of development (or an index of development such as the percapita income) and fertility is by no means close: nor is such a relation likely to be close in Kuwait in the near future.

Obviously, the prevailing high birth rates have unfavourable effects

on the age composition. P. Demeny[49], points to family planning and population education as powerful devices for achieving lower fertility. Features of the 'socio-economic fabric' need to be strengthened in rearranging the 'developmental priorities' to help in reducing fertility. He describes two broad approaches. Firstly, fertility choices can be indirectly influenced by affecting such factors as literacy, infant mortality, the status of women, and income distribution. The second approach aims to "eliminate or at least mitigate harmful costs borne and the benefits received by the people who make fertility decisions"[50]. However, one may argue that in Kuwait reduction of growth of a much needed labour factor is not really necessary.

Concerning the non-Kuwaiti portion, the annual average increase was 18.8 percent for the same period, principally through the continuous flow of immigrants. Those immigrants are by and large of working age. Accordingly, any discussion of the non-Kuwaiti portion's natural growth rates could be misleading.

2.8 The Potential Manpower Pool

In economic development it is important to determine the potential manpower pool. This necessitates breaking down the age and sex composition of the population. In 1970, the productive age group (15 to 64) was only 47.0 percent of the Kuwaiti population. The proportion of the productive age group is altered by including the non-Kuwaitis, who are mostly immigrants of the productive age. This brings the proportion up to 55.0 percent of the total population. The base of the population pyramid, which is composed of the non-active young (less than 15 years old) has been broadening. Whereas the non-active aged group (over 65 years of age) has remained stable between 1965 and 1970, the young population has increased from 38.0 percent to 43.2 percent of the total indigenous

Table 2.f.

Population by Age Group, Nationality and Sex, 1970

Age Groups	Kuwaitis			Non-Kuwaitis			Total		
	Males[3]	Females	Total	Males	Females	Total	Males	Females	Total
0-14	88,371	85,692	174,063	74,788	70,450	145,238	163,159	156,142	319,301
15-64	82,237	81,172	163,409	168,196	74,897	243,093	250,433	156,069	406,502
65 and over	4,871	4,989	9,860	1,278	1,528	2,806	6,149	6,517	12,666
Total[a]	175,479	171,853	347,332	244,262	146,875	391,137	419,741	318,728	738,609

Source: Computed from Statistical Abstract 1973, Section Two, p.26

a. 193 of population 'not-stated' under an age group, are excluded

population over the same period (see Table 2.f). This broad base of the population pyramid lays a heavy burden on the active population. Moreover, it reduces the potential manpower pool, but the future pool is increased.

This potential manpower pool is further drained. Amongst the Kuwaiti productive age group work is traditionally reserved to males. Thus of the Kuwaiti females in this group, only 2.4 percent were employed in 1970. As for the expatriate population, most of the males seek work on a temporary basis. Fearing the insecurity of jobs in Kuwait, they leave their families behind. Therefore, we find that the productive age group amongst them was broad, 62.2 percent of the total non-Kuwaiti population in 1970. Of this figure 69.2 percent were males. It is evident, therefore, that these factors unsettle the expatriate labour force and cause restlessness amongst them. This lowers their efficiency and creates a further drain on Kuwait's manpower structure, particularly since 74.6 percent of the 234,360 active labour force are transient immigrants.

From the manpower pool we must also subtract the student population. With the government's provision of free education and its rapid growth, roughly 31,500 (1972/73 estimates) of the productive age group were enrolled in government secondary schools, vocational and other institutions, the University of Kuwait (opened in 1966) and educational missions. Furthermore, a large number of the indigenous population are registered as 'not looking for work'. The majority of this group are females. Therefore, of the 406 thousand manpower pool, the labour force boiled down to 240 thousand, and the unemployment rate ran at 3.3 percent according to the 1970 census. However, unemployment amongst expatriates is lower than that amongst Kuwaitis, the expatriates being required to find work to qualify for permission to stay in the country. In other words, the labour

force, or manpower pool, runs short of one-third of the population.

2.9 Occupational Analysis

As for the sectoral dispersal of the labour force, about 30 percent were in the public sector, in 1970[51]. The distribution of the labour force in Kuwait by economic sectors is unique among developing countries. The services sector, broadly encompassing transport, commerce, administration, business, social, personal and household, and related activities is the leading sector in labour absorptive capacity. It employed close to two-thirds of the labour force in 1970. Only one-third was employed by industry and agriculture. The leading sector and the source of livelihood in Kuwait, oil, being highly capital intensive, provided for less than 2.5 percent of the labour force or 5,747 only (included in mining and quarrying). Table 2.g shows population by economic sectors. The services sector, is the largest single employer with 104,136, 47 percent of whom are Kuwaitis, largely employed in administration. The second largest employer is the construction sector with 33,013 employed. Here the intensity of non-Kuwaiti employment is very great, only 6 percent being Kuwaitis. Commerce, the third largest employer, is followed by manufacturing, transport, extractive industries, and agriculture and fishing.

In quantitative terms, a quarter of total jobs in Kuwait were held by Kuwaitis and three-quarters by non-Kuwaitis. The dependence of Kuwait on imported labour and the fact that non-Kuwaitis are required to find work, explains this disparity in the composition of the labour force. In qualitative terms, over 85 percent of professionals and technicians were non-Kuwaitis. At the same time, manual work is by and large catered for by expatriates, which the 'post-oil era Kuwaiti' was not prepared to do. In this sense, non-Kuwaitis occupy both ends of the skill spectrum[52].

Table 2.g.

Population[a] By Economic Activity And Nationality in 1970 Census

Sector	Kuwaitis	Non-Kuwaitis	Total
Agriculture, Hunting, & Fishing	802	3,258	4,060
Mining & Quarrying	1,675	5,496	7,171
Construction	2,188	31,484	33,672
Electricity, Gas & Water	2,133	5,119	7,252
Commerce	7,298	25,715	33,013
Transport	2,362	9,776	12,138
Services	36,826	67,310	104,136
Manufacturing	6,109	25,982	32,091
Others	247	580	827
Total	59,640	174,720	234,360

Source: Statistical Abstract, 1973, Table 21, pp.38-41.

a. Does not include population less than 12 years of age and those of the status "inactive"

Both Kuwaitis and non-Kuwaitis, being offered free education, a breakdown of literacy by nationality may be misleading. The development in educating the population has been marked. The government has recognised the importance of adult education and combating illiteracy in order to improve the quality of the work force. Between 1962/63 and 1972/73 expenditure on education quadrupled rising to KD 47 million. Women joining the eradication of illiteracy centres numbered 1,480 and men 5,073 in 1972/73; 3,038 women and 8,228 men joined adult education centres which offered intermediate secondary and commercial classes. These centres increased from 33 in 1965/66 to 81 in 1972/73. In all, education and eradication of illiteracy are expected to reduce the illiteracy rate considerably. At 35 percent, illiteracy in Kuwait is low by Middle-Eastern standards. However, these efforts have been insufficient to replace imported skills. Managerial and technical training remains virtually non-existent and the acquiring of these skills will involve a time lag[53]. Drastic changes in the attitude of Kuwaitis are required to stimulate the development of technical education. Non-Kuwaitis holding secondary certificates were more than quadruple (30,000) their Kuwaiti counterparts. The number of Kuwaitis holding university degrees more than tripled between 1965 and 1970, reaching 1,347. This, however, only represents one tenth of their non-Kuwaiti counterparts, of whom there are 13,023. Since technical training is particularly lacking in Kuwait, Kuwaitis are mainly employed in fields where neither operative skills, technical know-how nor expertise are needed. These fields are commerce, transport, and the police and fire brigade. The only professional occupations in which Kuwaitis dominated were the government executive officials and administrators.

In the public sector, the composition of the labour force is

distinctly different from other sectors. The Kuwaitis are well represented in this sector. In 1970 they accounted for about 50 percent of the 70,000 civil servants. In other words, 58 percent of the 59,640 Kuwaiti labour force were employed in the public sector. Any Kuwaiti is given priority for employment. In fact there is overstaffing in the public sector and this has created an imbalance between work volume and employment.

The shaky structure of administration, having little demarcations, has contributed to the chronic situation of disguised unemployment and underemployment. Many employees are involved in other private economic and social activities, and only sign in at their respective departments. The government is, therefore, providing a system of sinecures. A questionnaire run by Dr. Afifi amongst 400 administrators (in the administrative and quasi-private sectors) provided indicators of these difficiencies. The results indicate that administrative jobs involved no specific duties nor qualification requirements; there is no personnel training, nor evaluation of performance; and employment is on a nepotic basis[54].

Although the public sector is an extreme example of the prevailing traditional socio-political character of Kuwait, it is representative of labour power wastage and disguised unemployment. The discriminatory expansion of this sector has been a measure to absorb part of the inactive Kuwaiti labour force (140,000 persons) though employing them unproductively. In this sense, the public sector serves as the traditional sector in developing countries in terms of provision of employment. In 1972 90 thousand persons were employed in the public sector[55] to serve a population of 858 thousand. This compares with 110 thousand serving a population of close to 7 million in neighbouring Saudi Arabia (in 1966)[56]

With expatriates constituting 57 percent of the population, political and economic stability seems to be precariously balanced. Aside from the fact that expatriate labour earns more, on average, than they could have in their countries, they are generally unsettled and restless. A reason for this could be the discrimination they experience in welfare benefits, industry and the services sector, particularly the civil service[57]. Alternatively, since the indigenous population is broadly young, its future growth may keep up with the pace of that of the exogenous.

2.10 Summary and Conclusions

The role of the government is very important in the provision of welfare benefits, pumping purchasing power into the economy, and providing employment. The worst poverty is gradually being eradicated. But the wide income disparities still exist and result from the traditional socio-political structure, with a dominant merchant class. The government's uneven redistribution of wealth policies have increased these disparities. Oil, the source of this wealth, is being exhausted to build up an excess of surplus capital.

With high percapita income achieved, high levels of savings have been permitted. These savings could be mobilized to provide for domestic investment. Although investors may benefit from inflation, the risk involved is considerable. Therefore, in order to stimulate investment in industrial enterprise, inflation must be controlled. This may be achieved through fiscal, monetary and structural measures. National credit, capital markets[58] and the propensity to invest could well be stimulated. Part of the capital surplus can, therefore, be used to support the diversification of the economy. ((By striking some degree of balance among factors and sectors of the economy, growth could be sustained after the ultimate depletion of oil reserves. Reduction in exorbitant government spending,

the development of an effective taxation system, and lending to the government (through the issue of government bonds, etcetera) could help to absorb the inflationary pressure.

On the supply side, the economy's productive capacity could be expanded by exploiting growth potentials. Surplus capital could be used to develop such lagging factors as manpower. Although due attention is being paid to social overhead capital, as a generator of external economies, the human factor remains grossly underutilized. Only one-third of the population was active in 1970, and efficiency, as the public sector indicates, is low. The quality of the labour force being deficient, requires time to develop. Of more immediate concern is the utilization of potential manpower, and the absorption of underemployed labour. This necessitates increasing mobility between sectors up to levels allowed by bottleneck factors. In addition, labour supply could be facilitated by immigration and secured through integration into society. The Arabs of different nationalities, representing 42 percent of the population, can be relatively easily integrated due to communal religious beliefs and language, and to similarities of tradition. Alternatively, if diversification is not pursued reliance on imported labour and its resultant problems would be less.

Since aggregate supply is lagging far behind aggregate demand, the openness of the economic system is necessary. The favourable balance of payments situation gives the government's free trade policies its raison d'etre.

Export revenue stability of oil is an important issue for an economy which is specialized in its production. This vulnerability and concentration of trade are discussed in chapter 3, together with the openness of the economy and dependence on foreign trade.

1. For the distinction between growth and development, see H. Chenery, "Targets for Development", in The Widening Gap, edited by B. Ward, J. D. Runnalls, and L. D'Anjou, (New York: Columbia University Press, 1971) pp. 27-29.

2. El-Mallakh, R., "The Absorptive Capacity of the Arab World and Investment Policies", Seminar on Investment Policies of Arab Oil Producing Countries, 18-20 February 1974; further references Seminar on Investment, (Kuwait: Mimeograph. The Arab Planning Institute and Kuwait Economic Society, 1974) p.3 of article.

3. Proven oil reserves in Kuwait stood at 73 billion barrels in 1973, about 21 percent of Middle East total reserves. Oil and Gas Journal cited in Quarterly Economic Review Special No. 18, Oil Production, Revenues and Economic Development Prospects for Iraq, Iran, Saudi Arabia, Kuwait, United Arab Emirates, Oman, Qatar, and Bahrain, by K. McLachlan and NasriGhorban (London: The Economist Intelligence Unit Limited, 1974) table 2, p.9.

4. El-Mallakh, R., Economic Development and Regional Cooperation: Kuwait, (Chicago: The University of Chicago Press, 1969) p.97.

5. Ibid, p.97.

6. Ibid, p.100.

7. Khoja, M.W., "Al-Khasaes Al Moumayezah Lil Iktisad Al Kuwaiti" (The Main Characteristics of the Kuwaiti Economy); (Kuwait: mimeographed paper, Kuwait Economic Society, March 1974) p.16.

8. In 1971/72, the oil sector produced 64 percent of the gross Domestic Product.

9. This is referred to in Chapter Four.

10. The third factor of production, land, being largely arid is, therefore, not given much attention.

11. Dr. Khoja's op. cit., estimates are for the period 1962/63-1969/70, p.11.

12. Planned expenditure in the 1974/75 budget will not be discussed here, since it was formulated before the October 1973 price increases and is only provisional.

13. Majalat Ghorfat Tijart Wa Sina't Al Kuwait (Kuwait Chamber of Cemmerce and Industry Magazine); further references Kuwait Chamber of Commerce and Industry Magazine (in Arabic), Vol. XVI,No. 144, 1975, p.7.

14. The commercial law stipulates that the minimum Kuwaiti capital in any company is 51 percent. As for Joint-Stock companies, the law stipulates that stockholders should be Kuwaiti nationals.

15. In March 1975, the government announced the take-over of the remaining 40 percent foreign shares in KOC. See Kuwait Chamber of Commerce and Industry Magazine (in Arabic), Vol. XVI, No. 146, 1975, p.48.

16. Domestic income, excluding returns on external investments.

17. The establishments with independent budgetary institutions are: Kuwaiti Fund for Arab Economic Development; Credit and Savings Bank; Kuwait Airways; Central Bank of Kuwait; Shu'aiba Industrial Board; General Board of the

CHAPTER 3

Foreign Trade Dependence

This chapter reviews the foreign trade dependence of Kuwait. The trends and composition of foreign trade are exempli gratia of the economy's levels of growth and degree of imbalance. Section 1 provides a brief introduction to trade dependence. Sections 2, 3, and 4 discuss export instability, commodity concentration, and geographic concentration respectively. Their interrelationship is dealt with immediately after. Section 5 is concerned with the terms of trade; whilst section 6 deals with the import trade and import demand. The final section, 7, looks at stabilization policies and provides the conclusions to the chapter.

3.1 Introduction

We have seen in chapter 2 that the favourable balance of payments allows Kuwait to operate a free trade policy. Further, that this is necessary as aggregate supply lags far behind aggregate demand. Kuwait is largely dependent on trade for a number of reasons. Firstly, the good geographic location is enhanced by sea and airport facilities. Secondly, Kuwait is endowed with a favourable raw material and has a marked comparative advantage in it. Thirdly, the high levels of per capita output and consumption, and the growing size of the domestic market have necessitated the importation of commodities otherwise unavailable. This has been facilitated by the export of petroleum, which provides foreign exchange earnings necessary to finance imports. In the previous chapter the overspecialization in the production and trade of one primary product was noted to have created structural and factoral imbalances. Furthermore, it has also accentuated the degree of dependence on foreign trade.

Kuwait's wealth and small size may have some association with the dependence on foreign trade as a source of income. The wealth of Kuwait

is largely derived from the export of oil. In 1971/72 the foreign trade ratio, that is, the imports plus exports relation to income and imports, was 74.4 percent. The foreign trade ratio averaged 83.1 percent (taking the arithmetic mean over the period 1962/63 to 1971/72). This ratio compares with the 78 percent for Saudi Arabia (1969); 52 percent for Iraq (1969); 42 percent for Venezuela (1969)[1], and 8 percent for the U.S.A. (1969)[2].

Another factor illustrating the high trade dependence is the average propensity to import[3]. This has been estimated by Lloyd, for fifteen small countries, to range between 18 percent and 67 percent. By comparison, that of large developed countries was relatively low[4]. For Kuwait, the average propensity to import stood at 29.4 percent (weighted) between 1968/69 and 1971/72. The high average propensity to import would, therefore, seem to be a general characteristic of smallness. However, the average propensity to import of Kuwait in relation to the foreign trade ratio appear to be low, since the economy consistently maintains annual export surpluses.

This heavy foreign trade dependence and the large proportion of national income earned from exports corroborates Kuznets' broad generalization that, "foreign trade is of greater weight in the economic activity of small nations that have developed high levels of per capita output and consumption. The weight of exports (and correspondingly generated imports) in relation to total activity is likely to be greater in small than in equally underdeveloped but large countries."[5] In 1971/72 exports amounted to KD 983 million of which only KD 52 million were non-oil exports mainly in the form of re-exports. The proportion of these exports to GDP represented a high 69.4 percent, which is suspected to play a role in generating instability in the economy. It underlines Kuwait's vulnerability to export fluctuations. Other factors, however, affect the degree

of vulnerability in various ways. The foreign trade dependence, in addition to the high negative invisible transactions, with the rest of the world (see Table 2.a.) do not only demonstrate Kuwait's limited productive capacity. They also demonstrate the high degree of openness of the economy. Lack of economic diversification makes Kuwait heavily dependent on imports. Financed as it is by overspecialization in one material export, Kuwait's export stability, trade concentration and terms of trade are key issues.

3.2 Export Instability

MacBean, studied the instability generating effect of exports in relation to government expenditure or investment[6]. He measured the exports as a percentage of investment and government expenditure respectively and together of 64 countries (in 1958-59). He separated them into large and small countries (population $\gtrless$ 10 million) and subdivided them into developed and underdeveloped. He found that the role of exports is more important relative to investment and government expenditure in small countries than in large countries. The level of development was less important[7]. His average estimates for small countries closely associate with those of Kuwait as shown in Table 3.a. It emerges then, that the greater weight of exports in small countries can be expected to expose them to fluctuations in the international commodity markets. By contrast government expenditure and investment are generally regarded as more liable to national control[8].

It is clear that fluctuations in income have been similar to fluctuations in export receipts. The direction and consistency of timing of changes in GNP and exports are typical of a country with a very high ratio of trade to GNP. Hence, Kuwait is likely to be sensitive to short run changes in export receipts[9]. However, the country is fortunate in possessing an

South and the Arabian Gulf; Kuwait University (Higher Education); Kuwait Institute for Economic and Social Planning.

18. Expenditure on social services is estimated by Kuwait Chamber of Commerce and Industry at 34 percent and 33.8 percent of current expenditure in 1973/74 and 1974/75, respectively. See Kuwait Chamber of Commerce and Industry Magazine (in Arabic), Vol XV, No. 140, 1974, p.32.

19. Ibid, p.33.

20. Kuwait Chamber of Commerce and Industry Magazine (in Arabic) reports that the government approved food price subsidies are expected to run at KD 50 million in 1975, as opposed to KD 30 million in the preceeding year. See Kuwait Chamber of Commerce and Industry Magazine (in Arabic). Vol. XVI, No. 144, 1975, p.40.

21. Other expenditure included in the 'unclassified and transfer' item are maintenance of a foreign service, membership of international institutions, and foreign aid.

22. Quarterly Economic Review, The Arabian Peninsula: Shaikhdoms and Republics No. 1 - 1974 (London: The Economist Intelligence Unit, 1974) p.8.

23. Shehab, estimated selling surplus land to the public at 4 percent of its cost to the Treasury, between 1957 and 1962. This stood at 6 percent in 1973/74. See Shehab, F., "Kuwait: A Super-Affluent Society", Foreign Affairs, Vol. 42, No. 3, 1964, p.469.

24. Shiber, S. G., The Kuwait Urbanization (Kuwait: Kuwait Government Printing Press, 1964) p.368.

25. Shehab, F., op. cit., p.469.

26. The International Bank for Reconstruction and Development in 1965 had warned the government against the continuation of the land purchase scheme. See IBRD Mission's Report, The Economic Development of Kuwait (Baltimore: The Johns Hopkins Press, 1965) p.90.

27. This sum was about 70 percent of total banking credit.

28. Quarterly Economic Review reports that an allocation of KD 422 million was voted by the national assembly in 1973 for the purchase of military equipment over the next seven years. Quarterly Economic Review, op. cit., p.9.

29. The Arab Economist, Supplement Kuwait, No. 64, May 1974, p.28.

30. P. Samuelson explains that in order to achieve a greater multiplier, the greater the extra consumption responding is. Conversely, "the greater the marginal propensity to save 'leakage' into extra saving at each round of spending, the smaller the final multiplier". Samuelson, P., Economics, (New York: McGraw Hill Book Company, 1970) p.217.

31. Dr. Khoja, op. cit., has used the data which were available only for the period 1962/63 to 1969/70. For the following variables, to determine the national income multiplier: marginal propensities to consumption, importation, and investment. pp. 8-14.

32. Mabro, R. E., "Problems of Investment", Seminar on Investment, p.7 of article.

33. Quarterly Economic Review, Special No. 18, op. cit., p.45.

34. Bank Al Kuwait Al Markazi (Central Bank of Kuwait), Al Takrir Al Sanawi Al-Thaleth 1972 (Third Annual Report, 1972) Further references, Central Bank of Kuwait Report 1972 (Arabic), pp. 179f.

35. Mabro, R. E., op. cit., p.2 of article.

36. Ibid, p.10 of article.

37. Ibid, p.11 of article.

38. Quarterly Economic Review Special No. 18, p.46.

39. Bharier, J., "The Kuwaiti Dinar" International Currency Review, September/October 1970, p.4.

40. The Arab Economist, Op. cit., p.38.

41. Saba, E., "The Role of Arab Funds in the Money and Capital Markets of the World", Seminar on Investment, op. cit., p.12.

42. Bharier, op. cit., pp. 4f.

43. El-Mallakh, R., Seminar on Investment, op. cit., pp. 11-12 of article.

44. Mabro, R. E., Seminar on Investment, op. cit., p.9 of article.

45. Hill, A., "The Population of Kuwait", Geography, January 1969, p.88.

46. Kuwait has carried out four censuses, on a defacto basis: 1957, 1961, 1965 and 1970. The next will be in 1975 and after that at 5 year intervals.

47. It is hard to differentiate between Jordanians and Palestinians, because most Palestinians in Kuwait have lived or previously held Jordanian passports.

48. Demeny, P., "The Populations of the Underdeveloped Countries", Scientific American, Vol. 231, No. 3, 1974, p.155.

49. Ibid, p. 159.

50. Ibid, p. 159.

51. If workers on a daily basis who are mainly employed in the public construction are included, the public sector will be inflated to more than 40 percent of the labour force.

Table 3.a.

Average Ratios of Exports to Investment and Government Expenditure[a]

Country	$\frac{X}{I}$	$\frac{X}{G}$	$\frac{X}{I+G}$
Large Countries (over 10 million population)			
Developed	97.4	152.5	58.4
Underdeveloped	97.3	134.0	49.1
Small Countries ($<$10 million population)			
Developed	142.5	211.5	98.0
Underdeveloped	185.0	251.0	105.5
Kuwait	664.2	302.5	207.8

Source: MacBean, A., Export Instability and Economic Development, (London: Allen & Unwin, 1966) Table 3:1, pp. 60-61; Statistical Abstract 1973, Table 183 p. 211.

[a] The estimates are for 1971/72 in Kuwait; and 1958-9 averages for the rest (estimates are for 64 countries from U.N., 1961).

export whose opportunity costs are much lower than those in other developing countries. The following investigates the causes and extent of any export instability.

