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THE REGULATION OF FOREIGN INVESTMENT IN KUWAIT: THE ROLE OF LAW, POLITICS AND ECONOMIC POLICY IN THE DEVELOPMENT PROCESS

Thesis Submitted by

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Dedication

To

My best friend and husband Abdul-Rahman

My Father Mohammed and my Mother Sheikah

My Son Fahad and my Daughters Lujain and Deemah

To all of them I dedicate this work with gratitude for all their sustained support and understanding.

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ABBREVIATIONS

Agreement between Kuwait and the People's Republic of China	**KCHT**
American Independent Oil Company	**AMINOIL**
Anglo- Persian Oil Company	**APOC**
Arab Organisation for Investment Guarantees	**AOIG**
Arabian Oil Company	**AOC**
Bilateral Investment Agreement	**BIT**
British Petroleum	**BP**
Central Bank of Kuwait	**CBK**
Central Tenders Committee	**CTC**
Certificate of Deposit	**CD**
Commercial Companies Law	**CCL**
Committee for the Development of Industry	**CDI**
Counter Trade Offset Programme Executive Office	**CTOP/EO**
Eastern and General Syndicate	**EGS**
Economic Development Council	**EDC**
Economic Intelligence Unit	**EIU**
Europe Combined Terminals	**ECT**
Foreign Direct Investment	**FDI**
Free Export Zone	**FEZ**
Free Trade Zone	**FTZ**
Gross National Product	**GNP**
Gulf Co-operation Council	**GCC**
Gulf Organisation for Industrial Consultancy	**GOIC**
Income Tax Decree No. 3	**ITD**
Industrial Bank of Kuwait	**IBK**
Industrial Development and Planning Department	**IDPD**
Industrial Development Committee	**IDC**

Industrial Development Office	**IDO**
International Bank for Reconstruction and Development	**IBRD**
International Centre for the Settlement of Investment Disputes	**ICSID**
International Chamber of Commerce	**ICC**
International Monetary Fund	**IMF**
Joint Economic Committee	**JEC**
Kuwait Chemical Fertiliser Company	**KCFC**
Kuwait Foreign Petroleum Exploration Company	**KUFPEC**
Kuwait Institute for Scientific Research	**KISR**
Kuwait Investment Authority	**KIA**
Kuwait Oil Company	**KOC**
Kuwait Oil Tanker Company	**KOTC**
Kuwait Petroleum Corporation	**KPC**
Kuwaiti Centre for the Settlement of Disputes	**KCSD**
Kuwaiti Chamber of Commerce	**KCC**
Kuwaiti Commercial and Civil Procedural Law	**KCCP**
Kuwaiti Dinar	**KD**
Kuwaiti International Centre for the Settlement of Disputes	**KICSD**
Kuwaiti Model Law	**KML**
Kuwaiti Society of Engineers	**KSE**
Limited Liability Company	**WLL**
Memorandum of Agreement	**MOA**
Ministry of Commerce and Industry	**MCI**
Multilateral Investment Guarantee Agency	**MIGA**
New East Development Corporation	**NEDC**
Research and Development	**R&D**
Rotterdam Municipal Port Management, Europe Combined Terminals (ECT) GEM Consultants BV	**RMPM&ECT**
Shareholding Company	**SH**
The Commercial Law	**CL**

The Industry Law	**IL**
Trade Related Aspects of Intellectual Property	**TRIPS**
Transnational Corporation	**TNC**
Treaty between Kuwait and Hungary	**KHT**
Treaty between Kuwait and Romania	**KRT**
Turkish Petroleum Company	**TPC**
United Nations Center on Transnational Corporations	**UNCTC**
United Nations Commission on International Trade Law	**UNICITRAL**
United Nations Economic and Social Council	**ESCWA**
United Nations Industrial Development Organisation	**UNIDO**
World Intellectual Property Organisation	**WPO**

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It should be noted that the law discussed in this thesis is that which applied at 1 January 1995, although some subsequent developments have been incorporated wherever possible.

ABSTRACT

The relationship between law, foreign direct investment (FDI) and development is a neglected area of investigation, and this study seeks to contribute to the understanding of that relationship through an analysis of the legal regulation of FDI in Kuwait. As well as offering a general theoretical appraisal of the role of FDI in development, it puts forward some practical proposals for legislative innovation and administrative reform in Kuwait with the intention of showing how greater encouragement can be given to the expansion of FDI with a view to promoting the country's future economic and social well-being.

The approach in this thesis stresses the importance of considering the effectiveness of Kuwait's FDI regulations against the background of the country's historical evolution and in relation to the distinctive patterns of political economy which have emerged in Kuwait's twentieth-century transformation from a traditional to a more modern society with an impressive level of welfare provision. In this respect, considerable attention is given to the significance of the various oil concession agreements between Kuwait and foreign investors for the exploration and marketing of oil. It is these agreements which have led directly to the growth and development of the country's current FDI regulations, and which have gradually enabled Kuwait to determine its own foreign investment policies as British influence has declined and national independence has been gained. Criticisms are offered, however, of the failure of Kuwait to pay sufficient attention to the role of FDI in the non-oil sectors of the economy.

The close examination of the law and administrative practice of FDI in Kuwait reveals a range of failings and inadequacies which have tended to have a negative effect on the attraction of FDI. This particular area of policy in Kuwait has developed in a somewhat piecemeal fashion without sufficient coherence and co-ordination. All too often laws, once made, have not been implemented effectively, and the process through which potential foreign investors have had to make applications and seek permission has often been slow, cumbersome and unduly bureaucratic.

Several specific issues relating to this area of concern are investigated during the course of the present analysis. There is a particular focus on the problems of underdeveloped laws relating to technology transfer, human resources development, intellectual property regulations, FDI tax and non-tax incentives and guarantees, and procedures for the settlement of disputes. A critical analysis is offered of the limitations which apply to the types of business organisation open to foreign investors, especially in terms of the requirement that all such investors must have Kuwaiti partners. It is argued that the crucial requirements for Kuwait's future development are those of manpower advancement, the improvement and utilisation of technology, and the diversification of the economy leading to sustained industrialisation. These goals will be achieved only through a fairly comprehensive modification of the country's FDI laws and the associated administrative procedures. Above all, a clear evolutionary

strategy linking FDI to Kuwait's developmental priorities, and operating within a favourable investment climate marked by greater administrative flexibility, is required.

CHAPTER ONE

INTRODUCTION

Since its first development plan in 1976, Kuwait has continuously pursued the goal of economic diversification. Historically, Kuwait has been a single-product economy with little local technology, and it has therefore been vital for the country to encourage investment, technology and the expansion of her industrial base. These are all objectives for which foreign direct investment (FDI) is indispensable, but the ability of Kuwait to attract FDI has depended on a number of factors, including the legal framework which applies to FDI. This thesis seeks to offer a critical analysis of key aspects of the law governing foreign investment in Kuwait, whether directly or indirectly, and to do so in the context of an overall assessment of the role of FDI in promoting the country's development goals.

Kuwait's regulatory measures which relate to FDI are examined to see whether they are actually in line with government objectives. The aim is to establish whether there is a clear relationship between foreign investment, economic development and the laws governing foreign investment. An historical perspective on these issues is indispensable, and therefore this thesis also discusses the changes which have taken place in Kuwaiti society, demonstrating how it evolved from a nation of boat-builders to become a modern welfare state. Special attention is given to the impact of the discovery of oil on the Kuwaiti economy. To facilitate an understanding of these questions, the historical, political, economic and cultural aspects of the country are described. The major gaps in Kuwait's administrative procedures relating to foreign investment are identified, and problems associated with

excessive bureaucracy and the often inflexible policy environment are discussed.[1] The thesis also explores various aspects of international law which affect foreign investment in Kuwait.

The principal argument advanced in this thesis, and which connects the various constituent chapters, is that FDI can be either encouraged or impeded by Kuwaiti laws which incorporate the Government's policies and by other factors which affect foreign investment. As a basis for this proposition, it is necessary to bring together policy perspectives from the historical, social, economic, political and legal standpoints, and these perspectives need to address the following key questions:

- What is the role of FDI in Kuwaiti development?
- How important have Kuwaiti laws been as a means of attracting FDI?
- What are the factors which have prevented these laws from effectively promoting the country's developmental goals?

To begin with, in order to determine how FDI can be used as a vehicle for development, it is important to explain briefly the precise meaning of FDI and to understand the broad development goals of Kuwait.

1.1 THE MEANING OF FOREIGN DIRECT INVESTMENT

There are various definitions of foreign direct investment. For example, Sornarajah defines it as the "transfer of tangible or intangible assets from one country into another country for the purpose of use in that country to generate wealth under the total or partial control of the owner of the assets" (Sornarajah 1994: 4; see also Graham and Drugman 1991: 7). Another definition has been suggested by the International Monetary Fund (IMF): "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor's purpose being to have an effective choice in the management of the enterprises" (IMF 1980: para. 408). In the *Encyclopaedia of Public International Law* (1989, vol. 8: 246) FDI is defined as "a transfer of funds or materials from one country (called the capital exporting country) to another country (called the host country) in return for a direct or

[1] Chapters Four and Five deal with the mainly bureaucratic obstacles which face foreign investors in Kuwait.

indirect participation in the earnings of that enterprise". Although the definitions proposed by both the IMF and the *Encyclopaedia of International Law* appear to de-emphasise the role of control, the latter is in fact a very important factor in FDI, especially for those transnational corporations (TNCs) which desire to use FDI for the purpose of implementing a global strategy (Sornarajah 1994: 6).

Foreign investment can be either public or private, with the latter comprising both portfolio and direct investment.[1] In the case of FDI, funds do not necessarily cross frontiers, and not all capital flows across frontiers qualify as investment (Petrochilos 1989: 6)[2]. Portfolio investments, however, are "stocks or bonds purchased by the investing country (or person) which include purchases of equity in foreign corporations, provided that the acquisition of the equity does not involve a significant measure of managerial control. Portfolio investments tend to be more general in the host country and imply a transfer of capital only" (Al Rashed 1976: 172-173). Sornarajah (1994: 4) describes portfolio investment as "a movement of money for the purpose of buying shares in a company formed or functioning in another country". Foreign investors, in the case of portfolio investment, look for a higher return on capital which arises from its greater scarcity abroad. "It represents the seeking of alternative opportunities by scanning a much broader international horizon", and involves a movement of capital with funds being transferred from one area to another in search of higher interest rates (Petrochilos 1989 : 6).

In Kuwait the relevant provisions governing FDI cannot be found in one single law, but are contained in many different statutes originating at different times. It is important to stress, therefore, that in Kuwait there is no clear, unambiguous legal definition of FDI. The most concrete definitions can be found in various treaties entered into by Kuwait. For example, the Agreement between Kuwait and Germany for the Encouragement and Reciprocal

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[1] See J. G. Starke (ed), *The Protection and Encouragement of Private Foreign Investment,* Ford Foundation Seminar Paper (Canberra: Institute for Advanced Studies, 1966), p.1, for a definition of foreign investment generally and an indication of various forms of investing abroad.

[2] Petrochilos (1989: 6) notes that "Foreign aid is a capital flow but it does not entail payment of interest, dividends or repayment of principal. Inter-governmental loans, on the other hand, depend on the same political considerations but do give rise to payment of interest and principal. The economic effects of such funds on the receving country will obviously depend on the ways in which they are spent."

Protection of Investment defines investments as including "every kind of assets owned and controlled by an investor of a contracting State and invested or channelled directly or indirectly in the territory of the other contracting State in accordance with the legislation of that State"(Article 1 of the Agreement between Kuwait and Germany for the Encouragement and Reciprocal Protection of Investment, on 30th March 1994, Kuwait Al Yum 195).[1]

1.2 KUWAITI DEVELOPMENT GOALS

Kuwait cannot be classified simply as a developed or underdeveloped (or developing) country since it possesses characteristics of each category (Al-Sabah 1983: 62). For example, prior to the Iraqi invasion in 1990, Kuwait had one of the best social welfare programmes in the world (Behbehani, 1981: 4). The social insurance allocation was KD 410 million in 1990/91, which increased to KD 816 million in 1991/1992, a large amount considering Kuwait's small population. Child allowance rose from a pre-war level of KD10 to KD30 per month per child, and during the same period welfare payments for widows and orphans increased by 50 per cent. Social services such as health and education are free, and other utilities are heavily subsidised (General Union of Chamber of Commerce Industry and Agriculture for Arab Countries 1993: 194). The basic principle of employment policy in Kuwait is to employ any Kuwaiti who is ready and willing to work (Al-Sabah 1983: 66). This policy, together with the comprehensive welfare system, is a feature of a structured economy.

On the other hand, Kuwait's development has been hindered by a general shortage of manpower and especially of technically skilled indigenous labour. The country's population in 1994 stood at 1.5 million, of whom only 650,000 were Kuwaitis. Of this total population manpower.[2] Kuwait has also faced the danger of remaining a single -product (oil) economy.

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[1] In a similar treaty with the People's Republic of China the term investment is deemed to include: (a) movable and immovable property as well as any other property rights *in rem*, such as mortgages, liens, pledges, usufruct and similar rights; (b) shares, stocks and debentures of companies or other rights or interests in such companies; loans and bonds issued by a contracting State or any of its natural or juridical persons and returns retained for the purpose of re-investment; (c) claims to money or to any performance having economic value associated with an investment; (d) copyrights, trademarks, patents and other industrial property rights, know-how, trade names and goodwill; (e) any right conferred by law or contract and any licences and permits pursuant to law. (Article 1 of the Agreement between Kuwait and the People's Republic of China for the Promotion and Protection of Investments, on 23rd November 1985).

[1] This theme is further explored in Chapter Seven.

According to Al-Sabah (1983: 62), these factors, together with the country's low industrial capacity and reliance on imports of capital and consumer goods, characterise Kuwait as an underdeveloped economy. But this description, for the reasons stated above, is too stark and one-dimensional, ignoring the country's welfare advancement.

The rate of economic development in the non-oil sector continues to be slow because of inadequate infrastructure. Although Kuwait depends heavily on oil revenue for its economic development, it has been unable to capitalise on its wealth to develop the non-oil manufacturing sector.[1] Due to this state of affairs, there has been a rapid increase in the importation of foreign goods and manpower. The transfer of technology is an important step towards achieving technological advances and developing local capabilities which in turn can sustain and maintain technological competitiveness, and FDI is a crucially important channel for such transfer.[2]

Undoubtedly, the most crucial developmental problems of Kuwait are a shortage of skilled, technical and managerial manpower, and a weak industrial sector which fails to adapt foreign technologies to its needs. The key aims of Kuwait's economic policies should therefore be the diversification of sources of income, the reduction of imports, an increase of non-oil exports, the training of the Kuwaiti workforce, and the transfer of appropriate technology to Kuwait. This thesis seeks to explore the extent to which these goals have actually been recognised by Kuwaiti governments, especially in terms of the need for an

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[1] Following the Iraqi invasion, Kuwait's GDP fell sharply in 1990 and 1991. In order to stimulate economic recovery the Government has focused on rehabilitating the oil industry. But while these efforts have been surprisingly successful, oil revenues remain below prewar levels. The combination of declines in oil revenues and in investment income (due to a liquidation of foreign assets) has forced the Government to make difficult choices with regard to the economy. Accordingly, three priorities have been identified: the development of the oil industry, national defence, and the maintenance of living standards. For more about oil-based recovery after the Iraqui invasion, see "Kuwait: Oil-based Recovery to Continue in 1993", *Middle East Economics,* October 1992. And for the health and environmental impact of the invasion, refer to A.A. Shatti and S. Harrington, "The Environmental and Health Impact of the Kuwaiti Oil Fires", *Proceedings of an International Symposium held at the University of Birmingham,* 17 October 1991.See also chapter two for historical and economic development in Kuwait.

[2] With its wealth of surplus capital before the Iraqi invasion of 1990, Kuwait, did not demonstrate any keenness to attract foreign investment. It did, however, recognise the importance of foreign investment, utilised under aregulated system of control, as a tool to attract necessary technological and managerial talent, and to be able to deal with international markets (Bazarian and Fauerbach 1980: 128). Thus, today Kuwaiti economic policy is firmly grounded in the belief that the combination of Kuwaiti capital with the benefits found in foreign technology and international experience can help the country to attain its long-term goal of industrialisation (El Zaim 1976: 143).

appropriate and effective legal framework which can attract FDI. It is true that recently increasing attention has been paid to the role of FDI as an instrument of economic development and change, and as a vehicle for transferring management skills and technical know-how to host countries (Kojima 1978: 138). But the key question raised here is whether FDI can be considered as an important vehicle for Kuwait development goals.

Another preliminary point of some importance in this respect is that the sectors in which foreign investors may invest in Kuwait are not restricted. However, investors are required to form a partnership with Kuwaitis or with citizens of the Gulf Co-operation Council Countries, and the local partners must hold a majority share of the equity. As this thesis aims to show, this is a vitally important obstacle to the encouragement of FDI. Since much of the discussion in this thesis concerns the oil sector, it must be stressed that although control of this sector remains in Government hands, the production of oil is actually undertaken through a partnership with foreign investors (Al Sabah 1983: 16). For all these reasons, close attention will be paid in the analysis which follows to the often complex rules which apply to the formation and maintenance of legal partnerships of various kinds.

1.3 CHANGES IN ATTITUDE TOWARDS FDI

Foreign direct investment was viewed negatively by many developing countries in the period between the end of World War II and the 1970s. As more and more countries gained their independence, they tended to see FDI as evidence of the continuing imperialistic control of their economies (Fatouros 1995: 184). Developing countries realised that independence in itself did not solve their economic problems because control of their economies still rested in foreign hands. Thus, their negative attitude towards FDI resulted in hostile policies and actions, including expropriations (Biersteker 1987: 5). This attitude led to the nationalisation of the oil companies in many developing countries after those countries gained their independence. [1]

The early 1980s saw a conspicuous change in the attitude of developing countries: "With the decline in other external funds, the reduction in FDI (given the experiences of some

[1] See Chapter Three.

investors), the need arose to search for other funds including technology and an obvious option was FDI" (Shihata 1988:5). Thus, it would appear that the increasingly positive attitude of developing countries towards FDI is a result of the fact that foreign investment has been recognised as an economic necessity (Wallace *et al.* 1990).[1] Today, however, developing countries have come to realise that there needs to be a balanced relationship with foreign investors. They are able to create a more receptive and liberal investment environment that recognises the legitimate interests of foreign investors, but at the same time they have maintained the policies and procedures necessary to ensure the soundness of the investments and their compliance with local laws and regulations (Shihata 1988: 5-6).[2] The Kuwaiti Government takes the view that it can limit any possible evils of FDI through appropriate regulations. [3] The validity of this view needs to be considered very carefully, and both the positive and negative consequences of specific regulations need to be assessed.

1.4 THE PROSPECTS FOR FOREIGN INVESTMENT IN KUWAIT

As the Kuwaiti economy is a government-controlled economy, the scale and scope of government expenditure[4] are very important. In fact government expenditure is heavily dependent upon government revenue from oil exports, but at the same time the oil sector's direct link to the rest of the economy, in terms of the products and services that it buys, is extremely limited. Thus, the oil sector's impact on the rest of the economy is essentially indirect, and is expressed largely through the Government's decisions about how the oil revenue is to be used. In historical perspective, it can be seen that some of the revenue was passed on to the private sector through spending on infrastructure, land purchases, social

[1] Many developing countries encounter serious economic problems because of corruption and mismanagement (Apter 1987: 14). External borrowings also have an impact on the prospects for recovery (UNCTC 1987: Series A, No. 7).

[2] For more about the impact of foreign investment in developing countries, see Ibrahim Shihatta, *MIGA and Foreign Investment* (Martinus Nijhoff, 1988).

[3] Governments have been supported in their development of laws and administrative infrastructures by bilateral and multilateral assistance programmes, such as those of the UN Centre on Transnational Corporations. These programmes have also assisted countries in their negotiations with MNCs. Competition has led MNCs to search for improved working formulae, such as joint ventures and licensing, thereby, in some cases, reducing their exposure.