The export instability index ("I-I") is defined by Coppock[10] as the year-to-year changes in export earnings from the sale of goods and services corrected for trend (signs ignored). The trend line, assuming a linear time trend, is the logarithmic least-squares line through the series. The short-run index of Kuwaiti exports over the period 1962/63 to 1971/72 was a low 10.9. This compares with Coppock's mean for eight Middle Eastern countries (1946 to 1962) of 24.3 as compared with MacBean's 23.1 for forty-five underdeveloped countries and with 17.6 for eighteen developed countries[11]. This suggests that Kuwait's index not only compares favourably with that of developed countries but that there is a considerably lower export instability than in most countries.

Kuwait's relatively stable export earnings are not explained by the level of development per se. The international oil companies' pricing and marketing policies have greatly aided this stability[12]. With the notable exception of times of serious political trouble, the growth rate of exports around the trend line has been large enough to make the instability of this trend seem largely unimportant (see Table 3.b). For instance, the exclusion of the year 1967/68, that is, after the 1967 Middle East war, lowers the index of instability, for 1962/63 to 1971/72, to around 8.

Moreover, if "I-I" of exports is broken into "I-I" of prices and export volume, an interesting trend is revealed in the latter part of the "I-I" series. Between 1968/69 and 1971/72 prices show an "I-I" volume of 14.0 and an export volume "I-I" of 2.0. In other words, 87.3 percent and 12.7 percent of the instability of export earnings could be accounted for by export prices and export volume, respectively. This might be a

Table 3.b.

Exports, Growth of Exports, Imports, and GNP of Kuwait, 1962/63 to 1971/72 (In Million KD)

Year	Exports	Growth of Exports	Imports	GNP
1962/63	422		102	433
1963/64	436	+14	133	500
1964/65	471	+35	132	542
1965/66	493	+22	164	591
1966/67	510	+17	186	682
1967/68	513	+ 3	219	734
1968/69	587	+74	248	793
1969/70	628	+41	286	840
1970/71	706	+78	273	909
1971/72	983	+277	278	1151

Source: Statistical Abstract, 1968, Table 84 p.117; Statistical Abstract, 1973, Table 138, p.211; Central Bank of Kuwait, Annual Report, 1971, Table 31, p.63; Annual Report, 1972, Table 13, 15, pp.40 and 52; Sivasubramonian, S., Ali, A. M., National Accounts of Kuwait 1965/66 to 1967/68, (Kuwait: Kuwait Institute of Economic and Social Planning in the Middle East, 1968)p.46.

Note: Figures are rounded-off.

consequence of the increasing role and the firmer measures taken by the Organization of Oil Producing Countries (OPEC) during this period. The role of OPEC, which seeks to expand the oil export earnings of her members, and the gains and losses of Kuwait from international trade are discussed in section 5. The implications and effects on Kuwait's stability of specializing in primary exports and the degree of diversification of markets, are discussed first.

3.3 Commodity Concentration of Export Trade

Since Kuwait's export earnings are relatively stable, the general hypothesis tested here is not the instability generating effect of trade concentration, but the possibility of such an effect. In the subsequent exposition the Gini 'coefficient of concentration' is employed to analyse the foreign trade network. This method measures the geographic as well as the commodity concentration of exports and imports. It reveals the degree of dependence upon one or more commodities and customers. It also reflects the degree to which the economy is vulnerable. For the exports the coefficient of concentration is

$$100 \sqrt{\sum_{1}^{n} \left(\frac{x_i}{X} \right)^2}$$

where n is the number of export goods, X is the annual value of total exports, and x_i is the annual value of good i; the same applies to imports[13]. In the case of geographic concentration x_i is the annual value of goods exported to country i and n is the number of countries. The coefficient of commodity concentration yields an index of 100 for complete concentration and 10 for a complete dispersion. This range is possible when foreign trade is classified into ten sections, each of which is further subdivided into ten sections, whereby n = 100. Where the coefficient of concentration is higher than 40 the trade of a country is said to be highly concentrated[14].

Oil exports averaged 97 percent of total exports between 1962/63 and 1969/70. This is a distinctive characteristic of exports of the extractive industry and agricultural sector of developing countries[15]. Oil export dominance was cut by 2 to 3 percent in 1970/71 and 1971/72 with the share of non-oil exports rising to 5.5 percent of total exports. The non-oil export and re-export sector of Kuwait has been rapidly increasing in value. In 1971 an increase of 30.4 percent over the previous year was recorded. In 1972 this increase was 44.2 percent[16]. Despite this fact the commodity exports, as classified by the Foreign Trade Statistics of Kuwait, were almost perfectly concentrated at 95.0 percent in 1972. It should be noted that the commodity concentration of non-oil exports of local products was also high at 67.5. Two-thirds of these exports consisted of oil-based products. These were fertilizers, urea, and ammonium sulphate, which had almost doubled over the previous year. Non-oil exports consisted of iron and steel tubes, pipes and fittings (9 percent) and asbestos sheets and pipes (5.4 percent). Other important exports, which are rising, but slowly, are shrimps and fish, prefabricated houses, and wheat flour as shown in Table 3.c. It is generally assumed that a country with a high degree of specialization in the export of primary products, will be vulnerable to variations in demand in her consumer or major markets. However, it is evident that in the short-run Kuwait's specialization has contributed to the stability of earnings because of the favourable nature of the country's exports. Nonetheless, Kuwait is still dependent upon a depleting resource and limited economic activity.

3.4 Geographic Concentration of Export Trade

This section is concerned with the extent of the geographic concentration of Kuwait's exports, and the probability of its instability generating effect on the economy. The relationship between Kuwait's

Table 3.c.

Kuwait Exports of Locally Produced Commodities 1972 (In Million K.D.)

Commodity	Value	Percentage of Total
Fertilizers	10.924	66.5
Of which Urea	9.852	60.0
" " Ammonium Sulphate	1.072	6.5
Iron and Steel Tubes Pipes & Fittings	1.474	9.0
Asbestos Sheets & Pipes	0.885	5.4
Shrimps & Fish	0.496	3.0
Prefabricated Buildings of Wood	0.416	2.5
Wheat Flour	0.223	1.4
Other	2.012	12.2
Total	16.430	100.0

Source: Central Office of Statistics, The Planning Board, Yearly Bulletin of Foreign Trade Statistics 1972 Vol. 2 (Kuwait: Government Printing Press 1973), pp. 651-55

favourable geographic location and the market concentration of exports is also discussed. Kuwait's major crude oil customers in 1972 were Japan; the U.K.; Holland, and Italy, as shown in Table 3.d. The index of oil exports market at 34.0 is relatively highly concentrated. Kuwait, also exports processed natural gas, LPG, to Japan. The utilization of this resource is dealt with in chapter 5. The insufficient refining capacity of the developing nations make them Kuwait's main refined oil customers. These account for 32.2 percent of total refined exported products. Japan, again, is a major customer taking 29.5 percent of refined exports. Developed countries, mainly in Western Europe, import 16.1 percent of these products (see Table 3.d.). This accounts for the high index of market concentration of refined oil (40.9). Less than half of the refined oil exports go to developed countries (about 45.6 percent, including Japan). By contrast, over 84 percent of Kuwait's crude oil finds its market in these countries. Western Europe, Kuwait's main customer buys 12 percent of total oil imports from Kuwait[17]. The oligopoly of international oil companies[18] limits the opportunities of refining for the less developed countries. This has reinforced the tendency for industrial countries to rely heavily on the less developed countries for natural raw materials[19].

The refining capacity of Western Europe is in excess of consumption needs, which stands at 719 million long tons a year. This trend was initiated after the Second World War, and became more established in the 1960s. The location of refining in oil-consuming rather than oil-producing countries, is a feature of the industry in the Middle East. It is facilitated by the lack of any law binding foreign oil companies to refine a proportion of production in the country of origin[20]. The refining capacity in the Middle East stood at 53.4 percent of total

Table 3.d.

Destination of Exports of Crude and Refined Oil Produced by Kuwait, 1972

	Crude	Refined
Exports in Thousands of Barrels	1,065,819	145,972
Destination	%	%
Western Europe	57.2	10.1
United Kingdom	16.8	5.5
France	11.7	0.2
Italy	9.4	0.1
Holland	10.3	1.3
Ireland	4.6	-
Other	4.4	3.0
Asia	35.5	52.3
Japan	21.3	29.5
Singapore	5.5	1.5
South Korea	4.0	1.8
India	-	7.4
Other	4.7	12.1
North & South America	3.6	4.8
Oceanic Countries	2.7	5.4
Bunkers	-	22.2
Others	1.0	5.2
Total	100.0	100.0

Source: Central Office of Statistics. The Planning Board, Statistical Abstract 1973 (Kuwait: Government Printing Press, 1973) pp. 166-188

Note: The percentage of Refined to Crude is 13.7%

production in 1950, declined to 22.7 percent in 1965, and to 18.4 percent in 1969. In Kuwait the 1969 capacity stood at 11.3 percent (see Table 3.e) and over the period 1967 to 1972 averaged 12.1 percent. For a consuming country local refineries can have balance of payments benefits, create new employment and training opportunities, encourage industrial development and "let it be said, were thought to confer status"[21]. The same could be said for the producing country. Therefore, reversing this trend in the Middle East, as Mr. Lutfi, ex-Secretary General of OPEC argues, or at least the "maintenance of a fair share of refining capacity within the area" is desirable[22]. This is so in the case of Kuwait. The ratio of Kuwait's refining capacity to total production, as cited above, is lagging far behind that of some other Middle Eastern countries. In 1971/72 close to 1 percent of Kuwait's total imports[23] were petroleum products. Kuwait still uses a quarter of the refining capacity for ship's bunker fuel oil. The industrialized countries' refineries are, by contrast, expanding their enterprise to use oil as feedstocks for chemical plants, for example Naptha. "Refineries are now frequently the heart of petro-chemical complexes: in some cases major chemical companies are the investors. This type of development seems to be only at its beginning"[24].

Refined oil in the case of Kuwait is an export market commodity since total output exceeds total domestic demand. Thus despite being an important and profitable commodity, in terms of self-sufficiency alone it is uneconomic. The Shu'aiba refinery[25], opened in 1968, aimed to serve the export market. In increasing the refining capacity Kuwait has to expand the range of alternative markets. The Kuwait National Petroleum Company (KNPC) might provide an "instrument for getting into world markets"[26]. The Kuwait Oil Company (KOC) exported 93 percent of total crude oil exportation in 1972. The prospect of increasing the refining capacity

Table 3.e.

Production of Refined Oil and Crude Oil in Kuwait in Millions of Barrels per Year and Shares of Companies 1967-72

Year	Shares of Companies	Refined Oil	Crude Oil	Percent of Crude to Refined
1967	KOC	84.07	836.72	
	KNPC	-	-	
	AMINOIL	21.22	24.77	
	A.O.C.	-	50.60	
	Total	105.29	912.09	11.54
1968	KOC	92.70	886.13	
	KNPC	9.24	-	
	AMINOIL	15.30	15.26	
	AOC	-	54.75	
	Total	117.24	956.14	12.26
1969	KOC	78.44	940.04	
	KNPC	23.00	-	
	AMINOIL	12.59	12.89	
	AOC	-	58.84	
	Total	114.03	1,011.77	11.27
1970	KOC	86.45	998.11	
	KNPC	33.20	-	
	AMINOIL	28.27	29.86	
	AOC	-	62.64	
	Total	147.92	1,090.61	13.56
1971	KOC	81.86	1,067.80	
	KNPC	37.11	-	
	AMINOIL	31.31	33.27	
	AOC	-	65.30	
	Total	150.28	1,166.37	12.88
1972	KOC	65.73	1,097.72	
	KNPC	40.85	-	
	AMINOIL	27.91	28.89	
	AOC	-	74.99	
	Total	134.49	1,201.60	11.19
Mean				12.11

Source: General Oil Affairs, Ministry of Finance Oil, The Oil of Kuwait, Facts and Figures (Kuwait: Government Printing Press 1970) pp. 16-76; Statistical Abstract 1973, op cit. pp. 162-189

Abbreviations:		
	KOC	Kuwait Oil Company Limited
	KNPC	Kuwait National Petroleum Company
	AMINOIL	American Independent Oil Company
	AOC	Arabian Oil Company Limited

will, therefore, be nearer to realization after the nationalization of that company in 1975.

The index of Kuwait's non-oil exports of local products by destination is not highly concentrated (31.4 in 1972). This trade is remarkable, however, for the fact that it is conducted almost exclusively with developing countries. These are mainly India, China, Saudi Arabia, Sudan, and Pakistan as shown in Table 3.f.

Kuwait's expanding role in the entrepot trade is facilitated by liberal political and commercial policies. This allows the country to operate a free market[27]. Kuwait's immediate neighbours, Iran, Saudi Arabia, Bahrain, Qatar, and the U.A.E. benefit from these policies. Their booming economies have led to supply bottlenecks. They, therefore, rely on Kuwait to handle part of their imports. With two-thirds of Kuwait's re-exports going to these countries, Kuwait's geographic concentration was relatively high at 37.5 in 1972 (see Table 3.f.). This is a consequence of the rising demand for imports by Kuwait's neighbours. It is anticipated that this geographic concentration of re-exports will increase, at least until Kuwait's neighbours become capable of handling their own imports. The remainder of Kuwait's re-exports go to other Arab countries, the U.K. and the Indian subcontinent. These re-exports consist mainly of foodstuffs, tobacco, electronic equipment, spare-parts and machinery in addition to some consumer durables.

The geographic location of a country in relation to the centres of world trade is thought to affect international demand for the country's exports. This is apart from situations in which spheres of political influence may be involved. Leaving aside the role of Kuwait in the entrepot trade of the Gulf, can such a case be made out for Kuwait? A comparison of Kuwait with a sample of Gulf neighbours, Abu-Dhabi, Iraq,

Table 3.f.

Geographical Distribution of Kuwaiti Non-Oil Exports to Major Customers, 1972 (In Million K.D.)

Country	Re-exports[b]	Exports of Local Produce	Total Exports and Re-Exports
Saudi Arabia	10.256	1.997	12.253
U.A.E.	3.452	0.381	3.833
Iran	3.236	0.509	3.745
U.K.	3.716	negligible	3.716
India	0.387	2.836	3.223
Iraq	2.053	0.677	2.730
Lebanon	2.187	0.371	2.558
Sudan	0.405	1.966	2.371
China	0.013	2.343	2.356
Pakistan	0.375	1.783	2.158
Qatar	1.488	0.109	1.597
Bahrain	0.951	0.384	1.335
Tanzania	negligible	0.526	0.526
Others[a]	4.647	2.548	7.195
Total	33.166	16.430	49.596

Source: Derived by author from Central Office of Statistics, The Planning Board, Yearly Bulletin of Foreign Trade Statistics, 1972 Vols. 1 and 2 (Kuwait: Government Printing Press, 1973), pp. 1-729

a. Include goods of unknown origin, and ships' supply

b. IBRD Report estimates the declared export figures to be as much as 40% lower than the actual value of exports. IBRD op. cit. p.83. The unregistered re-exports are either carried out of the country by travelling visitors, or are smuggled to nearby Iraq and Iran as a result of the prevailing price differentials and protectionist policies in these countries.

Note: Figures are rounded off

and Saudi Arabia, shows slight variations in the degree of geographic concentration of their exports. These indices are highly concentrated in the case of Abu Dhabi (41.9) and Saudi Arabia (39.5), and relatively highly concentrated in the case of Iraq (31.7) and Kuwait (34.0)[28]. All these countries have one major customer. In the case of Saudi Arabia, Abu Dhabi and Kuwait this is Japan. For Iraq it is Italy. With the exception of Iraq, it could be maintained that Japan is not only attracted by these countries' proximity to herself. Japan is also attracted by their proximity to each other. The association, however, is blurred by the fact that Japan is the largest single net importer of oil in the world.

Finally, the degree of market concentration of a country's export trade may be misleading if the approximate ratio of largest export market to GDP is not considered. Table 3.g shows the ratio of exports, X , to GDP and the share of the largest market in total exportation.for four small Middle Eastern countries (Coppock's estimates) as compared to Kuwait. The export trade of these countries varies greatly as a ratio of gross domestic product. Three of these countries derive more than 10 percent of GDP from a single market. This indicates either a very high ratio of X/GDP (Saudi Arabia, Iraq, and Kuwait) or a relatively high geographic concentration (Iraq and Kuwait). In the case of Jordan, although she has a high geographic concentration in one market, the instability generating effect (if any) is dampened by the low share of exports to GDP. In the case of Kuwait, the ratio of her major market to GDP is the highest amongst the sample. This may increase the vulnerability of the economy to the hazards of market concentration.

A relatively high market concentration means that fluctuations in demand from one consuming country cannot be offset by counter fluctuations

Table 3.g.

Approximate Ratio of Largest Export Market to Gross Domestic Product

Country[a]	Ratio of Commodity Exports to GDP (X/GDP) (1)	Share of Largest Market in Total Exports (2)	Largest Market	Ratio of Largest Market in GDP (1)x(2)
Saudi Arabia	75.2%	19.0%	Bahrain	14.3
Lebanon	8.1%	14.4%	Syria	1.2
Jordan	15.7%	29.8%	"	4.7
Iraq	51.8%	22.5%	France	11.7
Kuwait	69.4%	21.3%[b]	Japan	14.8

Source: Table 3.d; Statistical Abstract 1973, Table 138, p.211; J. Coppock, Foreign Trade of the Middle East: Instability & Growth, 1946-1962 (Beirut: American University of Beirut, 1966), Table 11-4 pp. 214-219.

[a] Coppock's figures are the average ratios over the period 1946-1962 for Lebanon, Jordan, & Iraq. Figures for Saudi Arabia are for 1958 only. Figures for Kuwait are for 1971/72.

[b] This figure is for crude oil exports only. However, with the refined oil exports to Japan, it very clausely reflects the share of largest market in total exports, since the values of oil exports are not published.

in another. However, the importance of oil in world trade may have contributed to the export stability of Kuwait. This is likely to continue as long as the imports of her customers are stable. Until the nationalization of KOC, the international oil companies' marketing and pricing policies did much to stabilize export earnings, as pointed out above. It is to be expected that the State will develop these policies in order to avoid vulnerability to market concentration. In addition, diversification of product and increasing the refining capacity will help to steady future oil prices.

In conclusion, Kuwait, though having only a very small share of world trade, is a major exporter of one commodity. Moreover, in this commodity the country has a disproportionately important weight compared with other traded goods[29]. Kuwait is fortunate in that demand for oil and petroleum products has been relatively inelastic with respect to price. Although prices of oil have increased drastically in the 1970s, the average rate of world demand for oil is projected to continue to increase at 7.6 percent annually between 1973 and 1978[30]. The actual rate of increase in world demand in 1972 was 8 percent[31]. In this particular period, it seems safe to assume an association between the low elasticity of international demand for Kuwait's exports with a high degree of commodity concentration of exports. However, in the event of a world recession, the international demand for oil exports is likely to fall.

Kuwait's export trade among developing nations, small and large, is unique. A casual link exists between the country's export earnings and specialization in a commodity which is enormously important in world trade. That is, it is a function of the more favourable nature of Kuwait's primary product export compared with those of other developing countries. In the short-run, the high commodity and market concentration of Kuwait's exports

have had a stabilizing effect on the domestic economy. Under the auspices of OPEC, this may continue in the short-run since the relative change in fuel prices favour oil. This is possible if political stability increases and there are improvements in production and marketing. Fluctuations resulting from political instability, slump in demand for oil, and price cuts could be dealt with in the short term by utilizing the accumulated reserves. In the long term, however, there are dangers of a possible permanent shift to other fuel sources. This exposes Kuwait's high export trade concentration to considerable vulnerability. Here, the arguement for the diversification of the economy, particularly of the oil industry comes to the fore. This will be discussed in chapter 5. Our present concern is the extent to which the nature of Kuwait's raw material export protects the economy from the instability generating effect of commodity and market concentration. This requires studying the terms of trade.

3.5 Terms of Trade

The issue of 'fairness' in the distribution of income between raw material producing countries and industrialized countries has given rise to debate for some time. So far such debate has proved inconclusive and it seems likely to continue. Raul Prebisch, a one time Secretary General of the UNCTAD, has argued the case for the raw material producing countries, noting the deteriorating terms of trade between them and the rich industrialized countries[32]. Prebisch, believes that the downward trend in the terms of trade is the result of persistent differences in monoply power over the prices at which the two groups sell. This power is greater in manufactures than in primary products.

In one of the major raw materials internationally traded, petroleum, the picture may differ. Crude oil producing countries might be in a better position than other underdeveloped countries. The establishment

of OPEC, of which Kuwait is a founding member, in 1960, was "influenced by the growing dissatisfaction of host countries with the 50-50 profit sharing system"[33]. This system was originally formed in the Middle East in the 1950s. It was based on the posted price, an arbitrary technique[34] to impute the taxable income of concessionaries. Since its establishment OPEC's activities have supported the allegedly favourable position of crude oil producing countries.

In 1964[35], the collective bargaining of OPEC came to fruition. The organization saw that any reduction in the growth of oil supplies could be more than compensated for by increased per barrel take. That is because the organization assumes in its production programme a "general low over-all elasticity of demand in major consuming areas"[36]. Therefore, consumption may be correlated with income, and the incidence of any price increases would fall upon the consumer. It follows that these increases would lower the consumers' benefits accruing from their surplus and raise producers' benefits. Since increased oil production depletes this non-renewable asset[37], oil revenues ought to be maximised whilst reserves last. To do this, the transfer of 'decision-making' on price from the international companies to producing countries has been the objective of OPEC. Kindleberger, claims that OPEC "maintains crude petroleum prices well above long-run marginal costs to which it would fall under competitive conditions and as it is likely to do so, new entrants outside the 'cartel' come into production"[38].

We have seen that the rates of growth of GNP and that of foreign trade are interdependent. Therefore, changes in the magnitude and direction of the terms of trade for Kuwait serve as rough indicators of development. Obviously, for a country where 95 percent of total exports, national income, public finance and balance of payments are derived from oil resources,

discussing the terms at which oil is traded internationally will suffice. In this section the estimates of changes in the income terms of trade, I, of Kuwait for the years 1962 to 1973 are discussed and compared to estimates of changes in the net terms of trade, N. The income terms of trade are measured by the export quantities and export-import price relationship. The net barter terms of trade, N, are measured by the relative export-import prices. In the final part, an adjustment of I is made for changes in population.

It is important to point out that the net barter terms of trade imply that a country's loss may be another's gain. The income terms of trade do not do this. In principle, an index of the terms of trade could be rising for every country, at different rates, if there is sufficient bouyancy in world trade. This point is stressed by Wilson et. al[39]. It is necessary, however, to take account of changes arising in the cost of freight and insurance (as reflected in c.i.f. indices) or any "adjustment to a factoral basis" etc.[40] The net barter terms of trade N is: P_x/P_m, where P_x is the price of exports and P_m is the price of imports; the income terms of trade, I, is $P_x/P_m.Q_x$, where Q_x stands for the volume of exports. The term I, proposed by G. S. Dorrance, is a "useful indicator of the well being of a trading community"[41]. It requires comparing the volume of exports to the price of imports, that is, the "purchasing power of exports in terms of imports" or the "export gain from trade"[42]. This reduces I to X/P_m, by substituting X, the value of exports for $Q_x.P_x$.

It should be noted here that the terms of trade do not reflect the rise in the repatriated profits of international oil companies operating in Kuwait. Nor is allowance made for savings remitted by the non-Kuwaiti population among other invisible movements. The retained income, or 'returned value', that is the portion of total earnings of the export sector

retained in the country, would allow such qualifications to be made. Inadequate data has made the retained income difficult to quantify[43]. The following is, therefore, restricted to the less ambitious study of the purchasing power of exports, or the income terms of trade.

By comparing the two concepts N and I, the effect of a change in N or I, cannot be isolated from the effect of changes in the volume of exports, under a hypothetical ceteris paribus condition. The income terms of trade would provide better estimates of any gain from trade than the N alone. A rise in Q_x could offset a worsening N. For the purposes of calculation the period 1962 to 1973 is used. Although a short period, it has the virtue of being unaffected by breaks in the series or incomplete or provisional data. Such inadequacies would undoubtedly effect the quality of the price indices. To avoid statistical bias, prices and quantities are broken down separately instead of using the value of oil exports for imputing N. In this way a fuller comparability of the N series and the I series can be achieved. The base year of 1964, was chosen because it marks a change in the relative position of oil producers and oil consumers.

The price indices of Kuwait's oil exports are the imputed tax values, derived by Professor Mikdashi (until 1971), which are taken at f.o.b.[44] These imputed tax values, or realized prices are the posted prices less the selling charge allowance which was discontinued in 1971. After 1971 the postal prices and realized prices have become identical. The unit value indices of imports (c.i.f.) for the Asian Middle East are used, and are taken from the United Nations Monthly Bulletin of Statistics, for Pm of Kuwait. This general price index may differ from the price index of Kuwaiti imports as constructed by the Kuwaiti Central Bank. However, since this index is available only for the period following 1965/66, the U.N. indices have been used, in order to maintain uniformity throughout the period studied. Finally, the indices of the volume of exports Q_x and

growth of population indices, L, are constructed from the Kuwaiti Planning Board's estimates.

Kuwait has enjoyed a rising I since 1962, with this index rising slowly until 1971, as shown in Table 3.h. During this period I was reduced only in 1970, due to the reduction of P_x of oil resulting from the general depression of oil prices. This led to a marked deterioration in N. Since 1971, I has risen phenomenally following the Tehran agreement in June 1971 and the Geneva agreement in 1972. The rise in I of about 144 percent from 1962 to 1973 was accompanied by an improvement in N of about 59 percent. By comparing the average rates of annual growth of I and Q_x, that of Q_x (5.3 percent) fell short of the annual rate of growth of I which was as large as 13.6 percent. This does not represent a generally favourable movement in N.

As noted earlier, the general improvement of I may have been brought about by rising export volumes which offset deteriorating N under the ceteris paribus assumption. The differences in the rates of growth of I and Q_x above for the whole period are ambiguous. It is necessary, therefore, to distinguish the predominance of either Q_x or N vis-à-vis P_x, by dividing the series into two periods, before and after 1971. Until 1971, the growth of I was 5 percent. It is no coincidence that the improvement in Q_x was as large as 5.9 percent. During this period, then, the importance of improving Q_x is shown, of course without making any qualifications of technological progress. During this period, the impression conveyed may be misleading. For neither I nor N make allowances for invisibles and foreign exchange earnings, as has been pointed out above. In fact, Kuwaits export sector's balance of payments maintains a surplus with respect to her trading partners. However, attention must be drawn to the fact that increasing the exports of a depletable good is a sacrifice on the part of Kuwait.

Table 3.h.

Net Barter and Income Terms of Trade and Per Capita Income Terms of Trade 1962-1973 (1964=100)

Year	Net Barter Terms of Trade: $\frac{Px}{Pm}$	Income Terms of Trade: $\frac{Px.Qx}{Pm}$	Per Capita Terms of Trade: $\frac{Px.Qx}{Pm\ L}$
1962	103.3	87.7	105.8
1963	100.4	91.3	100.2
1964	100.0	100.0	100.0
1965	103.6	106.0	96.6
1966	101.0	108.7	90.4
1967	102.1	110.6	83.9
1968	104.6	118.8	82.2
1969	101.3	121.7	76.9
1970	90.6	117.4	67.7
1971	95.9	132.8	70.9
1972	110.9	158.3	78.5
1973	162.1	231.4	105.1

Derived from: UN, Monthly Bulletin of Statistics, July 1974, Vol. XXVIII, No. 7 (UN, New York, 1974), p.xxii

Central Office of Statistics, The Planning Board, Statistical Abstract 1973 (Kuwait: Government Printing Press, 1973) p.17

Mikdashi, Z., Op. Cit., Table 7.3 p.169

International Monetary Fund, International Financial Statistics, June 1974, Vol. XXVII No. 6 (IMF, Washington, D.C., 1974) pp. 30-31.

Petroleum Press Service (PPS, London) September 1973, p.358.

After 1971, the conservationist policies of oil were introduced. With the improving I, the predominant importance of P_x is shown. N improved by 66.2 percent between 1971 and 1973, although a sharp rise in P_m of 30 percent has been recorded. Part of this rise, however, could be attributed to rising costs of insurance and freight. The oil agreements, mentioned above, and the success of the joint bargaining efforts of OPEC have more than doubled (and after 1974 quintupled) the prices of oil. Certainly the sharp rise in prices of crude oil and its fairness are open to endless debate. It could be argued, for instance, that P_x of crude oil in the 1970s is a better reflection of its opportunity cost than that of the 1960s.

At this stage, the adjustment of I to L can be made by dividing I by L, the index of population growth. This gives the percapita income terms of trade. The high rate of growth of population growth of over 9 percent per annum, deflates the improving I. Thus, the percapita purchasing power of exports was declining prior to 1970. After this date they start rising and show an improvement of a meagre 5 percent in 1973 over 1964 (the base year). If this indicator is to suggest an index of individual welfare, it follows then that population growth, particularly the influx of population, needs to be controlled. A statutory policy of the rate and professional composition of incoming population could be introduced as determined by the requirements of planned diversification of the economy.

It is appropriate to conclude that Kuwait has been successful in raising the purchasing power of her exports. With little improvement in N until 1971, this has been at the expense of depleting her limited oil reserves. The net barter terms of trade have shown substantial gains after 1971 only. Although the ratchet effect[45] may protect her export

prices, this gain is not warranted in the long-run with rapidly rising import prices, as a result of the world wide inflation. Kuwait's openness allows the absorption of this inflation as discussed in the next section. The impact of changes in physical output and export earnings do not reflect on employment nor wages in the oil sector itself. They rather reflect on government revenues and their allocation, since the oil sector is highly capital intensive and employs a small portion of the work force. This was pointed out in the previous chapter. Extrapolating for future policies, however, requires knowledge of changes of prices and income elasticities as well as changes in the volume of world trade[46]. For this purpose, it would also be useful to compare changes in I for Kuwait in relation to those of trading partners. This is particularly important since, in principle, we can have rising income terms of trade, irrespective of what happens to the net barter terms of trade.

3.6 Import Trade and Import Demand

With the heavy dependence of the economy on a single product and the growth in the size of the domestic market, a simultaneous growth in imported goods takes place. Imports sustain the high level of consumption and development projects. Kuwait's capacity to import is related to her liquidity position. The total liquidity resource, gold and foreign exchange[47], of about KD 590 million (approximately £745 million) in 1972, were equal to 225 percent of her 1972 imports. The liquidity factors clearly illustrate the ability of Kuwait to import without any restrictions. With the rapidly growing export earnings, her liquidity position will become even more favourable. These earnings finance one of the highest percapita retained imports in the world, about KD 325 in 1972 (approx. £410).

The main tariff duty is the 4 percent ad valorem (see Chapter 4). Government, oil companies, and most food product importations are exempt

from duty. The openness of the economy is further portrayed by the broadness of supplier markets, with an index of concentration of imports by country of origin of 26.9 in 1972. This allows a wider range of substitution and more effective competition among suppliers. The main suppliers, in order of importance, were Japan, U.S.A., Britain, West Germany, Lebanon, and Italy. A review of the regional distribution of major suppliers shows that Europe (40.8 percent) remains the main source for imports, with Asia (31.4 percent), and America (14.6 percent) increasing their share. The Arab world with the exception of Lebanon (4 percent) remains a minor supplier (see Table 3.i.).

The openness of the economy combines with such factors as location, transport facilities, and an experienced mercantile class in foreign trade to make commerce an attractive economic activity. The formation of numerous local import companies have easily attracted stockholders, and have been assisted by bank participation[48]. The commercial banks' major business is becoming the financing of imported goods. The high returns in the import trade have made investment in these companies lucrative. The commercial banks' participation is in the form of short-term credits. The lending process is accelerated as bank advances for these loans can circulate up to three or four times a year. However, the low interest rates (a maximum of 7 percent) and the rapid increase in money supply, aggravate inflationary pressures. Theoretically, increases in money supply should stimulate demand for imports. However, growth in the economy is not sufficient to meet the increase in money supply (30 percent in 1972 over 1971). Further, the boom in Kuwait's export proceeds has led to increase in domestic costs and prices, which in subsequent periods proved resistant to downward tendencies. Consequently, Kuwait is subject to the ratchet effect on the economy, common in oil-producing countries.

Table 3.i.

Geographical Distribution of Kuwaiti Imports by Major Suppliers, 1972

(In Million K.D.)

Country	Value	As Per Cent
Arab World	24.011	9.2
Lebanon	13.545	5.2
Africa	2.909	1.1
America	38.197	14.6
U.S.A.	34.328	13.1
Asia	82.326	31.4
India	7.595	2.9
Japan	41.967	16.0
China People's Republic	8.456	3.2
Europe	107.025	40.8
European Economic Community	84.988	32.4
France	11.016	4.2
Federal Republic of Germany	21.762	8.3
United Kingdom	26.613	10.2
Italy	12.258	4.7
Other West European Countries	12.401	4.7
European Centrally Planned Economies	9.636	3.7
Australia	7.312	2.8
Other	0.397	0.1
Total	262.177	100.0

Source: Central Office of Statistics, The Planning Board, Statistical Abstract 1973 (Kuwait: Government Printing Press 1973) pp. 324-331

Aside from imbalances in the economy (discussed in Chapter 2) the weak competitive forces increase inflationary pressures. The mercantile class excercises a high degree of freedom in price-making with the exception of a few essential commodities[49]. With legal entry into business and import trade restricted exclusively to Kuwaitis (non-Kuwaitis hire Kuwaiti names in order to engage in business), the market mechanism, loses its flexibility. Competitive forces are reduced, since non-Kuwaitis form the bulk of the working population. Moreover, according to the Central Bank, in 1972 the increase in profit margins by a number of wholesalers or retailers, or both was undoubtedly a primary factor in the increase of local prices[50]. Exclusive dealership or agencies for highly desired goods might be the source of some high profits[51]. Apart from the high profit margins, the high commodity prices partly reflect world export prices. Kuwait's heavy dependence on world markets and openness means the country's markets are exposed to externally originating inflation, as has been mentioned above. High profit margins and the weakness of competitive forces, are in a sense price distortions rather than inflationary tendencies.

The government price control mechanism to curb rises in domestic prices of essential goods has been unsuccessful. The net price rises in these commodities are thus borne by the consumer, and, naturally are felt more by those in the fixed income brackets. The still strong tribal traditions, in a country with high percapita purchasing power, results in a rigidly fixed consumption pattern, emulating that of the upper class. This factor is in addition to the acquired taste for imported goods. Consequently, the economy is largely independent of cost considerations, which lowers the average consumer's elasticity of substitution between different consumer goods. Therefore, 'rational' profit calculations induce business to stick to the 'high margin' policy discussed above.

Import demand in the 1960s and early 1970s showed a slowly rising trend. The income elasticity of import demand is the marginal propensity to import divided by the average propensity to import in the base year, in this case 1963/64[52]. During the period 1963/64 to 1973 income elasticities of import demand were relatively stable.[53] In 1973, the income elasticity was 0.41. This low elasticity could be attributed to the saturation of the market with imported commodities (mainly consumers')[54]. Moreover, high positive changes in real income contribute to the low value of the numerator, that is, the marginal propensity to import, in calculating the income elasticity fraction. Changes in the import demand that are attributed to income movements can, therefore, be attributed to changes in prices. The extent of the reactions to price changes remain ambiguous and require estimates of the price reaction for individual commodities[55].

As the economy grows, the demand eventually created, as well as present purchases, will need to be accounted for. In this situation of economic development and rapid growth, changes in the economic structure occur. It is, therefore, implausible to extrapolate import demand using income elasticities of demand. Essentially, it would be applying "cyclical income elasticities to situations in which real income has grown secularly..."[56] This is to be expected, for the counterpart of a 'given increment' in real income, could have a wide range of "possible changes in the level of import demand"[57].

As for commodity imports, in 1971 they were relatively dispersed with a 24.9 index of concentration. However, there is a high proportion of finished consumption goods which amounted to 72.4 percent of total 1971 imports. This is accounted for by the consumption orientation of Kuwaiti society. This figure almost exactly coincides with that of the imports originating in industrialized countries,[58] which was 74.1 percent in 1971/72.

Consumer goods which represented two-thirds of the total in 1972, rose between 1965/66 and 1971/72 from KD 101.6 million to KD 157.3 million. When adjusted to population changes, this figure remains relatively stable at KD 217.6 percapita and KD 204.8 percapita, respectively. This can be attributed to the saturation of the market referred to above. Other plausible explanations for fluctuations in the volume of consumer goods, are the variations in Kuwait's re-exports, and changes in their inventory (primary non-durables). On the other hand, the establishment of new industries (see Chapter 4) and the development of the economic infrastructure has led to rapid increases in capital goods imports. Between 1965/66 and 1971/72 capital goods increased from KD 16.6 million to KD 47.8 million; that is from 11.5 percent to 20.3 percent as of total imports; and from KD 35.6 percapita to KD 62.2 percapita (see Table 3.j.).

All these indicators, in absolute and relative terms, point to the expansion of industry, particularly those utilizing Kuwait's raw materials. One can expect an increasing need for spare-parts and a slowly changing composition of commodity imports. Industrialization in general is likely, therefore, to stimulate import demand.

3.7 Export Earnings Stabilization Policies and Conclusions

Integrated markets, particularly EEC, with whom Kuwait has tc bargain, intensify the vulnerability of the economy to export trade concentration. Demand and supply conditions give rise to disequilibria between prices of manufactured and raw materials. Commodity agreements are aimed at remedying seasonal or cyclical fluctuations in prices of agricultural or other primary products. These fluctuations do not exist in the case of oil[59]. Therefore, other approaches stabilizing and controlling long-term export earnings of Kuwait, are required.

In the long-run, oil prices may be reduced drastically, in relative terms.

Table 3.j.

Total & Percapita Distribution of Imports According to Capital Goods, Intermediate Goods, and Consumption Goods 1965/66 and 1971/72

Year	Class	Value in Million KD	Percentage of Total	Per Capita in KD
1965/66	Capital Goods	16.6	11.5%	35.6
1971/72		47.8	20.3%	62.2
1965/66	Intermediate Goods	26.0	18.0%	55.7
1971/72		30.2	12.8%	39.3
1965/66	Consumption Goods	101.6	70.5%	217.6
1971/72		157.3	66.9%	204.8

Source: Central Bank of Kuwait, Al-Takrir Al-Sanawi Al-Thaleth, 1972 (Third Annual Report 1972), (Kuwait: Makhwi P. Press, 1972) p.157

Hence, there is a need to negotiate between basic industrial commodities and oil prices. In the short-run, capital surplusses generated through recent oil price rises, do not contribute to the stability of the international monetary system[60]. Since national income and export revenues are highly correlated, stable currency exchange rates are necessary[61]. Fluctuations of international currencies have adverse effects on the external value of Kuwait's currency.

The appreciation of the Kuwaiti dinar in the past five years has had several consequences[62]. Firstly, it has led to a drop in the value of Kuwait's overseas assets. Secondly, non-oil exports are less competitive in terms of price. On the other hand, the revenue from oil exports has been safeguarded by exchange adjustments in the dollar price of oil. At present, the inelasticity of world demand for oil and adjustments in the dollar price of oil, make modifications in Kuwait's exchange rate unnecessary. A continued significant appreciation of the Kuwaiti dinar could conceivably lead to a balance of payments deterioration. Devaluation may then be required. This would have ramifications for Kuwait's fiscal and montary policies. Kuwait currently has no budgetary systems of direct control. As we have seen in Chapter 2, development expenditure oscillates with changes in available revenue.

A change in the aggregate supply of oil, would affect the terms of trade. Therefore, another approach to stabilization of oil prices (in real terms) is cooperation among oil producers. After the nationalization of KOC, it is proposed that a Kuwaiti marketing board be set-up. By cooperating with other producers (within OPEC) this board will act as a monoply. Controlled production in line with preservation policies in cooperation with other producers would stabilize oil prices. Effective cooperation could avoid possible price wars between producers. Fluctuations in supply could be

reduced by implementing an OPEC production plan (perhaps by imposing export quotas). This requires taking into account the price elasticity of demand for oil and its change relative to other energy sources. The cross elasticity and income elasticity of demand for oil of the various groups of consumers, in toto, need to be accounted for[63]. Fluctuations resulting from political instability, a slump in demand for oil, or price cuts could be treated through the utilization of Kuwait's accumulated reserves, but only in the short-run.

In conclusion, Kuwait's foreign trade ratio is high. This is evident not only from the value of exports, but also from the high average propensity to import - a characteristic of smallness. The greater weight of exports in small nations, in general, can be expected to expose them to fluctuations on the international commodity markets. However, the index of stability for Kuwait's export earnings was found to be relatively stable. Serious political trouble in the area has adverse effects on this stability. A stable political situation will therefore do much to maintain these earnings.

Kuwait's commodity exports are highly concentrated, and their market concentration is relatively high. Kuwait's export stability is likely to be less involved with geographic concentration than with the stability of her customers' imports[64]. In the mid-seventies, it seems safe to assume an association between the low elasticity of international demand for Kuwaiti exports, with a high degree of commodity concentration of exports. Kuwait's unique export trade position is likely to be favoured in the short-run because of the relative change in oil prices.

Improvements in production and marketing, necessary to stabilize export earnings, may entail increasing the refining capacity and expanding Kuwait's oil-tanker fleet[65]. It might also be viable to direct investments into downstream marketing as well as refining facilities in consuming countries

(especially developing).

Kuwait also plays an important role in the entrepot trade. This role will have a parallel growth to that of demand for imported commodities in the gulf. Similarly, demand for non-oil exports of local produce will largely depend on the developing countries' markets. Therefore, developing trade relations with these countries is essential.

The income terms of trade have shown that Kuwait has been successful in raising the purchasing power of her exports. In 1970, the low percapita purchasing power started improving. If used as an index of individual welfare it still suggests the employment of selective controls over population influx. Although the net barter terms of trade have shown substantial gains since 1971, these gains are not warranted in the long-run, with the rapidly rising import prices. Liberal trade policies, coupled with Kuwait's large dependence on imported commodities allow her market to absorb externally originating inflation. In addition, the imbalances in the economy, weak competitive forces, and market mechanism inflexibilities, increase the inflationary pressure. Controlling inflation may involve fiscal, monetary, and structural measures outlined in Chapter 2.

Import demand shows a slowing trend in the 1970s, mainly because of the partial saturation of the market with consumer goods. These goods still represent two-thirds of imports. However, the continuing development of the economic infrastructure, and the establishment of new industries has stimulated demand for capital goods' imports. This is slowly changing the composition of commodity imports. Moreover the potential long-run dangers of high export trade concentration indicate the urgency for a form of diversification, particularly of the oil industry. This would stimulate import demand, which the favourable balance of payments might be able to support. Rather, controls on imports are likely to increase the inflationary

pressure. The topic of diversification of the economy is discussed in the following chapters on industrialization.

Notes to Chapter 3

1. I.M.F., International Financial Statistics, June 1974, Vol. XXVII, No. 6.

2. Central Bank of Kuwait, Al-Takrir Al-Sanawi Al Thani, 1971 (Second Annual Report, 1971), (Kuwait: Makwi P. Press, 1971) p.63.

3. Lloyd, P. J., International Trade Problems of Small Nations, (Durham: Duke University Press, 1968) p.54.

4. Ibid p.54.

5. Kuznets, S., "Economic Growth of Small Nations", in Economic Consequences of the Size of Nations, edited by E. Robinson (London: MacMillan & Co. Ltd., 1963), pp.21ff.

6. MacBean, A. I., Export Instability and Economic Development, (London: George Allen & Unwin Ltd., 1966) pp. 59-62. Kenen et al carried out a broader statistical analysis of export instability and economic growth. In general, their findings do not contradict MacBean's. However, they find one strong inverse connection between instability and the level of investment in developing countries in the 1960s. See Kenen, P. B., & Voivodas, C. S., "Export Instability & Economic Growth", Kyklos, Volume XXV, 1973, pp.791-803.

7. Ibid, p.61.

8. Ibid, p.59.

9. The time-series comparison of Kuwait's fluctuations in export receipts and GNP, shows that 7 out of the 9 years ending in 1971/72, on a current year basis, were in the same direction. c.f. MacBean's time-series comparison for underdeveloped countries. Ibid, pp.63-65.

10. The instability index of exports "I-I" can be expressed in algebraic terms as follows:

$$\text{"I-I"} = 100 \times \text{antilog } V_{\log}, \text{ where } V_{\log} = \frac{\sum\left(\log \frac{X_{t+1}}{X_t} - m\right)^2}{N}$$

where Xt is value of a country's exports in year t; N is number of years minus 1; m is the arithmetic mean of the differences between the logs of the Xs, e.g. $X_{t+1} - X_t$; and $V_{\log}$ is the logarithmic variance of the series. See Coppock, J., Foreign Trade of the Middle East: Instability and Growth, 1946-1962 (Beirut: Economic Research Institute, American University of Beirut, 1966) pp.3-5.

11. Ibid, Table 11-1, pp.208-209. Also MacBean, opt. cit., Table 2:1, p.35.

12. MacBean refers the more stable payments of expatriate companies to the governments and factors of production in the country in which they operate, to the fact that repatriated profits are allowed to fluctuate more, Ibid p.87; Coppock concludes that this stability is true of most oil-producing countries, op. cit. p.201.

13. The index of trade concentration was first used by Hirschman, A. O., in National Power and the Structure of World Trade, (University of California Press, 1945), Chapter VI, pp.98-116. See also Michael, M., "Concentration of Exports and Imports: An International Comparison", The Economic Journal, Dec. 1958, pp.722-24.

14. When using this technique one must be careful to ascertain that the commodity classification employed by the statistical source does not give rise to categories including heterogeneous goods.

15. The extractive industry and agricultural sector of the developing countries, on average, still provide 80 percent of all goods exported. See E. Hamman, "Trends in the World Demand for Primary Products and their Implications for the Exports of Developing Countries", Institute of National Planning, Cairo, memeograph No. 757/1967 pp.1ff., cited in G. Barthel, Industrialization in the Arab Countries of the Middle East, (Berlin: Akademie-Verlag, 1972) pp. 166ff.

16. The value of non-oil exports and re-export sector in 1971 was KD 34.4 million, and in 1972 was KD 49.6 million.

17. Western Europe imported from Kuwait 82.641 million long tons out of a total of 696 million long tons crude oil imports in 1972. See B.P., Statistical Review of the World Oil Industry, London, 1972.

18. The nature of the oligopolistic international oil firms, and the concentrated structure of the international oil industry is surveyed in Mikdashi, Z., The Community of Oil-Exporting Countries, A Study in Governmental Co-operation, (London: Allen & Unwin, 1972) Chapter 2. Professor Mikdashi points out that the marketing of oil, and consequently its geographic distribution, depends on the major producing countries (foreign), which engage in marketing as well as refining and transporting through their affiliates. Ibid, pp.54-5.

19. Johnson, H. J., ed., Trade Strategy for Rich and Poor Nations (London: Allen & Unwin, 1971) pp.30-57.

20. Venezuela requires foreign oil companies to refine locally at least 30 percent of their production. See Lutfi, A., OPEC Oil, Middle East Oil Monographs No. 6 (Beirut: The Middle East Research and Publishing Center, 1968) p.17.

21. Shell, Seminar on Oil Affairs (Shell Centre, 1971) B.2, p.1.

22. Lutfi, op. cit. pp.17ff.

23. In 1971/72, KD 2.59 million was spent on imported petroleum products in the form of asphalt, and lubricating engine oil.

24. Shell Seminar, op. cit., B.2, p.3.

25. The Shu'aiba refinery was built by the Kuwait National Petroleum Company, a 60:40 State/private enterprise and was the first all-hydrogen refinery in the world. It cost $ 150 million and in 1972 produced 40.85 million barrels. See Planning and Development Department, Al-Idarah Al-Amah Lemantakat Al-Shu'aiba (Shu'aiba Area Authority) (Kuwait: Dar Al-Siasah Press, 1973) pp. 40-1.