[4] In the economists' jargon, government expenditure is the only independent variable in the macro-economic model. All other variables, such as consumption, saving, investment, etc., are dependent on government expenditure.

benefits, etc. However, despite this stimulus, the productive base of the economy, excluding the oil sector, did not expand in proportion to the growth of the population. Hence the role of the private sector in the economy continues to be relatively modest and the role of the Government is still dominant (Al-Fayez 1995). [1] Most of the economy is state-owned with the oil sector accounting for a very high percentage of GDP. Other significant state-controlled sectors are telecommunications, electricity, water, transport, education and health.

The private sector is largely confined to financial services, some areas of transportation, construction and myriad other services. Apart from refining, the oil and petrochemicals sector in Kuwait is very limited in its scope (Brothers: 1995). A reduction of the Government's role in the economy could be achieved by reducing the entrepreneurs' obligations to rely on bureaucrats for every decision concerning the deployment and movement of factors of production, mainly capital and labour. This would require the revamping of the existing laws on investment and on the movement of people. Deregulation, if carried out effectively, would free economic activity from unnecessary bureaucratic impediments, and would establish private economic enterprises which could compete with the existing government enterprises (Al-Fayez: 1995). Opening the door for foreigners to invest in the local economy in partnership with the private sector could have several positive results in terms of improving Kuwait's international relations, and facilitating the transfer of technology and modern management techniques (Al-Bader: 1995).

Kuwait's ability to attract foreign investors depends on many factors, in particular the general soundness of the country's economy and its ability to provide suitable investment opportunities supported by appropriate laws and regulations related to the needs of foreigners. To take just one important example, the Government's policy of privatising public utilities clearly indicates the need to attract specialised international companies to participate in the ownership and management of those utilities. The Offset Programme, which was started a short while ago, is considered to be one method which can be used to encourage eligible foreign investors to identify feasible projects. In this way the scheme can undoubtedly help to

[1] For more details of the economic situation in Kuwait, see Chapter Two.

utilise foreign know-how for the establishment of new industries.[1] As for other considerations which usually attract foreign investors, Kuwait has a strong, stable and freely convertible currency, and repatriation facilities for both capital and realised profits.[2] The success of Kuwait, or any other emerging market, in attracting international investors depends on a package of economic policies which successfully raises the competitiveness of local institutions and companies. This is considered to be one of the major challenges faced by decision-makers in Kuwait, especially given the prevailing conditions in the local labour market. In order to formulate appropriate measures which are conducive to a work environment, with high levels of efficiency and productivity, a careful study by the Government is required. There is no doubt that the foreign investor plays an important role in achieving this objective through the transfer of technical and managerial skills (Al-Bader 1995: 7).

Areas in which foreign capital and expertise can be employed, and in which foreign companies can participate in any profits or losses, are: toll roads, power generation, water supply, environmental protection services, healthcare, banking, telecommunications, transportation, as well as the oil sector. As Brothers (1995: 4) points out:"By attracting foreign investors you will be reducing the borrowing requirement or delaying the need to impose charges for services or even taxes and you will be sending a subtle message to the neighbour and so help security of the nation. In addition, there will be a significant technical and managerial transfer which will have a material benefit over the years. Furthermore, it will help to shift control of industry away from Government to the private sector, which in itself, is a worthy goal."

Turning to the basic legal principles which apply to all foreign investors doing business in Kuwait, they may be summarised as follows:

1) Foreign investors, i.e. non-GCC nationals, cannot freely acquire shares in Kuwaiti shareholding companies.

[1] For discussion of the Offset Programme see Chapter Seven.
[2] See Chapters Six and Nine for details about the encouragemant and protection of FDI in Kuwait.

2) Foreigners can participate in only two forms of company, and can hold up to a maximum of 49 per cent of the equity (40 per cent in the case of banks and insurance companies). The first form is the limited liability company (WLL), [1] which is similar to the French SARL or the Germany GmbH, but different from the common law limited liability company in that it does not have a board of directors or issue share certificates. Secondly, there is the shareholding company (SH), which in fact is similar to a common law limited liability company. The law directs that shareholding companies in Kuwait can only be established by Kuwaiti nationals.[2] In cases where foreign capital and expertise are needed, exceptions are made, provided that foreign shareholdings do not exceed 49 per cent.

3) The portions of the net profits of a Kuwaiti corporate entity or joint venture attributable, respectively, to foreign shareholders or to foreign corporate partners are subject to corporate income tax.

4) Net profits include amounts receivable in royalties, management fees, technical services and interest.

At the same time, foreign joint venture partners in industrial projects may benefit from incentives given to manufacturing industries under Industry Law, No.6, including tax holidays of up to ten years at the discretion of the Ministry of Finance, industrial sites at nominal rent and duty-free imports of machinery, spare parts, raw materials and semi-finished products for the first five years of operations. It is possible that in future these incentives may be reduced gradually as the Government looks for new sources of revenues,[3] although they may still remain fairly generous (Dabdoub 1995: 9-10). As will be emphasised in this thesis, the Industry Law No. 6 of 1965 is of particular significance in terms of its regulatory implications for FDI, and the question of whether the Law is in need of revision must be addressed.

In most countries incentives are coupled with numerous restrictions which, although justified in theory, often result in bureaucratic interference in investment affairs, leading to unnecessary delays and corruption. There is abundant evidence to show that the co-existence

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[1] WLL denotes companies with limited liability.
[2] For more explanation of the legal forms of doing business in Kuwait see Chapter Five.
[3] For more about incentives to promote foreign investment in Kuwait see Chapters Six and Eight.

of excessive restrictions with overindulgent incentives sends mixed signals to potential investors, who become confused about the Government's intentions or the overall investment environment (Shihata 1990 : 137). Kuwait's fundamental aim in providing support, incentives and protection for foreign investment should be to create opportunities for reducing imports. It is for this reason that it is essential to develop an industrial sector capable of meeting the initial need of the local market, and of subsequently competing in foreign markets.

In market economies, law is universally regarded as a powerful instrument for supporting and implementing government policies.[1] In Kuwait, state policy has tended to take the place of law. This lack of recognition of the role of law has also meant that policy implementation has been achieved by means of over-centralised planning through administrative commands and instructions for management of the economy and the operation of enterprises. In order to achieve its future developmental goals, Kuwait must recognise the positive contribution which law can make towards success.

1.5 THEORETICAL BACKGROUND TO THE ROLE OF FDI

Many theories have been put forward concerning the factors which influence FDI. First of all, there is the economic theory of transnational corporation (TNC) behaviour, which can be seen in the theory of international trade and the theory of the firm. The theory of international trade suggests that TNCs move their capital to those places where profits are highest. However, there are two flaws in this theory. First, it assumes a perfect market situation; and secondly, it does not explain why TNCs engage in direct investments rather than foreign lending and portfolio investments (Lall and Streeton 1977: 17).

The orthodox theory of the firm is effectively neo-classical. It makes use of trade and welfare theories in order to analyse FDI and accepts the need for state intervention to rectify any flaws (Petrochilos 1989: 8). However, the assumption of a perfect market situation leads, under this theory, to the view that when TNCs have reached their optimum size in the home market, thus suffering diminishing returns of scale, they will then invest abroad. This

[1] See, generally, Terence Daintith (ed), *Law as an Instrument of Economic Policy: Comparative and Critical Approaches* (1988).

argument clearly does not explain why some TNCs grow in extremely imperfect markets or invest abroad when there are no clear signs that they have reached their optimum size in the home market (Lall and Streeton 1977: 18). It cannot be denied that the main reason why TNCs invest overseas is in order to maximise their profits.[1]

Legal views on foreign investment have been directly affected by such theoretical disputes.[2] Various theories give conflicting views about the effects of foreign investments, for example in terms of whether such investments are to the advantage or disadvantage of developing countries. A third view takes a middle stance and claims that FDI is both beneficial and harmful, and that ways should be sought to increase the benefits and diminish the harmful effects.[3] The classical, dependency and structuralist theories will now be discussed in turn in order to illustrate the main parameters of the debate.

1.5.1 Classical Theory

The classical theory states that foreign investment is wholly beneficial to the host state, and that it is also necessary for the development and economic well-being of the whole world (Biersteker 1987: 12). Foreign investment brings skills, technology and employment to host states, providing these states with access to overseas markets, and it also helps to "mobilise local resources that would otherwise not be mobilised - or at least, release foreign exchange available to a country to do the same thing" (Robock *et al.* 1977: 277). Classical theorists argue that developing countries require foreign investment in order to achieve economic development (Biersteker 1987: 13). This belief appears to be supported by the fact that there are few nations today which seem to be able to achieve economic growth and greater prosperity without foreign investment.

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[1] Recent theories have turned to explanations based on market imperfections. These are oligopolistic theories which explain that foreign direct investment is typical of an oligopolistic firm, which has some sort of superiority, searching for control in an imperfect market in order to maximise profits. These theories suggest that firms venture into direct foreign investments because of their oligopolistic characteristics, and that their investment and operation abroad enable them to survive by strengthening and expanding oligopolistic systems (Kiyoshi Kojima 1978: 60).

[2] T. Biersteker suggests that there are six alternative theoretical approaches to international political economy: see T. Biersteker, *Multinationals, the State and the Control of the Nigerian Economy* (1987), pp.11 and 44.

[3] For further analysis see Sornarajah, *The International Law on Foreign Investment* (1994), pp.38-50, and Biersteker, op. cit.

International instruments concerned with the law on foreign investment, including preambles of bilateral and multilateral agreements, frequently highlight the benefits of foreign investment.[1] These arguments are invariably based on the classical theory and are certainly questionable (Sornarajah 1994: 40-42). The Vice-President of the World Bank, Mr. Shihata, offered an example of the classical theory position when he stated that

> FDI is an important vehicle for the transfer of technology. It usually brings in new knowledge on processing techniques, product design and packaging, communications technology as well as market development and strategy. These inputs are generally injected over the life of the investment, enabling the project to keep pace with technical innovations and developments in the world markets (Shihata 1991: 486).

The fact that the Kuwaiti Government imposes strict restrictions on equity participation by foreign investors (see Chapter Five) indicates that it does not subscribe to this classical theory. One criticism levelled against the theory is that it views development mainly in terms of the flow of foreign investment or capital into the host state. Although capital inflow is a result of foreign investment, it can be argued that the inflow often ends up in the hands of the few and does not necessarily filter down to the masses: "Foreign investment as such leads to exploitation and inequality" (Sornarajah 1994: 42). Such views are put forward by the dependency theorists, who view development in wider terms by taking into account the development of the country not only in terms of capital, but also in terms of the well-being of the people as a whole.

1.5.2 Dependency Theory

The formulation of dependency theory owed much to the work of Latin American sociologists and historians (Cardoso 1977; Peter Evans 1979). In recent years theorists such as Samir Amin have been added to their ranks. These relative newcomers basically work with the theory of imperialism, taking into account the effects of imperialism on the internal maturation of peripheral countries (Evans 1979: 26).

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[1] See the preambles to the Kuwaiti-German Bilateral Investment Treaty and the Kuwaiti-Chinese Bilateral Investment Treaty. The agreement between Kuwait and the People's Republic of China for the Promotion and Protection of Investments states that " the encouragement and reciprocal protection under international agreements of such investments will be conducive to the stimulation of business initiatives and will increase prosperity in both contracting states"

Dependency theory claims that on balance foreign investment does not contribute significantly to economic development (Sornarajah 1994: 43). The underlying argument is that TNCs are primarily concerned with the interests of their stakeholders (parent companies and shareholders) in their home countries: an argument which is undoubtedly far too harsh. Dependency theory holds that foreign investors exploit and plunder the resources of developing countries, somewhat along the lines of colonialism (Ghai 1987: 771). It is apparent that Kuwait does not subscribe to this general theory, as can been seen by the number of treaties concerned with the promotion of investments to which it is a party. [1]

The starting point of dependency theory, according to Evans (1979: 26), is a consideration of a country's relations with the external world. A dependent country relies on the income derived from the export of a few primary products, and is thus dependent on the development and expansion of another country's economy. It follows that economic fluctuations in the other country can adversely affect the dependent country. Samir Amin further argues that: "Since productive investments are financed by foreign capital, they must inevitably lead to an outflow of profits and this retards growth. Often, external aid is required and he who calls the piper dictates the tune" (Amin 1976: 247).

The current perception of foreign investment tends not to represent either of the two extreme positions of classical theory and dependency theory. Foreign investment may not be entirely beneficial to the host state, but neither is it correct to state that it contributes nothing to development. The key issue would seem to be whether the contribution of TNCs to development could be improved, and there is undoubtedly evidence that foreign investment can have some adverse effects on development in certain contexts and circumstances (Bergsten 1978: 368-369).

1.5.3 Structuralist Theory

The structuralist view is that multinationals have played an extremely important role in the industrialisation efforts of less developed countries (Biersteker 1987: 24). Structuralist theorists argue that there are both advantages and disadvantages to foreign investment: it can

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[1] See Chapters Six, Eight and Nine.

promote growth and development, but can also lead to excessive dependence on private investment from abroad (Hirschman 1971: 225-226). Like the dependency theorists, structuralists believe that development should reduce the levels of poverty, unemployment and inequality in a society (Biersteker 1987: 24). However, unlike the proponents of dependency theory, structuralists believe that if the governments of host states can influence or control TNCs, they can then gain from the benefits of foreign investment, so that no purpose is served by terminating foreign investment altogether.

1.5.4 Theoretical Relevance to the Case of Kuwait

The United Nations Centre on Transnational Corporations, while agreeing that under certain circumstances foreign investment via TNCs could have adverse effects, also suggests that, if properly managed, TNCs can contribute to genuine development in the host states (Sornarajah 1994: 46-48). Although detailed data are unavailable for an in-depth study, Chapters Four and Five of this thesis identify attempts by Kuwait to limit what are sometimes regarded as the damaging effects of foreign investment. These attempts would appear to indicate that broadly speaking the Kuwaiti Government supports the UNCTC's viewpoint. It is also the case that many third world governments have based their development strategies, including systems of national planning and internationally negotiated commodity agreements, on the works of the social democratic scholars who are most clearly identified with the structuralist theory.[1]

A key question, then, is: how exactly can foreign investment contribute to development of the host state? This development is claimed to be a result of several processes, in particular:

- the transfer or mobilisation of capital;
- the transfer of technology and hence the possibility of industrialisation; and
- the generation of income and employment.

[1] Biersteker (1987). A notable contemporary base of the structuralist school is the Institute of Development Studies at the University of Sussex in England, many of whose fellows have influenced decisions in developing economies. They argue, on the one hand, that there are celebrated and undoubted contributions of private international investment to development. On the other hand, foreign investment brings not only the dangers of economic plunder and political domination, but a number of other serious effects and side-effects which can handicap the development efforts of countries placing prolonged and substantial reliance on private investment from abroad (Hirschman 1971: 225-226).

These processes lead to the enhancement of local labour skills and expertise, and this in turn leads to an improvement in the quality and capacity of the human resources available in the host state. This thesis proposes to examine the extent to which these claims are supportable in the case of Kuwait. Due to the traditional differences in opinion between capital-exporting countries and capital-importing countries, the system of law which governs foreign investment is an important consideration.[1] In the next section, a brief explanation of the sources of both international law and domestic law is given, and the relationship between those international and domestic laws affecting foreign investment in Kuwait is discussed.

1.6 THE RELATIONSHIP BETWEEN INTERNATIONAL AND DOMESTIC LAW AFFECTING FOREIGN INVESTMENTS

Whether any real body of international law exists to regulate FDI is debatable. As Fatouros (1995: 188) points out, there is certainly no single legal instrument covering all aspects of FDI in all, or even most, home and host countries. The existing international legal framework is a diverse and fragmented collection of norms and instruments, and many important gaps remain to be filled. Article 38 of the Statute of the International Court of Justice contains an authoritative statement on the sources of international law. However, the most recent edition of Oppenheim[2] argue that those sources should not be viewed as the total number of sources.[3] Attempts have been made by some writers to classify these sources so that "international conventions, custom and the general principles of law are described as the three exclusive law-creating processes while judicial decisions and academic writings are regarded as law-determining agencies, dealing with the verification of alleged rules" (Shaw 1994: 59). However, such theories are not universally accepted.

[1] The thesis addresses this subject in Chapter Nine.
[2] See, *Oppenheim's International Law*,Vol.1 (1996, 9th Edition) R, Jennings and A. Watts (ed.), (London, Longman.)
[3] "The court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: (a) International conventions, whether general or particular, establishing rules expressly recognised by the contesting states; (b) international custom, as evidence of a general practice accepted as law; (c) the general principles of law recognised by civilised nations; (d) subject to the provisions of Article 59, judicial decisions and the teaching of the most highly qualified publicists of the various nations as subsidiary means for the determination of rules of law."

Customary international rules and principles relevant to foreign investment include the principle of national sovereignty, which confirms the right of a state to control both the entry of foreign enterprises and individuals on to its territory, and also the operations of those enterprises in that territory (Fatouros 1995: 189). Customary law also contains a variety of other rules relevant to foreign investment. For example, as Asante points out, "some important elements of the traditional law of state responsibility are the notions of acquired right, particularly the requirements with respect to expropriation of foreign property, the rules governing state contracts, such as *pacta sunt servanda*, and the proscription of non-discriminatory treatment for aliens and alien property, or economic interests" (Asante 1988: 590).[1] These are all essentially principles of customary law.

There are many areas where Kuwaiti laws regulating foreign investment discriminate against foreigners. As previously explained, foreigners have to form partnerships with Kuwaiti nationals, and these partnerships must be on a 49:51 per cent shareholding basis. Foreign investors, including investment enterprises, are not allowed to own land, and they must also pay taxes on their shares of business profits, whereas their Kuwaiti counterparts do not. Apart from these examples of discrimination, foreign and Kuwaiti investors receive the same standard of treatment, and in general it seems that the standards which Kuwait applies to foreign investors act as neither an encouragement nor discouragement.

The principle of state sovereignty means that each country is entitled to regulate the exploitation of its own resources. This includes the right of expropriation of foreign property in the public interest, provided that compensation is paid (Sornarajah 1994: 142).[2] The Government of Kuwait therefore possesses the right to interfere with the interests of the foreign investor in appropriate circumstances, but must abide by the compensation requirement.[3] Unless the host state has itself placed limitations on its own rights, the jurisdiction of the host state extends to the regulation of foreign investment. Specific norms, for example the duty to pay compensation in the event of expropriation (contained in Kuwait's

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[1] Many arbitral tribunals use general principles of law to rule on which law is applicable in foreign investment disputes. However, the use of principles distilled from one particular area of international society may not necessarily be acceptable to other areas of international society (see Sornarajah 1994: 77-78).
[2] This is further explored in Chapter Eight.
[3] These issues are discussed in Chapters Four, Five, Eight and Nine.

investment treaties), can form the basis for such limitations. Although treaties are an important source of international regulation of, no single treaty provides a comprehensive code for the international regulation of foreign investment. This suggests that states have differing opinions, and that there is certainly no single standard of treatment of foreign investments (Sornarajah 1994: 18, 73).[1]

National laws in fact form an essential part of the legal regime governing foreign investments. As Fatouros (1995: 192) has observed, "international rules and practices function in constant interaction with national ones, deferring to them, supplementing them or replacing them, in a continuous dialectical relation". It is therefore necessary briefly to consider the unique sources of law in Kuwait.

1.7 SOURCES OF LAW IN KUWAIT

Following the independence of Kuwait, a modern legal system was developed which replaced the customs, historical traditions and tribal rules that had previously been the main sources of law (Al-Jamal 1970). The complex nature of those sources must be understood, particularly the influence of Islam. At the turn of the nineteenth century, the Ottoman State issued *the Majallat of Al-Ahkam Al-Adliyah - The Magazine of Judicial Provisions*. This was adopted by Kuwait in 1938 as the law governing civil and commercial dealings, and was preserved as a compilation of Islamic law (Abdu Reda, Abdul Rasul: 1991). However, the adoption of a Civil Code in 1980 replaced the *Majallat* (Kabbaka, Basam: 1991).[2] After minor modifications, Kuwait adopted some of the French-style Egyptian legal codes in the areas of commerce, banking, industry and insurance (Amin 1991: 97-98).[3]

In 1963 the Kuwaiti constitution was adopted, and a new era in the legal and judicial system began. Laws were issued to regulate civil and commercial hearings and procedures,

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[1] The implications of Kuwait's success at regional treaty levels are discussed in Chapter Eight.

[2] The *Majallat* (Magazine), as amended by a number of Kuwaiti statutes, was applicable in areas of property and endowment up to February 1981, when it was replaced by a new Civil Code of 1930.