26. The KNPC is authorized by its charter to "engage in all phases of the petroleum industry, natural gas, and other hydrocarbons, refining, manufacturing, transporting... and distribution, selling, and exporting such substances". See Stocking, G. W., Middle East Oil (London: Allen Lane the Penguin Press, 1971, pp.440-1.

27. There is a tariff duty of 2 percent ad valorem only on goods transshiped in Kuwait. However, exports of live sheep and poultry are prohibited and those of certain items as sugar and fats may be either licenced or prohibited in time for emergency or shortage in Kuwait. Those of arms, ammunition and scrap metal require licences.

28. The indices of geographic concentration for these countries have been computed from: Central Department of Statistics, Statistical Yearbook 1972, Eighth, Kingdom of Saudi Arabia (Government Press, 1972) Table 9, pp.288-325; Statistics & Research Department, Central Bank of Iraq, Bulletin No. III, (Baghdad; Government Press, 1973), Table 30, 32 and 33; General Union of Chambers of Commerce, Industry and Agriculture for Arab Countries, Arab Economic

Report, (Beirut, 1973) pp.300-302. Commodity divisions have been maintained uniformly throughout the calculations.

29. Kuwait produced 6.4 percent of world oil consumption in 1972.

30. Pan Arab Consultants for Petroleum Economic and Industrial Development, The General Agreement on Participation In Respect of Crude Oil Concessions In the Arabian Gulf States, Studies on Key Petroleum Issues, No. 1, 1973 (Beirut: Parcons, 1973) p.118.

31. The Arab Economist, Supplement Kuwait, No. 64, May 1974, p.13.

32. See the statement by Raul Prebisch, Secretary-General of UNCTAD, published in Proceedings of the United Nations Conference on Trade & Development, Geneva, 23 March - 16 June 1964. Vol. II, Policy Statements (New York; U.N., 1966) p.76.

33. Mikdashi, op. cit. p.40.

34. See Penrose, E., "Middle East Oil: The International Distribution of Profits & Income Taxes", Economica, Vol. 27, August 1960, p.208. Posted prices, asserts Professor Penrose, provide the means of "attributing profit to crude production alone", on which the producing countries share in the total profits on the integrated operations of the major companies would be based.

35. Mikdashi, op. cit. p.186.

36. Ibid, p.116.

37. See Chapter 2 for Kuwait's oil reserves estimates.

38. Kindleberger, Power and Money (London: MacMillan & Company Ltd., 1970) p.78-80. OPEC was established in 1960 after the oil price cuts of August 1960, with one chief goal "the restoration of precut prices". See G. Stocking op. cit., p.417. Kuwait is also a member of the 1968 established Organization of Arab Petroleum Exporting Countries (OAPEC).

39. Wilson, T., Sinha, R. P., Castree, J. R., "The Income Terms of Trade of Developed and Developing Countries", The Economic Journal, Vol. 79, December, 1969, p.816.

40. Ibid, p.816.

41. Imlah, A. H., "The Terms of Trade of the United Kingdom", The Journal of Economic History, Vol. X, No. 2, 1950, pp.176-7.

42. Ibid, p.176.

43. See Reynolds, C. W., "Domestic Consequences of Export Instability" American Economic Review, Vol. LIII, No. 2, 1963, pp.99-102.

44. Mikdashi, op. cit., Table 7.3, pp.169-170.

45. The ratchet effect links between the theory of economic development and the trade cycle theory. It is explained by the irreversibility of demand functions. When a society becomes used to a higher level of consumption, their preferences are corrected upwards, producing higher levels of demand for income than the preceding one, at the expense of leisure. See Duesenberry's ratchet effect argument in: Duesenberry, J. S., Income Saving and the Theory of Consumer Behaviour, (Cambridge, Mass.: Harvard University Press, 1949), p.115.

46. T. Wilson, et al, op. cit. p.832.

47. The liquidity resources exclude the 'gold tranche' position with the International Monetary Fund.

48. See El-Mallakh, R., Economic Development and Regional Cooperation: Kuwait (Chicago: University of Chicago Press, 1969) pp.90f.

49. Eid, N., The Legal Aspects of Marketing Behaviour in Lebanon and Kuwait, (Beirut: Librairie du Liban, 1970) pp.61ff. Bread, flour, fish, water and drugs are some of the essential commodities on which a form of governmental price control is excercised. The June 6, 1967 Decree No.24 gives the Minister of Trade & Industry, the authority to subject essential commodities to the system of price-fixing.

50. Bank Al-Kuwait Al-Markazi, Al-Takrir Al-Sanawi Al-Thaleth, 1972 (Central Bank of Kuwait, Annual Report 1972), (Kuwait: Makhawi P. Press, 1972) p.54.

51. IBRD, The Economic Development of Kuwait. (Baltimore: John Hopkins Press, 1965) p.79.

52. I have applied to Kuwait the methodology of studying import elasticities employed by Harberger, A. C., in his article, "Some Evidence on the International Price Mechanism", Journal of Political Economy, Vol. 65, No.6, 1957, pp.506-12.

53. The average income elasticity of import demand between 1963/64 and 1973 was around the 0.40 mark. The average propensity to import in the base year 1963/64 was 0.266, and the marginal propensity to import in 1973 was 0.11, giving an income elasticity of import demand of 0.41.

54. This partial saturation can be substantiated by the fact that in the mid-60s, the income elasticity of import demand was higher; for instance, in 1965/66 it reached 1.32 and 1.41 in 1966/67.

55. Harberger points out that a study of the reaction to price changes, which occur, by and large, when the import or export prices of a country move in roughly parallel pattern, should concentrate on those periods. This could be particularly useful in the case of Kuwait.

56. Ibid, p.172.

57. Ibid, p.169.

58. Statistical Abstract 1973, Tables 223 & 224, pp.407-410.

59. Mikdashi, op. cit. p.207.

60. Moursi, F., "Strategies For Maintaining the Value of Most Savings & Investments of Capital Surplus Countries in the Context of the Future International Monetary System" (Translation of Arabic Original). Seminar on Investment Policies of Arab Oil Producing Countries 18-20 Feb. 1974 (Kuwait: The Arab Planning Institute & Kuwait Economic Society, 1974) p.88 (18 of paper).

61. In this context it should be noted that Kuwait has ceased to be a scheduled territory in terms of the U.K. Exchange Control Act of 1947. There is, therefore, no prescription for Kuwait of emergency requirements. The country is still, however, regarded as an Overseas Stirling Area. See IMF, 25th Annual Report 1974 (Washington D.C.) p.271.

62. In the financial year 1973/74 the dollar value of the Kuwaiti dinar went up by about 12 percent.

63. The analysis of price elasticity of demand involves other sources of energy, as 90 percent of oil is used for this purpose, as well as the relationship between the prices of crude and refined products. See Shell Seminar, opt. cit., A.3 p-1. For estimates of these elasticities see Mikdashi op. cit. pp. 116-121.

64. Kuwait's export stability is susceptible to an economic or political retaliation by her customers.

65. The Kuwait Oil Tankers' Company, with a present fleet capacity of 800,000 tons is in actual fact expanding its capacity. The company has placed orders for 4 super-tankers, which when delivered in 1976 will bring the fleet's capacity to over 2.1 million tons.

CHAPTER 4

Industrialization in Kuwait

The present chapter surveys industrialization in Kuwait. It is hoped that this will facilitate a better understanding of industrial planning and potential industrial projects which are discussed in Chapter 5. Section 1 introduces the concept of diversification through industrialization as a means of sustaining growth in the economy. Section 2 traces the evolution of present industry from four basic activities. Section 3 examines the current industrial structure. Section 4 reviews industrial financing and vocational training; whilst Section 5 deals with the government's industrial control policies. Section 6 discusses the growth trends and interdependence of industrial activities and public utilities. Finally, Section 7 provides the summary and conclusions to the chapter.

4.1 Introduction

The overspecialization of the economy in oil production makes its dominance over other economic activities analogous to an agrarian sector which more usually forms the dominant sector in developing countries. Basically, the oil sector is modern in its orientation and development in that it is a technologically advanced, capital intensive enterprise. But the capital absorptive capacity of this sector is limited. Investment in oil production is required only to the point necessary to support oil exports[1]. This is due to the profitability of foreign trade and the efficiency of the international division of labour reflected in Kuwait's improving terms of trade. On the surface, the net effect of income and price elasticities on the country's terms of trade favour increased specialization.

It is generally thought that specializing in raw material production is an enclave type of development which does not have a strong effect on the

economy. Singer[2] argues that specialization in raw material exports, largely as a result of investment by the industrialized countries in developing countries has certain adverse consequences. It removes most of the secondary and cumulative effects of investment from the host country to the investing country. This type of specialization and lack of secondary and cumulative effects of investment has restricted economic development. Economic activities have been concentrated in areas offering less scope for technological progress, internal and external economies, and generally restrained the development of industry.

Dr. Khoja[3] of the KFAED has estimated the developmental impact of Kuwait's oil sector on the rest of the economy for the period 1962/63 to 1969/70. To estimate the extent to which the growth potential of the oil sector is realized, Khoja compared the value added of the exogenous variables[4] to the value added of other economic sectors. The oil sector's contribution to national income is the main component of the exogenous variables. This analysis entails considering variations in the ratio of national income to the value of the difference between total exports and the net factor income transactions with the rest of the world. This ratio, which averaged at 1.76 during this period, dropped from 1.9 in 1962/63 to 1.6 in 1969/70. That is, the ratio of national income to the oil sector's contribution has diminished with the rise of this sector's value added. A diminishing ratio means that the oil sector's contribution to national income is growing faster than that of the value added of the rest of the economy. Therefore, the developmental impact in generating and increasing the value added of other sectors by the oil sector, has diminished.

In the short-run, the limited effect of this sector on the economy is not alarming. The contribution of overseas investment earnings to national income is growing. The maximization and securing of the earnings have been dealt

with in Chapter 2. With recent oil price rises, the purchasing power of Kuwait's exports is favourable. But the improvement in the terms of trade cannot be guaranteed for long periods as world inflation erodes the oil price increases. In addition, the overspecialization of the economy intensifies factoral and sectoral imbalances (refer to Chapter 2). Therefore, diversification of the productive pattern would reduce the degree of vulnerability of the economy. Khoja's results indicate that in the case of Kuwait diversification would reduce the economy's vulnerability in two ways. Firstly, it would increase the value added of non-oil sectors - inclusive of overseas earnings - relative to the oil sector. This outcome is contrary to the expected results of diversification[5]. Secondly, diversification would decrease the ratio of the percentage change in national income to that of the oil sector. The change in the last proportion is a result of the change in the structure and the behavioural characteristics of the economy[6] over time.

It is generally accepted that a degree of diversification of the pattern of production would broaden the scope of technical progress; develop human resources; maintain the long-run growth rates of national income; and absorb part of the capital surplus. Kuwait is distinct among developing countries in the sense that the dominant sector is oil production, whereas the traditional sector (in terms of employment) is services. Hence, diversification of sectors and factors of production for Kuwait has unique features. With the agricultural sector virtually non-existent and its potentials minimal, diversification involves striking some degree of balance between the oil sector and the manufacturing sector; and between the trade and services sector and the manufacturing sector. In brief, a concrete development policy requires establishing a degree of balance between the traditional and dominant sectors and the modern urban-industrial sector. The following sections are concerned with the present structure of the industrial sector.

4.2 Evolution of the Industrial Sector

Since the late 1950s, industrialization has gathered momentum with the development of the oil industry. Previously all the developmental requirements of oil and the social and economic infrastructure were imported. Industrial units were set-up randomly rather than according to a plan. The number of these units totalled 2370 in 1970, of which 1755 employed an average of 3 or less workers[7]. Average employment in the rest did not exceed 18 workers. By and large, these industrial units carried out repairs and maintenance.

Industrial development in Kuwait can be traced back to four activities: construction activities and construction materials; public utilities; marine oriented industries; repairs and maintenance. With the proliferation of development needs, and rapidly rising demand for public and residential buildings, one of the first sectors to flourish was the construction. Initially, most of the construction materials needed in Kuwait were imported. The development of the construction sector has led to the utilization of Kuwait's quarrying localities. High transport costs of the heavy construction materials, and cheap energy, has given local production a competitive edge over imported materials. For instance, by 1953 all raw materials were available to produce sand-lime bricks. Deposits of limestone and rock with a good calcium carbonate content and deposits of sand containing a high silica content were discovered in the Ushairej area[8]. In 1956, a sand-lime brick plant (established in 1953) started the production of bricks using imported lime. In 1958, after the completion of a lime-making plant powered by natural gas, sand-lime brick was produced wholly from domestic inputs. The output now satisfies the domestic market.

In the public utilities sector, the industrial activities which have developed include gas manufacture, seawater desalination, and electricity generation. Due to the inadequacy of fresh water supply, the remarkable

development of water desalination and distillation plants (caustic soda, salt, hydrochloric acid) was necessary to meet rapidly rising consumption.

Marine-oriented activities, historically, have been a traditional sector. Marine resources, and the large variety of fish breeds in the Gulf were for long the source of livelihood for Kuwaitis. With fishing and pearling, related activities, mainly boat building, evolved. This traditional sector and its experienced labour force have formed the foundations of todays modern fishing, fish-packing and shrimp processing industries.

The fourth activity, repairs and maintenance has been stimulated through the rapid rise of car ownership. The development of an adequate road network, high percapita income and the liberal import policy resulted in a total registration of 174 thousand motor vehicles by 1972. This represented approximately 1 vehicle to every 5 persons. The transport equipment importation represented an astounding 14.2 percent of total 1972 imports. Motor vehicle importation of this proportion has induced the rapid development of repairs and maintenance industries, with skills largely acquired on the job. Supplementing these industrial activities, other miscellaneous activities have been set-up such as flour-milling, bread-baking, tailoring, and various handicraft activities.

In the early 1960s the government initiated a policy of participation in order to establish an organized industrial sector. On 4 March 1965 the National Industries Act was passed[9]. Its aim is to organize, develop, and encourage this sector. It defines the industrial establishment as that engaged basically in transforming raw materials into semi or fully-processed products.[10] Thenceforth, industrialization has stressed the petroleum and natural gas-based industries.

4.3 Current Industrial Structure

The manufacturing sector, excluding oil extraction and refining, has two

distinct features. Firstly, in terms of products, oil-based industries are predominant. Secondly, the predominant organizational structure is the quasi-public or mixed sector in respect of both investment and output. The non-oil based industries are concentrated in the private sector. These are characterized by small scale, labour intensive establishments and cater for the local market. These industrial establishments are small both in terms of fixed capital and employment[11]. The only exceptions are beverage manufactures, fishing and fish-packing.

According to the 1970 industrial census, the value of fixed capital and the number of employees in the private manufacturing sector to the manufacturing sector's total (both private and mixed) was 9.2 percent and 59.3 percent, respectively. The number of private establishments was 332, or 96.5 percent of the total as shown in Table 4.a. Employment, therefore, varied between 3 and 80 employees, whilst the manufacturing of beverages (4 establishments), fishing and fish-packing (1 establishment) were medium-sized establishments, employing over 150 employees. With these exceptions, all types of establishments in the private sector average only 16.7 employees per establishment. Their main activities as shown in Table 4.b, were the manufacture of food, soft drinks, printing and printed products, metal and non-metallic mineral products, chemicals and chemical and plastic products (industries derived from petrochemicals). In addition, there are a number of repair firms of different non-electrical, electrical, and transport equipment. That is, local private industries generally provide consumer products, and are aimed at the satisfaction of local demand. However, they have difficulties in selling.

By Middle Eastern standards, the Kuwaiti consumers are well informed about the market. They have access to, and their tastes are biased towards, a variety of alternative imported products. Therefore, tariff protection, with tariff duties sliding up to 15 percent, is not sufficient to protect local

Table 4.a

Total Fixed Assets, and Employment in the Industrial Sector, in thousand KDs (1970 census)

Industrial Activity	Number of Establishments	Percentage	Number of Employees	Percentage	Fixed Assets	Percentage
Manufacturing						
Mixed Sector	12	3.5	4681	41.7	66835	90.8
Private Sector	332	96.5	6804	59.3	6794	9.2
Total Manufacturing	344	100.0	11485	100.0	73628	100.0
Total Mining & Quarrying	13	3.7	5964	34	90747	55
Total Manufacturing	344	96.3	11485	66	73628	45
Total Industrial Sector	357	100	17451	100	164375	100

Source: Central Office of Statistics, The Planning Board, Statistical Abstract 1973 (Kuwait: Government P. Press, 1973) Tables 186, 187 pp.264-275; Administration of Industrial Affairs, Ministry of Trade and Industry, Itijahat Wa Istratigiat Al-Tanmiah Al-Sinaiah Le Dawalat Al-Kuwait, Tripoli, 1974 (Strategy and Prospects of Industrial Development in Kuwait) (Kuwait: Government P. Press, 1974) Table 14, p.19.

Table 4.b

Private Sector Manufacturing Industries

(1970 census)

Industrial Activity	Number of Establish-ments	Number of Employees	Value of Fixed Capital (in KD)
Fishing & Fish Packing[a]	1	158	202509
Manufacture of Food	37	779	1313739
" " Beverages	4	1180	1552817
" " Footwear & Made-up Textiles	8	34	3535
" " Paper & Paper Products	3	69	205157
" " Printing & Printed Products	24	738	861383
" " Leather & Leather Products	4	36	4125
" " Chemicals & Chemical Products	7	24	647912
" " Non-Metallic Mineral Products	59	1433	781247
" " Metal Products	131	1444	793530
" & Repair of Non-Electrical Equipment	19	240	188454
" & Repair of Electrical Equipment	23	203	123835
" & Repair of Transport Equipment	10	162	40406
" of Plastic Products	2	25	75114
Total	332	6804	6793761

Source: Statistical Abstract 1973, Table 187, pp. 270-275; Strategy and Prospects of Industrial Development in Kuwait, Tripoli, 1974, op.cit, Table 16, p.21. (in Arabic)

[a]This company later merged with two others to form the 'United Fisheries Company'(1971).

production (see section 4.5). However, even if the local market were protected, technological competitiveness of local industries would improve their selling position. Despite the fact that some of these industries are equipped with modern machinary, their productivity is generally low (refer to Chapter 5, section 4). Local industry retains a relative competitive leverage over imports, only because of the high transportation costs.

Small scale industry of this sort cannot provide a 'take-off' group. Noting this, Professor Bowen-Jones[12] postulates that one of the reasons for the small size of industrial establishments in Kuwait is that they are "predominantly family affairs". However, it may be that these establishments could play an important complementary and interdependent role in industrial development. Their activities, as demanders of products, as suppliers of needs, and as agents of repair and maintenance, expand through the spread effect with the growth of the leading manufacturing industries.

As noted above the mixed sector is dominant. This is represented by its 90.8 percent share of total investment in the fixed assets of the manufacturing sector (see Table 4.a). The mixed sector is defined to include all firms where the Kuwaiti government holds between 20-80 percent of the equity. The remainder is held by nationals, individuals, and private enterprises. In order to set-up industrial ventures and to channel the surplus capital into the manufacturing sector, the government initiated a policy of direct participation with the private sector in 1961. The government either participates in the equity of industrial firms, or establishes industrial plants and later offers their equity to the public for general subscription. The Kuwait Chemical Fertilizers Company and the Kuwait Prefabricated Housing Company are examples of the latter.

An account of invested capital is necessary to assess the contribution of the public sector to the manufacturing industry. In Kuwait, insufficient

statistics prevent estimations of accumulated and retained reserves. However, the role of the public sector can be estimated by its share of authorized capital of the manufacturing sector, in toto. Since the mixed sector companies represent the bulk of Kuwait's manufacturing industries, the share of the public sector was approximately 51 percent of the sector's total fixed capital, in 1970.

This sector is characterized by medium to large-scale, capital intensive establishments, generally inclined to monopoly. Table 4.c shows details of companies in the mixed sector. Total investments are about KD 160 million, and the employment to establishment ratio ranges from 45 to 1500. The vast majority of the mixed sector's output is oil-based. Oil-based and related industries are fertilizers, chemicals and chemical products, metal tanks and tankers. They generate over 90 percent of the net value added in the manufacturing sector. The other existing industries are related to construction, for example metal pipes, sand-lime bricks, paints, varnishes, furniture, asbestos pipes and sheets, wooden pre-fabricated houses, and cement. The remainder process bread, macaroni and biscuits. These industries are largely export-oriented, particularly the oil-based output, 90 percent of which is exported due to the small requirements of the local market (see Table 3.c). Therefore, the rapid rise in the value of industrial exports portrays the growth of this sector. These exports averaged at KD 6 million in 1970 and 1971, and more than doubled by 1972 (KD 16 million). More importantly, the expansion is expected to continue, and the output to double again within the following two years.

4.4 Industrial Financing and Vocational Training

This section is in two parts. The first deals with the government's promotional policies for, and the contribution of commercial banks to industrial financing. Part two elaborates another element of the

Table 4.c

Mixed Sector Manufacturing Industries (1970 census)

Value: Million KD

Company	Date of Establishment	Total Investment	Fixed Assets (at cost)	Products
Kuwait National Petroleum Company	1960	53.285	57.085	Naphtha, benzene, kerosine, oils, heavy fuels
Kuwait Petrochemical Company	1963	40.425	27.779	Urea, liquid ammonia
Chemical Fertilizers Company	1964	15.223	9.867	Sulphuric acid, ammonium sulphate, and urea
National Industries Company	1960	7.144	5.538	Construction material, dry batteries
Kuwait Asbestos Company	1960	1.855	1.382	Asbestos pipes and sheets
Kuwait Cement Company	1968	1.659	1.140	Portland cement
Kuwait Prefabricated Housing Co.	1964	1.013	1.276	Prefabricated houses
Kuwait Metal Pipe Company	1966	1.409	0.988	Petroleum, water, gas, etc., pipes
Kuwait Flour Mills Company	1961	7.858	3.802	Flour, bread, macaroni, biscuits
Kuwait United Fishing Company	1971	30.000	14.034	Shrimps, fish-packing and freezing

Source: Strategy and Prospects of Industrial Development in Kuwait, Tripoli; 1974, op. cit., Table 15, p.20, (in Arabic)

government's promotional policies, namely vocational training. Government industrial financing is both direct and indirect. Participation in mixed enterprises, as discussed above, and the provision of loans to mixed sector industries through the Ministry of Finance and Petroleum are the direct measures. The indirect measures consist of fiscal legislation and industrial financing through specialized financial institutions.

Fiscal legislation provides tax exemptions for up to ten years for new industrial establishments[13]. Further incentive to industrial financing is the government's liberal policy on foreign investments. Foreign investments are entitled to the same privileges given to national capital as far as freedom of capital transfers are concerned. On the other hand, the commercial law (No. 2/1961) requires all business to have a majority Kuwaiti participation in order to ensure local control. Apart from oil refining, foreign investment has been insignificant.

Specialized industrial financing is indirect and is at present carried out by the Savings and Credit Bank[14]. This bank was established in 1965 to replace the Credit Bank, and is fully government-owned. In the financial year 1971/72 (ending in March) it granted KD 35.6 million in loans, or 23 percent of total commercial banking loans. As shown in Table 4.d its industrial loans did not exceed 3.9 percent. The bank's interest rates on agriculture, social and industrial loans did not exceed 3 percent[15], and were borne by the Ministry of Finance and Petroleum. Industrial loans are restricted to less than 50 percent of the nominal capital of a project. Remarkably though, the bank is prepared to finance unprofitable projects, if their social rates of return are high. As a developmental financial institution, the bank has yet to take the important step of subscribing to the investment of industrial projects. The bank's limited contribution to industrial financing can be explained by its policy of concentrating on the

Table 4.d

Loans Given by the Savings & Credit Bank and the Commercial Banks in Million KD. According to Type of Loan in 1972 (March 31st)

Type of Loan	Savings & Credit Bank		Commercial Banks	
	Value	Percentage	Value	Percentage
Real Estate	31.20	87.5	-	-
Industrial	1.40	3.9	21.30	14.1
Social	2.20	6.2	-	-
Agricultural	0.05	0.1	-	-
Trade	-	-	106.30	70.4
Construction	-	-	23.50	15.5
Other	0.77	2.2	-	-
Total	35.62	100.0	151.10	100.0

Percentage of Savings & Credit Bank Loans to Total Commercial Banking Loans=22.9%

Source: Central Bank of Kuwait, Al-Takrir Al-Sanawi Al-Thaleth (Third Annual Report) 1972, (Kuwait: Makhowi P. Press, 1972) Tables 52 and 55 pp.123 and 128.

provision of social loans (housing etc.). Accordingly, credit shortage remains an important constraint to new industries particularly small ones, needing to purchase capital goods and bear other operational expenses. In order to ease this financial constraint, the Industrial Development Bank (IDB) was established in 1974.

As shown in Table 4.e, the IDB's capital of KD 10 million, is underwritten by the government and the Kuwaiti financial institutions. This is the usual proceding in other LDCs. Article No. 5 of the agreement establishing the IDB and its by-laws stipulates that the bank's aim is to help develop and diversify the economy. It aims at achieving this through encouraging new industries and supporting existing private and mixed sector establishments in all fields. In the long-run, the IDB could assist substantially in developing industry. Provided that there is no discriminatory treatment, it could help reduce capital market imperfections. It could also contribute to the reduction of the cost of financing investments, and the role of direct government loans to industry.

In fact, commercial banks and not specialized public financial institutions provide the bulk of industrial credit. The commercial banks are now awarding industrial projects short-term credit on a rotating basis. In 1972, of the total loans to the industrial sector, KD 21 million were granted by commercial banks, as compared to KD 1.4 million by the Savings and Credit Bank. The abundance of capital in the private sector means that private financing can be substantial. Since the Central Bank is restricted by law (Article 166 of the Commercial Law) to a 7 percent interest rate ceiling, its intervention to stabilize and facilitate the saving-investment process is limited. Consequently, the private sector's preference for investment abroad continues.

The government is aware of the importance of the role of vocational and technical training for obtaining skills. Thus it has established the

Table 4.e

The Underwriters to the Industrial Development Bank's Capital

Name of Underwriter	Value in '000 K.D.
Government of Kuwait	3,500
Central Bank of Kuwait	1,400
The National Bank of Kuwait	1,000
The Commercial Bank of Kuwait	0,500
The Gulf Bank	0,500
Al-Ahli Bank of Kuwait	0,500
Bank of Kuwait and the Middle East	0,500
Kuwait Real-Estate Bank	0,300
Kuwait Re-Insurance Co.	0,075
Gulf Insurance Co.	0,075
Al-Ahlia Insurance Co.	0,075
Kuwait Flour Mills Co.	0,500
Kuwait Manufacturing Metal Pipe Company	0,500
National Industries Company	0,500
TOTAL	10,000

Source: The Arab Economist, Supplement Kuwait, May 1974 No. 64 (Centre for Economic, Financial and Social Research and Documentation S.A.L., Beirut, 1974) p.59

Technical School in Kuwait City which has an estimated 700 students per year. The ILO manages the Shuwaikh Training Centre of the Ministry of Social Affairs and Employment which provides further training in mechanical and electrical engineering. The period of training is for 18 months, and has 116 trainees. In 1973 the number of trainees completing their course was 54. The Ministry has plans for expanding enrollment and establishing other centres. By preparing the outstanding trainees (11 out the 54 in 1973), the Ministry hopes to extend the training staff. Moreover, the centre is sponsoring upgrading courses of 4 months duration for civil service technicians. In 1973 about 50 employees of the Ministries of Electricity and Water, and General Works joined these courses. In addition, 16 industrial supervisors enrolled for similar courses. It is planned to repeat the upgrading courses 2 to 3 times every year to make the fullest use of the centre's facilities.

The government is resorting to other courses of action in order to expand vocational training. Arrangements are being made with industries and technical institutions in industrially developed countries for up-grading courses and 'on-the-job' training for operative supervisors and managers. Finally, whereas technical training remains limited, managerial training in the mixed sector is non-existent (see Chapter 2 section 9). Time lags add yet another impediment to the materialization of these skills.

4.5 Government Control Variables

The public sector's industrial policies can be in the form of licences, quotas, taxes, tariffs, and price and output subsidies (in the public sector). In a broad sense, these policies behave as control variables[16]. The particular control variables which the Kuwaiti government employs are licences, tariff exemptions, and tariff protection. Nevertheless, these instruments are used to a limited extent, and on a temporary basis allowing competitive forces to operate.

The Administration for Industrial Affairs (AIA) is the industrial sector's

organizational organ and is responsible for providing it with services and facilities as prescribed by law. It operates within the rules and regulations of the National Industries Act of 1965. The Industrial Development Committee prepares the necessary studies and recommendations for industrial development and provides means for the co-ordination, protection, encouragement, and licencing of individual industrial projects.

Through these organizational structures, the government has the power to grant tariff protection for local industries of up to 50 percent of c.i.f. import prices of similar goods. But active industrial protection is still modest, and ranges between 10 and 15 percent for a limited period (usually 5 to 10 years) for import-substitution products. Although it is insufficient at this level, it may encourage some private enterprises where internal economies, reflecting increasing return to scale (along production functions) exist. These economies allow such supplier firms to equalize their costs with c.i.f. import prices. Other firms require a longer period of protection to equalize their cost with c.i.f. import prices. Where external economies exist, in particular, the period of production ought to be stretched.

According to the infant industry dogma[17], this low level of protection may prove ineffective to most protected firms. In the process, it will represent a net moderate loss to the consumer[18]. Of course, effective protection is unexpected in the forseeable future, not least since the government does not require tariffs as a source of revenue. An alternative to protection could be the application of the 'infant industry' policy, directed on a pilot project[19] basis with subsidies applied on a regressive basis. Since the aim is increased production, this could be an optimal government policy. The object of tariff protection, at least in the short-run, is not the reduction of the volume of imports. The last control available, licences, is discussed in the following chapter, with the industrial planning experience of Kuwait.

4.6 Growth of the Industrial Sector

We have seen earlier that growth in oil revenues overshadows growth in other sectors. Therefore, to understand the full contribution of the non-oil industrial activities to the national economy, the manufacturing and construction sectors are taken together to represent the industrial sector. The growth trends and expansion of both activities, as well as the public utilities sector, are demonstrative of their interdependence.

In the case of the manufacturing sector, its overall growth rate was 17 percent per annum between 1971/72 and 1972/73. Its contribution to GDP increased immensely by 73 percent between 1966 and 1972/73. But the significance of the growth of the manufacturing sector in absolute terms has been dampened in relative terms by the growth of oil revenues. In relative terms, it constituted 3.5 percent of GDP in 1966, falling to 3.0 percent in 1972/73, as shown in Table 4.f.

The construction sector, as a necessary input to establishing and expanding refineries, gas, petroleum or other industrial sites, has been growing at a similar rate. For the same period, 1971/72 to 1972/73, its growth rate was 16 percent per annum, representing a forward linkage effect[20]. Outside the oil sector, construction is the largest single sector, representing 3.3 percent of GDP in 1972/73. Hence, the impact on employment was disproportionate, for it employed 28 percent of the labour force, less than 13 percent of whom were Kuwaitis (in 1970). Naturally, further expansion of the industrial sector will create pressure on the limited supply of labour.

There is a backward linkage effect between the rapidly growing construction projects, and the local building materials industry (construction projects are discussed in Chapter 2, section 4). This effect is clearly demonstrated by the construction materials industry's 49 percent share (KD 12.5 million) of total capital investment in the non-oil industrial sector in 1973. For instance, the Cement Company envisaging this boom, is carrying out geological surveys in different parts of Kuwait to secure raw materials to expand the company's production capacity from 300,000 tons per year to 750,000

Table 4.f

Contribution of Sectors to GDP, 1970/71 to 1972/73

(in Million KD)

Sector	1970/71		1971/72		1972/73[e]	
	Value	Percentage	Value	Percentage	Value	Percentage
Extractive	656	60.7	906	64.0	983	63.2
Manufacturing	38	3.5	42	3.0	46	3.0
Construction	34	3.2	40	2.8	52	3.3
Utilities	75	6.9	88	6.2	104	6.7
Services	146	13.5	163	11.5	182	11.7
Government Services	132	12.2	176	12.5	189	12.1
Total	1081	100.0	1415	100.0	1556	100.0

Source: Central Bank of Kuwait, Annual Report 1973, Table 5, p.28, (in Arabic)

e = estimates

tons in 1975. The second phase of this survey has been completed. It shows the availability of 100 million tons of clink-stone used for the production of the necessary clinker for cement production. The development potentials of the construction materials industry is derived from the availability of local raw materials shown in the case of the sand-lime brick production. The government recognized these potentials and signed a contract in July 1973 with the Canadian consultancy company G. Sproulf to carry out, in cooperation with Kuwait University, a 14 month long geological survey of quarrying localities, suitable for the construction of manufacturing industries[21].

The public utilities sector, is complementary to the industrial sector. Its complementarity produces external economies to the latter. These utilities, consisting of electricity, water, and natural gas, figure pre-eminently in industrialization plans[22]. Domestic production of these utilities are induced by derived demand, or backward linkage effects from the manufacturing sector. A notable example is the Shuaiba industrial estate's utilization, and with the exception of natural gas, the production of these utilities. Of the potable water consumed in Kuwait in 1972, only 8 percent was potable underground well-water. Therefore, water desalination and distillation was stepped up. It doubled between 1967 and 1972 to meet the 15 percent per annum growth in potable water consumption. The Shuaiba estate's desalination plants produce about 44 percent of the total potable water production. Its industries use a small, though increasing portion of this water directly from the estate's northern plant for cooling and other processes. The estate's electric power generating plants produced 76 percent of Kuwait's total electric output in 1972. Its industries consumed close to a quarter of the 3009 million kilowatt-hours consumed by the public in this year. Consumption of electricity by these industries has been rising at a staggering rate of 31.5 percent per annum as opposed to a general rise in electric

consumption of 19 percent per annum between 1968 and 1972. The natural gas consumption of the estate has been growing at similarly high rates of up to 36 percent per annum for the same period as opposed to the 7 percent annual rate of growth in consumption for the country. The natural gas is supplied to the estate directly from the Bourgan Fields. In 1972, the estate and public utilities' share of total natural gas consumption was 35 percent. It was utilized both as a feedstock and a fuel by the petrochemical and refining industries, and in electric generation, and water desalination.

The industries of the estate have access to external economies through the availability of these utilities and port facilities. Therefore, a determinant of the spread effect, the interdependence through backward and forward linkages among the manufacturing, the construction, and the public utilities activities may stimulate further local activities. It is also likely that the backward linkage effect will be highest in the manufacturing of final products. The relative importance of oil as an energy source and as a feedstock may alter accordingly.

4.7 Summary and Conclusions

The industrial sector evolved from four activities, construction and construction materials, public utilities, marine-oriented industries and repairs and maintenance. Since the late 1950s industrialization has gathered momentum. However, industrial units were set-up randomly, and the size of these units, reflecting the scale, was very small. In the early 1960s, the government initiated a policy of participation in order to establish an organized sector. The growth of the organized, or mixed sector changed the organizational and production structure of the manufacturing sector. Whereas industries of the private manufacturing sector remained, by and large, small scale, labour intensive, catering for the local market, the mixed sector industries, were largely medium and large scale, capital intensive, and export-

oriented oil-based industries.

Apart from the government's direct participation and establishing of industrial projects, there were other measures for the promotion of industrial financing. Fiscal legislation for both national and foreign investment is liberal, though the latter has been insignificant. Indirect government financing since 1960 was initially carried out by the Credit Bank and later by the Savings and Credit Bank. Their contribution to industrial financing was limited as their activities were geared to financing social projects. This prompted the establishment of the Industrial Development Bank in 1974. By comparison, indirect financing by commercial banks has been much more significant. However, both private and public industrial financing has realized only an infinitesimal part of its potential. Another government measure for the promotion of industrialization is vocational training. Although vocational training is expanding, it remains limited, and time consuming. The public sector's control variables for industrialization are restricted. The level of industrial protection is low. Subsidies applied on a regressive basis may prove to be more beneficial.

Finally, the development of the oil sector has had little impact on the rest of the economy. Therefore, to reduce the degree of vulnerability of the economy and to develop the productive capacity, the development of the industrial sector becomes a necessity. The complementarity of the manufacturing, construction, and public utilities activities, is exemplified by their similar rates of growth. Growth of industrialization by developing complementarities, external economies, and accumulation are items discussed in the following chapter which reviews the methods and planning course of industrialization.

Notes to Chapter 4

1. The level and breakdown of investment in the oil industry is reviewed by Sayegh, K. S., Oil and Arab Regional Development (New York: Frederick A. Praeger, 1968) pp.33-45.

2. Singer, H., "The Distribution of Gains between Investment and Borrowing Countries" Papers & Proceedings of the American Economic Association, Supplement to American Economic Review, Vol. 40, No. 2, 1950, p.147.

3. Khoja, M., op. cit., pp.14-16. See chapter 2 footnote 7.

4. The exogenous variable is the difference between the value of total exports and net factor transactions with the rest of the world. The net factor transactions, as employed by Khoja, consists of the difference between the profits repatriated by the international oil companies in Kuwait, and earnings of public and private sectors from overseas investments.

5. See for instance Thomson, W. R., A Preface to Urban Economics (Baltimore: The Johns Hopkins University Press, 1965) Chapter 4; and Nourse, N. O., Regional Economics (New York: McGraw Hill Co., 1968) Chapter 7.

6. Khoja, op. cit., p.23-24.

7. Administration of Industrial Affairs, Ministry of Trade & Industry, Itijahat Wa Istratigiat Al-Tanmiah Al-Sinaiah La-Dawlat Al-Kuwait, Tripoli, 1974, The Third Conference of the Industrial Development of Arab Countries, April 1974, Tripoli (Strategy & Prospects of Industrial Development in Kuwait) (Kuwait Government P. Press, 1974), p.18.

8. United Nations, Industrial Development in the Arab Countries, selected documents presented to the Symposium on Industrial Development in the Arab Countries, Kuwait 1-10 March 1966 (New York: U.N. Publication, 1967) p.102.

9. The Ministerial Regulation No. 5/71 for the protection of the national industry (an amendment of the National Industries Act of 1965), published in Al-Kuwait Al-Yawom (Kuwait Today) No. 838 of 25 July 1971, provides tariff protection on certain imports varying between 10 and 15 percent of the c.i.f. import price. It was later supplemented by Regulation No. 2/72. The protected products include metallic furniture, wooden domestic furniture, biscuits, metallic fibres, cast-iron, casting pig-iron, aluminium products, and packaging material.

10. The definition of industrial establishments by the National Industries Act also includes firms engaged in the assembly, mixing, filling, or packing of products provided that these operations are carried out mechanically.

11. An establishment employing less than 100 workers is considered small in size. Size and scale of an establishment have been used synonymously, since the classification is restricted by statistical information, to the number of workers.

12. Bowen-Jones, H., "Urbanization and Economic Development". offprint from the Exploding City (Edinburgh University Press, 1972), p.102. Professor Bowen-Jones' observations are based on the 1965 industrial census, and were confirmed by the 1970 industrial census.

13. U.N. op. cit., p.13.

14. The scope of operations of the Savings and Credit Bank are broadened by being

authorized to borrow an amount equal to its subscribed capital (KD 20 million) against government guarantee.

15. The Savings and Credit Bank charges interest rates comparable to commercial banks, on non-developmental loans, averaging at 7.75 percent.

16. Sen points out that these control variables are each constrained by political, social, and administrative considerations within certain ranges. Therefore, it's important for a planner to know which of these variables are within his control. See Sen, A. K., "Control Areas & Accounting Prices: An approach to Economic Evaluation". Economic Journal, Vol. 82, Special Issue 1972, pp. 486-8.

17. Kemp, M. C., "The Mill-Bastable Infant Industry Dogma, Journal of Political Economy, Vol. 68, February 1960, pp.65-6.

18. Johnson maintains that subsidies on production or equivalent taxation of production of alternative products, raise the domestic prices to producers only, whilst leaving consumers free to buy at world prices. See Johnson, H. G., "Optimal Trade Intervention in the Presence of Domestic Distortions", in Caves, R. E., Kenen, P. B., and Johnson, H. G., (eds.), Trade, Growth and the Balance of Payments, Amsterdam: North Holland Publishing Company, 1965) pp.31-2.

19. El-Mallakh, R., Economic Development and Regional Cooperation: Kuwait (Chicago: The University of Chicago Press, 1969) pp.109-110.

20. Forward linkages are the interdependence through sales to other sectors, whilst backward linkages are the interdependence through purchases from other sectors. The former are more behavioural in their inducements than the latter which are technically determined. See Meier, G., Leading Issues in Economic Development (Oxford University Press, 1970) pp. 100f.

21. Annual Report 1973 pp.178-9.

22. See "Mixed Prospects for a M. E. Petrochemicals Industry," Middle East Economic Digest, Vol. 18, No. 14, 1974, pp.389-396.

CHAPTER 5

Development Planning

This chapter is concerned with industrial planning in Kuwait and its implication for the development of the economy. Section 1 is concerned with the background to industrial planning, and potential industrial projects. Section 2 reviews the theories of balanced and unbalanced growth in relation to the industrialization of Kuwait. Section 3 deals with the criteria governing the public sector's investment policies and how these policies could induce the private sector's ability to invest. Section 4 discusses labour constraints and the importance of labour productivity. Section 5 reviews the prospects for advanced technology with Kuwait's factor endowments. Section 6 discusses the use of natural gas in industrialization. Finally, section 7 provides the summary and conclusions to the chapter.

5.1 Development Planning

Industrial Planning is not new to Kuwait. The first step taken in this direction was the setting-up of industrial estates in 1952. This step accompanied the approval of the organizational plan of Kuwait city and its suburbs. An industrial estate was conventially defined as a plot of land embracing a group of factories provided with the necessary public utilities. The land was divided into small parcels which were offered by the government at nominal rents with long-term leases over fifty years. These estates aimed, initially, at encouraging economic activity generally[1].

There are three such industrial estates: an area within the limits of Kuwait city; an area near the seaport known as the Shuwaikh industrial estate; and the third is the Shuaiba industrial estate. The last, called after a nearby village, is the most important and is located 50 kilometers south of Kuwait city, on the Gulf. An Emiree decree was issued approving the Shuaiba estate project on 14 May 1964. The decree also appointed a committee of eight,

chaired by the Minister of Finance and Industry[2], to supervise the projects.

Work on the Shuaiba estate started in 1964 to provide public utilities and industrial projects. Public utilities located within the estate now include electric power stations; natural gas; water distillation and cooling water pumping stations; a seaport; an oil jetty; roads, street lighting, a drainage system; industrial clinics, and a medical centre. The importance of this estate is that it was the first major step towards the development of an industrial sector. The estate was intended primarily to help set-up heavy industry. The first was the Kuwait Chemical Fertilizers Company in 1965, and this was followed by the Kuwait National Petroleum Company.

Diversification plans were drawn up in 1963 by the Industrial and Process Engineering Consultants of London, under the auspices of the Kuwaiti Ministry of Finance and Industry. Emphasis was given to projects utilizing petroleum and gas, especially petrochemicals and fertilizers. There were others for aluminium smelting, steel, cement, tyres, and plastics[3]. Some of these projects have been implemented. Other projects were incorporated into the first development plan (1968-1972), and then into the industrial development scheme during the past three years.

The general principle of the first development plan was to maximise the national income. Its aim was to diversify economic activities. It was, however, recognized that there are limits which restrict the level of investment. The limits generally depend on the availability of skilled labour, new markets, and the expansion of the country's industrial framework. Since these dependent factors take time to materialise, the plan opted to phase industrial development[4]. Therefore, in the preamble to the plan, about 9.4 percent of total national investment only - KD 86 million - was alloted to the industrial sector[5]. Finally, we may note that the role of this plan has been to act as a guideline for the private and public sectors' investments. Subsequently, evaluating the outcome of the plan at present is premature.

The Administration of Industrial Affairs (AIA) of the Ministry of Trade and Industry, designed the industrial development scheme to set-up mixed sector industries. The scheme, which classifies planned industries according to their market orientation, is consistent with previously designed and implemented industrialization plans. All potential export-oriented industrial projects are oil-based, with the exception of aluminium smelting, which is powered by natural gas. As shown in Table 5.a., the planned investments totalled KD 250 million, distributed amongst the primary lubrication oils; liquid gas; aluminium smelting; primary and intermediate petrochemicals; melamine; and azotic (nitric) fertilizers. New plans are being drawn up to expand the petrochemical complex project and raise its capital investment from KD 100 million to KD 400 million. This would raise the total planned investments in export-oriented industries to KD 550 million.

Planned import-substitution industrial projects can be divided into the manufacturing of construction materials, food processing and other consumer goods. The bulk of investment is allocated to the manufacturing of construction materials - about KD 60 million out of KD 81 million (Table 5.b.). The most important construction materials projects are construction iron (KD 35 million); wood sawing and compressed wood and veneer (KD 4 million); and the expansion of the Cement Company's capacity by 700,000 tons (KD 16 million). Consumer goods projects include spinning and weaving (KD 8 million); tyres (KD 64 million); and sugar refining (KD 2 million). In 1973, 26 import-substitution projects, employing an estimated labour force of 1 thousand were licenced, partly or fully. These totalled approximately KD 8 million, as shown in Table 5.c. The most important construction materials projects were crushed stone and crushed artificial stone. In food processing the largest project was sugar refining. Metal furniture and other consumer goods projects were also licenced.

From these potential projects, the following industrialization course emerges:

1 - Of an estimated KD 639 million planned investments, 86 percent are

Table 5.a

Export-Oriented Industrial Projects[a]

Industrial Activity	Investment Estimates in Million KD	Volume of Production
Aluminium Plant	35	120,000 tons p.a.
Primary & Intermediate Petrochemicals[b]	100	Different products
Liquified Petroleum Gas	100	4.5 million tons p.a.
Lubricating Oils	5	60,000 tons p.a.
Melamine	4	10,000 tons p.a.
Nitric Fertilizers	6	14 tons daily
Total Investment	250	

Source: Administration of Industrial Affairs, Ministry of Trade & Industry, Itijahat Wa Istratigiat Al-Tanmiah Al-Sinaiah Le-Dawlat Al-Kuwait, Tripoli 1974 (Strategy & Prospects of Industrial Development in Kuwait), (Kuwait: Government Printing Press, 1974), Table 24, p.31 (Arabic).

Note: p.a. = per annum.

[a]Studies of projects and means of implementation are being prepared. The private sector will participate in these projects.

[b]Planned capital investment in the petrochemical complex project might be raised to KD 400 million.

Table 5.b

Investment Estimates for Domestic Consumption Projects for the Next Five Years

Industrial Activity	Investment Estimates in Million K.D.	Volume of Production Estimates	General Remarks	Employment Estimates
Dry Batteries	0.60	15 Million Units (3 sizes)	Partly licensed 1973	90
Chemical Detergents	0.75	3,000 tons p.a.	Under Execution	-
Iron Production (construction iron)	35.00	300,000 tons p.a.	Seeking Licensing in 1974 (Direct Contraction Method)	-
Car Tyres	4.00	10,000 tons p.a.	Preparation of Implementation Studies	-
Oil & Margarine	1.00	6,000 tons p.a.	Under Execution	-
Tanning & Wool Compressing	0.50	600,000 sheep & goat leather	Seeking licencing in 1974	-
Galvanised Water Tubes & Joints	0.75	15,000 tons p.a.	Partly licensed in 1973	60
Tubes with Spiral Welding	1.50	40,000 tons p.a.	Expansion of Present Plant	-
Wood Sawing, Compressed Wood & Veneer	4.00	11,000 m^3	Seeking Licensing in 1974	-
Spinning & Weaving	8.00	20 million metres	" " " "	-
Cement (Portland)	16.00	700,000 tons p.a.	" " " "	-
Dry Dock	2.00	Maintenance & Servicing of Fishing Boats	Seeking licensing in 1974	-
Pharmaceuticals	1.50	75 Medical Groups	" " " "	-
Metallic & Office Furniture	0.75	2,500 tons p.a.	Partly licensed in 1973	123
Sugar Refining	2.00	30,000 tons	Licensed in 1973	122
Plastic Packing Bags	0.65	36 million Polypropylene Bags	Under Execution	-
Gravel & Mosaic Stones	2.00	300,000 tons	Licensed in 1973	199
Total Investments	81.00			

Source: Strategy & Prospects of Industrial Development in Kuwait, Tripoli, 1974, op. cit., Table 23, p.30 (Arabic): The Arab Economist, Supplement Kuwait No. 64, May 1974, Tables 2 and 3 pp.60-1.