[3] In 1959 the Government of Kuwait invited Abd-Al-Razzag Sanhori (an Egyptian jurist who had drafted the Egyptian Civil Code of 1948) to assist and advise on the codification and modernisation of the Kuwaiti legal system. According to Ballantyne (1986), Sarhouri wrote the constitution and a commercial code (which had been replaced in 1981), and also wrote a Court's Law and a Conflict of Laws Code which is the only one in the area apart from some fragmentary provisions in Bahrain and Qatar and in the Oman Banking Law.

and to set up a new judicial system. The primary sources of the Kuwaiti Civil Code (1980) and the Constitutional Law (1962) are (a) Islamic law (b) Constitutional Law (c) legislation and (d) tribal traditions and local customs. Secular traditions remain the most important source of law, although Islamic laws are applicable in certain instances.[1] The Kuwaiti legal system is still developing, with an increasing use of Islamic law. Mention must also be made of the increasingly important GCC laws which are based on a policy of harmonisation of the laws of all the GCC member states (Amin 1991: 77-95). Evidently foreign investments in Kuwait are governed by municipal laws as well as by international treaties, contracts, etc. For example, Kuwait is a member of the WTO and is therefore subject to WTO rules governing foreign investment.[2]

1.8 AIMS OF THE STUDY

The choice of subject for this research was prompted by the author's conviction that the protection and encouragement of foreign direct investment in Kuwait has to be regarded as an indispensable factor in the social and economic development of the country. In this respect, due importance has been given in the research to the nature of the problems confronting the foreign investor, and an attempt has been made to find solutions to these problems. The thesis is primarily concerned with the extent to which Kuwaiti laws, regulations and provisions are deemed to be favourable or unfavourable for foreign investment in Kuwait.

The historical background to the problem of foreign investment in Kuwait has also been touched upon in order to show the reasons for the general lack of FDI, and also to point out the likely advantages in the event of Kuwait changing its policies. A proper balance is required between the flow of foreign capital and the appropriate means of dealing with that flow. The present study is believed to be unique as it is an original attempt to explain the Kuwaiti regulations that affect foreign investment in the context of the country's history,

[1] Chapter Ten discusses the attempts made to eliminate foreign investors' concerns about the extent to which the *Shari'a* applies to commercial transactions.

[2] However these rules are likely to be of limited relevance to Kuwait in the immediate future. See, in particular, the Agreement On Trade-Related Investment Measures. See generally Michael J. Trebilcock and Robert Howse in *The Regulation of International Trade*, (London, New York), pp 248- 300.

political economy and development path. As Sir Henry Maine [1] argued, the study of law must always be approached historically, but it is also wise to adopt a broader perspective. The forms of law and other legal concepts used within a particular society evolve as a product of the historical transformation of socio-economic relations and are thus an integral part of those relations. Maine's principal contribution is in his general emphasis on historical context and the importance of coherent hypotheses concerning the evolution of legal ideas.

Karl Marx's view was that the development of law does not result simply from the exercise of human will or from the autonomous logic of ideas, but is related to changes in the social relations and material forces involved in production. As the economic structure of a society changes, many changes may also be expected to take place in the areas of law, politics, religion and other forms of social relations. However, this does not mean that the development of law, legal ideas and institutions is entirely dependent on the economic element. As Engels stated, "economic conditions may ultimately be decisive, but political ideologies, judicial forms and the class of individuals will influence the course of historical changes" and will "in many case preponderantly determine their form" (Ghai *et al.* 1987: 3-10). Urging the adoption of an historical analysis of the economic and social forces which shape legal rules, ideas, institutions and processes, Ghai, Luckham and Snider (1987: xii) have set out a clear basis for a political economy of law approach:

> We aim to analyse law, legal processes and legal institutions in their social, economic and political context. Lawyers usually pay close attention to legal rules and principles, but they often neglect the political and economic context which shapes the way in which law is made and applied. Other social scientists have been concerned to analyse the basic structure of society, but they have usually neglected the manifold, complex roles of law. We are convinced, however, that both approaches must be combined: the analysis of law in its social context yields numerous insights into the organisation of society, the roles of law and the limits of social change. Our approach is therefore explicitly historical and contextual.

To understand Kuwaiti regulation on foreign investment, as in Maine, Marx and Engel's view, we have to look at the historical development of Kuwait in social, economical and political context.

[1] See Sir Henry Maine, 'The Development of Law', in Y.Ghai *et al.*, *The* Political *Economy of Law: A Third World Reader* (1987), p.35.

Wealth in Kuwait has been heavily dependent on oil resoures and could have been better used for the enhancement of the potential of the country's human resources. In spite of having planned development programmes, the state in Kuwait has not formulated a coherent strategy for ensuring the growth of people's abilities, skills and professional capacities. Kuwait has a benevolent government which is generous to the people, but it has failed conspicuously to develop human resources.

It must be noted that there is presently a conspicuously lack of studies of the relationship between foreign investment as a fundamental factor in the development of human resources and the legal principles governing foreign investment. The present work attempts to fill this major gap, but at the same time, in a work which is primarily a legal analysis, it is not possible to deal with all the social, economic, and political aspects of foreign investment. Nevertheless, particularly significant non-legal issues have had to be considered.

It is perhaps obvious that the current laws regulating foreign investment in Kuwait have been made in order to protect and uphold national sovereignty and the economic interests of Kuwaiti citizens. The existence of excessive bureaucratic hurdles and impediments to foreign investment must be seen within this context. In recent years Kuwait has attempted to attract foreign investment by providing various incentives, but there are no definite indications of the effectiveness of these policies. In actual fact the incentives themselves are restricted by many preconditions which are bound to render them ineffective. It is intended that this study should shed light on the serious defects in the existing laws governing foreign investment which have rendered them incapable of attracting the requisite foreign capital to Kuwait.

1.9 ACADEMIC WRITINGS ON FOREIGN INVESTMENT, LAW AND ECONOMIC DEVELOPMENT IN KUWAIT

Apart from some general studies of the economic and political history of the country, very little work has been done on the economics of foreign investment in Kuwait, especially work that is related to the oil market and to the portfolio investment strategy of overseas foreign investors. Two works which do deserve mention are the unpublished PhD thesis by Fahad M. Al-Rashed (1976), *Kuwait's Investment Strategy, 1975-1985* (Claremont University), and

by Dr Mohammad Watyan (1984), *A Cross-Cultural Comparison of Perspectives on Investment Decision Making between Americans and Kuwaitis* (School of Business and Management, United States International University).

Concerning foreign investment regulations in Kuwait, some research has been published in a variety of legal journals. Of particular significance are the following contributions to the *Arab Law Quarterly*: Samir Saleh (1985-86), 'The Recognition and Enforcement of Foreign Arbitral Awards in the States of the Arab Middle East'; W.M. Ballantyne (1985-86), 'The Constitutions of the Gulf States: A Comparative Study'; Isa Huneidi (1989), 'Arbitration Under Kuwaiti Law'; William F. Pepper (1991), 'Foreign Capital Investment in Member States of the Gulf Co-operation Council: Considerations, Issues and Concerns for Investors'; and John O. Gerald (1991), 'Legal Aspects of Doing Business in Kuwait'.

The problems posed by foreign investment laws in Kuwait have not been adequately dealt with in academic circles. In particular, the central question concerning the effect of foreign investment on development has not received any serious attention. There have been several legal studies purporting to tackle this issue, but no Kuwaiti academic, jurist or legal expert has demonstrated a keen interest in the vital aspects of foreign investment.

In this respect mention should be made of the fact that the proposed changes in Kuwaiti investment laws outlined in this thesis have been based on the theory of structural adjustment. Adherents of this theory maintain that professional legal experts have an important role to play in highlighting the importance of legal matters for social, political and economic development. The absence of a well-defined strategy in terms of state policy concerning foreign investment is regrettable, and this has been responsible for the fact that there are no legal studies concerning the relationship between foreign investment and development. Such studies would help decision-makers in Kuwait to have a clearer vision of their goals. The availability of such studies is regarded as an important step along the road of progress and prosperity. Legal experts, jurists and academics should therefore be encouraged to play a positive role in the decision-making process.

In view of the lack of relevant academic studies, it is necessary in this thesis to focus attention on the importance of foreign investment in its various forms and its role in development. Accordingly, the question as to the sort of development that ought to be pursued by Kuwait must be addressed, although others may ask whether there is a need to form a new definition of Kuwait-specific development which would incorporate the customs and traditions of the country. In this research, desirable development is defined as the development that would help with the promotion and enhancement of technical skills, and of a healthy, forward-looking attitude towards future technological change in Kuwait, giving priority to its importance in all government decision-making so that the general social and economic life of the country can be improved. Such a perspective can facilitate a positive debate to which the country's academics, legal experts and jurists can all contribute.

1.10 SOURCES RELIED ON IN THIS STUDY AND METHODS OF GATHERING DATA

The author encountered a number of problems due to the non-availability of data which would have made the process research easier and more manageable. There is generally a very small body of literature dealing with foreign investment and its role in development. The majority of economic studies dealing with investment in Kuwait tend to focus upon the kind of development encouraged and fostered by the Government. Equally, there has been a serious lack of literature dealing with foreign investment from a legal point of view. Most of the available studies approach the problem purely from an economic or historical perspective. The present work is therefore the first scholarly analysis to present the problem of foreign investment in Kuwait from an inter-disciplinary perspective by establishing various connections between FDI and legal or historical issues.

The sources on which this research has relied are: primary documents, such as legislation, judicial decisions, government and corporate reports; and secondary sources, including national and regional newspapers and business magazines (for information about the business environment and legal regulations applicable in Kuwait), books and journal articles. It should also be mentioned that there are very few references or sources dealing with the legal

aspects of foreign investment in Kuwait, and the author tried to fill this informational gap by conducting interviews with Kuwaiti experts and officials, all of whose contributions are fully acknowledged in the text.

1.11 FRAMEWORK OF THE STUDY

This thesis is divided into five parts. Part One, which consists of Chapter One (the present chapter), provides a number of definitions and explains certain crucial factors which have an influence on foreign investment. In order to understand the potential role of law in development, this chapter considers conflicting theories concerning the impact of foreign investment on developing countries.

Part Two of the thesis (Chapters Two and Three) offers an historical analysis. The historical transformation of economic, political and social life in Kuwait provides the necessary background to an understanding of the current role of law, including foreign investment regulations, in the Kuwaiti development process. Chapter Two discusses the state of Kuwait before the discovery of oil in 1946, its subsequent evolution as a modern state after the commencement of oil extraction, and the general impact of this on the country's way of life. Chapter Three examines the evolution of Kuwait's foreign investment regime, and it identifies three major stages of development: the first stage was prior to the discovery of oil, when the level of foreign investment was negligible and when Britain had control over Kuwait's policy on foreign investment; the second period was characterised by the oil concession agreements, whose conditions greatly affected Kuwaiti policy on foreign investment; the last stage saw the evolution of the post-independence regulations, when policies began to be adopted for the purpose of fostering foreign investment and economic development. A summary of the foreign investment regulations introduced after independence is provided. The major rules which affect foreign investment are discussed in some detail in subsequent chapters.

Part Three contains Chapters Four to Nine, which examine in detail the Kuwaiti laws governing foreign investment. The aim is to analyse the various legal norms which regulate foreign direct investment in Kuwait and to consider their effects on investments and on

economic development more generally. Chapter Four discusses the regulations used for screening and approving foreign business proposals before licences are given to allow the commencement of business activity. This chapter demonstrates that the procedures are unnecessarily cumbersome, and a number of specific recommendations are made to improve the situation. Chapter Five discusses the main forms of business organisation which may be used to meet the needs of foreign investors with respect to ownership, control and divestment. The chapter concludes that the laws regulating economic activity in Kuwait should be amended. Chapter Six seeks to analyse the suitability of the incentives provided by the state and their likely effect in encouraging and protecting foreign direct investments, and an attempt is made to outline factors which are central to the formation of an effective legal framework for attracting FDI to Kuwait. The specific incentives considered include a low rate of customs duties (4 per cent), the freeing of restrictions on the repatriation of profits, free economic zones, and attractive conditions for bank loans. This chapter concludes that Kuwait's incentives to attract foreign investment are certainly steps in the right direction. Chapter Seven examines how the regulatory framework governing foreign direct investment operations affects the role which foreign investment can play in Kuwait's development, with particular reference to the transfer of technology and manpower problems. This chapter deals with the choices and mechanisms for the transfer of appropriate technology, and considers the key factors which affect technology acquisition. The chapter also reviews the regulation of intellectual property, such as patents, trade marks, copyright and designs, and looks at the new Offset Programme adopted by the government to attract foreign investment. This programme is an attempt to lay down conditions for foreign investors in respect of the transfer of technology. In this chapter criticisms of the Offset Programme are presented, and recommendations for change are proposed. The final issue that is dealt with in this chapter is the problem of the shortage of human resources. The causes of the problem are examined, and possible means of solving it are assessed. This chapter concludes by suggesting some solutions to the problems of an absence of technology and the lack of professional expertise in the Kuwaiti labour force. Chapter Eight deals specifically with the impact of Kuwait's tax regime on foreign investment and highlights a range of inadequacies. Chapter Nine deals with

guarantees, safeguards and the general treatment of foreign direct investment. It concludes that in order to attract foreign investment, Kuwait must offer both protective measures and industrial incentives.

Part Four (Chapter Ten) reviews the judicial system in Kuwait. It considers the various techniques and procedures for the settlement of investment disputes involving foreign investors, including various forms of arbitration, and proposes a number of changes which are designed to modernise the system and make it more effective.

Finally, Part Five (Chapter Eleven) reviews the fundamental problems which confront Kuwait's development, and then proposes some policy recommendations, suggesting both solutions and reforms of the legal framework governing foreign investment in Kuwait. While it is acknowledged that Kuwait has attempted to streamline its regulations for FDI, it is argued that there is still much scope for further innovation.

CHAPTER TWO

THE HISTORICAL AND ECONOMIC DEVELOPMENT OF KUWAIT

2.0 AN INTRODUCTION TO KUWAIT

The historical analysis presented in this chapter and continued in Chapter Three provides an important framework for understanding the growth and development of foreign direct investment (FDI) in the Kuwaiti economy. In this chapter the focus is on the broad social, economic and political evolution of the country from its origins to modern times. In Chapter Three attention shifts to the specific issue of the way in which Kuwait's FDI regime has been constructed and modified in the twentieth century. Throughout the analysis the emphasis is on explaining the factors which have contributed to the inadequacies of Kuwait's current FDI regime. It will then be possible to suggest ways in which that regime might be improved to attract a higher level of FDI, particularly in those economic sectors which must be given priority in the country's future development plans.

To begin with, it is necessary to present an overview of Kuwait's socio-economic and political situation. Kuwait is a Muslim state which now enjoys one of the highest per capita incomes in the world. However, despite this level of wealth - which is due mainly to the fact that Kuwait has a remarkable concentration of oil reserves - the country is highly insecure. This is primarily because the total population of Kuwait is less than two million, making its territories virtually impossible to defend, while at the same time its borders, and indeed its very existence as an independent state, are disputed by neighbouring states.[1]

Kuwait was never colonised, but from 1899, for a period of about sixty years, it became a British Protectorate (Winstone and Freeth 1972: 210-217). Even under the

[1] Kuwait is positioned at the core of a highly sensitive and turbulent region of the world, the Middle East. Being at the north-western part of the Gulf, its territorial waters meet those of Iraq and Iran in such a constricted section of the Gulf. The delicacy of Kuwait's location becomes clearer when it is realised that the boundaries of these territorial waters have never been defined. Nor have the land boundaries separating Kuwait and Iraq. Kuwait shares land and sea boundaries with both Iraq and Saudi Arabia and marine borders with Iran. Being situated at the center of these regional "superpowers" renders Kuwait weaker than all of its neighbours. The possession of huge oil reserve accentuates Kuwait's vulnerability.

Protectorate, however, the British presence was minimal and at no time were there any British troops in the land.[1] This is a fact which distinguishes Kuwait's history from that of other developing countries which have experienced a more direct form of colonial rule.

In the twentieth century Kuwait has experienced a profound and often turbulent transformation from a nomadic to a settled society, and this transformation has had far-reaching social, economic and political consequences. Since the 1940s, in particular, the pace of change has been heightened as a result of the development of oil extraction and the consequent financial benefits to the country which made it possible to invest in major economic and social projects. However, the country's excessive reliance on oil revenues led to a lack of balance in the economy which has often been described in terms of a combination of development and underdevelopment. After the damage caused to the oil sector by the Iraqi invasion in 1990 and 1991, the overwhelming priority of the Government was to rectify that damage and ensure that all oil production was restored. Today, the country's leadership seeks to encourage the growth of the private sector, reduce the role of the state and stimulate a more diversified economy (Al-Roudan 1995). These objectives now represent the longer-term ambitions for the post-war period in the state of Kuwait, and it is in this context that the significance of Kuwait's FDI regime needs to be assessed (as will be explained in more detail in Chapter Three).

2.1 GEOGRAPHY AND LOCATION

The geography and location of Kuwait have had a tremendous impact on the country's development. On a world scale, Kuwait is very small, with a total area of only 17,818 square kilometres or 6,880 square miles (Al-Fahad & Co. 1986: 1). Shaped roughly like a triangle, it

[1] Winstone and Freeth (1972): *Kuwait: Prospect and Reality*. Perhaps the best retrospective comment on this 'storm in a teacup' was provided by David Holden, the *Sunday Times*' Middle East expert, in his book *Farewell to Arabia*: "For sixty-two years... no significant British land force had ever been summoned to its [Kuwait's] defence. Now, in the first month of its independence, nearly 6000 British troops poured into the country to prove that Britain was still in earnest about upholding peace in the Gulf."

is located at the upper north-west tip of the Arabian Gulf, surrounded to the north and west by Iraq and to the south by Saudi Arabia, while to the east lie the waters of the Arabian Gulf (Ministry of Information 1989: 27). Kuwait shares a neutral zone with Saudi Arabia at the south which also borders on the Gulf (International Bank for Reconstruction and Development [IBRD] 1965: 19). There are also several offshore islands: Failaka and Warba are the larger ones, but only Failaka is permanently inhabited.

2.2 KUWAIT'S EARLY ORIGINS AND HISTORICAL BACKGROUND

2.2.1 Kuwait in Ancient Times

The remains of two stone-age cities dating back to the second century BC can be found on the island of Failaka (Abdul Malek 1976: 4) where archaeologists have discovered artefacts indicating that extensive trade was carried on from these cities to India and Greece (Khazal 1962, Pt. 1: 11). At the southern tip of Failaka was a Hellenistic settlement dating back to at least the seventh century BC (Mansfield 1990: 7).

The presence of Islam in the Gulf region has had an enduring influence on Kuwaiti society. Evidence suggests that this process began during the time of the Prophet Mohamed himself, following his conquest of Mecca in AD 630 when he sent emissaries to the tribal leaders of the Gulf and to most other parts of Arabia. There is no evidence of a permanent settlement at that time in what is today known as Kuwait. However, it is known that Muslim armies fought a great battle on land which is now partly within the present territory of Kuwait and extends further into Iraq (Y.S.F. Al-Sabah 1980: 1).

2.2.2 The Start of a Nation

A mid-seventeenth century chart of the Dutch East India Company identifies a small fishing village in the present area of Kuwait known as "Grane" or, in Arabic, *Al-Gurain* (Abu Hakima 1983: 1). The actual title "Kuwait", which was the accepted name of this area by the end of the eighteenth century, is derived from the word *kut* and means "small fort". Historical research has shown that a fortress was indeed built on the site of present-day Kuwait City at

some time between 1660 and 1680 by an Emir from the Bani Khalid tribe, who were then rulers of Eastern Arabia (Al-Farhan 1960: 61). The Utoob, a large family of the Anaiza tribe originating in the central Arabian area of Nejid, migrated to this coastal village in the early 1700s to escape an extended period of drought in their homeland (Mansfield 1990: 5). They lived in Grane (Kuwait) under a form of local independence from the Bani Khalid (Abu-Hakima 1984: 5) whose influence ended in the mid-eighteenth century due to continuing factional rivalry and external threats from the Wahabbis, also of Central Arabia and their bitter enemies. After the settlement of the Utoob in Kuwait, the city flourished, giving rise to the need for some kind of governing body to run its affairs (Khazal 1962, Pt.1: 11). Each of three groups within the emergent political organisation was given responsibility for one aspect of administration, either community affairs, trade or pearling - a principle of power-sharing which has survived to the present day (Mansfield 1990: 5).