Notes: Employment Estimates include both personal and The Arab Economist estimates. The public sector will participate in some of these projects.

Table 5.c.

Licensed Industrial Projects During 1973

Kind of Industry	Estimated Capital in '000 K.D.	Estimated Labour Force
Sugar	2,000	122
European Bread	17	10
Ice	21	9
Fruit Juice	80	30
Soft Drinks	460	78
Animal Feed	46	12
Copy and Note Books	38	16
Cement Paper Sacks	230	19
Paper Envelopes	35	11
Paper and Plastic Bags	35	12
Sanitary Products	105	78
Hydrogen Oxide	150	19
Dry Batteries	325	44
Bottling Carbon Gas	70	21
Carbon Dioxide Gas	55	10
Powder, Cream, Candles	75	13
Glass for Cars' Windows	100	21
Crushed Stones	1,500	149
Artificial Crushed Stones	1,155	50
Insulating Material for Construction	38	11
Cement Roofs	125	27
Aluminium Roofs	54	18
Galvanised Metal Pipes	500	40
Central Air-conditioning Apertures	8	11
Metal Furniture	500	82
Electric Lamps	72	67
Total	7,794	980

Source: The Arab Economist, Supplement Kuwait May 1974 No.64, Table 2, p.60.

concentrated in capital intensive large-scale, export-oriented projects.

2 - Export-oriented projects make full use of the country's decided product advantages.

3 - Petrochemicals are planned to become the leading modern industrial sector. Of the total planned investments, KD 400 million - 63 percent - is allocated to the petrochemical complex. This can be compared to less than KD 160 million investment in the fixed assets of the mixed sector until 1970. This is representative of the desire to speed up the pace of the diversification of the economy.

4 - The scale of import-substitution projects, small and medium, has been determined by effective local demand. Development needs have determined the nature of products, which are mainly construction materials.

5 - These potential projects are consistent with previously designed and/or implemented plans, making use of linkage effects and external economies.

5.2 Balanced or Unbalanced Growth

In seeking the most efficient methods of resource allocation, planners face the choice of developing along the lines of either balanced or unbalanced growth. The principal authors of the theory of growth, Nurkse, Rosenstein-Rodan, Lewis, and Scitovsky[6], argue for 'balanced growth'. Balanced growth means the simultaneous expansion of a number of sectors of production. Nurkse, considered that the inducement to invest lies in expanding the market size. This is based on Say's law that supply creates its own demand. Balanced growth should, therefore, lead to the expansion of the small market, and assist in stimulating investment.

Hirschman, who argues for unbalanced growth, maintains that growth "is the end result of a series of uneven advances of one sector followed by the catching-up of other sectors. If the catching-up overreaches its goal, as it often does, then the stage is set for further advances elsewhere. The advantage of this

kind of seesaw advance over 'balanced growth', where every activity expands perfectly in step with every other, is that it leaves considerable scope to induced investment decisions"[7]. In this way, development decision-making, the most scarce resource in developing countries, is economized. Other scarce resources, such as capital, entrepreneurial ability, or natural resources, are producible in the process of development.

Kuwait has been following both lines. The government has, so far, stressed the social overhead capital (SOC) expenditure more than the directly productive activities (DPA), a position advocated by balanced growth. This is suitable for a capital-surplus economy. But, generally, one cannot assume an elastic capital and labour supply in developing countries. The country is trying to achieve a form of balance between the oil and the non-oil sector, and between services and industry. An advantage of this development is that it may assist in absorbing the unproductively employed labour, through the expansion of other productive sectors.

Paradoxically, the development of the industrial sector itself, follows the line of unbalanced growth. In this modern sector, plans emphasize the creation of leading sectors concentrated in oil-based industries, specifically petro-chemicals. In this context of industrial specialization, Chenery suggests that as a result of vertical and horizontal industrial interdependence, investments are likely to prove more profitable in interrelated sectors of industry than when undertaken in isolation[8]. Streeten, puts forward a dynamic argument for unbalanced growth supported by the fact that if increases in output are concentrated in a few sectors, technological progress may be more rapid[9]. Thus, within the industrial sector, growth in the leading industries would be 'communicated' to the followers, and from one establishment to another.

From the demand point of view, planned industries in Kuwait are either import-substitution or export-oriented. From this point of view, Viner notes that whenever a new activity is export-oriented, import-substituting, or

cost-reducing rather than output increasing, balanced growth is not required.

The theory of balanced growth stresses the ability of investment opportunities and their productivity, on the one hand, and the generation of savings, on the other. In contrast, a basic proposition of unbalanced growth is not the availability of savings but the ability to invest. This is clearly demonstrated in the case of Kuwait. The high percapita income in Kuwait has been accompanied by one of the highest propensities to save in the world, averaging at 48.8 percent between 1970 and 1972. The average propensity to invest for the same period was 15.6 percent; that is, investment fell short of savings by two-thirds. Both potential savings and savings that have been accumulated over time are substantial. The channelling of existing savings is accompanied by a shortage to make and execute development decisions. Hirschman's criticism of the supply side of balanced growth, that developing countries do not have sufficient saving does not apply to Kuwait. Ironically, it is the availability of surplus capital which has reduced the ability to invest. Therefore, in order to induce investment, economize on decision-making, and attain rapid technological progress, a strategy of imbalanced industrial development seems viable in the case of Kuwait.

In a modern sector, such as Kuwait's industrial sector, Hirschman[11] represents the ability to invest (or the absorptive capacity of capital) as a coefficient ν applied to the total income of the economy's modern sector, Ym yields the investment ν.Ym. This investment is generally low not because ν, the ability to invest, is low, but because Ym relative to the economy's total income Y, is low, as shown in Chapter 4 section 6. This could be attributed to the lack of productive investment opportunities. Therefore, there is a need for a modern sector to generate the required ability to invest and vice versa. For investment ν.Ym to catch up with s.Y (where s is the economy's propensity to save) the modern sector has to expand, and the expansion should be larger than

S. Hirschman, emphasizes the complementarity effect of investment which would play the role of "pace-setter for additional investment"[12].

Generally, complementarity effects mean that the increased output of an operator will "pressure" the increase of the available supply of other operators, whether the commodity pressured is produced by private or public producers, or imported[13]. Production complementarities produce external economies. The disequilibrium pattern of development is induced by a preceding disequilibrium achieved by making use of external economies. This expansion generates new external economies which may be taken advantage of by subsequent ventures. It is relevant to note here that external economies "should not be limited to the impact of the provision of economic overheads on other industries but should include the effects and intereffects of an expansion in any industry"[14], since all industries are sources and recepients of external economies.

Hirschman recognizes that in the process of preceding investments inducing subsequent ones, there are differing levels of 'inducements'. Because of this 'asymmetry', re-investment in new activities which bring about external diseconomies would be restrained, while stimulationg "complementary capital formation elsewhere in the economy"[15]. Therefore, the investment-creating effect of complementary activities, cannot be matched by competitive or substitution effects, unless competitive activities are strong - compared to complementary ones. It must be borne in mind that in the long-run, when high levels of development are reached, complementarity effects would be polarized. Naturally, further expansion of the economy would be hindered by the supply of savings, as more traditional models of economic growth imply.

5.3 Investment Inducements and the Public Sector's Investment Policies

In the formulation of criteria for Kuwaiti public investments, a set of objectives must be considered. Firstly, the accomplishment of the complementary objectives of public policy. These include the diversification of production patterns, and the securing of higher social returns. Secondly, the distribution

of gains from these projects to the nation at large, since their actual revenues play the role of transfer payments from users of project outputs, to the community as a whole[16]. Thirdly, the cumulative process involved in the re-investment of the revenue from projects. Fourthly, the certainty, and soundness of these projects for the absorption of a certain part of government surplus capital. Apart from these considerations government investment has "specific structural features". These include economies of large scale, capital-intensive techniques, inclination to monoply and product's importance.

In the previous section we saw that Kuwait is following a mixed form of development. We have also pointed out that the provision of SOC facilities, by the public sector, ahead of DPA demand suits a capital surplus economy. This unusual process of development creates a set of pressures and incentives to DPA investors, which accords with the arguments of unbalanced growth. An example of building in excess of demand is the provision of industrial estates or other infrastructural facilities which make DPA investments attractive. By providing services, facilities, and maintenance, industrial estates encourage small scale industries and reduce their initial production costs by exploiting external economies.

In Chapter 2 we saw that the private sector is not prepared to take the risk and uncertainty involved in large-scale industries on its own. On the other hand, increasing the efficiency of DPA investments from the private sector depends on stimulating the entrepreneurial motivation. The nature of planned industrial development, therefore, necessitates the public sector's participation to stimulate private entrepreneurial ability. However, in mixed enterprise industries the financial feasibility of proposed investment by the public and the private sectors are based on different considerations. For the private sector, profit is the main, if not the sole consideration. Whereas one of the advantages of public enterprise is that "narrow profit and loss considerations

need not dominate investment decisions"[18]. However, the structural features of these ventures - particularly the monopolistic power - could prove a means of earning higher profits. Therefore, the government should continue its successful policy of setting-up the industrial projects, and later offering their equity to the public for general subscription. This policy would provide the necessary conditions for the asymmetric sequence of industrial development making use of complementarities, the cumulative process, and external economies.

After creating a situation in which a disequilibrium leads to a sequence of similar developmental disequilibria, policy-makers may not need to interfere. It is likely that social and private profitability will coincide simply "because 'input' and 'output' of external economies are the same for each successive venture"[19]. In this manner, decision-making can be economized.

Another government policy is its direct participation which can be applied to assist the ability to invest in 'infant industries'. In the situation of infant industry, H. Johnson[20] singles out two cases which make government intervention valid. Both occur when private investments are socially profitable, but privately unprofitable.

The first case for government intervention is when the social rate of return on the investment exceeds the private rate of return. Johnson cites two reasons for this, the first is that during the learning period of the new production technique, the individual(s) who has introduced it would have borne the burdens of carrying it[21]. Once acquired, the technique could be applied by others. The second reason is the dependence of the production technique on the skill of the labour force. The private rate of return on investment in 'on-the-job' training may be lower than the social rate of return since the acquired skills may be hired away by competitors. Moreover, the subsidies to production on a regressive basis may not necessarily stimulate investment in knowledge (see Chapter 4 section 5). Johnson recommends a governmental policy financing

'on-the-job' training. The Kuwaiti government has initiated such a move on a comparatively small scale.

The second case for government intervention is when the private rate of return needed to stimulate investment exceeds the social and private rates of return available "on alternative investments for a variety of reasons"[22]. One of these reasons is risk-taking by the private entrepreneur. For a long time capital has been invested in land rather than elsewhere because of the high returns and the little risk involved in land speculation. It is evident, heuristically, that luxury construction represents a substantial portion of fixed capital formation in Kuwait. Unfortunately, data is not available for quantification. The government's direct participation in the mixed sector has the effect of raising confidence, particularly in large scale, capital-intensive enterprises. In this manner, the public sector's participation becomes a warranty. A further reason for intervention here is the imperfections in the capital market. Studies of working capital requirements and financing those requirements by planning authorities are vital. Apart from servicing management with information on the relative efficiency of an industry, they serve bankers as guidelines in estimating credit applications[23]. The IDB would eventually ease this financial constraint (see Chapter 4 section 4).

Finally, Kuwait's approach to the broad industrialization development shows a desirable flexibility. This flexibility allows complementary effects to induce new investments and to be net beneficiaries of external economies. Constraints to development, inherent in the structure of the economy, remain but should eventually be overcome in the process of developing leading industries within the modern sector. One of these constraints is the availability of skilled labour which is the topic of the following section.

5.4 The Labour Constraint

This section is divided into two parts. The first is concerned with labour productivity, whilst the second discusses labour shortage. The impact

of employment in the industrial sector outweighs its impact on the national income. With the rapid growth of interdependent activities within this sector, labour shortage could become acute. Labour productivity in the industrial sector and its accurate measurement are, therefore, important. At present such measurements can only be crudely inferred. Table 5.d. compares the net value added by employees to their wages, and the total value of production of the mixed manufacturing sector for the year 1970. This sector is focused upon in the discussion because of the relative importance of its net value added contribution to GDP. In 1970, it amounted to KD 69.8 million as compared with KD 3.2 million from the private sector. Only crude estimates of labour productivity can be discovered through analysis of the degree of association between the value added and variables such as the scale (or size) of establishment, wage bills, and the total value of production. This association is one available key to labour productivity in the light of the present lack of information on this subject. Labour productivity, however, may change not only from one activity to another, but also between establishments engaged in the same activity. This may be accentuated by the use of averages throughout, due to limited statistical information.

The scale of these establishments are crudely based on the average number of their employees. The ratio of wage bills (total payments to employees) to net value added (NVA) are lowest in the following areas, food, furniture, chemicals, oil and coal products. The NVA per employee unit in these activities is the highest in the mixed sector. In the large-scale, capital intensive establishments, that is, 'the chemicals' and 'oil and coal products', the average payments per employee is also the highest in the mixed sector. These are KD 1406 per year and KD 2676 per year respectively. High average wages are explained by the fact that skilled labour and technicians are more concentrated in the larger-scale, capital intensive activities. Although average wages are

Table 5.d.

Net Value Added (NVA) in the Manufacturing Sector, Compared to Wages, Value of Production and Per Employee (1970)

Industrial Activity (No. of Establishments) / Scale of Establishment Average Ratio of Employees to Establishment		NVA Per Employee (in K.D.)	Per cent of payments to Employees to NVA	Per cent of NVA to Total Value of production
Printing & Printed Products (6)	27	804	74	51
Electrical Equipment & Repairs (10)	31	1,207	70	58
Non-Electrical Equipment & Repairs (8)	31	678	104	54
Food (14)	41	2,367	34	26
Furniture (14)	45	1,329	65	49
Paper & Paper Products (1)	55	2,213	29	44
Transport Equipment Repairs (8)	63	1,291	64	58
Metal Products (11)	67	1,335	53	43
Non-Metallic Mineral Products (12)	112	699	115	28
Chemicals (5)	166	2,452	57	38
Oil & Coal Products (4)	341	45,195	6	72
Beverages (2)	426	691	76	29

Calculated from table 186 in the Statistical Abstract 1973, pp. 264-9.

highest in 'oil and coal products', the low ratio of the wage-bill to NVA (6 percent) is depressed by the high NVA contribution per employee. It is similarly reflected in the high ratio of NVA to the total value of production. This does not simply suggest a high labour productivity. In the particular case of oil and coal products (basically refining activities), the association does not prove the causation. It merely suggests that the quality of labour-skilled - and the capital-intensive techniques where economies of scale have been achieved, could play an important role in raising labour productivity. In contrast, this ratio (wage-bill to NVA) is much higher in 'chemicals' (57 percent) and shows how the wage costs can be a heavy burden on NVA. Therefore, high labour costs may eventually prove to be a constraint.

In the remaining activities, the average payment per employee is low irrespective of the scale of the establishment and varies between KD 509 and KD 857 per year. In some of these activities it is clear that labour productivity is low. For instance, in the labour-intensive activities of 'beverages' and 'non-metallic mineral products', the cost of the wage-bill weighs very heavily on NVA. This is despite low average wages in these activities. Furthermore, in these two activities, the NVA per employee is very low and the ratio of NVA to total value of production is very high.

Therefore, one means of overcoming the labour constraint is the introduction of capital intensive techniques thereby increasing labour productivity. That is, Kuwait should stress labour productivity instead of capital productivity. Obviously, other factors such as labour quality, better management, and economies of scale, would operate to increase labour productivity.

The envisaged rapid expansion of the modern sector will be based upon advanced capital intensive techniques, largely dependent on skilled labour. It will, therefore, necessarily require a higher per unit ratio of skilled to unskilled labour. This is demonstrated in the case of 'chemicals' and 'oil and

coal products' industries. The most productive utilization of skilled labour requires economic planning to determine its combination with unskilled labour and capital[24]. In 1970, the proportion of operative and managerial skills to total manpower was 11.6 percent, of which 84 percent was expatriate. Even with increased government investment in upgrading sources and the provision of technical factors, the domestic skilled labour supply is likely to be inelastic, at least in the short run. The widespread inefficient utilization of manpower is aggravated by the fact that the effective supply of labour lags 41 percent behind the absolute supply. This effects the supply of unskilled as well as skilled labour and is basically a consequence of social attitudes acquired during the oil era and prevailing tribal traditions. The fact that these attitudes and traditions are unlikely to change in the near future lays a heavy burden on attempts to productively utilize the country's potential manpower resources. If industrial development is to continue both skilled and unskilled labour will, consequently, need to be imported.

The preceding discussion of productivity demonstrated that the cost of the wage bill can be a burden on the value added and on the output of some industries. Generally, wages in Kuwait are higher than those in neighbouring countries which provide her with labour. Kuwait's rapidly growing economy with a scarcity of labour is likely to experience a sharp increase in that factor's market value. A liberal policy on immigration may help to alleviate labour scarcity and, therefore, hold down wage levels. A similar effect could be achieved through the free movement of labour envisaged within the framework of the Arab Common Market. However, in the final analysis, it is likely that a liberal policy and ex aequo labour mobility in a common market would be constrained by political and social considerations.

5.5 The Factor Endowment of Kuwait and the Prospects for Advanced Technology

In the industrialized countries, the contemporary trend for industrialization is virtually confined to the development of labour-saving advanced technology.

and is increasingly highly capital intensive. Advanced technology may not, in terms of efficiency, be appropriate to the factor endowment of developing countries. Kindleberger, regards the adoption of modern technology by developing countries as a "mere demonstration effect on the side of production". Modern technology, in developing countries, wastes capital "since it uses it too intensively in a narrow sector". He maintains that such a capital wastage accrues to developing countries, because of their factor proportions where "labor-saving, capital-using inventions are not appropriate"[25].

Factor proportions in Kuwait differ from other developing countries. Whereas Kuwait has a labour constraint, the country has abundant capital and a potential comparative advantage in the production of capital intensive commodities. The allocation of 86 percent of total planned industrial investment to capital-intensive projects, is not a mere coincidence. With abundant capital, the criterion of the value of output achieved per unit of capital investment is not as critical as output per unit of labour.

It is generally believed that in a developing economy, factor costs do not reflect their opportunity cost[26]. In the growing economy of Kuwait, the disparities between factor costs and their opportunity costs may increase over time. With regard to labour, the scarcity of labour will inevitably result in an increase in its opportunity cost. In the case of capital, as already mentioned, the ability to invest could be generated through the expansion of the modern sector by the establishment of leading industries. One way of achieving this would be the direct participation of the government. This may lead to a less than proportionate decrease in the market cost of capital in relation to its opportunity cost.

More importantly, the all-round rise in output per head produced by the concentration of large firms in an area might prove a useful instrument in inducing technical progress[27]. The establishment of research and development departments by these enterprises would strengthen this process. Further

concentration of such industries as petrochemicals and other technologically interrelated activities, is favoured by the need to up-date and innovate manufacturing processes. A systematic correlation between high concentration and rapid technological progress, however, does not exist[28].

The simplest approach to any allocation problem might be that of concentrating on the scarcest resources - labour and entrepreneurial ability. Since the disparity between the availability of, and demand for these factors seems likely to increase, the need for increasing labour productivity rather than capital productivity is more pronounced. Generally, if technical progress, which involves increasing labour productivity affects only new investment, "the greater the rate of investment the greater the increase in labour productivity"[29]. Hence, if from an increase in the investment ratio, an increase in the growth rate results, the rate of growth of employment will increase less proportionately[30]. As shown in our discussion of labour productivity, increasing capital inputs may not be enough to induce growth of labour productivity in Kuwait. In addition to technical progress, other "residual factors" such as higher skills, and improved management are important[31]. Introducing routinized decision making and modern technology would help to economize entrepreneurial ability. By the same token, the labour productivity effects of technology may assist in saving the high costs of the wage bill (see Chapter 5 section 4), and reduce labour influx. Furthermore, over time external economies will materialize with the current changes in productivity.

5.6 The Use of Natural Gas

In recent years there has been a rapid growth of natural gas utilization by the industrial sector in Kuwait. One of the leading potential projects is the liquified petroleum gas, LPG, which will make use of the country's surplus gas. Kuwait's natural gas supply depends on the oil fields, since the country does not have either dry, or natural gas fields. Therefore, the natural gas recovery is directly proportional to the level of oil produced. With the 1972 crude

output of 3.29 million barrels per day, 1774.8 million cubic feet of natural gas per day was produced. Total natural gas production amounted to 647,808 million cubic feet in 1972, of which only 38.2 percent was utilized[32]. A prima facie argument for industrialization is the present wastage of surplus gas production. Furthermore, this argument does not conflict with conservationist policies. Apart from its use as fuel, natural gas can be used as a chemical raw material, or as a reducing agent.

There are over 1,000 organic chemicals commercially produced from natural gas. The multiplicity of uses of these products, make their application wider and their long-term prospects greater than fertilizers, which Kuwait is currently producing. Whereas in 1973 the demand for oil as a fuel input rose by 4 percent over the previous year, that for petrochemicals rose by 10 percent. More importantly, the relative revenue of petrochemicals is eight times that of crude oil[33].

Kuwait is planning to develop a petrochemical complex which will produce primary and intermediate petrochemicals. Among the merits of producing intermediate products, cited by the IBRD mission to Kuwait, were the financial advantages of the high content of cheap fuel and power in their production; the small size of their research, development, and technical staffs; and the easing of the development into final products through the experience gained in their production and marketing. Intermediates, however, are themselves produced from primary petrochemicals. For Kuwait, this presents a major obstacle to their production. Primary petrochemical production requires the separation of Kuwait's oil field gas into its constituent parts - butane, propane, and ethane. This is achieved through a process of liquification facilitated by the fact that each liquifies at a different temperature[34]. However, ethane the most useful primary petrochemical also happens to be the last element to be separated in the process of liquification.

One of the advantages of the LPG project is that it will provide Kuwait

with the opportunity of separating methane and ethane (the residual LPG) from propane and butane (LPG). Ethane can then be separated in one step. However, conservation studies carried out by the Ministry of Finance and Petroleum, have shown that the separation of ethane will affect the future needs of Kuwait[35]. An alternative is separating propane which entails moderate additional investments. Propane (saturated) yields the following primary products (unsaturated): ethylene (26%); methane (34%); hydrogen (13%); ethane (10%); propylene (10%); other (7%).

Intermediate products are derived from the reaction of these primary petrochemicals, the most important of which is ethylene (70%). However, the choice of the primary product family to be developed ethylene, propylene (or both), or butadene, depends on further studies. These should include the relative costs of transportation, marketing and final products to be produced. It should be emphasized here that Kuwait will reap further benefits by producing final-product petrochemicals in which the margin of profit is higher.

The other use of natural gas is as a reducing agent, for example in the reduction of metallic ores. Kuwait intends to use the advanced technique of 'direct contraction' for steel production for the local market (see Table 5.b). Finally, the use of natural gas as fuel, is demonstrated by the aluminium smelting project. The main cost consideration in the production of aluminium is electric power. The production of this factor from natural gas would represent a considerable cost saving to Kuwait. This might offset the high transportation costs of alumina to Kuwait.

5.7 Summary and Conclusions

Kuwait's present pattern of industrialization illustrates the need to speed up the pace of economic diversification. The development of the industrial sector has been unbalanced. However, the theory of unbalanced growth emphasizes the need for such a modern sector to generate the required ability to invest, and vice versa.

Production complementarities, which produce external economies, create pressures and incentives to invest in directly productive activities. The provision of SOC facilities in excess of DPA demand creates a further set of pressures and incentives to DPA investors. It seems likely that the public sector will continue to supply the necessary SOC, as in the past. Moreover, the continuation of the public sector's policies of participation with the private sector to set-up leading industries provides the necessary conditions for the asymmetric sequence of industrial development. This sequence makes use of complementarities, the cumulative process, and external economies. Participation is applicable to the situation of infant industries, where the social rate of return needed to stimulate investment exceeds the private rates of return of alternative investments. When this occurs, a governmental policy subsidizing the learning process may become necessary. After creating the asymmetric sequence of industrial development, policy-makers may not need to interfere.

The leading planned industries are concentrated in large-scale capital intensive, export-oriented projects. Planners have recognized a number of factors that hinder the extensive development of import-substitution production. Firstly, the limited effective demand for these products. Secondly, the high labour cost of total production costs. Furthermore, the balance of payments and terms of trade favour the maintenance of a liberal policy rather than a protective one. Planners assume that given the flexibility and openness of the economy, imports can be used, whenever the supply of a given commodity is not available domestically. Most of the import-substitution planned projects are in fields such as construction material, where cost-reduction is envisaged. These projects make use of the spread effect as export-oriented industries may behave as catalysts.

The interdependence of mixed sector industries and their use of external economies, are important factors affecting their location in the Shuaiba industrial estate (discussed in Chapter 4). Small and medium scale plants are

more likely to be dependent on these factors than large-scale plants. Elements considered external economies to small plants, are internal economies to large ones. These elements include specialist maintenance services, and infra-structural investment. The coastal location of the Shuaiba estate is favourable to large-scale export-oriented industries dependent on the international market. In the case of integrated petrochemical industries, concentration in one location has many economic advantages, not least of all economies of scale. A locational implication of this process[36] is the preference of these industries to avoid densely populated metropolitan areas and the respective problems of land-use and pollution. Locational concentration will instigate the need to provide adequate housing with reasonable distances.

The interdependence of iron and steel, aluminium, petrochemicals, and cement, projects with other sectors is potentially very high. For instance, to the interdependence of chemicalization and electrification, the production of oil products has complementarity effects on oil refining, and natural gas utilization. Determining the actual composition of the industrial programme, particularly in the case of petrochemicals and their broad range of end-products, requires carrying out further technical studies and market research. Mathmatical techniques, such as input-output analysis and linear programming, could be introduced. These techniques could help to qualify the strength of the linkage effects and maximize the benefits taking account of project costs and final demand. Reliable data on intra-sectoral and inter-sectoral relationships is not available. This information could be compiled in future, or similar information from other countries could be used.

Export-oriented industries are more likely to be conducive to development than tariff prtection. They require new skills - either acquired in the process of learning or imported - and new methods of production. With the introduction of these methods and skills, the spread effect will be more pronounced through

making them available to other activities in the economy. The determinants of the spread effect of expanding or establishing these industries are present in the value added which is distributed largely to local factors of production. This distribution would expand further if imported labour is integrated in the social system or if labour is mobilized between occupations. Either case would reduce the share of the value added devoted to the remuneration of foreign factors of production. Finally, an important consideration for export-oriented industries is the search for a market outlet, or an inducement market. This search necessitates a discussion of cooperation and market integration, the subject of the following chapter.

Notes to Chapter 5

1. U.N., Industrial Development in the Arab Countries, Selected documents presented to the Symposium on Industrial Development in the Arab Countries, Kuwait 1-10 March 1966 (New York: U.N. Publication, 1967) p.33.

2. The industrial sector used to be looked after by the Ministry of Finance and Industry. It is now incorporated with trade as the Trade and Industry ministerial portfolio.

3. See Ministry of Finance and Industry, Industrial Survey 1963, by Industrial and Process Engineering Consultants, London, Vol. 2 (Kuwait, 1963)(mimeographed in Arabic). This report examines and evaluates potential industries in Kuwait.

4. The Planning Board, The First Five Year Development Plan, 1967/68-1971/72 (Kuwait: Government Printing Press, 1968) p.74.

5. Ibid, p.74.

6. Nurkse, R., Problems of Capital Formation in Underdeveloped Countries (Oxford: Basil Blackwell and Mott Ltd., 1953), ch.1; Rosenstein-Rodan, P. N., "Problem of Industrialization of Eastern and South-Eastern Europe", Economic Journal, Vol. 53, June-September 1945, p.205-16; Scitovsky, T., "Two Concepts of External Economies", Journal of Political Economy, Vol. 62, April 1954, pp.143-51; Lewis, W. A., The Theory of Economic Growth, (Homewood, Ill.: Richard D. Irwin, Inc., 1955) pp. 274-83. Nurkse and Rosenstein-Rodan stress balance in the demand side, whereas Scitovsky and Lewis, stress balance in the supply side.

7. Hirschman, A. O., The Strategy of Economic Development (Clinton, Mass.: Yale University Press, 1973) p.63.

8. Chenery, H. B., "Comparative Advantage and Development Policy", American Economic Review, Vol. 51, March 1961, p.6.

9. Streeten, P., "Unbalanced Growth", Oxford Economic Papers, Vol. 11, 1959, pp.167-91.

10. Viner, J., "Stability and Progress: The Poorer Countries' Problem", First Congress of the International Economic Association, Rome, September 6-11, 1956; mimeographed paper, pp.25-31. Reprinted in Hague, D., Stability and Progress in the World Economy, (London: Macmillan and Company Ltd., 1958). Hirschman points out the restrictive nature of Viner's output-increasing category in that such activities can be introduced, if they produce highly desired and new products. The availability of these products leads to "an increase in the demand for income". See Hirschman, op. cit., note 4, p.53.

11. Ibid, pp.35-40

12. Ibid, p.41.

13. Ibid, p.67.

14. Balassa, B., The Theory of Economic Integration (London: George Allen and Unwin, 1962) p. 150. In general, external economies result from the spread of economic and technological know-how, the raising of the educational level of the population, development of infrastructure, industrial standardization, and the direct interaction of plants.

15. Hirschman, op. cit., p.72.

16. Marglin, S. A., Public Investment Criteria, (London: Allen and Unwin,1969) pp.86-92.

17. Meier, G. M., Leading Issues in Economic Development (Oxford University Press, 1970) p.705.

18. Marglin, op. cit., p.88.

19. Hirschman, op. cit., p.72.

20. Johnson, H. G., "Optimal Trade Intervention in the Presence of Domestic Distotions", in Caves, R. E., Kenen, P. B., and Johnson, H. G., (eds.), Trade, Growth and the Balance of Payments (Amsterdam: North Holland Publishing Company, 1965) pp.3-34.

21. Kemp, M. C., "The Mill-Bastable Infant Industry Dogma", Journal of Political Economy, Vol. 68, February 1960, pp.65-6.

22. Johnson, op. cit., p.30.

23. U.N., op. cit., p.15.

24. Baer, W., Hervé, M. E., "Employment and Industrialization in Developing Countries", in Jolly, R., DeKadt, E., Singer, H., and Wilson, F., (eds.), Third World Employment (Harmondsworth: Penguin Books Ltd., 1973)

25. Kindleberger, C. P., Economic Development (New York: McGraw-Hill, 1965) pp.250 and 263.

26. Chenery, H. B., "Comparative Advantage and Development Policy" American Economic Review, Vol. 51, March 1961, p.23.

27. Utton, M. A., Industrial Concentration (Harmondsworth: Penguin Books Ltd., 1970) p.27.

28. Ibid, pp.28-29.

29. Stewart, F., and Streeten P. P., "Conflicts between Output and Employment Objectives", in Third World Employment, op. cit., p.382.

30. Ibid., p.382.

31. Marsden, K., "Progressive Technologies for Developing Countries" in Third World Employment, op. cit., pp.322-3.

32. All the low pressure and atmospheric gas, together with some of the high pressure gas are flared off in the fields. The rest is either re-injected into oil wells, processed as LPG, or utilized by the Shuaiba estate.

33. All the technical information in this passage is based on the article "al-Petrochemawyat Wa Mustakbalha Fi Al-Kuwait" (The Prospects of Petrochemicals in Kuwait) prepared by the Kuwait Petroleum Company for the Kuwait Chambers Magazine, Vol XV, No. 139, July 1974, pp.27-30.

34. Ethane is liquified at $-88^{\circ}C$; propane at $-42^{\circ}C$; butane at $-1^{\circ}C$.

35. The Ministry of Finance and Petroleum conservation studies take into consideration the quantitative and not the qualitative basis for the separation of ethane, which needs to be replaced by liquid fuel.

36. Economic Commission for Europe, Criteria for Location of Industrial Plants (Changes and Problems) (New York: UN Publication, 1967) pp.20-28.

CHAPTER 6

Economic Cooperation and the Arab Common Market

This chapter is concerned with Kuwait's position in the Arab Common Market. Particular attention is paid to Kuwait's economic justification of the country's present status in the Market. For the purposes of this chapter, the static analysis of regional integration is employed. Section 1 introduces the rationale for a small nation's economic cooperation. Section 2 outlines the background to the Arab Common Market. Section 3 introduces the static analysis of regional integration. Sections 4 and 5 apply this analysis to Kuwait's trade with the Arab Common Market. Section 6 discusses factoral complementarity amongst the Market members. Section 7 provides the conclusions to the chapter.

6.1 Introduction

Small nations are a priori always at a comparative disadvantage[1]. Means for establishing partial equality, at least, with large nations is, therefore, essential for development. No pejorative sense whatever attaches to the expression 'small nation' as far as Kuwait is concerned. The monetary, financial, and general economic conditions of Kuwait are incomparably better than those of most large nations. Despite this all possibilities of achieving self-sufficiency, let alone balancing Kuwait's economy, are beyond the country's means.

In the early stages of economic development, compactness and smallness of the market size, and the limited range of resources, hamper developmental prospects. These limitations, coupled with the depleting nature of oil and the country's entire dependence on foreign trade, in the long-run make Kuwait vulnerable to the unpredictable future oscillation in the international market. As a result of the marked disagreement in perspective, between the industrialized nations and the less developed oil-producing nations, over oil prices; oil

concessions; oil depletion; and the competing demands for alternative oil-use, Kuwait placed a ceiling on production of 3 million barrels per day. Assuming more stable prices, in the long-run[2], Kuwait would have to develop on the basis of a rather slower rate of growth of export proceeds. Consequently, the ratio of domestic expenditure to foreign trade (including intra-regional trade) will tend to rise rapidly in the future. Creating a regional market would tend to retard the rise in this ratio, and welfare gains could be achieved[3].

In Chapter 5 we discussed Kuwait's plans to diversify the economy and to establish a mixed pattern of industrialization to pool surplus capital, in order to sustain long-run growth. The mixed pattern of export-oriented and import-substitution industrialization, is to be integrated with the oil sector. However, in developing nations, in general, and small ones, in particular, economies of scale may not become possible until they join a wider regional market[4].

Kuwait signed the Arab Economic Union Council's resolution and joined the Arab Common Market (ACM) in 1964. The objective was to enlarge the market, and pool resources with other members along the lines of other large regional groupings such as the EEC, the East African Common Market, and the Asia Group centred on India[5]. However, Kuwait did not ratify the agreement. On 5 September 1967 the Administration of Industrial Affairs of the Ministry of Trade and Industry, issued the 'Memorandum over the Arab Common Market and Industrialization in the State of Kuwait'. This memorandum outlines the Kuwaiti authorities' main objection to ratification. This is that the incentive to participate in the ACM is not favourable at this stage of Kuwait's economic development. Within the ACM prospects of economic gain through an increase in the rate of growth of output, or some component of it (and the welfare implications of this) was seen to be limited. Nevertheless, the industries Kuwait is setting-up, or planning to set-up, certainly require an inducement market. Economic and political rationale point towards the ACM, in particular, and the Arab world,

in general. The economic justification for Kuwait's refusal to ratify the Arab Economic Union Council's resolution, and the country's preference for bilateral agreements, requires an understanding of the pros and cons of the ACM and Kuwait's cooperation endeavours.

6.2 Background to the Arab Common Market

Cooperation is a gradual process, and in economic integration it ranges from a free trade area, to a total economic integration among countries in the same region.

In the case of the free trade area, area-origin products are exempted from tariff and quantitative restrictions. However, participating countries are free to fix their own tariffs and other restrictions separately on imports of products originating elsewhere. The European Free Trade Association (EFTA, 1961) and the Latin American Free Trade Association (ECLA, 1960) are closely related examples of this kind of arrangement[6]. Consumption and production effects are achieved by the rule of origin[7]. By contrast, the customs union requires common external tariffs which determine the production and consumption effects. The common market encompasses the free movement of factors of production as well as commodities within the area. In the closest form of integration, complete economic integration, a form of supra-national authority would be necessary to supervise the economic policies and to harmonise the monetary, social and financial systems of member countries.

On August 13, 1964 the Arab Economic Union Council[8] elaborated a set of 'Decisions and Recommendations' calling for the gradual establishment of an Arab Common Market, to enter into force in January 1965. The Council's decision No. 17, which was signed by Kuwait, Syria, Iraq, Egypt, and Jordan in 1964, Yemen in 1967, and Sudan in 1969, was left open to the other members of the Arab League. The Arab Common Market agreement replaced the 1953 'Multilateral Trade Agreement' which had suffered from a number of "built-in defects"[9]. The ACM aimed to establish a free trade area and not a customs union since it

does not impose a common external tariff. It stipulates the gradual elimination, over periods ranging from five to ten years, of customs duties and administrative restrictions (licences, prohibitions, and quantitative restrictions) on agricultural and industrial products originating in the area. It seeks, in theory, the removal of constraints on the movement of all resources, material, financial and human[10].

Committments undertaken by the members, however, are weakened by giving each member the right to fix the annual share of commodities to be liberated; the right to "request of the Economic Unity Council that certain products be reserved from the exemption or reductions in customs duties"; and the removal of quantitative restrictions for "very justifiable reasons"[11]. The duration of such exceptions must not exceed the implementing stages. Furthermore, the Arab Payments Union was expected to support trade amongst the members with a projected small fixed capital of fifteen million Arab Accounting Dinars (each equivalent to a Kuwaiti Dinar or to 2.48828 grams of pure gold). Finally, members' committment to the agreement were considerably weakened by political frictions amongst them[12].

6.3 Static Analysis of Economic Cooperation

The ACM attempted to encourage inter-area trade expansion by a resolution abolishing all customs duties on agricultural and industrial products, from January 1965 to January 1971. This was to be achieved in equal installments[13]. Yet between 1970 and 1972 the inter-area trade was still very limited and represented around 7 percent (excluding oil) of the area's total trade. Further, inter-area trade figures are only available for a limited period. Other information such as production costs, and elasticities of demand are also unavailable. These considerations restrict the use of dynamic analysis. Therefore, the following discussion adopts the comparative static analysis based on the pure theory of integration. It deals principally with the welfare implications of the trade arrangement, and with the increased production and

trade in final goods due to specialization. The effects of a union are limited by assuming constant costs of production for any commodity, and zero elasticities of demand. Moreover, economies of scale are disregarded and the terms of trade are assumed to be constant.

When a customs union is formed, tariffs on area origin imports are abolished. This alters relative prices of goods facing consumers and opportunity costs to the economy are introduced. Hence, the welfare implications of customs unions depend on the efficiency of resource allocation[14]. In a case of complete specialization the issue, in Vinerian terms, turns on whether the locus of production shifts from the high-cost partner to the lower-cost partner, that is, trade creation, or in the opposite direction thus diverting trade. "The free-trader can properly approve" of trade creating shifts, whereas the protectionist approves of the trade diverting type of shifts[15]. On balance, consumer welfare depends on whether or not trade creation and the consumption effect, which could be either positive or negative[16], outweighs trade diversion. A more optimal allocation of resources in production is achieved if trade creation is predominant and there is a welfare gain. Of course, the viability of an integration hinges on a relatively equitable sharing of welfare gains among the participants.

The trade creating and trade diverting effects, though based on a short-term framework, are important tools when developing countries, such as the ACM countries, are considered. These tools are employed in the following sections, which attempt to provide an understanding of Kuwait's frozen membership. Before proceding to this discussion, Kuwait's balance of trade with ACM members is briefly reviewed.

Table 6.a gives a summary of Kuwait's trade balance with the six other members (in 1972). From 1963 to 1967, Kuwait had a significant deficit in its trade with Syria, Egypt, and Jordan, while its trade with Iraq was balanced and that with Sudan and Yemen negligible. Kuwait's trade balance from 1968 to 1972

Table 6.a.

Kuwait: Trade With Arab Common Market Members, 1972 (In Million K.D.)

Country	Value of Imports	Value of Exports	Balance of Trade
Iraq	4.295	2.730	- 1.565
Jordan	2.238	0.490	- 1.748
Syria	1.631	0.542	- 1.089
Egypt	0.847	0.530	- 0.317
Yemen	-	0.122	+ 0.122
Sudan	0.080	2.370	+ 2.290
Total	9.091	6.784	- 2.307
Total with All Arab Countries	24.011	28.911	+ 4.900

Source: Compiled from Central Office of Statistics, The Planning Board Statistical Abstract 1973 (Kuwait: Government P. Press 1973) Tables 215 & 216 pp. 324-337

Note: Figures are rounded off

remained negative with the former four states, but showed signs of improvement with Egypt and Iraq[17]. On the other hand, Kuwait's trade balance with Sudan was in surplus. Exports to Sudan rose from a mere KD 6,000 to KD 2,370,000. Since Kuwait does not suffer from a balance of payments malady, the country's trading position does not represent an impedement to cooperation. Moreover, since Kuwait's non-oil exports' productive capacity was limited during this period, and the volume of Kuwait's trade transactions with the ACM was very small, the effect of the trade balance can be disregarded.

6.4 The Import Side

To understand Kuwait's frozen membership it would be well to take into account the nature of the country's ACM imports. Generally, the Arab countries' exports are similar. They consist of raw materials, such as oil, minerals, phosphates, and agricultural cash products - mainly cotton. These materials are needed for industries in the more advanced countries. Kuwait's imports from the ACM consist of vegetables and fruit from Iraq, Syria, Jordan, and Egypt; cement from Iraq; textiles and clothing from Syria; cigarettes and olive oil from Jordan; pharmaceuticals, printed material and books, canned food and feature films from Egypt. The demand for these imports is limited. In 1972, Kuwait's imports from the ACM represented 3.5 percent of total imports.

Kuwait's imports from the ACM are in effect free as the government imposes a non-preferential tariff of only 4 percent ad valorem on most imports. The abolition of this tariff in accordance with ACM membership would not greatly benefit Kuwaiti consumers[18]. The scope of trade creation is widest in one or more agricultural products in which ACM countries have a comparative advantage. But Kuwait's imports of these products is mainly in the form of foodstuffs, the demand for which, as the per capita income rises (according to Engel's law), increases less than that for other goods and services. Demand for foodstuffs in Kuwait increased by 15 percent between 1970 and 1972, while demand for other goods and services increased by approximately 18 percent. The increase in

per capita income was 26 percent during this period. Trade expansion in this area can, therefore, be expected to be limited.

Despite the limited trade creating and diverting effects, trade diversion in food and raw materials could be achieved through a common agricultural policy. Such a policy entails the use of variable levies designed to bring the price of foreign exporters up to the ACM level. This amounts to the application of variable quotas since the purpose of the levy is to ensure that imports from non-member countries are admitted only after all produce of supplying member countries has been sold[19]. Such a policy might be acceptable to Kuwait since most of the country's agricultural goods are imported. It might, however, represent a net welfare loss to consumers.

Kuwait's ACM imports of semi-finished and finished products are planned to be or are actually being substituted domestically. They include pharmaceuticals, cement, processed food, batteries, furniture and building and construction materials. Import-substitution industrialization takes into account the considerable cost reducing effects of domestic production (see Chapter 5), and the availability of the necessary raw materials. Kuwait wants to continue infant industry protection since the ACM does not provide for a common external tariff. The government envisages that protection, although limited, combined with other government incentive policies, social overhead capital expenditure and other technological external economies, and complementarities, would help these industries to compete favourably with imports. It is conceivable that in the long-run, they will cross the threshold of exportation. An example of the effectiveness of the 15 percent tariff protection is flour and flour by-products. This industry not only covers the domestic market, but has reached the export-oriented stage of development. Infant industry protection is inadequate in cases where the economic size of industries and the narrowness of the market require further protection to reduce domestic prices below world prices. As suggested in Chapter 4, subsidization of production on a regressive

basis may prove to be an optimal public sector policy.

Were the ACM an actively operating body, and Kuwait opted to participate, the rapidly growing economies might induce trade expansion prospects. Trade expansion through increased consumption of ACM imports has welfare gains as it may reinforce any gain from trade creation and partly offset any loss from trade diversion[20]. The extent of expansion in ACM originating imports from trade creation would depend in the final analysis on the dynamic effects of improving the quality, and reducing the costs of ACM manufactures. The ACM is a relatively high-cost area, in general[21]. In addition, it depends on the development of industrialization. In the short-run, however, ACM specialization in products such as textiles, clothing, sugar (though they remain net importers of sugar) could compete favourably with non-area products, and possibly lead to trade creation. Whether trade diversion will improve the imports figure (of 3.5 percent) depends on two factors: Firstly, it depends on whether the ACM develops a discriminatory common tariff against non-area countries, and whether Kuwait is willing to bear the potentially harmful effects of such an arrangement. This would involve discrimination in favour of ACM and against lower-cost sources of supply. Under this condition, Kuwait would be compelled to revise its free-trade policies. Secondly, it depends upon the possibility of overcoming the market imperfections. Market imperfections in Kuwait, as discussed in Chapter 2, are accounted for by the concentration of market power in a few business firms, particularly in the import trade[22]. This results in personal and weak competition. Another factor contributing to market imperfections is the low average consumer's elasticity of substitution between different goods. The low elasticity of substitution is the result of two elements. The first is the Kuwaiti consumption pattern which is rigorously oriented towards Western European and U.S. products. The second is that this consumption pattern is highly independent of cost considerations amongst Kuwaiti nationals, in general, and the high income brackets, in particular. Therefore, should the Kuwaiti

consumption pattern be changed, after "a period of adjustment and substitution"[23] in favour of ACM products, with high percapita income and propensity to import, a pure trade diversion could take place. However, the consumption effect of trade diversion represents a welfare loss to the consumer. Similarly, the production effect would adversely affect the domestically oriented industry, which is in its infant stage.

6.5 The Export Side, and the Markets of Export-Oriented Industries

It is recognized that economic integration leads through industrial specialization to a new hierarchy of industries able to satisfy regional production criteria[24]. Investigation of the ACM members' economies shows that they have, or are in the process of developing specialized industries. These industries which are based on geographical location and national resources, could develop into complementary rather than competing industries. By introducing a codified pattern of investment, an adequate degree of complementarity among the participants could be attained. In relation to this it is interesting to note that Egypt specializes in cotton production (which accounted for 51 percent of exports in 1971), in foodstuff industries (29.4 percent of the gross value of industrial production in the same year), spinning and weaving, and engineering industries. Syria, although also specializing in cotton production (42 percent of exports in 1971), is not in direct competition with the Egyptian textile industry since their cotton commodities differ as finished goods. Syria also produces agricultural products (wheat, barley, tobacco). Likewise, Iraq specializes in agricultural products but of a different order (dates, cereals, and rice) in addition to oil production. Petrochemical potentials exist, whereby production of fertilizers could be domestically oriented for Iraq's agricultural sector's use. Sudan specializes in agricultural production too, primarily in cotton (61 percent of total exports in 1971), Arabic gum, ground nuts, and sesame. Jordan has the Dead Sea mineral salts as a base for industrialization[25].

In the case of Kuwait, agricultural exports are limited. Only 0.3 percent of GNP was generated by this sector in 1971/72. Kuwait's specialization in the production and exportation of oil to non-area countries has weakened the incentive to adhere to the ACM resolutions. However, the major potential industrial projects and the operative industries are directed towards specializing in petrochemicals. Specialization in petrochemicals, an export-oriented industry, does not require domestic protection but rather the securing of markets. Fertilizer production, a case in point, needs an inducement market similar to the ACM, which relies heavily on agriculture. In circumstances other than those presently prevailing, the large potentials of the ACM could enable Kuwait to expand fertilizer production.