In about 1752, the first Sheikh of Kuwait was chosen from the Sabah family (a branch of the Utoobi tribe) according to tribal customs (Khoujah and Sadler 1979: 9). Following tradition, a covenant known as Baya'ah gave the ruling Sheikh authority to administer justice and the affairs of the thriving town with the consent of the people. The first Sheikh or Amir to be chosen was Sheikh Sabah I (Al-Mogatei 1987: 14). On assuming leadership (see Appendix I), his priorities were to consolidate security, ensure social harmony and justice, stimulate prosperity and guarantee peaceful relations with neighbouring countries. His main achievement, however, was to build a *sour* (a town wall) in about 1760, that is eight years after the Bani Khalid lost their influence, for protection against Bedouin raids. The Utoob made efforts to develop and expand their city until 1762, when Sheikh Sabah was succeeded by his youngest son, Abdullah I (Kuna 1986: 14-15).

With the Persian conquest of Basra in 1776 came the establishment of Kuwait as an important caravan-trading station on the route from the Gulf to Aleppo, Syria (Al-Sadoon 1990: 36), thus replacing Bushair and Basra as the major Gulf port for the British East India Company. These developing ties to the East India Company had far-reaching effects on Kuwait's economy and security and opened up to Kuwait a new range of foreign influences (Marlowe 1962: 24). A larger variety of trade goods from further afield became available in

Kuwait with the settling of Bahrain by other families of the Utoob tribe (Khazal 1962, Pt.1: 38). Fleet vessels traded through the Indian Ocean and the Red Sea, importing such goods as fabrics, spices, cotton, sugar and timber (Mansfield 1990: 19-20). By the end of the eighteenth century, Kuwait was competing with the busiest ports in the Gulf and had become one of the region's most important commercial centres (Kuna 1986: 15).

In the final years of the eighteenth century, Kuwait was busy resisting incessant incursions from the Wahabbi of Nejid. This led to the development of stronger fortifications, naval power and the expansion of the country's fighting forces (Lorimer 1915, Pt. 1, Vol. 1: 1006). Eventually ships of the British Navy were sent to patrol the waters of the Gulf and eliminate the growing threat of pirate attacks on commercial shipping. Kuwait suffered a general decline in its trading position during this period, but the effects were only transitory and by 1860 prosperity had returned, with the total population reaching approximately 25,000. During the same period Sheikh Abdullah was succeeded by his son, Jaber II (1815-1858) who inherited a strong and stable political structure. Under Sheik Abdullah the separation of powers had been consolidated, with the ruling family giving up its previous share in the merchants' profits in order to dedicate itself to the tasks of governing. State and Sabah family funds now came from a two per cent duty on all imports.

From the earliest times, Kuwait's leaders had to avoid outside threats through careful diplomacy with surrounding tribes, the Ottoman rulers and European traders, all of whom recognised the country's great economic and strategic importance (Crystal 1992: 8-9). While Eastern Arabia and Iraq gradually came under European or direct Ottoman rule, Kuwait sought to retain its autonomy. In particular, it maintained good relations with the Ottomans (*Regional Survey of the World* 1993: 587-588) despite great feelings of insecurity due to the ever-present threat of annexation (Crusoe and Kemp 1993: 6). In practice, however, the Ottomans turned to the Iranian ports, Basra and Kuwait, for supplies and logistical support. (Abu-Hakimah 1984: 235).

In 1871 Medhat Pasha, the Ottoman ruler, asked Kuwait for assistance in his military expedition aimed at enforcing Ottoman rule in Al-Hussa, Eastern Arabia. The Sheikh of Kuwait was willing to co-operate (Al-Saleh 1972: 63) and, after a successful expedition to Al-

Hasa, Kuwait was proclaimed an autonomous borough within the administrative area of the Province of Basra but ruled by the Al-Sabah family. The Sheikh was given the honorary title of gaimmagam or deputy governor, and he controlled internal affairs while Kuwaiti vessels flew the Ottoman flag (Al-Saleh 1972: 64). Medhat Pasha later wrote in his autobiography that "the Kuwaitis had successfully resisted all Constantinople's efforts to bring them into the Ottoman orbit" (Lauterpacht *et al.* 1991: 13). When Medhat fell from power a year later, Ottoman authority in Kuwait was greatly diminished.

At the end of the nineteenth century, however, the Ottomans renewed their efforts to interfere in Kuwait's internal affairs. As a result, upon coming to power in 1896, Sheikh Mubarak Al-Sabah (later known as Mubarak the Great) sought, on his own initiative, to enter into a more formal protective alliance with Great Britain (Crystal 1992: 12). By 1899 Kuwait had signed an agreement to become a British protectorate in all but name, undertaking "not to lease, dispose of or give concessions to any individual power or land in the Sheikhdom for any purpose without British permission, not to receive agents or representatives of foreign governments without British agreement" (Khoujah and Sadler 1979: 11-12). The significance of this agreement for the subsequent development of the Kuwaiti economy in the twentieth century would soon become clear. In 1913 London obtained the monopoly of any future oil concessions, although another thirty years were to pass before the first drillings took place (Noafal 1969: 179). In 1915 Sheikh Mubarak died, but British interests in Kuwait continued to be based on the agreement which Mubarak had made, and the relationship between the two countries remained intact (Khoujah and Sadler 1979: 12; see Appendix II for the text of the 1899 Agreement).

In 1938, during the reign of Sheikh Ahmed Al-Jaber, oil was discovered by the Anglo-American Company and the Kuwait Oil Company Limited. However, production was delayed by the outbreak of the Second World War, and the first shipment of oil was not actually exported until 1946 (Kuna 1986: 22).[1] Once the oil industry began to develop, Kuwait started to change rapidly from a traditional sheikhdom to a modern state, although the transformation was in most respects unplanned and led to a range of unanticipated

[1] See Chapter Three for more details about the discovery of oil in Kuwait.

consequences. The availability of oil revenues made it possible for the country to initiate major projects of economic and social development. Some of these projects were highly innovative. Thus Abu-Hakima (1984: 157) tells us that Sheikh Ahmed was so eager for social change and development that he spent the first payment handed to him by the oil companies (before the actual discovery of oil) on a project to advance education for women. Following the death of Sheikh Ahmed in 1950, Sheikh Abdullah Al-Salim came to power, and in 1951 he established an extensive programme of public works, including schemes for medical and educational development. The infrastructure was being prepared for greater political ambitions and the assertion of the country's autonomy. In January 1961 the Kuwaiti Government declared the country's independence and assumed full responsibility for its own foreign policy.

Following independence, in June 1961, the Kuwaiti-British agreement of 1899 was replaced by a treaty of mutual co-operation and friendship (Official Gazette No. 331 of 1961, and see Appendix III for the independence agreement). Soon afterwards Kuwait joined the United Nations and began to play the role of an active participant in world politics. On 25 June 1961, however, a major threat to the country's independence and security emerged when Premier Qasim of Iraq announced Iraq's intention to annex Kuwait. Kuwait consequently turned to Saudi Arabia and Britain for aid, and Britain responded by sending troops. These were replaced by troops from Arab League countries after Kuwait was given membership of the League on 20 July 1961. The threatened Iraqi invasion did not materialise at this time.[1]

2.3 THE POLITICAL SYSTEM IN KUWAIT

2.3.1 Political Development

[1] On 25 June 1961, only six days after Kuwait's independence, General Qasim, the Iraqi Premier, in a news conference in Baghdad, laid claim to Iraqi sovereignty over Kuwait. He stated that Kuwait was an inseparable part of Iraq on the basis that during the Ottoman rule it had been part of the Iraqi province of Basra and it should therefore be annexed to Iraq (Al Baharna 1975: 250-256). In law, Qasim could not justify his claim, although he employed legal, historical and political arguments (Khadduri 1969: 168). The delineation of the Kuwait-Iraq border and the recognition of Kuwait's independence were upheld by treaties and agreements that are binding under international law. (For discussion of the Iraq-Kuwait conflict, see Mona Al Yagout, "International law aspects of Iraq-Kuwait conflict on Historic and Legal Rights," unpublished Master's Thesis, 1991).

During the twentieth century, Kuwait's political system has undergone the transition from a British protectorate to an independent state. The process has not always been easy: it has been marked by a number of critical junctures and has involved a range of important constitutional changes affecting the structure and operation of government. These changes must be understood in the context of this thesis since they have had a direct impact on the development of Kuwait's FDI regime.

On 2 February 1921 the leading families of Kuwait met with the Al-Sabah family to demand participation in the management of the nation and the formation of a consultative council. The result was the writing of a new Charter (Al-Shamlan 1959: 196-197) whose fifth article stipulated that the Al-Sabah family and the citizens would elect a limited number of men to manage the affairs of the country on the basis of justice and equity. Under this Charter - the first proper constitutional document in Kuwait's history - a Constitutional Council was formed during the reign of Sheikh Ahmed Al-Jaber. Though appointed by the rulers, none of the Council members belonged to the Al-Sabah family, a condition required under Article Five of the Charter (Al-Tabtabai 1985: 274). The two most important guidelines laid down by the Charter were that legal judgments would be based on Islamic Law (*The Shar'ia'*), and that the Council and rulers would consult on domestic and foreign matters (Khazal, Pt.1: 15). Although the Council had no legislative authority, it offered Kuwaitis their first chance to participate in the writing of a national constitution and to work alongside the rulers in managing the country's affairs (Al-Tabtabai 1985: 274).[1]

Political participation remained limited during the next fifteen years, although there was a growing national movement which reached a position of some influence by 1937-38. Conditions in Kuwait had led twelve citizens to form a secret society whose aim was to increase political consciousness among the citizens and to promote the country' modernisation. When the members of this secret society made a public declaration of their

[1] Political stability was achieved the next decade during which Kuwait was ruled by traditions and Islamic teachings with very simple organisational structures. But this was to change with the emergence of competition among oil companies for the acquisition of concessions. (See Mohammad Hussain Ali for more details on political life in Kuwait: "Oil and Dependent Development: A Case Study of Kuwait, unpublished master's thesis, Pacific Lutheran University, 1980, pp. 56-71).

movement's existence and its aims, a delegation was formed to submit their demands to the ruler (Al-Jassim 1973: 219-222). Among other things, the reformers demanded the formation of a legislative council to consist of the non-royal leaders of the country and which would possess the power to write the laws of the nation. The Amir, Sheikh Ahmed, refused these demands, but other members of the ruling family, including Sheikh Abdullah Al-Salim, thought it necessary to approve them. The outcome was an agreement to form a Legislative Council. Elections were held[1] with the participation of 150 families, representing the majority of the population at that time (Al-Jassim 1973: 225). Fourteen successful members formed the first Legislative Council, one of the earliest councils of its kind in any Arab country. During the Council's first meeting, Sheikh Abdullah Al-Salim was elected as its chairman in appreciation of his support for the reform movement.

It must be stressed that Kuwait at this time lacked the constitutional framework necessary to organise the affairs of the country effectively or to enact laws. This situation could not be permitted to continue since there were a number of urgent social and economic problems which had to be dealt with. Consequently the newly-formed Council worked to lay down a draft Constitutional Law which the Ruler of Kuwait, Sheikh Ahmad Al-Jaber Al-Sabah, approved on 2 July 1938. The main provisions included the following:

> Article One: The nation is the source of authority and is represented by its elected representatives.
>
> Article Two: The National Legislative Council shall enact the following laws: the budget, the courts, public security, banks, health buildings and emergencies and any law required for the legal interest of the country (Hassan 1968: 108).
>
> Article Three: The Legislative Parliament is the source of approval to all internal and external treaties, privileges and agreements and everything that arises newly by this means is not considered legal unless it will be accepted by Parliament and supervised by it.
>
> Article Four: Since no Court of Appeal is available in the country, the duties of such court will be within the competence of the National Legislative Council until such a court is established for this purpose.
>
> Article Five: The Chairman of the Legislative Council will represent the executive authority in the country (Al-Tabtabai 1985: 292-293).

[1] The legislative council was elected as follows: a committee was established consisting of three notable Kuwaitis. A selected list of the electorate was made and the elections were conducted in the house of a Kuwaiti citizen, leading to the election of 14 members (see Abdul Rasoul Abdul Reda: 1991).

It should be stressed that the reform movement at this time had no fundamental objection to the reign of the Al-Sabah family, but they wanted greater opportunities for participation in decision-making in relation to the newly introduced services, such as education and health, and the budget. They were also especially anxious to oversee the distribution of the new oil revenues. Major reforms also took place during this period in the judicial, financial, cultural and security areas. In general, the country was now beginning to confront issues of social and political transformation, but there were still problems because the process of policy-making lacked co-ordination and a clear sense of direction.

Although the Legislative Council was generally effective, there were internal, personal and external forces working against its continued existence. The British had reservations regarding the Article which called for the Council's approval of international treaties and agreements, a responsibility that had previously been managed solely by the British authorities (Al-Jassim 1973: 97). In addition other Arab countries with absolute rulers tried to downplay the role of the elected Legislative Council in Kuwait, fearing that their own nationals would demand similar political reforms. In Kuwait these pressures led to a conflict between the ruler and the Council. On 21 December 1938, Sheikh Ahmed dissolved the Council, declaring that he would reinstate it when peace and calm returned (Al-Jassim 1973: 246-247). In fact another Council, headed by Sheikh Abdullah Al-Salim and called the Consultative Council, was established on 14 March 1939. Other members of the new Council were four Sheikhs from the Al-Sabah family and nine Kuwaiti notables (Abu-Hakima 1984: 157).

Sheikh Abdullah Al-Salim assumed power in Kuwait in 1952 following the death of Sheikh Ahmad Al-Jaber, and during the next few years the influx of substantial oil royalties facilitated a major structural transformation of the economy (as will be discussed in more detail below). This inevitably led to renewed demands for social and political change. By the end of the 1950s, a new movement calling for complete independence from Britain was underway, and pressure increased for the establishment of an elected national assembly. On 26 July 1961 Amiri Decree No. 12 was issued, calling for public elections for a Constitutional Council which would undertake the writing of a national constitution and would serve as a

temporary legislative authority (Al-Tabtabai 1985: 315). On 30 December 1961 47 candidates competed for 20 seats in the first public and free elections held in Kuwait.[1]

The first meeting of the newly elected Constitutional Council took place on 20 January 1962, when a temporary constitution, composed of 38 Articles which guaranteed basic freedoms for all Kuwaitis, was adopted. The mission of the Council was limited to passing or rejecting the laws submitted to it by the Council of Ministers (which included, for the first time, a limited number of non-royals) and to preparing, within one year, a permanent constitution (Arab Unity Studies Centre 1983: 653-664). When the Constitutional Council submitted its draft constitution to the Amir, it was accepted without changes. He signed the document on 11 November 1962, and elections were duly held on 23 January 1963. The Constitution came into effect six days later, on 29 January, when the first National Assembly met for the first time (for the full text of the Kuwaiti Constitution, see Appendix IV).

2.3.2 The Constitution

The Constitution, a binding contract between the Amir and the people, represent the most significant political achievement in the modern history of Kuwait (See Appendix IV). It was greatly influenced by the laws, legislation and practices of Egypt before the revolution of 1952 and by British, French and Russian constitutional practices. It also reflected the patterns of patronage in Kuwait and the social and commercial traditions of the country. Of its many innovations, the establishment of a National Assembly was the most significant and, potentially, the most controversial given the economic and social challenges that now faced the country. To this day the question of whether such an assembly is capable of providing the country with the necessary legislative leadership is open to debate.

2.3.3 The National Assembly and its Legislative Role

On 23 January 1963, 210 candidates competed for 50 seats in the National Assembly. Members were elected for a period of four years, and power was shared with sixteen ministers. In the years up to 23 January 1981, five public elections were held in Kuwait.[2]

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[1] The right of women to participate in elections is not allowed. Article No. 1 of the Kuwaiti Election Law stipulates the condition that electors have to be male and not female. (See Al-Tabtabai 1985: 684.)

[2] Article 82 of the constitution of the state of Kuwait state that a member of the National Assembly shall:

The Constitution remained in effect from January 1963 until August 1976, when it was suspended for a period of five years.[1] This was the result of the gradual emergence of fundamental differences between the members of the opposition and the Government owing to the representatives' demands that the exploitation of oil by foreign monopolistic companies should be stopped. In other words, the whole issue of the oil industry began to pose problems for the authority of the National Assembly.

Foreign companies dominated the oil industry by means of what the opposition considered to be unfair concessions that allowed the companies to accumulate vast profits and so much power that they felt free to violate the laws of the state (*Al-Taliah* 1984). Thus the Kuwait Oil Company (KOC) was in practice able to block any new legislation which it saw as a threat to its rights, and therefore reform became extremely difficult. Nevertheless, in 1955 the Government issued the Income Tax Decree, No.3, imposing an income tax on every "body corporate" wheresoever incorporated. BP and Gulf Oil, and also the operating company (KOC), agreed to comply with this law despite the original concession conditions (see the Agreement of October 11, 1955 concerning BP and Gulf Oil, compliance with the Kuwaiti Income Tax Law, No.3 of 1955.) In fact there were no actual conditions in the concession agreement that prevented the state from imposing income tax on oil companies, although there were restrictions on the right of the state to amend unilaterally the concession agreement itself (Article 17 of the 1934 Agreement between the Government of Kuwait and BP and Gulf Oil). Increasingly, the representatives in the National Assembly voiced their dissatisfaction with the power of the oil companies, and called for more Government support

a) be a Kuwaiti by origin in accordance with law;
b) be qualified as an elector in accordance with the electoral law;
c) be not less than thirty calendar years of age on the day of election;
d) be able to read and write Arabic well.

[1] Many reasons were given to explain why the political authority took this unexpected decision: for example, the justification for the recent procedures on the inactivities of the National Assembly, and the lack of mutual understanding between the Assembly and the executive authority contravened the contents of all speeches delivered by the executive authority upon the opening and closing of each legislative session. The Assembly's dissolution was not rooted in any political issue related to differences between the legislative body and the members of the executive authority. On the contrary, it happened for other more important reasons. It was a constitutional suspension of certain articles in the constitution and degraded the importance of the consultative council without any legality or protection. (For more on democratic life in Kuwait see: M. Al Rumaihi, *The Experiment of Political life in Kuwait,* Arab Unity Studies Centre, 1983; J.E. Peterson, *The Arab Gulf States: Steps towards Political Participation,* Centre of Strategies and International Studies, D.A. Publications, 1987, p.56.) In addition to the above reasons for the dissolution, there were other external and Arab factors. The common aim was to suspend democratic activity and power sharing.

for the National Petroleum Company and the national oil industry. For example, they demanded that Kuwaiti citizens should be sent abroad to be educated and trained for the top oil industry posts. When the Government subsequently rejected these demands, eight members of the Assembly submitted their resignations in 1965, and the following year new elections were held to fill the vacated seats (*Al-Taliah*, 1984: 54-56 and Al Rumaihi, 1979, p.39).

In 1967, immediately after the general election, a second major crisis broke out when the Opposition accused the Government of interfering in the elections. In spite of these difficulties, elections for four consecutive National Assemblies took place in 1963, 1967, 1971 and 1975. In August 1976 the Amir dissolved the fourth Assembly only one year after it was elected and imposed restrictions on the press. He also suspended several articles of the Constitution, including: Article 57 which required that ministers should be selected from among the elected members of the National Assembly; Article 107, which stipulated that new elections should be held within two months or the old Assembly must be reinstated; Article 174, which required the approval by the National Assembly of any revision of the Constitution; and Article 181, which prevented any suspension of the Constitution except in the case of martial law. In an attempt to justify the dissolution of the Assembly, the Government used the example of the civil war in Lebanon to illustrate the political dangers that had to be avoided. Lebanon was until then considered to be the one island of democracy in the Arab world, but the toleration of an unrestrained press and a vocal opposition were identified as destructive factors.

In Kuwait the Crown Prince, Sheikh Jaber, was reappointed as Prime Minister and formed a new Cabinet (Peterson 1987: 56). The dissolution statement promised that Kuwait's democratic system would be reinstated in not less than four years. Between 1976 and 1981 it became clear that the previous fourteen years of elected representation had been highly effective and were closer to the spirit of the country's Constitution. However, it could not be denied that the incorporation of an elected National Assembly in the country's political structure had proved to be difficult. When, in January 1981, new elections were held and the National Assembly was reinstated, a variety of new assertive political groups began to

emerge. It was clear by this time that a tension prevailed between popular democratic demands and the Government's fear of instability. Thus, it was not entirely unexpected when, in 1986, the Government again dissolved the Assembly and suspended the Constitution (*The Middle East*, 30 January 1990: 15). An Amiri decree explained the reasons for this dissolution as follows:

> The country has encountered many adversities and difficult situations which it has not experienced before. So its security was exposed to violent plots which threatened the lives of the people and almost succeeded in the destruction of the nation's resources and the substance of its existence. The flames of the current war between the neighbouring Muslim countries have almost reached its borders; in addition it has encountered a severe economic crisis. Instead of joining, the different and contradictory points of view have broken out and new political blocks and parties appeared which put an end to the nation's unity and laid obstacles before work. The Council of Ministers has become unable to continue its work. (Text broadcast in Kuwait, Domestic Service, 3 July 1989 [FBIS] Middle East and Africa, 7 July 1986).

A campaign by former Parliamentarians for the restoration of the National Assembly began at the end of the Iran-Iraq war. After agitation between November 1989 and February 1990, the formation of a Consultative National Council, charged with amending the Constitution, was announced by the Amir. Reconvened after the Iraqi occupation, its main achievement was to request higher financial compensation from the Government. In 1992, acting on earlier promises made during the Iraqi invasion, the Amir dissolved the Council and called for new elections for the National Assembly which were held in October of that year (Economist Intelligence Unit, 1993-1994: 4). This was further evidence that Kuwait had still not successfully institutionalised the position of an elected assembly in its constitutional and political system, and this failing continues to have far-reaching consequences for the whole public policy-making process.

2.4 KUWAIT BEFORE THE DISCOVERY OF OIL (UP TO 1946)

The above summary account of Kuwait's historical development from a city to a nation, and of the consequent social and political transformation of the country, allows us to appreciate the context within which a system of economic organisation has evolved. In this section the focus is on the structure of the Kuwaiti economy up to 1946, that is in the period before the exploitation of oil resources had a significant impact. Developments during this earlier period

provided the basis for the country's emergence as a major oil-based economy after the Second World War, but, as will be explained below, they endowed the country with both strengths and weaknesses when it came to managing the social, economic and political consequences of the discovery of oil.

2.4.1 The Economy

Before the discovery of oil, a sea-based economy dominated the economic life of Kuwait. The city's proximity to India, Iran and areas to the west increased its importance as a trading centre (Ministry of Information, 1989: 158). Along with the seafaring trade and the accompanying activities of smugglers, the other foundations of Kuwait's economy were pearling and boat-building, activities which were the livelihood of the state from its establishment in the 1870s until the outbreak of the Second World War.

Pearling

Pearl diving was a principal economic activity in the pre-oil era because of the high-quality pearls found in Gulf waters and the scarcity of other viable economic resources. It was also a very profitable activity, and the Kuwaitis gained a reputation, locally and internationally, for this activity (Abdul-Mougni 1977: 41). However, it was a strictly seasonal occupation, running from mid-May to mid-September, the hottest months of the year (Crystal 1992: 3). Typically, divers worked from sunrise to sunset. There was no cold water to offer relief, and divers were completely dependent on the sea for food. In addition they faced the risks of shark attacks, drowning and fatal cramps, problems which were aggravated by the primitiveness of their vessels (Al-Shamlan 1975: 319). Despite these risks and the fact that divers were the lifeblood of the pearling industry, most of the profits went to the ship-owners (Al-Rumaihi 1979: 4).[1] When hiring divers, the skipper lent them money to support their

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[1] The divers used locally built ships, and their tools were primitive. On each ship there was a crew of some thirty to thirty-five divers, with a clear division of labour. The head of the ship was the *Nokhada* (usually the owner and *skipper*), and his orders had to be obeyed. Next in status were the divers who were responsible for the whole process of pearling. With lower status than the divers were the assistants, the "seep", who in turn had assistants below them. Finally came the *tabbana*, the young boys who were sent by their families to gain experience at sea. (For more details on pearling, see Mohammad R. Al-Sharrad, "The Impact of Oil on the Demographic Structure of the Contemporary Kuwaiti Society", unpublished master's thesis, Pacific Lutheran

families for the duration of the season, using the credit-based system, salaf. The divers drew no wages and worked instead for a share in the profits to be realised when the pearls were sold. The salaf debts had to be repaid at the end of the season out of the pearlers' share. If there were no profits, divers would be obliged to work for the same skipper the following season in order to repay the debt. If the pearler died, the sons inherited the debt and had to work to settle their father's account (Al-Kukasi 1972: 218).

The profits were distributed as follows: At the end of the season, when the pearls were sold, a portion of the profits was deducted by the owner of the ship as payment for the provision of food, water and other incidental expenses. An additional deduction amounting to 20 per cent of the net value of the pearls constituted the ship-owner's share. The remainder became glata shares which were divided among the men on board according to rank and number. Divers and the Captain Nokada each took three shares; the seep who pulled divers up from the sea, two shares; the seep's assistant, if any was on board, one share, and the ship's cook, one share (Al-Rumaihi 1979: 4). Clearly the laws of the pearling industry favoured ship-owners over divers, and this enabled the owners to maintain their hold. A further illustration of this dominance is to be seen in the 19th Article Statement of the Laws of the Pearling Industry (1940) which declared: "If the sailor (diver) dies and he has nothing except his house, and he has children and if the house was bought from pearling money, the Nokada must wait until the diver's children are grown, then he may ask them to choose either to pay their father's debt, or to pay the debt by selling their house."

Al-Sabah (1980: 16) describes how the pearl-diving industry provided high income for the Sheikh of Kuwait and the merchants. A tax for each diving boat, equivalent to the advances paid for one sailor, was imposed by the Sheikh. The merchants accumulated capital (profits) by hiring most divers at subsistence level through their ownership of pearling boats, which gave them a share of the profits, and by gaining numerous houses from those divers who could not pay their debts. In this way both the merchants and the captains became extremely rich.

University.)

The importance of pearling to Kuwaiti society at this time cannot be overstated. By 1907 the number of ships had reached 461 and there were 9,200 persons working on them. In 1920 there were 509 ships with 25,000 workers out of a total population of 80,000 (Al-Moghani 1975: 56-57). However, the development of the Japanese cultured pearl industry heralded the rapid decline of Kuwaiti pearling, and the international economic collapse of 1929 hastened the process. By the 1940s, when oil had already been discovered in Kuwait, pearling as an economic activity had virtually come to an end.

Seafaring and Trade

Seafaring was the second most important economic activity in Kuwait during this period and flourished as a natural counterpart to the pearling industry. When the pearling season ended each year with the onset of cooler weather, the trading season began and continued for about nine months. Kuwaiti trade merchants offered transit trading services and carried dates from Kuwait down the Gulf coast, trading them for money or in exchange for other goods. They then sailed on to India and Africa's eastern coast. The pearl-diving industry provided pearls for export to Bahrain, and from there the better quality pearls were sent to Europe, with the inferior ones being sent to India. The ships returned with timber (usually mangrove poles for building) and tea, rice, cotton, spices and other goods. Many of the goods brought to Kuwait in this way were subsequently re-exported (overland by caravan) to Saudi Arabia, Baghdad and Aleppo (Khoujah and Sadler 1979: 12-13).

A low two per cent import duty was levied by the Sheikh of Kuwait, undercutting duties at other trading ports in the Gulf. This did not produce much income, but the Sheikh derived further finance from protecting caravan trade through the desert (Y.S.F. Al-Sabah 1980: 20). Given the pattern of trade, the merchants naturally established links in their particular market trading areas. They owned date and other crop plantations, and financed and capitalised other ventures. Kuwaiti merchants also established agencies, often headed by a family member, in most ports around the Indian Ocean. These agencies became centres for wholesale activities (Khoujah and Sadler 1979: 13).

In 1820 the total value of goods imported into Kuwait was estimated at 710,000 Indian Rupees (RS), but by 1905 the value had risen to a remarkable 4,818,929 RS. During the same period the value of exported goods rose from an estimated 142,000 RS (in 1820) to 1,154,322 RS (1905), and the number of Kuwaiti-owned sailing ships increased from 35 to 86, increasing further to 291 by 1932 (Y.S.F. Al-Sabah 1980: 20). Together, trade and pearling (both classified as traditional economic activities as they depended on a low level of technology and an illiterate labour force) employed most of the Kuwaiti labour force during these years.

Smuggling

A black market trade (Al Souk Al Souda) was also a major source of Kuwaiti income. Kuwaitis were good smugglers and trackers, bringing weapons, food and gold to Iraq and Saudi Arabia (Al-Jassim 1973: 148-150). As far as Kuwaitis were concerned, there was nothing illegal in these transactions, though the affected governments did not share that opinion. Smuggling, like all similar occupations, was a risky affair, with imprisonment as well as confiscation of gold as the punishment for those who were caught. To many, however, the risk was well worth taking because the financial rewards were high.

Gold was bought in America, South Africa or on the Beirut free market and transferred legally to Kuwait. After that, it was smuggled mainly into India, where it was at a premium and in high demand. Payment for gold was made in Indian rupees which were legal tender throughout the Arabian Gulf area (Daniels 1971: 20-22). Smuggling was always a sideline for the Kuwaitis, but it remained an important alternative source of income due to the harsh conditions of life at that time (Khoujah and Sadler 1979: 15). Furthermore, the merchants who dealt in smuggled goods attained great wealth and influence over Kuwait's social, economic and political development (Al-Qenai 1968: 60-61).

Boat-Building

Another important sea-based economic activity was boat-building. Kuwait's shipbuilders and chandlers were skilled craftsmen who built trading ships that travelled as far as India and

Eastern Arabia. Kuwait also exported its ships to other Gulf ports and in fact became the boat-building centre for the whole region (Al-Sabah 1980: 22-23). According to Dickson (1956: 473), one primary reason for this was that in the dry climate of Kuwait, the wood used to build boats seasoned much better than in other nearby areas. On average, the Kuwaiti shipyard produced over fifty ships of different sizes and types per year. When the success of cultured pearls from Japan threatened Kuwait's pearl-diving industry, this in turn affected the boat-building industry, which suffered greatly as a consequence (Y.S.F. Al-Sabah 1980: 23).

2.4.2 Pre-Oil Society in Kuwait

The Population

It can thus be seen, in terms of pre-oil society in Kuwait, that the traditional industries of pearling, sea trading and boat-building were of crucial economic importance. This was a consequence of a number of factors stemming from the country's customs, laws and social organisation. Most significantly, in demographic terms Kuwaiti society was heterogeneous and highly mobile as immigration to and from the country was strongly connected with its economic position and the seasonal basis of certain activities, especially pearling. Nomads came from the desert to participate in pearling, and from sea and land merchants came to look for commerce. In due course, most of these merchants and labourers went back to their homelands (Al-Rumaihi 1975: 67).

Statistics on the size of the population of Kuwait show that there were just 4,000 inhabitants in 1813. The number had risen to 35,000 by 1905. After that year, the growth rate increased annually by an average of 4.7 per cent. By 1919 the population numbered 85,000, and in 1947 the inhabitants were estimated to be 120,000 (Al-Sabah 1980: 24-25). Inevitably, this increase in population placed great pressure on the country's economic resources. It also gave rise to new problems of governmental and administrative regulation, many of which stemmed from the power relationships between the various social classes which had emerged in Kuwait.

Social Classes

There was never any doubt that the Sheikhs formed Kuwait's ruling class and the top layer of the social stratum. The main function of this ruling class was to make political decisions to serve the needs of Kuwaitis and to settle disputes between the Arabian tribes living in Kuwait (Al-Deyeen and Al-De'ej 1972). The ruling family was supported by taxes paid by the *Nokada* (captains), merchants and peasants (Abu-Hakima 1967: 108-109). The merchant class was largely made up of people who had emigrated to Kuwait in order to maintain their trade with the Arabian Gulf, Indian and East African ports. In economic terms it depended heavily on the interest taken from the *Nokada* due to the debt system and income from the exploitation of the divers and sailors (Al-Deyeen and Al-De'ej, 1972). Below the merchants was a class of artisans formed from the people who engaged in manufacturing. Lastly, there was the peasant class to which the majority of Kuwaiti people belonged. This consisted of sailors, divers, fishermen, farmers and some who worked within the craft industries. The main point to be stressed is the strongly hierarchical nature of this clearly divided class structure.

The pre-oil class structure was rooted in traditional norms and customs rather than a written constitution or formal laws. The underlying social loyalties were tribal and denominational. Thus even the state welfare system was a reflection of the traditional philosophy of interrelated responsibilities, and the latter was also a crucial basis of support for the system of free enterprise. In general, however, Kuwait society was characterised at this time by clear features of underdevelopment, and this made it impossible for the country to withstand the development of capitalistic enterprises that came with the discovery and exploitation of oil resources. In turn that development produced many profound shocks for the whole of Kuwaiti society. It is to the evolution of the Kuwaiti economy after 1946 - largely under the impact of the growth of the oil industry - that the analysis now turns.

2.5 THE DEVELOPMENT OF MODERN KUWAIT, 1946 TO THE PRESENT

2.5.1 Oil Production and Revenues

The emergence of Kuwait's modern economy can be dated from 1946, when oil production began and the first shipment of oil was exported (although the first oil discoveries had been made just before the Second World War). The main concession for the exploration and exploitation of oil was held by the Kuwait Oil Company (KOC), which was jointly owned by British Petroleum (BP) and the American Gulf Oil Corporation (for further discussion of these concessions, see Chapter Three). The income from oil grew in direct proportion to the production of crude oil, which reached 1.83 million barrels per day (m/b/d) in 1962. It peaked at 3.3 m/b/d in 1972, at which point an output ceiling of 2 m/b/d was introduced for the purpose of conservation. Proven reserves were 946 million barrels at the beginning of 1992 (EIU, 1993-1994: 15).

In order to exploit the oil reserves, the rulers of Kuwait, along with local businesses, entered into co-operative ventures with foreign concerns. This is most important in the context of the argument of this thesis because it reveals the dependency of the modern Kuwait economy on the capital, knowledge and expertise of foreign companies. Khoujah and Sadler (1979: 25) point out that this co-operation - which was also a relationship of dependency - was the key factor in promoting the rapid development of Kuwait's oil industry and the country's infrastructure. After 1946 oil replaced the previously dominant activities of pearling and seafaring as the leading economic sector, and, alongside the oil industry, a large Government sector also emerged (Koujah and Sadler 1979: 26).

As revenues began pouring in, the Kuwaiti Government was faced with the choice of whether to invest locally or internationally. As the IBRD noted, "most of the oil revenues were converted into local currency through the banking system and spent in the local economy for the current operations of the government for development projects and for the purchase of land by the government from the private sector" (IBRD 1965: 27-28).

Domestically, the Government had to choose whether to invest in social welfare or in production ventures. Kuwait opted for major expenditures on social welfare, and for this purpose the Investment Board was established in 1952 with responsibilities for initiating and overseeing infrastructure projects (Gaylani 1977: 44-46).

One of the unique characteristics of Kuwait is that a comprehensive taxation system has never been developed (for further information on this subject see Chapter Eight). Today the only taxes are those levied on foreign oil companies which operate locally. Thus, the cost of public activities is borne almost entirely by the oil companies because resource allocations have been accomplished directly through the transfer of revenues from those companies to the Government.[1] The continuous flow of revenue from the oil sector has allowed the public expenditure programme to expand without reliance on the taxation process. Once again, the uniqueness of this situation must be emphasised. The Government continues to channel oil revenues into the economy through its national budget for current and capital expenditures (Al-Rashid 1976: 8). As we shall see, this heavy dependency on oil revenues makes the Kuwaiti economy extremely vulnerable to external factors in the global economy and political situation. Increasingly, it is recognised that the country's economy must now be diversified so as to reduce its reliance on oil.

During the 1960s the Government sought diversification through joint-financing with the private sectors in certain industries and implementation of the land-distribution programme (Gaylani 1977: 49-52). In 1960 the IBRD mission recommended that 18 per cent of the total revenues of the state should be allocated to domestic development. The Government did eventually act upon this recommendation, attempting to diversify the economy by means of investment in private and semi-private industries, thus raising existing levels of technical skills and capital-intensive investment.

As a result of the growth in Government expenditures for construction, social services and the land-purchasing programme, there has been an increasing demand for goods and services. The rise in accumulated capital in the private sector has extended into new areas

[1] This situation differs from the usual case where resource allocation in the economy from the private to the public sector is accomplished by the process of taxation.

such as services and manufacturing activities (Al-Rashid 1976: 7-11). Given the limited absorptive capacity of the Kuwait economy, domestic investment has been shipped to foreign outlets. A number of semi-public companies (the two most important of which are the Kuwait Investment Company and the Kuwait Foreign Trade and Contracting Company) have made certain investments abroad, ranging from Euro-dollar bonds and property, in the case of KIO, to the setting up and financing of joint-venture projects in the case of the Foreign Trade and Contracting Company.

The remarkable increase in oil production has been responsible for much of the growth of Kuwait's population. The general pattern has been for labour to shift from traditional occupations into the employment opportunities offered, first, by the oil industry itself, secondly by the expanding Government service, and thirdly by the growing construction industry. Expatriate workers have been attracted by the highest wage rates in the Middle East (and, in the higher ranks of the public service, by possibly the highest wages in the world) and by the free health, education and other services of a welfare state. The new high-income economy has also meant the growth of jobs in the rapidly increasing number of service occupations (IBRD 1965: 27-28).

Oil has also been the key factor in providing Kuwait with a decent standard of living for everyone. Kuwaitis have benefited from the fact that their population - despite recent growth - remains small in relation to the huge oil revenues and resources. The growing income from oil has also been accompanied by increasing expenditures for construction and social services, and this has been the major factor behind the economic changes as well as the sole determinant of the level of economic activities.

2.5.2 The Evolution of the Welfare State

Before 1950 Kuwait city was a relatively small Arab seaport consisting of small adobe structures, unpaved streets, an old-fashioned *souk* (market) and a primitive port. The discovery of oil and the availability of large new sources of revenue led to the widespread demand for a new kind of community, and one major consequence has been the evolution of

an impressive welfare state. This in turn depended on extensive investment in infrastructure projects without which the efficient provision of welfare to the whole society would not have been possible.

A major construction programme was initiated in 1949. The first projects were the tuberculosis hospital, the public security building, and some schools and roads. As revenues increased, pressure grew for a vastly expanded programme. Street renovation, education, medical services, ports, roads and housing were the principal fields of investment. The Land Acquisition Programme was intended to hasten the development of modern Kuwait. The Government embarked upon a programme of extensive urban land purchase and resale as the main method of distributing oil revenues among the population. Some of the purchased land was used to expand the network of roads within the city and its suburbs, and some was used for public construction. However, most land was resold to the private sector at nominal prices (Al-Mallakh 1968: 75-76).

Foreign consultants prepared a city plan in October 1951 (amended in February 1954) under which the city grew from the confines of an old walled town to a wider area which completely enveloped the old city. The road system helped to define the spatial character of this modern city. In 1951 five large construction companies were engaged to undertake the main Government projects. This proved to be very expensive, but it enabled rapid physical changes to be made. There was large-scale construction of roads, schools, hospitals and public buildings, and there was a move towards a systematic, planned development of outlying communities, airports and low-income housing (IBRD 1965: 28-30).

To further its development, it was obvious that Kuwait needed an adequate supply of fresh water. Because Kuwait is a basically a flat desert area (apart from a few oases along the coast), a new fresh water supply had to be brought from the Shatt Al-Arab in Iraq. Kuwait also began to use processes for the distillation of sea-water, with a major plant being installed in the early 1950s and having a capacity of 6 million gallons per day. Further plants have since been installed, reaching a total production level of 12,978 million gallons a day in 1990, and 40,589 million gallons per day in 1993 (*Monthly Digest of Statistics* 1993: 37). Water

consumption is mainly for residential use, with industrial and agricultural consumption being relatively small.