Kuwait's exports of locally produced commodities increased between 1965/66 and 1972 by nineteen fold, 70.3 percent of which emanated from the chemical and fertilizer industries. Of Kuwait's total petrochemical exports, only 14.4 percent went in 1972 to the area, 80 percent of which to Sudan[26]. At present, the prospects of enlarging Kuwait's markets for these specialized products, through participation in the ACM are not very encouraging. In the country's drive to market export-oriented products, the tariff structure of the ACM does not give these products a preferential treatment. The ACM has stipulated the removal of tariffs on agricultural, animal products and mineral resources listed in schedule A; and on manufactured goods listed in schedule B, which were annexed to the'Multilateral Trade Agreement'; and on other manufactured goods, listed in schedule E. The 1st July 1971 was the date for final liberation of these commodities from customs and other duties. A review of these items indicates clearly that the tariffs on them were ineffective barriers to trade. On the other hand, items that face more effective barriers, demand on which are relatively inelastic (for example, fertilizers), have not yet been freed. Therefore, Kuwait's exports have to face large variances amongst the rates of ACM countries' tariffs. The ACM countries' structure of protection can be

attributed to balance of payments difficulties, as well as to other considerations.

Another impediment to Kuwait's marketing in the ACM is the restriction of tariff reductions to only those industrial products in which the total Arab value added contribution is not less than 40 percent. The ratio of value added to gross (inclusive of Arab contribution) value is still below 40 percent in some Kuwaiti manufacturing industries (see Table 5.d).

The balance between trade creating and trade diverting effects cannot be assessed empirically with regards to Kuwait's exports to the ACM. However, inferences can be made for one of Kuwait's main exports to the ACM, fertilizers. For the ACM, the costs of importing Kuwait's fertilizers is relatively high, not only because of Kuwait's high production costs, but also because of the high transportation costs. To import Kuwait's fertilizers, if economies of scale and reduction in transportation costs are not achieved, would constitute a pure trade diversion.

If the ACM employs the common market mechanism effectively (with a common external tariff), buying Kuwait's new manufactured output may initially, therefore represent a trade diversion. However, the spread of prosperity could, potentially, be substantial to ACM countries. The marginal propensity of Kuwait's imports from the ACM buyer(s) can be assumed to be higher than a critical point at which the spill-over is zero[27], given the increasing needs of rapid growth and development in Kuwait. The net spill-over ratio here is the ratio of the increase in an ACM country's income to the increase in Kuwait's output[28]. Gains and losses from a common market arrangement can then be represented by two elements. Firstly, the extra income generated from Kuwait's new manufactured output, which displaces imports into the common market, will generate income in the ACM country(s). That is to say, from a positive spill-over ratio, ACM country(s) will benefit from Kuwait's importation from them. The second element is that with trade diversion, buying Kuwait's manufactured goods represents a

loss to ACM buyer(s). They may have to pay higher prices than they would if buying from the rest of the world. Through the mechanism of the multiplier, however, new industries can grow to derive economies of scale in the long-run. Thus the benefits of the market, in the long-run can outweigh the backwash risks[29] The costs to ACM members of Kuwait's exports could be reduced by Kuwait's down-stream investment in these countries. Down-stream investment includes market-based industries such as refineries, final product petrochemicals and fertilizers, related industries, and storing and transportation facilities. It might be noted here, that Kuwait has started such investments as in the case of the Sumed pipeline from the Gulf of Suez to the Mediterranean and other joint-ventures in Egypt costing more than $900 million[30]. These investments would also help to avoid the harmful duplication of projects within the ACM.

6.6 Factors of Production and Kuwait's Cooperation Endeavours

A degree of complementarity is evident in the factors of production in the ACM. The area as a whole shows a considerable balance of payments surplus. This is explained by the rising oil revenues, and the improving balance of payments of Iraq (ID 36 million surplus in 1971) and Jordan (JD 8.7 million in 1972). In 1974, Kuwait alone showed a surplus of about KD 2 billion. However, capital is unevenly distributed among the members and most ACM members have balance of payments constraints. In joining a union, therefore, they are primarily concerned with the reallocation of this factor. The capital shortage and balance of payments constraints are exemplified by Sudan's signature of a bilateral contract with Kuwait to provide Sudan's entire need for fertilizers in the next five years. The initial payment is to be delayed for five years after the first goods' receipts by Sudan, with static prices applying over the whole period[31].

The utilization of this growing factor, through a coordinated economic development policy, has so far been neglected by the ACM. This negligence, has limited the opportunities to utilize Kuwait's capital surplus, by spreading the

benefits of industrialization through the use of labour-intensive techniques of production to the ACM members who are endowed with labour. Henceforth, Kuwait's main concern has been the creation of the proper investment atmosphere.

In order to assist in the creation of this atmosphere in the Arab world, the Kuwaiti government set-up the Kuwait Fund for Arab Economic Development (KFAED) in 1961. The objective of the KFAED[32] has been to support and complement regionalism. The Fund, which is now the largest Arab financial institution, has an authorized capital of KD 200 million which is to be increased to KD 1,000 million (see Chapter 2 section 6). The Fund has financed 42 development projects in all the Arab countries except Kuwait herself, Saudi Arabia, Oman, Mauritania, and Somalia. It had extended KD 120 million by the end of 1973, of which KD 80 million were actually drawn. Annual interest rates were 3 percent for agricultural projects, and 4 percent for industrial. Terms of maturity ranged between 10 and 25 years. The Fund followed a cautious policy of studying and carrying out technical, economic, financial, and legal appraisals to these projects, before granting the loans. However, the Fund has avoided financing development plans, and deficits in the balances of payments which are burdens to most ACM countries. It justified this position on the grounds of limited financial resources and the difficulties of appraising these plans[33].

To further the objective of the KFAED and to encourage a larger sharing of the aid burden among the Arab oil-producers[34], Kuwait put forward a proposal at the Khartoum Summit Meeting in September 1967, for the establishment of an 'Arab Fund'. The 'Arab Fund', later to be known as the Arab Fund for Economic and Social Development, replaced the previous agreement of the 'Arab Financial Institution for Development'. As an inter-governmental body, this Fund is intended to promote development in the Arab countries. Kuwait subscribed 30 percent of the KD 100 million capital. A final organ to strengthen Kuwait's objective, is the Inter-Arab Investment Guarantee Corporation which was drafted by the Kuwaiti Fund, signed by 5 members of the Arab Economic Unity Council, and

is to be centred in Kuwait. With a capital of KD 10 million, it is intended to insure the Arab investor against non-commercial risks in Arab countries. These instruments will not guarantee the use of Kuwait's capital surplus as a complementary factor of production within the ACM, and other Arab countries, unless a coordinated pattern of investment is adopted. This explains the Kuwaiti government's and the private sector's preference for participation - on a large scale - in joint ventures with the financial houses of Europe, Japan and America. The Kuwait Investment Company has gone as far as co-managing new Eurobond issues.

The other factor of production, labour, is assumed to be a complementary rather than a competitive factor in the ACM. Non-Kuwaiti labour mans 86 percent of Kuwait's manufacturing industry. Lower incomes in the ACM relative to Kuwait, would induce the migration of workers to Kuwait, since mobility of labour occurs in response to marginal productivity differentials. The wage opportunities in Kuwait for Arab labour are certainly higher than real wages in their countries of origin. This partly explains the high geographical mobility towards Kuwait[35]. The concept of complementarity may be misleading, however, for the Arab countries largely supply unskilled labour. Their supply of skilled labour remains short of its demand. Kuwait needs highly specialized labour for its advantage, as discussed above, is dependent on highly specialized products. Moreover, migration gives rise to intangible costs, such as those arising from different cultural and behavioural patterns and the marginal quality of migrant labour. These costs may be summed up in the phrase 'social distance'[36]; so that the greater the 'social distance', the greater will be the economic differential needed to overcome these non-economic barriers[37]. Therefore, the outlay for the economic differential needed to attract, or induce migration of Arab skills may prove relatively high to Kuwait. However, to sustain industrialization, given the socio-economic inflexibilities of the post-oil era, freedom of ACM labour movement is a second best solution. The level of geographical movement

of labour needed would depend, in the final analysis, on the degree of substitutability of capital for labour, and subsequently how the price of labour to the price of capital will develop.

6.7 Conclusions

The limited inter-area trade suggests a high degree of competitiveness. This could be accounted for by the similarity in their exports and their manufactures which are limited in range and highly substitutable for imports from outside the area. In the short-run, trade expansion within the area is, therefore, highly unlikely. Although trade diversion is limited, a trade expansion may not be sufficient to compensate for the losses of diversion in Kuwait's imports to the ACM from lower-cost sources. The trade links through the ACM agreement are not particularly associated with the economic development policies, and the consolidation of the trade relation with these countries cannot be implemented without the active role of the state. This is a basic difference between Kuwait as a free trader, and the ACM members who remain highly protectionist. Trade which has been the main theme of the ACM, has not been associated with industrial cooperation and economic development. The reverse is true, and therefore, both remain weak within the framework of the ACM.

In the short-run Kuwait's frozen membership, particularly with the non-adherence of other members to the ACM resolutions, is therefore, justified. In the long-run, factors of production complementarity could be of vital importance. Kuwait would have access to a wide labour market. Capital could be channelled to develop labour-intensive industries. It could also be utilized in downstream investment, provided investments are guaranteed by receipient countries. These capital outlets might determine the dimensions of future industrialization programmes for Kuwait. In the case of petrochemicals, investing in some related and end-product industries may be more profitable in these countries.

The dynamics of regional integration amongst the ACM members are vast.

Actual statistical information or plausible approximations should be employed to measure the beneficial effects of spread versus the risks of backwash, potentials of economies of scale, elasticities of demand, and production complementarities.

A final important consideration in the bargaining position of a small country is its terms of trade. The bargaining power of a group such as the ACM may help reinforce the improvement in Kuwait's terms of trade, achieved by the concerted efforts of another group, OPEC.

Notes to Chapter 6

1. See Marcey, G., "How Far Can Foreign Trade and Customs Agreements Confer Upon Small Nations the Advantages of Large Nations?", in Robinson, E. A. G. (ed.) Economic Consequences of the Size of Nations (London: Macmillan and Company Ltd., 1963) pp. 265-281.

2. After the nationalization of the KOC, if the Kuwaiti government sells its oil directly to its customers, prices of crude oil may level off at their present levels according to oil industry experts' predictions.

3. See Mikesell, R. F., "The Theory of Common Markets as Applied to Regional Arrangements among Developing Countries", in Harrod, R. F., and Hagne, D. C.(eds.), International Trade Theory in a Developing World, (London: Macmillan and Company Ltd., 1963) pp.210-12.

4. Scitovsky contrasts the difference between technological factors and economic ones determining optimum-size of a small economy. He points out that the technological optimum may be reached much sooner than the economic optimum, to provide an adequate outlet for full capacity output of the efficient productive plant in an industry. See Scitovsky, T., "International Trade and Economic Integration as a Means of Overcoming the Disadvantages of a Small Nation", in Robinson, op. cit., pp.282-3.

5. The EEC and EFTA, greatly extended the market area of protection of manufacturers in developed countries from their competitors in the developing countries, by giving members of these arrangements free entry to the markets of other members. See Johnson, H. G., Trade Strategy for Rich and Poor Nations, (London: Allen and Unwin, 1971) pp.10-24.

6. Viner, J., "The Economics of Customs Unions", in Robson, P. (ed.), International Economic Integration (Harmondsworth: Penguin Books Ltd., 1971), pp.31-47. He noted that the term 'free trade area' as a technical term in the language of this field was introduced by the draft Havana Charter of 1946.

7. Shibata, H., "A Theory of Free Trade Areas", in Robson, op. cit., pp.70-71.

8. The Arab Economic Union Council was established in June 1957 by the Arab Economic Council. It was conceived as a separate agreement, not falling within the scope of the Arab League, as a decision making flexible legislative machinery.

9. See Dajani, B., "Regional Cooperation among Arab States in the Field of Industrial Development", in Arab Economic Report, published by the General Union of Chambers of Commerce, Industry and Agriculture for Arab Countries, Beirut, 1973, pp.7-49.

10. In order to avoid confusion, the trade arrangement is referred to as a common market throughout.

11. See Article 14 of Decision No. 17 of the Arab Economic Unity Council: The Arab Common Market.

12. Wionczek, M. S. (ed.), Economic Cooperation in Latin America, Africa and Asia (Cambridge, Mass: MIT Press, 1969) pp.284-6.

13. The May 1969 Economic Union Council's decision. See Dajani, op. cit., p.26.

14. See Robson, op. cit., p.11.

15. This is a basic difference between Kuwait, a free trader, and the rest of ACM members, who are protectionists. See also Viner, op. cit., p.33.

16. Consumption effect of one product may favourable due to the formation of the union, but it may have harmful effects by reducing consumption of other products and possibly more than offsetting those benefits. See Cooper, C. A., and Massell, B. F., "A New Look at Customs Union Theory", Economic Journal, Vol. 75, December, 1965, pp.742-47.

17. In 1968, the first substantial quantities of Fertilizers were exported to Iraq after the Kuwait Chemical Fertilizer Company (KCFC) had overcome the problems of the initial 'setting-up' phases.

18. This is particularly so in the foodstuffs market, as most of these items are zero rated (tariffs) in Kuwait. That is, these products have to compete under the same conditions as non-area members'. However, in later stages of integration, if a common external tariff is set for the union at a higher level than the previous duty, Kuwaiti consumers would have then to face a higher common union price.

19. See Balassa, B., "Trade Creation and Trade Diversion in the European Common Market", Economic Journal, Vol. 77, March 1967, pp.1-21

20. Meade, J. E., discusses the effects of trade expansion in The Theory of Customs Unions (Amsterdam: North Holland Publishing Co., 1956) pp.29-43.

21. UNIDO's Report and Proceedings of Interregional Seminar in Beirut, 4-15 January 1971, considered the level of protection for some industrial products in many Arab countries (mainly ACM members) to be excessive. Nominal tariffs within the range of 50 to 100 percent are found in them, and quantitative restrictions frequently permitting industries to develop with a high cost structure. See UNIDO, Selected Aspects of Industrial Policy (New York: U.N. Publications, 1971) pp.27-8.

22. Eid, N., The Legal Aspects of Marketing Behaviour in Lebanon and Kuwait (Beirut: Librairie du Liban, 1970) p.23.

23. El-Mallakh, R., Economic Development and Regional Cooperation: Kuwait, (Chicago: University of Chicago Press, 1969) p.169.

24. Chenery, H. B., "Patterns of Industrial Growth", American Economic Review, Vol.50, September 1960, p.651.

25. Yemen is still at a very early stage of development, and its population depends on agriculture, livestock, and emigrant workers' transfers from Saudi Arabia; and on Arab foreign aid.

26. Out of KD 11.5 million petrochemical exports, ACM members accounted for KD 1.7 million only, with India, China, and Pakistan as the main customers.

27. This analysis is based on Professor Brown's investigation of the East Afric market, cited in Newlyn, W., "Gains and Losses in the East African Common Market", in Robson, op. cit., pp.350-1. He represents the marginal propensity to import to be critical at 0.024.

28. Ibid, p.350.

29. Ibid, p.351.

30. Middle East Economic Digest, Vol. 18, No. 8, 1974, pp.199-202.

31. According to the Arab Economic Report, 1973 (p.264) the contract is expected to provide 800,000 tons of Urea and Ammonium Sulphate worth $ 50.4 million.

32. For a discussion of the KFAED's role in development finance and other fields see Al-Hamad, Financing Arab Economic Development, The Experience of Kuwait Fund (Kuwait: KFAED Publications, 1972).

33. Shihata, I. F. I., "Investment of Arab Surplus Funds in the Arab Region: Some Organizational Aspects", (Translation of Arabic Original), Seminar on Investment Policies of Arab Oil Producing Countries, 18-20 February, 1974 (Kuwait: mimeograph, The Arab Planning Institute and Kuwait Economic Society, 1974) p.19 of article.

34. See Stephens, R., The Arabs' New Frontier, (London: Temple Smith, 1973), p.68.

35. Of the 305,560 persons given permits between 1968-1972, 83 percent were Arabs.

36. Isard, W., et al,Methods of Regional Analysis: An Introduction to Regional Science (Cambridge, Mass: MIT Press 1960) p.541.

37. Bird, R., "The Need for Regional Policy in a Common Market", Scottish Journal of Political Economy, Vol. 12, November 1965, pp.228-9.

CHAPTER 7

Summary and Conclusions

The monetary, financial, and general economic conditions of the mini-economy of Kuwait, are incomparably better than those of most large nations. However, features ascribed to small nations, such as a limited geographic size, a relatively small national market, and a limited range of national resources are true of Kuwait. Moreover, Kuwait remains a dualistic economy, which is illustrated by the divorce between growth and development. In some spheres, such as the social overhead capital facilities, the country has developed rapidly. Growth in GNP since the 1950s has been rapid, but this is only due to the tremendous expansion in oil production and exportation. Therefore, despite the high GNP level achieved, the productive capacity and capital absorptive capacity of the economy remain limited, and the resultant capital leakages have reduced local multiplier effects. In a rentier economy, where there is consumption with little production, the large dependence on imported commodities is facilitated by the surplus capital and foreign exchange reserves. These reserves help maintain the favourable balance of payments which permits the country to continue the free trade policy.

Kuwait's exports are highly concentrated and their market concentration is relatively high. Export stability is likely to be less involved with geographic concentration than with the stability of her customers' imports. So far, export receipts have been relatively stable and compare advantageously with most developed countries. Political stability in the area will undoubtedly help to maintain these earnings.

In the highly capital intensive oil sector, employment opportunities are limited. The major concentration of employment has, therefore, been in trade and services. High income levels prevailing in government service have made

Kuwaitis reluctant to enter these occupations however, and as a consequence, most of those engaged in productive employment are immigrants. The heterogenous population, offers the economy a variety of skills and technical know-how, without changing the higherechelons of the socio-political hierarchy. Growth and development of the labour force has been completely out of balance with that of the capital. This factoral imbalance reflects the extremity of the dualistic economy.

The emergence and pre-eminence of the public sector in the transformation of the desert economy into a welfare state has been facilitated by the rapid increase in oil revenues. Through the injection of purchasing power into the economy and the provision of welfare benefits and employment, the government plays a very important role in economic activity. However, the nature of the Kuwaiti socio-political structure and the lack of governmental regulatory and limited pump-priming instruments, have led to increasing income disparities. Equitable redistribution of wealth through such public schemes as land purchase, have failed. The sudden influx of wealth from oil production has led to a need to control inflationary tendencies. This involves a set of fiscal, monetary, and structural measures as outlined in Chapter 2. A more satisfactory policy would be the expansion of the economy's productive capacity to satisfy part of local demand, which could help reduce inflation. The public sector's supply of social and economic infrastructure in excess of demand, serves to stimulate the development of directly productive activities. Perhaps, the government itself should initially play a more direct role rather than rely on private enterprise.

The developmental impact of the oil sector on the rest of the economy has been limited. Unless the government initiates the diversification of markets and products - after the nationalization of KOC - oil depletion, and the high market concentration will increase the long-run vulnerability of the economy. By encouraging industrial diversification, the government could help reduce

the vulnerability of the economy, and sustain long-term growth. By developing leading industries in line with the theory of unbalanced growth, and by the public sector's participation with the private, the much needed ability to invest could be generated. The asymmetric sequence of industrial development makes use of the cumulative process, production complementarities, and external economies, which create pressures and incentives to invest in directly productive activities. One instance of this is the interdependence of chemicalization and electrification in Kuwait which has complementarity effects on oil refining and natural gas utilization. The oil conservation policy and industrialization need not be contradictory objectives.

Import-substitution is handicapped by the limited effective demand for these products and the high labour cost of total production. The low level of protection which may prove ineffective for local firms could be replaced by subsidies on production which could gradually be decreased. Where cost reduction is envisaged, import-substitution industries are planned. Export-oriented industries, in which planned investments are largely concentrated, may behave as a catalyst to these projects. The course of industrial development is largely on the bases of capital intensive, large scale, technologically advanced industries. By following this course, the economy can circumvent the constraints of a small local market, a restricted manpower pool, and as a 'late-comer' benefit from technological advancements pioneered elsewhere. Regional cooperation, through purposeful and reciprocal efforts, can be one viable means of achieving industrial development for a small developing nation such as Kuwait. Cooperation has proved useful between the OPEC countries, and has strengthened the bargaining position of Kuwait. In the 1970s, OPEC was able to improve oil prices markedly. A small developing nation may not have been able to achieve this goal on her own, despite oil's favourable position in world trade. Increased oil prices have improved Kuwait's income and barter terms of trade as is evident from the post 1972 data (especially in 1974).

Technological cooperation, accessability to markets and to a larger skilled labour pool, can be attained by an active Arab Common Market. However, in the short-run, Kuwait's frozen membership in the ACM, particularly with the non-adherence of other members to its resolutions, seems justified. In this rapidly growing area, the long-term benefits of regional integration are likely to be substantial. Elements of a complementary and diversified industrialized regional structure are already present in this market. Cooperation would allow for economies of scale, improvement of product quality, increased productivity and cost-reduction, making these products competitive internationally[1]

Lack of technical information, rather than the cost of acquiring it, is an impediment to Kuwait's industrial projects. Technical information and documentation centres are needed at the national level and in cooperation with other countries, in order to facilitate the selection of technology. The cooperation of such institutions as the Kuwait Institute for Economic and Social Planning with Kuwait University should involve the development of sources of technical information and its dissemination nationally, and the promotion of industrial research. By appropriately coordinating with these institutions, the Industrial Development Bank could provide extension services in the fields of advice and technical information, particularly for small scale entrepreneurs. Establishing an industrial research institute should be supplemented by research and development departments within the large industrial enterprises. These departments play a leading role in advanced countries. Under contractual agreements for the purchase of technical know-how training for local personnel could be provided[2]. The purchase of technical know-how should proceed, where it cannot be obtained through regional cooperation or "<u>developed by locally adapting freely available technology</u>"[3]. A further obstacle facing technological transfer is that a contract to use a particular technology, may not licence future improvements. If it does, another impediment may be the constantly

rising "technological competence of established competitors"[4]. In one case, the production of intermediate petrochemicals, this point ought not to be overemphasized since intermediate products can be used to produce a number of final products.

The establishment of such industries as petrochemicals and metallurgy should be stressed at the regional level. In determining the industrial programme, mathematical techniques, such as Input-Output models,could be used. They should take into account transactions with, and the industrial structure of, the region and of other Gulf states in order to avoid any wasteful duplication.

Low productive employment, imperfect occupational mobility of local labour, and the slow development of local skills require a new socio-economic order offering expatriate labour, security and equal opportunities with Kuwaiti nationals. Since raising labour and managerial productivity is important, training in general and upgrading courses are essential to use modern technology effectively. However, since training takes time to materialize, access to readily available skilled labour, particularly of the ACM, is necessary for the operation and maintenance of modern equipment.

Petrochemicals, Kuwait's main export-oriented industry, has world wide markets. Exporting to complementary plants in different markets, for instance, those of the ACM might prove more profitable. With the next phase of export-oriented industrialization, inspection and control schemes, and the standardization of product quality should be enforced.

Kuwait, which has developed an aid and cheap loans programme, plays a more important role in the financial world than the country's physical size would suggest. With the establishment of specialized financial institutions, and the expansion of the banking system, Kuwait could develop into a financial centre for the Middle East. The growing importance of returns on investments abroad,

suggest that new channels could be probed into, insuring the growth of their returns in real value. By making long-term investments in inflation-proof assets, investment risks may be circumvented to a certain degree. Finally, the development of the financial system may partly compensate for the lagging sectors in the short-term, and complement industrialization in the long-term.

Notes to Chapter 7

1. El-Mallakh, in Seminar on Investment Policies (See Chapter 2 footnotes 2), p.7 of article.

2. U.N.I.D.O., Selected Aspects of Industrial Policy, Report and Proceedings of Interregional Seminar, Beirut, 4-15 January 1971, (New York: U.N. Publications, 1971), pp.20-24.

3. U.N.I.D.O., Ibid, p.21.

4. Myrdal, G., "The Transfer of Technology to Underdeveloped Countries", Scientific American, September 1974, Vol. 231, No.3,p.173.

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