The generation of electricity has been developed together with the expansion of water distribution plants. There has inevitably been a rapid increase in the demand for electric power in Kuwait as the nation's living standards have increased. Installed power capacity increased from 160 megawatts (mw) in 1962 to 560 mw in 1970. Maximum peak demand rose from 99 mw in 1962 to 516 mw in 1970 (IBRD 1971: 10). In 1990 electricity maximum load increased to 9,500 mw and reached 30,040 in 1993 (*Monthly Digest of Statistics* 1993, Vol. 6: 36).

With the achievement of full independence in 1961, Kuwait also became much more concerned with matters of key national interest, in particular the safeguarding of its oil-export earnings and the need to establish an independent monetary system and strengthen economic relations with other Arab countries. As well as developing its role in OPEC, in 1960 the Government decided to substitute a new national currency for the Indian rupee and also proceeded to create its own aid organisation, the Kuwait Fund for Arab Economic Development. The Kuwaiti Government instituted a social services programme or 'ministry', a department which expanded rapidly. It also sought to provide for all the needs of a state, including ports, telecommunications, public works and townships, a judicial system, a security system, a foreign service and a military force (Khoujah and Sadler 1979: 30-31). As Girgis (1984: 34-35) points out, "the establishment of so many social services of a very high standard, freely available to all, including free education at all levels, free health services, and low-cost housing for those in need, represents an investment in the nation that cannot be measured only in financial terms".

Social Services

The Kuwaiti welfare system may appear to be 'modern', but its roots can be seen to go back to the long tradition of governmental paternalism and the country's strong tribal customs and

traditions.[1] The foundations of this system had been established by 1956 and have since been strongly consolidated so that Kuwait now has one of the most comprehensive welfare systems in the world (Khoujah and Sadler 1979: 31-32). The most important and broadest category of government expenditure is social services, comprising expenditures on housing, education, information, public health and labour, and other social affairs. In the 1978/79 budget, KD 243,978 million of the ordinary expenditure was earmarked for ministries concerned with the provision of these services. With the completion of several major infrastructure projects, development expenditure declined from KD 928 million (30 per cent of total expenditure) in 1982/1983 to KD 643 million (22 per cent of total expenditure) in 1988/89 (IMF, SM/90/72, 25 April 1990: 26-29).

The capital-expenditure allocation reflects the undisputed prominence of the service sector. Given the absorptive capacity constraints inhibiting agriculture and industrial development, the expansion of social services became an avenue for both income distribution and the expanded utilisation of oil revenue. Expenditure on education and health has also contributed to human capital formation since it has resulted in imported levels of labour productivity (Al-Mallakh and Atta 1981: 106-197). Each of these two areas of development will now be examined briefly, and this will be followed by some brief comments on housing policy.

Education

Education policy is a major component of Kuwait's welfare system. The main objective behind these efforts has been the development of the country's human capital, since Kuwait's economic and social progress depends heavily on the availability of an educated workforce. Kuwait has certainly made rapid advances in education, aided by an abundance of capital (following the exploitation of oil resources) and the small size of the population. In the 1930s there were only two schools, but this number rose to 61 in 1956, 160 in 1966, and aremarkable 1,002 in 1986/87 (EIU 1988/89: 2). The number of Kuwaiti students rose

[1] According to one source, "The concept of the Welfare State is part and parcel of the paternalist nature of Kuwait's Sheikhdom, though it owes a great deal in inspiration and form to western models" (H. V. F. Winston and Zahra Freeth, *Kuwait: Prospect and Reality*, Allen and Unwin, London, 1972, p.194).

from 600 in 1936 to 101,045 in 1966. The budgetary allocation on education rose from less than half a million dollars in 1946 to 56 million dollars in 1966, reaching 141 million dollars in 1991/92 (IMF, SM/92/51, 1992).

Education is now compulsory and is free to every citizen in Kuwait. In recent years there has been a particular focus of the development of higher education and training facilities. In 1966 both the Public Authority for Higher Education and the University of Kuwait were opened. In 1969 enrolment at Kuwait University was 1,717 and in 1970 the first BA and BSc degrees were conferred. In an attempt to overcome the lack of Kuwaitis in technical and clerical jobs, vocational institutes have also been created. The Central Training Institute administers programmes of study which encompass nursing, teaching, business administration and technical skills (Metra Consulting 1984: 225). Higher education in Kuwait is impressive but remains selective and is aimed at strengthening the relationship between effort and reward, emphasising those disciplines which will most immediately affect the nation's economic and social development.

Health

In the pre-oil period, Kuwait, like many other developing countries in the region, was characterised by the widespread incidence of two serious endemic diseases of the desert: smallpox and tuberculosis. Prior to 1946 only limited means were available for health services and hygienic care. Hence the Government quickly harnessed oil revenues in order to do everything possible to improve health conditions. The Amiri hospital (finally built in 1949) was the first step in the country's strategy, and was soon followed by the building of further sanatoria, mental hospitals, maternity units and the Al-Sabah hospitals. All facilities were supplied with the most advanced medical equipment available (Khoujah and Sadler 1979: 32). The expenditure on public health increased from KD 14,691,000 in 1967/68 to KD 28,066,000 in 1974/75. KD 19 million was budgeted in 1989/90 (IMF, SM/90/72, 25 April 1990).

Public health services in Kuwait today are highly developed by world standards. All health services, including the most modern hospitals, were free to residents and non-residents

until minimal fees were instituted in 1994 for non-Kuwaitis (*Arab Times*, 12 January 1994). In 1987 there were 2,841 Government doctors and 287 private doctors, with 5,503 beds in Government hospitals and (in 1985) a further 598 private clinic beds. Life expectancy in 1987 was 71 years for men and 75 years for women, among the highest in the Arab world (EIU, Country Profile, Kuwait, 1992/93: 9).

Housing

After education and health, housing has become a key sector of economic and social development in Kuwait. With its rapidly expanding economy, the need for greater housing provision and higher standards of accommodation has become evident. The Government began a gigantic housing programme in 1976, announcing the bold objective of providing housing for all Kuwaitis within four years. The 1976/77-1980/81 development plan allocated KD 1,400 million for housing construction. The Government and the private sector were to work together in the implementation of this programme.

In providing housing, the Government, through the National Housing Authority, covers just over fifty per cent of the estimated cost, while the private sector covers the difference, mainly through loans from the Savings and Credit Bank. The Real Estate Bank of Kuwait was established by the private sector in 1973 in response to the high return on investment in real estate ventures (Al-Mallakh 1981: 33-34).

2.5.3 Socio-Economic Development

As has been emphasised throughout this chapter, modern social and structural change in Kuwait has occurred as a direct result of the expansion of national wealth made possible by the disovery of oil (Al-Feel 1969: 212-219). The changes in Kuwait's economic infrastructure or mode of production - as outlined above - have to be coupled with changes in what may be called the society's superstructure, especially in life-styles, the family and social norms and values. Basically, the whole social change process has taken the form of a transformation from precapitalistic forms of production which depended on pearling and seafaring and were

associated with feudal and semi-feudal relations of production, to a capitalistic mode of production which depends on the oil industry, and in which the relations of production can be seen to be formalised in the country's written constitution. In other words, the new capitalistic relations of production are expressed in a whole range of economic, political, social and judicial manifestations (M. Al-Sharrad: 48-49). As we shall see during the course of our analysis, Kuwait's legal regime can only be understood if it is seen as one of these major manifestations of a particular set of capitalistic relations stemming from the dominant mode of production which has emerged during the twentieth century.

Beyond investing reserves and paying for the cost of general Government administration, the state in Kuwait has used its financial resources to build, expand and modernise the social and physical infrastructure of Kuwait whilst attempting to keep in step with dramatic population increases. The intention behind most uses of Kuwait's new-found wealth has been to spend money for value received. Seen from another point of view, however, the principal purpose has been to channel oil profits towards citizens as part of the state's wealth-sharing philosophy. (Stanford Research Institution , Project 2340, May 1974: 1).

Population and Labour Force

The growth of the economy in the oil era has been reflected in Kuwait's remarkable population increase. This has created a great deal of pressure for urban change and planned development. As a consequence of rapid urbanisation in the 1950s, the wall surrounding the original city of Kuwait was demolished and a radical redevelopment programme was inaugurated. The 1985 census showed that Kuwait's population was 1,697,301, of whom 681,288 (40.1 per cent) were actually Kuwaiti citizens. With the Kuwaiti population growing by an average of 3.9 per cent per year, the estimated total population in mid-1990 was 2.14 million. However, the definition of citizenship is a very strict one: citizenship applies only to descendants of people who were themselves in Kuwait in 1920, together with a relatively

small number of naturalised Kuwaitis. In 1993 the census revealed a population of 1,433,204 of whom less than half (621,235) were Kuwaitis (EIU 1993-1994: 8-9).

The size of the local labour force in Kuwait is constrained not only by the population size but also by the gender composition of the population, the distinction between Kuwaiti and non-Kuwaiti nationals, and by attitudes towards the role of women in the economy. However, the primary source of labour supply in Kuwait consists of foreigners. This fact is of great significance in terms of Kuwait's foreign direct investment policies and raises obvious issues concerning the way in which FDI itself can contribute to the development of Kuwait's own human resources. After the discovery of oil, Kuwait became a "pull-factor" area, attracting workers of various nationalities due to the lack of appropriate local labour with which to develop the country (Al-Khares 1975: 5-6). The local workforce at that time was represented principally by divers, pearlers, merchants and artisans who left their jobs after the decline of the traditional industries and went to work in the public sector or in the oil fields. However, because local skills were limited, there existed an unfilled need for manpower (Al-Khares 1975: 19). Today it has to be recognised that Kuwait needs to remedy the shortage of skills amongst its own workforce.

Al Khares (1975: 20-21) points out that the Government and the oil companies took on the task of recruiting foreign labour by organising the necessary numbers of labourers, skilled workers and technicians. These non-national groups worked mainly in the construction field as there were many active construction projects at that time (Al-Khares 1975: 20-21). The result was that the proportion of Kuwaitis who were foreigners declined from 55 per cent in 1957 to 47 per cent in 1965. In 1993 it was estimated that non-Kuwaiti residents accounted for 56.7 per cent of the population and the remainder were Kuwaitis (EIU 1993/94: 9). Today there continues to be a high demand for technological expertise, particularly in electronics, data processing, design, maintenance and finance. This is a factor closely related to the impact of foreign direct investment since such investment is a key channel in providing for the transfer of technological skills.

The rapid population growth in Kuwait has relied not only on the influx of workers for infrastructure projects and jobs created by the expansion of public services. It has also

been due to the increase in the number of Kuwaiti citizens through a concentrated effort to naturalise tribesmen residing in the country's deserts, along with a limited number of people who had lived in the country for an extended time. The combination of these factors resulted in a compounded growth rate of the Kuwaiti population that was almost double the natural growth rate of other countries in the region (Khoujah and Sadler 1979: 37). Yet, despite this rapid increase in population, the workforce participation rate in Kuwait has actually declined. The ratio of total workforce to total population, which stood at 42.1 per cent in 1957, fell consistently over the years to 30.6 per cent in 1975 (Al-Mallak 1981: 90) and 36 per cent in 1980. According to the 1985 census, 59.5 per cent of Kuwaiti men and 13.8 per cent of Kuwaiti women were economically active, while 91.7 per cent of non-Kuwaiti men and 42.7 per cent of non-Kuwaiti women were part of the labour force (EIU, 1993/1994: 12-13).

The growth of the proportion of the population participating in the workforce is low among the Kuwaitis in comparison to other nations due to several factors, including the larger proportion of young people in continuing education and the low female labour force participation rate which is a result of social and cultural constraints and traditional views about the appropriate role of women in society (although this situation is gradually undergoing change). The younger generation and the female population must now be seen as important components of the country's potential labour force (Khoujah and Sadler 1979: 39-42).

Employment

Kuwait's employment structure is heavily dependent - indeed *over*dependent - on the oil sector. However, it is still the case that the total employment level in this sector is low in proportion to the economic importance of oil as measured by its contribution to the Gross National Product (GNP). By comparison there appears to be a surprisingly high level of employment in the expanded public service sector (which, as we have made clear, is financially dependent on oil revenues). Thus public sector employment in the social services increased from an estimated 46 per cent of the labour force in 1980 to 49 per cent in 1988. 78 per cent of Kuwaiti workers are now employed in the social service sector, which is a

remarkably high figure, although Kuwaitis themselves account for only about 30 per cent of the total number employed in social services.

If we examine employment levels in other sectors, we find that the number of workers in construction decreased from 20 per cent in 1980 to 16 per cent in 1988. Wholesale and retail trade accounted for 12 per cent of the labour force in 1990, and this sector was followed by manufacturing (7 per cent), transport (3 per cent) and agriculture and fisheries (1 per cent). Most of the remaining Kuwaiti workers are employed (in an approximately equal distibution) in transport and communications, finance and business services, and trade and manufacturing (IMF, SM/90/72, 25 April 1990: 17-18). On the other hand, non-Kuwaitis are more evenly distributed among such major activities as Government service, trade, manufacturing, general services and construction (Khoujah and Sadler 1979: 41-42).

Social Change

In addition to obvious shifts in the employment structure, highly significant changes in social relations and values have resulted from the oil-based development of the Kuwaiti economy since 1946. From their first establishment, oil companies employed thousands of Kuwaitis as construction workers, guards, in local transportation, and in some clerical jobs. Workers found themselves able, for the first time, to sell their labour power in return for wages. Accordingly, consumption patterns changed and workers could now afford to buy luxuries (Al-Rumaihi 1975: 48-49). The consequent transformation of the population's whole life-style, social relations and family life has been remarkable.

In traditional Kuwaiti society, the prevalent form of family organisation was the extended family, a multi-functional social unit in which the oldest male exercised his authority. With economic change, however, disturbances within the family occurred as a result of family members gaining the psychological feeling of economic independence, thereby reducing the power of the family patriarch and breaking down family unity (Al-Feel 1974-1975: 492). Thus, the Kuwaiti family started to be transformed from an extended family structure to the nuclear family (Attia 1980: 59).

Undoubtedly the most profound change in Kuwait has been in the basic social (class) structure, and this has had far-reaching political consequences. As explained above, the pre-oil society in Kuwait was composed of three major classes: the ruling family, the merchants, and the working class. Among these groups, the merchant class exercised the greatest power and authority due to its control of the economy. Both the ruling family and the working classes came to have an economic dependency on the merchants. The oil era witnessed a major reordering of the social structure. Political power became concentrated in the hands of the ruling family because it exerted control over oil income and its distribution. Now it was the merchants who depended economically on the Government; and the newly affluent working class also came to be subject to the same relations of dependency. Thus, of the three major classes in Kuwait, two have definitely increased their power (the rulers and the working class) and one (the merchants) has lost ground (Al-Ebraheem 1975: 122).

2.6 THE STRUCTURE AND CHARACTERISTICS OF KUWAIT'S ECONOMY, 1960 TO THE PRESENT

It should now be apparent that the Kuwaiti economic system is a unique one, combining the basic features of capitalism and a form of welfare state socialism on the one hand, and of development and underdevelopment on the other. The economy displays a basic reliance on free enterprise and a market economy for the allocation of resources. The means of production, capital and land can be owned by private individuals and by industries. Strictly centralised planning is not practised. At the same time, as Al Rashed (1976: 13) points out, the Kuwaiti Government plays a decisive role in the economy through its use of fiscal and monetary policies to determine the national budget and credit which, accordingly, influence the decisions of individuals and businesses. Full employment is a Government objective, and the standard of public services (such as health and education) is impressively high. In addition, all utilities are publicly owned and controlled, and the services provided by these utilities are subsidised by the Government. In other words there is a strong and extensive public sector.

The Kuwaiti economy displays several features normally associated with a developed country (Al-Mallak 1968: 1-5, Al-Sabah 1983:62).[1] A high annual growth rate, one of the highest per capita incomes in the world, one of the world's highest savings rates, and a consistently favourable balance of payments. Throughout the 1960s, the economy had one of the highest known levels of per capita imports (Planning Board 1970). However, at the same time, other features of Kuwait's economy are indicative of its continuing underdevelopment: a small gross domestic product, reliance upon a single commodity export, and a small territorial size and small population. Kuwait also lacks a well-developed financial market, an efficient bureaucracy and sufficient human capital (Abdul Jaleel 1988: 11-12). Furthermore, Kuwait tends to be over-dependent on imports, both of capital and consumer products. The industrial sector is largely inactive (a major weakness which the Government has still not successfully addressed), and though there is a high level of technological development, there tends to be a low level of employment in the productive economic sector. By contrast, there is a continuing rapid growth in the service sector (Al-Mallakh 1968: 1-5).

2.6.1 The Kuwaiti Economy in the 1980s and 1990s

We can now turn to the key characteristics of the Kuwaiti economy during the last two decades. In general, we must note a combination of impressive achievements and major difficulties which point to the need for new policy initiatives and a re-thinking of Government strategy in relation to the economy.

In 1990 the IMF (SM/90/72: 1) was able to report that: "Kuwait has achieved considerable economic and social progress through the development of its enormous oil reserves and generally prudent economic management." The country has also had significant

[1] The Iraqi invasion on August 2, 1990 and ensuing war resulted in large-scale damage to Kuwait's infrastructure and dramatically altered the economy and its prospects (IMF 1992, 2-6). Provisional data for 1990-1991 shows that as aresult of the Iraqi invasion, GDP at current prices fell by 26 percent in 1990 and by afurther 39 percent in 1991 to alevel lower than 1985 GDP by nearly 50 percent (NBK 1994, 10)."The period immediately following liberation saw a substancial surge in domestic demand, as inventories were replenished, destroyed household goods were replaced and reconstruction started. Domestic demand was met almost entirely by imports. by early 1992, activity in the private sector still remained depressed because of financial difficulties of many traders and businessmen, the sharp reduction of domestic demand resulting from the near halving of population (estimated at about 1.3 million in early February 1992), and the loss of previously booming transit trade with Iraq." (IMF 1992, 2-6)

success in diversifying the economy, with more than half of GDP now originating in the non-oil sector. Oil revenue has allowed the country to build a modern infrastructure and to maintain large external current-account surpluses which have facilitated the acquisition of real and financial assets abroad.

By the early 1980s, as we have seen, Kuwait's infrastructure was mostly in place. Besides accumulating revenues from oil exports, the Government received investment earnings from accumulated official foreign assets. The result was an impressive overall budget surplus. Foreign assets accumulated in two official funds: the General Reserve Fund and the Reserve Fund for Future Generations. By 1990 Kuwait's assets were estimated to be between US $80-100 billion, including non-liquid claims on neighbouring countries and not accounting for unrealised capital gains. Throughout the 1980s, non-oil sectors, particularly services and construction, gained in importance. However, the role of the private sector has remained small, with its contribution to GDP remaining at 20 per cent or less (IMF, SM/92/51: 2).

Despite the country's impressive economic achievements, Kuwait's financial sector experienced a crisis during the 1980s. The Souk Al-Manakh was an unofficial stock market which arose when the Ministry of Commerce and Industry restricted the licensing of new public companies in Kuwait after 1977. The Al-Manakh traded shares in companies established outside the country, and speculation was heavy during the period 1977 to 1982. Since this speculation was partly financed through post-dated cheques and bank credit, the market was vulnerable and a price collapse occurred in August 1982. This was to have a long-term effect on investor liquidity and confidence.

Perhaps the most dramatic economic shift in the 1980s was that receipts from oil exports declined: from over US $19 billion in 1980 to US $7 billion in 1988. In the face of foreign exchange losses, the Government began to cut back on development outlays in 1982 and 1983. Current expenditures were kept largely unchanged, but their composition was shifted towards wages and salaries, and all other components, including subsidies, declined. The Government also cut back on its official foreign assistance. The effect of these cutbacks was that the country's overall fiscal position remained in surplus, but the economy stagnated.

In 1987 the Government introduced a range of debt instruments. Since investment income was largely reinvested, the Government needed additional gross financing. As for the country's monetary policy, this was limited by the fact that Kuwait's dinar was tied to a basket of currencies heavily weighted to the US dollar. Domestic interest rates tended to follow foreign rates during most of the 1980s.

Kuwait also experienced a recession in the non-oil sector during the mid-1980s. This was the result of reduced fiscal stimulation by the Government, uncertainty caused by Middle Eastern regional conflicts, and the 1982 unofficial stock market crash. In 1985 and 1986, the Government announced plans to try to revive the economy, but these were largely ineffective since the fiscal stimulus remained weak (IMF, SM/90/72: 2).

The Iraqi invasion in August 1990 had a dramatic impact on the Kuwaiti economy, and the consequences are still being felt today. There was a major dislocation of the population, whose number was reduced to about 400,000 at the end of the occupation as a result of a significant reduction in the number of aliens permitted to remain in Kuwait. The production and export of oil were interrupted, infrastructure was damaged, several billion dollars' worth of assets were stolen, including gold and currency from the Central Bank, household goods and money were taken from houses, and equipment and capital goods were taken from factories and warehouses. All this had far-reaching repercussions in terms of private-sector confidence. While Kuwait certainly had sufficient foreign assets to rebuild itself physically to pre-invasion levels (when it was worth in excess of $100,000 million), the confidence of the private sector had been undermined. Even with order totally restored and solid guarantees against external invasion, private investment in the economy by national and foreign business is likely to remain a problematic factor for years to come.

2.6.2 The Public Sector and the Private Sector

The Public Sector

Kuwait's economy, while tending towards an open market with little or no exchange controls, tariffs or taxes, is dominated by the public sector, and the significance of this fact cannot be

overstated (El Said 1985: 13). In Kuwait the state performs a number of key economic roles: main financier, major employer, major single consumer, major developer and major investor. The private sector still remains reluctant to embark on any venture without first securing Government backing, and this leads to a continuing lack of dynamism and innovation in the private sector (see Amiri Decree 3/1955 of October 10, 1955, Al Kuwait Alyum: 3).

Until the mid 1980s, the state tended not to devise formal development plans, although guidelines were set for certain sectors. Given the growing complexity of the market, and in an attempt to bolster confidence following the Al-Manakh crisis, the Government did adopt a five-year plan for the years 1985/1986 to 1989/1990. According to the EIC (1992/93: 10-11), the plan's main aims were to maximise the capacity of local industry and to expand the role of the private sector.

Total state expenditures averaged about three billion KD annually during the 1980s. Development expenditure declined during this period since most major infrastructure projects had already been completed by this time: the fall was from 30 per cent of total expenditure in 1982/83 to 22 per cent in 1988/89. In the reconstruction period since the Iraqi invasion, the Government has put development expenditures towards limited maintenance and reconstruction, with no expenditures toward new budgets (IMF, 1992: 6-8).

Wages and salaries still account for the largest part of current spending: 41 per cent in the fiscal year 1988/89. This is because Kuwaitis, in their Constitution, are actually guaranteed employment in the state sector, a unique and - it must be said - highly questionable provision (Article 41 of Kuwaiti Constitution 1962; see Appendix No. IV). After the Iraqi invasion, the Government expected to reduce the wage bill since the amount of expatriate labour was significantly reduced; but this can only be described as a short-term measure which cannot be relied upon as a permanent solution.

Although much of the country's modern infrastructure is now in place, the state remains responsible for all utilities, including water, gas, electricity and telephone, and also continues to devote a high level of expenditure to welfare-state benefits such as education, health, family allowances and transportation. Another main source of Government expenditure has been the land-purchase programme, which began in 1952. Land purchased

by the state was used for roads and public facilities, with the unused land being re-sold to the private sector for commercial use. The state has also undertaken an impressive large-scale housing programme. Today questions are increasingly being asked about the need to strike a better balance between public and private sector responsibilities in these key policy areas, and the virtues of privatisation are being widely canvassed.

As Al-Rashed (1976: 30) points out, since the public sector dominates the Kuwaiti economy, "the utilisation of Kuwaiti economic resources depends to a great extent on the effectiveness of the government bureaucracy". The Government's role is especially significant in the allocation and distribution of economic resources. It also has the major responsibility for stabilisation. It is the economy's largest spender and the biggest employer, and it is responsible for initiating economic planning. Most accumulated capital is controlled by the Government in the form of reserves, and this represents the base and the foundation of Kuwait's future post-oil economy. Formally, the Government position supports the utilisation of resources and wants to achieve a stronger economic structure, but the Government bureaucracy has not been efficient enough fully to implement these principles (Al Rashed 1976: 242). Diversification of the economy will increase Government effectiveness, but it should not be the objective; rather it should be the tool through which local resources can be utilised. The public sector has taken the initiative in attempting to expand the economy's industrial base, hoping to attract private investment into local ventures. The time has come to assess the success of this programme, and to continue to stimulate the private sector by whatever means seems to be most appropriate. As we shall see, this agenda must include careful attention to the encouragement of private foreign direct investment (beyond the confines of the oil sector).

The Private Sector

Although the public sector still dominates Kuwait's economy, the private sector has gradually assumed increasing importance, and most commentators stress its potenial contributions to the future development of the economy. It should be remembered that in the past Kuwait's economy was generally characterised by free enterprise and trade, and these traditional "virtues" - as they are often described - are still fostered today. To take just one example, in 1965 the Industrial Development Committee was established to promote industry and to license private enterprise development in the non-oil sector (Khoujah and Sadler 1979: 124). The whole private sector has steadily grown over the years, building as it has upon the growth in public sector expenditures in construction and social services and the growth in Kuwait's population and income. It has now extended into such sophisticated services as tanker shipping, fisheries and wholesale and retail trade (Al Rashed 1976: 30). However, the contribution of the private sector to GDP has remained at a level of nearly 20 per cent (IMF, SM/92/51: 2-12).

In December 1989 a Joint Economic Committee (JEC), chaired by the Governor of the Central Bank, was formed. Once again, the need to balance the growth and development of the non-oil sector was stressed. The JEC report recommended that housing finance be transferred to the private sector which should be encouraged to seek out foreign technical expertise through business partnerships. Other policies that were pursued during this time included: stipulating percentages of public sector projects to be assigned to local contractors, increasing protective tariffs on certain imports, and giving preference to domestic producers in Government procurement of goods and services (IMF 1988).

Finally, the Government has sought to stimulate the private sector through the privatisation of certain Government services, including telecommunications and transportation. The IMF (1992: 2-12) suggests that the efforts to encourage the private sector "would concentrate on areas in which Kuwait may develop a comparative advantage, such as in provision of financial services, the downstream oil sector, and other professional services". Other Government measures designed to stimulate the private sector include

proposals for a KD 600 million petrochemical complex and a KD 300 million causeway between Kuwait City and the site of a proposed town at Subiya (General Union of Chambers of Commerce 1993: 169).

2.6.3 Particular Sectors of the Economy

The Oil Sector

As has been repeatedly emphasised above, the oil sector continues to have an excessively dominant position in the Kuwait's economy. Proven reserves rose from 67 billion (bn) barrels in 1983 to 94 bn barrels at the beginning of 1992. The oil sector contributes positively to the economy both through direct expenditures in the local market and, more significantly, through the revenue which it earns for the state. During the late 1960s and early 1970s, oil prices rose precipitously and stayed high. Oil and gas revenues formed 90 per cent of Government revenues. During the 1980s, the contribution of the oil sector to GDP fell from 76 per cent to 45.2 per cent (Hunaidi 1985: 27), and this confirmed that the local economy was vulnerable to fluctuations in the world price and demand for oil. Thus the positive role of oil in the economy must now be balanced against the economic vulnerability which its dominant position causes for the country as a whole.

The oil sector originally operated under the Kuwait Oil Company (KOC), a joint venture with BP and Gulf Oil. KOC underwent various changes in profit-sharing and ownership, and was finally nationalised in 1975 (for details see Chapters Three and Nine). In 1980 the industry was reorganised and the Kuwait Petroleum Corporation (KPC) was formed as an umbrella organisation. KPC's objectives were to optimise growth and development in the oil sector, to maintain a reserve of resources for future generations, to maximise profits, and to oversee domestic and foreign investments in the oil fields. Attached to the Ministry of Oil, KPC was to acquire all Government shares in Kuwait oil companies with capital in excess of KD 1,000 million (Hunaidi 1985: 27). KPC pays the Ministry of Oil official prices for the oil which it extracts, while the Government pays KOC exploration and extraction costs.

KPC now oversees five major subsidiaries (EIU 1990/91: 13): the Kuwait Oil Company (KOC), which produces oil and gas outside the Neutral Zone; the Kuwait National Petroleum Corporation (KNPC), which controls refining, gas processing and product marketing; the Kuwait Petrochemical Industry Company (PIC), in charge of the domestic petrochemical and fertiliser industries; the Kuwait Oil Tanker Company (KOTC), which deals with the transportation of crude oil and LPG; and the Kuwait Foreign Petroleum Exploration Company (KUFPEC), which is responsible for exploration and development of overseas concessions. The Arabian Oil Company, a Japanese concern, oversees oil production in the Neutral Zone.

During the invasion of Kuwait, the Iraqis sabotaged 810 of Kuwait's 1,080 oil wells, setting 742 of them on fire. Although international teams of firefighters extinguished the fires in less than a year, by mid-1993 only 40 per cent of Kuwait's pre-war wells had been fully repaired or redrilled (EIU 1993/94: 15-16). Kuwait's refinery capacity was 730,000 barrels per day (b/d) at the end of 1989. By the fourth quarter of 1993, refinery capacity was 545,000 b/d.

Agriculture

Agriculture has not received much attention so far in this analysis for the simple reason that it contributes little to the Kuwait economy, with most food being imported, and such imports making up about one-tenth of total imports. Only in poultry production is more than one third of the demand met from domestic sources (Metra Consulting 1984: 177). Agriculture in Kuwait has always been limited due to natural conditions such as poor soil, inhospitable climate and lack of water for irrigation. In 1985 and 1986, only 0.4 per cent of Kuwait's land was cultivated, with 4,500 hectares being used for vegetables and 2,200 hectares for fruit and timber. Holdings numbered 1,886. The traditional winter crops in Kuwait are tomatoes, cucumbers and alfalfa (EIU 1993-1994: 14-15).

Government subsidies have inevitably played a large role in the agricultural sector. To encourage labour to remain in farming (instead of moving to more lucrative jobs in Government and industry), the Government has provided generous financial assistance

towards land purchases, tools, seeds and equipment. At its experimental farm to the south of Kuwait City, the Government promotes programmes to increase agricultural production, and advanced technology, such as agroponic and hydroponic cultivation, are being used experimentally. Less expensive methods of increasing yields, including polyethylene mulching and drip irrigation, are now being introduced. Foreign companies have entered into joint-productive ventures, and this has promoted the use of modern agricultural techniques (Bazarin and Fauerbach 1980: 476-478). During the 1980s, greenhouse production increased dramatically: in 1985/86 it occupied 270 hectares of land and production was 32,300 tons, compared with the winter vegetable crop of 74,500 tons. Tomatoes and cucumbers are the major greenhouse crop.

The Iraqi invasion caused an enormous decrease in agricultural production. For example, the UN's Food and Agriculture Organisation estimates that tomato production fell from 34,000 tons in 1990 to only 3,000 tons in 1992 (EIU 1993/94: 14-15). This was a major cause of concern, and the ensuing problems have still not been solved. At the same time, however, the small size of Kuwait's agricultural sector proved in some respects to be an advantage since a greater reliance on domestic agricultural production would have led to even more severe difficulties as a result of the Iraqi invasion.

Manufacturing

Manufacturing is a relatively weak sector in Kuwait, and this is an issue which needs to be addressed as a matter of some urgency. The reasons for this position are largely historical. As Al-Rashid (1976: 22) has explained, the Kuwaitis have traditionally had well-developed skills in trading, and in the oil era it is certainly trade, rather than manufacturing, which brought higher profits in the short run. Although the Government formally supports the development of industry, the bureaucracy has not done much actively to encourage the growth of the manufacturing sector. Thus the Shuaiba industrial area, developed in 1984, remains largely unused, and in general technical and managerial skills remain limited.

Industry in Kuwait tends to fall into two categories (Al-Rashid 1976: 18-22). First, there are large-scale industries which are either wholly or partly Government-owned. For

instance, oil and gas have provided the base for Government-owned refining and petrochemical industries. The second type of industry is small-scale, meeting primary local needs such as in construction material, food processing and consumer-oriented products.

State policy towards manufacturing has been torn between the need for downstream oil development, with an adjunct construction-materials industry, or the development of a broad-based sector. In late 1974 the Industrial Bank of Kuwait (IBK) was established with 49 per cent Government participation in order to stimulate the industrial sector by helping to find local partners and venture capital for appropriate projects (Metra Consulting 1984: 175-176). During the 1980s the growth of the manufacturing sector was erratic, but the sector's share of non-oil GDP did rise steadily, averaging 13.5 per cent from 1982 to 1986 and reaching 24 per cent by 1989.

2.6.4 The Monetary System and Financial Market

Kuwait's monetary system and financial market have to be considered as important components of the economy, and any weaknesses in the country's economic development must be related in part to the way in which sources of finance have been regulated. On 1 April 1961 Kuwait achieved independence and thus established control over its monetary system with the establishment of the Currency Board and the Kuwaiti dinar put into circulation to replace the Indian rupee. Further institutional development came with the establishment of the Central Bank of Kuwait (CBK) as the main monetary and financial regulatory body of the country, as stated in Law 32 of 1968.[1] Al-Mallakh (1981: 53) describes the functions of the CBK as follows: "to issue currency, to secure the stability of the dinar, to undertake policies which would aid the economic and social development of Kuwait, to control the Kuwaiti banking system, to serve as the government bankers, and to be the government's financial

[1] Under the law, the CBK is empowered to:
i. act as a banker and fiscal agent of the Government;
ii. issue and maintain the stability and convertibility of the Kuwaiti currency;
iii. direct credit policy with a view to promoting economic growth;
iv. set interest rates;
v. issue negotiable bills and undertake operations relating to the sale and management of Government securities;
vi. regulate banks and other financial institutions.
The CBK is also the Government's agent for managing a part of the country's foreign exchange reserves.

advisor". The CBK is governed by a board which includes representatives from the Ministries of Finance, Commerce and Industry. Besides the Central Bank, the Kuwaiti financial system consists of seven commercial banks, four specialised credit institutions, and eighteen investment companies (two of which are Government-controlled, with the Government holding substantial shares in many of the others). There also exists a large, informal sector based on merchants, money-lenders and money-changers (EIU 1993/94: 25). The Central Bank's monetary policy became more strict during the 1980s. According to the EIU (1993/94: 25), the CBK has exercised stronger powers over the commercial banks than have central banks in neighbouring Gulf countries. Furthermore, Kuwait's banking system continues to be dependent upon foreign managerial and technical skills.

The commercial banks, faced with limited domestic outlets for investment, still tend to invest the major part of their holdings abroad, which can only be described as a source of weakness for the Kuwaiti domestic economy. Investment companies have played a similar role: in the early 1970s they dealt mainly in Government funds but, since the mid-1970s, private savings have also been included. These companies have acted as underwriters of international bond issues of the World Bank and other foreign governments and institutions. The largest investment companies are the Kuwait Foreign Trading, Contracting and Investment Company, the Kuwait International Investment Company, and the Kuwait Investment Company (IMF 1988: 38-39).

Kuwait's financial market was established in 1962, with the introduction of a law concerning the organisation of trading in foreign securities. It is further governed by Company Law No. 15 of 1960 and Law No. 32 of 1970. The Minister of Trade and Industry, through Decree No. 61 of 1976, established a Securities Commission to create the rules governing the trading of shares and securities in the financial market. Formally opened in April 1977, the market provides an investment outlet for the growing liquidity available in private hands. Accordingly, the number of public shareholding companies has grown enormously.

Following the collapse of the Al-Manakh stock market, the Government issued new by-laws limiting trading on the market to the following financial papers and securities (ESCWA 1990: 41-42):

1. Shares of Kuwaiti public shareholding companies which are members of the market.
2. Shares of Kuwaiti companies with liability listed in the market.
3. Shares of non-Kuwaiti public shareholding companies listed in the market.
4. Securities issued by Kuwaiti public shareholding companies for domestic as well as foreign borrowers.
5. Certificates of deposits (CDs) of Kuwaiti banks.
6. Commercial bank acceptances.
7. Any financial papers and securities accepted for trading by the Financial Market Committee.

Ownership of shares is limited to Kuwaiti nationals. However, non-Kuwaitis may enter into partnership in the establishment of Kuwaiti shareholding companies if this is deemed necessary, as long as their shareholding remains less than 49 per cent of the company capital and providing that the deal is approved by the Ministry of Trade and Industry.

2.6.5 Kuwait's Strategy for the Promotion of Inward Investment

At this stage of our analysis, direct links need to be established between the discussion of Kuwait's economic development and the particular problem of promoting inward investment. The key issue, to begin with, concerns the level of inward investment which Kuwait actually needs and the specific purposes which such investment should be seen to serve. Hitherto the Government has not approached its analysis of FDI in such a systematic way.

Part of the problem, as always, is that too much emphasis has been placed on the oil sector. In 1992 Kuwait's oil exports reached a value of KD 1,803 million (Central Bank of Kuwait Report 1990-1992: 91). The country's oil reserves were estimated to extend for another 150 years, given current production levels. It is clear, however, that further diversification of the economy is now necessary not only to secure long-run sources of income, but also to insulate the country from changes in the price of crude oil, production

quotas, the world demand for oil and political unrest. The experience of the Iraqi invasion has reinforced these lessons, but it is not clear whether successful diversification requires a large quantity of FDI.

Al-Sabah (1980: 35-135) points out that the Kuwaiti economy displays a capital surplus in three areas: national savings, which exceed domestic investment; public revenue, which exceeds public expenditure; and the balance of payments. Therefor it can be said that Kuwait's need for foreign investment is limited, and that the main purpose of such investment must be to introduce much needed technical and management skills into the economy. Since the major hindrance to the economic development of Kuwait lies in its inability to obtain crucially important factors of production from abroad, this brings foreign direct investment into the scene as the most appropriate and efficient means of transfering technology and managerial know-how (Ghanayem 1981: 5). This is a perspective which receives careful attention in the present analysis.

Al-Hamad (1974: 15-16), the Director-General of the Kuwait Fund for Arab Economic Development, has admitted that "technological and marketing know-how, imaginative enterprise, efficient management (not to mention other well-known socio-political constraints) are no less necessary factors, and even more difficult to acquire". According to Al-Hamad:

> If we are to borrow these factors from abroad and rapidly increase our capacity for additional investments, the facts of life point - whether we like it or not - primarily to the achievements and capabilities of one of the most dynamic forms of economic organisation in the modern world, to the international giant forms or the so-called 'multinational' corporations. These powerful engines of growth could significantly increase our absorption capacity by easing our shortages of some of the most important factors: entrepreneurial and managerial capabilities, technical know-how, marketing and demand opportunities and even the availability of material and financial resources.

Another related problem is that Kuwait's industrialisation effort is very recent in origin, and it can be criticised for being inadequate, with its actual achievements falling short of the set targets. It has also led to an over-reliance on foreign investment, or at least certain kinds of foreign investment. This is understandable because of the limited absorptive capacity of the domestic economy; but this capacity should not be seen as a fixed quantity; rather it is

fluid and dynamic. Kuwait appears to be making the mistake of trading off cheaply domestic benefits against foreign returns. There are crucial uncertainties implicit in foreign investments, and the Kuwaitis have not yet recognised this fact. However, the returns on foreign investment are already covering a substantial portion of the import bill and this is a real achievement (UNID), 1981: pp.233-234). Al-Sabah (1980: 135-360) describes several other benefits from foreign investment in Kuwait: the contribution of national income through payments to local factors of production, the improvement of the national budget through taxes, and the injection of forward and backward linkages into the economy. Joint ventures are especially welcome in the oil and petrochemical industries. In other words, what is now needed is a more balanced view of the advantages and disadvantages of Kuwait's reliance on foreign investment, rather than a one-sided picture.

Currently, Kuwaiti policy towards FDI seems to be reasonably clear. Al-Roudan (1995), second Deputy Prime Minister, Minister of Finance and Chairman of the Board of the Kuwait Investment Authority (KIA), states that Kuwait encourages local and foreign investors in order to foster joint-participation economic development programmes. In early 1993 the World Bank was asked to draw up an action plan for continued economic growth, with particular reference to the scope for the privatisation of Government enterprises. A World Bank mission subsequently visited Kuwait and recommended that, in the light of evident inefficiency and low productivity, about 75 enterprises wholly or partially owned by the Government should be sold to local or foreign investors.[1] Most of these recommendations have in principle been accepted (World Bank Group, 1993).

Towards the end of 1993, the authorities finalised plans to establish a free trade zone (FTZ) at Kuwait's main port complex. (For further discussion see Chapter Six.) Early the following year, an Offset Programme was implemented which required foreign firms that are

[1] Enterprises to be privatised would include telecommunications, health services, utilities such as electricity and water, and certain downstream activities in the oil sector. It is planned that a privatisation authority working under the Minister of Finance will oversee the implementation. As a first step in this process, the National Assembly has drafted a Regulatory Commission Law in order to limit monopolistic and oligopolistic price determination in newly privatised activities. Moreover, although the eventual scale and nature of privatisation has not yet been determined, decisions have been made to move ahead in some sectors, for example, telecommunication services, electricity generation, and retail gasoline stations. (For further discussion of privatisation, see Chapter Five.)

awarded Government contracts to reinvest 30 per cent of the contract value in joint ventures with Kuwaiti-owned firms (IMF 1994: 16-17). (For more information about the Offset Programme see Chapter Seven.) While Kuwait clearly welcomes foreign investment and offers incentives such as tax holidays, free access to industrial sites and financial aid for feasibility studies, FDI is nevertheless carefully regulated through various measures. Commercial Law 12 of 1961 limits foreign participation to 49 per cent in Kuwaiti shareholding companies. (For more about foreign participation see Chapter Five.) Industrial Law No. 6 of 1965 requires Government licensing of processing, manufacturing, assembling, packaging and blending operations.

Since the Kuwaiti economy exhibits a strong foreign-exchange position, the free exchange of remittances of dividends and earnings is allowed. International payments and transfers are not limited, and there are no restrictions on receipts from exports or the re-exports of invisibles. There is no limit on the amount of wages and salaries that foreign workers in Kuwait may send to their home countries.

A law regulating commercial agencies in Kuwait was passed on 19 July 1964, and another law governing trade marks was passed in April 1961, enabling both local and foreign trade marks to be registered. (See further Chapter 7.) Throughout this thesis emphasis is placed on the current need for the legal environment in Kuwait, including the tender, sale and rental laws, to be thoroughly modernised, and for joint ventures between private companies and qualified foreign companies to be positively encouraged (Crusoe and Kemp 1993: 24-28). In general terms, the challenge that faces Kuwait is that the capital accumulated in excess of domestic needs (replacement funds) needs to be channelled into foreign investment outlets that would at least preserve the value of its limited economic wealth. Because of the enormous degree of uncertainty and complexity in the investment markets and the nature of the funds, what is clearly required is a well-defined objective strategy for Kuwait's investment (Al-Rashed 1976: 243-244). Such a strategy must accommodate the investment funds into the investment environment and provide decision-makers with due direction and cohesion. But this means that a whole range of important issues in the world investment environment must be taken into account.

In order to appreciate fully the nature of these tasks, the structure of Kuwait's foreign investment regulations, as they have evolved during the twentieth century, will be discussed in the next chapter. Once the basic inadequacies of current regulations are appreciated, it will then be possible, in subsequent chapters, to examine the major problems in more detail and to propose specific ways of reforming and improving the regulatory regime in accordance with present-day circumstances. The point must again be emphasised that any discussion of the FDI regime in Kuwait must be carefully related to an understanding of Kuwait's actual need for foreign investment at the present time. The purpose of this chapter has been to show that historically there has been an inadequate appreciation of why FDI is, or is not, important for the Kuwaiti domestic economy. As a result, as we shall see in the next chapter, the legal regime surrounding FDI has developed in a piecemeal and generally ill-informed manner.

CHAPTER THREE

THE EVOLUTION OF KUWAIT'S FOREIGN INVESTMENT REGIME, 1899 TO THE PRESENT

3.0 INTRODUCTION

In order to understand Kuwait's current foreign investment regulations, an examination of the recent historical context of those policies is necessary.[1] Here the focus is on those specific factors which have shaped the development of the country's FDI regime, seen against the broader background - outlined in Chapter Two - of the experience of profound social, economic and political change in Kuwait during the twentieth century. To begin with, three broad stages in the evolution of approaches to FDI in Kuwait can be identified:

(i) The period from 1899 to 1932, during which Kuwait was a British protectorate, with the British Government exercising ultimate control over foreign investment in the country. British policy in Kuwait fostered its own economic and political interests by seeking to reduce competition from non-British companies.

(ii) The period from 1932 to 1960 was characterised by the gradual erosion of British political influence. As a result, Kuwait gained the freedom to determine its own foreign investment policies and to arrange oil concessions with foreign investors.

(iii) The period beginning in 1961, when Kuwait, as an independent state, began to adopt policies specifically designed to encourage foreign investment and promote the country's economic development.

Each of these stages will now be discussed in turn.

3.1 STAGE 1 : THE BRITISH PROTECTORATE

Before the late 1890s the activities of foreign investors in Kuwait were minimal. However, after that date Britain became increasingly concerned with the development of Kuwait's

[1] For an examination of Kuwait's socio-economic development see Chapter Two.

economic potential. The process did not at first seem to threaten Kuwait since the interests of the two countries were in several respects mutual: Kuwait needed an ally to protect it against annexation by neighbouring countries,[1] while Britain was concerned about the security of the sea-route to India. India was placed second in importance (in commercial and political terms) to the British Isles. Therefore, Britain entered into an agreement with Kuwait whereby the country would be used as a base to defend the sea-route to India through the Persian Gulf, while at the same time Kuwaiti leaders would be shielded from foreign harassment. In return for this protection, Britain assumed the right to discourage investment attempts by non-British concerns (Yousiff Bilovisch 1982: 3).

Despite this appearance of mutual interest, it soon became clear that the British were seeking to exert political and commercial control over Kuwait. Thus, in 1899 Sheikh Mubarak pledged in a treaty that he would neither receive foreign representatives nor transfer or lease any portion of Kuwait's territory without first obtaining approval from the British Government (Foreign Office Records Confidential Print 1971: 50).[2] The 1899 Agreement prevented the Sheikh from accepting any proposals or entertaining any ideas regarding his territory from foreigners, other than UK nationals, without Britain's prior approval.[3] This enabled Britain to secure supremacy in Kuwait, to restrict economic competition from other countries, and to control Kuwait's foreign investment policy.

Britain was thus able to prevent German investment in Kuwait in the 1900s, when it blocked Kuwaiti involvement in the proposed Berlin-Baghdad Railway, which sought to locate its southern terminal inside Kuwait (Shwadran 1973: 407). In September 1899 the Commander of HMS *Melpomene* delivered a message to the Sheikh from the British Government, instructing him not to make any arrangements with the German Commission

[1] See Part I, Chapter Two for a full discussion of this issue.
[2] See Part II, Chapter Two. For the original Arabic and English texts of the agreement, see Indian Foreign and a Political Department, *Part 5, Treaties and Undertakings in Force between the British Government and Rulers of Kuwait, 1884-1913*, pp.1-14.
[3] Similar agreements had previously been made by the British Government with the Sheikh of Bahrain in 1880, the Sultan of Muscat and Oman in 1891, and the Trucial Sheikhs in 1892 (Chisholm 1975: 85).

which had visited Kuwait (without British approval) to promote the railway link (Al Baharnah 1968: 43). Britain reiterated its position on 15 April 1900 when it informed the German Ambassador in London that the Sheikh was bound by the 1899 agreement not to transfer or lease any of his territory without the consent of the British Government (Lorimer 1970: 1027).

To further assert its supremacy, Britain appointed a political agent to Kuwait in 1904. At the same time, the Sheikh was asked to sign additional agreements giving Britain the right to manage Kuwaiti economic development and foreign policy. By doing so, Britain hoped eventually to assume total control over Kuwait's natural resources (Noafal 1969: 179). The 1911 and 1913 administrative and economic agreements signed by Sheikh Mubarak stripped him of even more power with respect to the country's natural resources. The first of these agreements was the letter of 1911 from the Sheikh to the British political agent in Kuwait, confirming that he endorsed the agent's advice not to allow foreigners to dive for sponges and pearls in Kuwaiti territorial waters without Britain's consent.

Most significantly, the future of oil exploration in Kuwait was the subject of the second agreement of 27 October 1913. In this letter, the Sheikh simply reiterated his intention to conform to the policy of not granting foreign concessions without prior British approval (Aitchison 1933: 264-265). Accordingly, by 1914 Kuwait had become totally dependent on Britain in matters of finance and development. By this time, oil was gaining prominence as a source of enormous financial earnings due to new technological and military requirements. Exploratory studies had already suggested that there might be oil in Kuwait, and this further accentuated Kuwait's commercial importance to Britain. It also raised serious issues about Kuwait's national security. The British Government's oil interests in Kuwait received special consideration, even though Britain had not signed any concessions with Kuwait for the exploration and control of oil (Shwadran 1973: 407).

In order to pursue its economic and imperial objectives, the British Government entered into the so-called Red Line Agreement with certain other countries in relation to the exploitation of oil in the Gulf region. Although this Agreement excluded Kuwait, it was indicative of the plans that Britain had for the region as a whole, and demonstrated the self-

serving attitude of Britain towards the Gulf states. To further secure its position of dominance, Britain required Kuwait to observe a "British Nationality" condition for prospective oil investors in Kuwait. These two important matters are briefly discussed in the following sub-sections, beginning with the Red Line Agreement.

3.1.1 The Red Line Agreement

The Red Line Agreement began as a commercial arrangement between a cartel of British, German and Dutch interests which sought to exploit Middle Eastern oil reserves. Later, French and American interests joined the alliance, and the Agreement was formally concluded on 31 July 1928, its name being derived from the fact that the signatories used red lines on a map to delineate areas of influence in the Ottoman Empire (Naser 1977: 17). The Agreement did not actually apply to Kuwait, as the country was already under British as opposed to Ottoman rule.[1] Operating through the TPC (Turkish Petroleum Company), the Europeans thus gained direct control over oil exploitation in the Middle East during the 1920s.[2] This anti-competitive agreement was contrary to the open door policy of the USA, whose Government asked American oil companies to band together in the New East Development Corporation (NEDC)[3] to effect a compromise agreement with the TPC. The American group (NEDC), along with the other oil companies, entered into an agreement which limited their activities to the area marked in red on the map (Winston and Freeth 1972:129). The Red Line Agreement[4] had a broad purpose which was expressed in Article 10:

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[1] The Red Line Agreement was the culmination of policies that Britain had been pursuing since the 1910s. Commercial interests had always been the principal motivation behind the role that Britain had played in the Gulf. For instance, Britain acquired a controlling interest in the Anglo-Persian Oil Company, which had a huge Persian oil concession. This helped to guarantee an adequate oil supply for its navy. Simultaneously, the prospect that vast oil reserves might be found throughout the Gulf region (which was mainly under Ottoman control) also attracted foreign investors. Accordingly, in 1914, the British - along with German and Dutch interests - formed the Turkish Petroleum Company, which secured oil concessions in the Ottoman Empire. Through these commercial manoeuvres, the British were able to secure authority over oil concessions throughout the Ottoman Empire using their controlling interests in both the Anglo-Persian Oil Company and the Turkish Petroleum Company (Stocking 1971: 43).

[2] By this time France (through the D'Arcy Group) had joined Britain, Germany and the Netherlands in the Turkish Petroleum Company.

[3] The NEDC included the Standard Oil Company of New Jersey, Socony Oil, Gulf Oil, Atlantic Refining and the Mexican Petroleum Company.

[4] For more details about the Red Line Agreement, see Isawi and Yeganeh 1962; Shwadran 1973; and Moseley 1973.

> All the parties hereto agree that the Turkish Company shall, except as hereinafter mentioned, have the sole right to seek or obtain oil concessions within the defined area, and each of the Groups hereby covenants and agrees with the Turkish Company and with the other Groups that excepting only as herein provided or authorised such Groups will not nor will any of its Associated Companies either personally or through the intermediary of any person, firm, company, or corporation seek for or obtain or be interested, directly or indirectly, in the production of oil within the defined area or in the purchase of any such oil otherwise than through the Turkish Company or an Operating Company under the Turkish Company. (US Senate, *International Petroleum Cartel*: 66).

In the opinion of George Lenczowski (1960: 16), the Red Line Agreement was engineered to protect British interests against the more aggressive American oil companies and their desire to expand into the Middle East. This was in keeping with the general policy of exclusion practised by Britain in regions under its control, particularly in the Persian Gulf. According to the British Government, the TPC was the most successful means of extending and consolidating British control over Middle East oil reserves (Bilovich 1982: 41). It is not difficult to imagine how hard it would have been for any nation in the Gulf to formulate its own foreign investment policies without undue influence from the cartel, given that oil was the main exploitable resource in the region. The Red Line Agreement set the basis for negotiations for oil exploration rights in Kuwait (Winston and Freeth 1972: 129) and shaped the development of the oil industry in the Middle East for the next two decades (Moseley 1973: 30). The Agreement represented the second stage in Britain's assumption of control over foreign investment policy in Kuwait.

3.1.2 The British Nationality Clause

Oil exploration did not actually begin in Kuwait until the early 1920s. Given the extent of British control, the protection of British national interests became a paramount feature of Kuwait's foreign investment policy at this time. Initially, that control was exerted by ensuring that the Sheikh obtained a clearance from British officials before granting concessions to explore and exploit oil in his territory. However, in the face of increasing competition from non-British interests seeking to exploit Kuwait's resources, Britain proceeded to secure even tighter control by requiring (on 29 November 1928) that a British

Nationality Clause be inserted into any Kuwait oil concessions (Winston and Freeth 1972: 130). The clause read as follows:

> The company being granted the concession must be at the time of signing a British company and it must remain a British company and that control of the company must never pass into the hands of foreigners. (Chisholm 1975: 35)

In this instance, the expression "foreigners" indicated persons who were neither British subjects nor subjects of the Sheikh (Chisholm 1975: 35). Clearly, the clause sought to discourage all "foreign" investment in Kuwait, but it has been suggested that this policy was in fact implemented only in the case of oil resources. Al Shammari (1980: 25) has noted that "it is clear that during this stage foreign investment other than British investment was not allowed. But, it seems that the British clause was only required as far as natural resources, particularly oil, are concerned." A brief description of the incident which led to the introduction of this clause may help to clarify the situation.

In the early 1920s, Major Frank Holmes (a New Zealander), representing the Eastern and General Syndicate (EGS), obtained an oil concession from the Sheikh of Kuwait.[1] Having secured the concession, Holmes then attempted to sell it to the British company, APOC. However, APOC declined the offer and proceeded to apply for a concession on an exclusive basis. Meanwhile, Holmes had offered the concession to an American company, the Gulf Oil Corporation, which had expressed an interest in acquiring it by November 1927. The Sheikh was apparently willing to transfer the concession to the American company, but the British Colonial Office interrupted the negotiations and insisted upon including a new clause in the concession, later to be known as the "British Nationality Clause" (Shwadran 1973: 407).

[1] EGS had originally been established in London in 1920 by Janson and Holmes, together with a few other engineers. The syndicate's best negotiator and representative was Holmes who, in 1921, set out for the Persian Gulf to obtain oil concessions (Al Ebraheem 1975: 78). It should be noted that EGS did not have the requisite funds for oil exploration. Its primary purpose was to purchase oil concessions in the Middle East in order to sell them at a profit to companies capable of operating in the concession area. The success of groups such as EGS could have had an indirect impact on Kuwait's foreign investment policies with regard to commercial agents if they had been allowed to operate as they were originally incorporated. (See Chapter 5 on how commercial agents are now regulated in Kuwait.)

3.1.3 The British Nationality Clause versus the American Open Policy

The new Sheikh Ahmad (who succeeded Mubarak) saw the competition between APOC and EGS as an opportunity to weaken British influence in Kuwait and to gain some freedom to formulate policies without interference. His negotiating strategy was to let the two aggressive British competitors bid against each other. This proved successful in the sense that it helped to guarantee the best possible concession terms for Kuwait and to strengthen the Sheikh's political position (OPEC *Bulletin* 1988: 26-27). However, the strategy failed to remove the limits on his policy formulation powers since the British Nationality Clause remained in force.

Interestingly, a similar clause was removed from a concession EGS had obtained in Bahrain in 1929. Consequently, Holmes anticipated that the British would act in the same way in Kuwait, but this did not happen. There is insufficient evidence conclusively to support any theory as to why Britain waived the application of the clause in Bahrain but not in Kuwait. Nonetheless, Khoujah and Sadler (1979: 20-21) suggest that the British attitude towards Gulf Oil in Kuwait was possibly due to an apprehension that the introduction of other foreign interests into Kuwait might lead to an anti-British rebellion. This was an apprehension which apparently did not extend to the situation in Bahrain.

Holmes persisted in his efforts to persuade the British Government to use the same provisions in Kuwait as those he had obtained in Bahrain (Al Khaususi 1983: 296). The draft agreement which Holmes discussed with Sheikh Ahmad and the political agent in Kuwait was sent by EGS to the British Colonial Office in August 1930.[1] On 31 January 1931 EGS received a letter from the Colonial Office stating that, according to the Secretary of State, the Sheikh of Kuwait was unwilling to grant a concession to any foreign corporation and would not sign an agreement without the British Nationality Clause (Chisholm 1975:36). Actually,

[1] EGS pointed out that it contained all the same provisions (including a substitution for the British Nationality Clause) which the Colonial Office had accepted in their Bahrain concession and which EGS was willing to accept in a Kuwait concession (Winston &Freeth 1972: 132). Although some writers seem impressed by the fact that Holmes did not conceal EGS's intention to assign the concession, if obtained, to American oil interests in the Gulf (Waheem 1982: 204), it is arguable that this transparency may have been irrelevant. Even if Holmes had concealed his intention to transfer the concession, Britain could still have vetoed any such move on the basis of the British Nationality Clause. Before discussing the matter further, the British Colonial Office replied that they had to confer with other relevant British Government offices and with their political resident in the Gulf. Finally, on 13 January 1931, after countless enquiries, EGS was informed that all of their observations had been noted and that they could expect a letter regarding a decision in a few days.

the Sheikh (who was more concerned with Kuwait's best interests than British interests) was waiting for Britain to waive this clause.[1]

As a result of British interference, Gulf Oil complained to the US State Department on 3 December 1931 about the problems presented by the British Government in this affair[2]. Following pressure from the American Secretary of State, Britain finally decided to waive the use of the British Nationality Clause in Kuwait. It is not entirely clear why the British were willing to do this. All that can be inferred is that Britain seemed unwilling openly to oppose the Americans on this matter (Shwadran 1973: 408-409).

Gulf Oil and APOC, the two competitors in Kuwait, subsequently attempted to reach an agreement in which the parties would split the oil concession on a fifty-fifty basis (Waheem 1982: 235). Rather than bidding against each other for the concession, the two companies agreed on 14 December 1933 to apply as one company. Their proposal read as follows: "Anglo- Persian and Gulf Oil have decided that it would be mutually advantageous for them to join together to secure a concession or concessions and to arrange for subsequent operations in Kuwait, in the best interest of both parties" (Mikdashi 1966: 81-82). Accordingly, APOC and Gulf Oil formed a joint venture with the Kuwait Oil Company (KOC), which had a capital of 50,000 pounds sterling split equally between the two partners. KOC was granted, for a period of 75 years, an oil concession which included the state of Kuwait, its islands (excluding Kubbar) and territorial waters (Mikdashi 1966:82).[3] With the waiving of the British Nationality Clause, Kuwait overcame the first obstacle to securing indigenous regulation of foreign investment without undue interference.[4]

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[1] The misrepresentation by the British Government of the Sheikh's intentions was a part of a deliberate plan to delay the efforts of Holmes, who was representing an American interest. This ploy was obvious to Holmes and his allies, and was confirmed in July 1931 when he received a letter from the Sheikh of Kuwait in which he plainly stated that he had not insisted on the inclusion of the British Nationality Clause in the concession agreement (Waheem 1982: 205), but that he had to remain loyal to the British Government. The Sheikh also stated in the same letter that, if the British government and EGS could come to some sort of compromise, then he would be willing to enter into further discussions with Holmes.

[2] Following the complaint by Gulf Oil, the US Secretary of State, Henry L. Stimson, promptly informed the American Chargep d'Affaires in London that he was to notify the British Government that, unless they altered their stand in this matter, Gulf Oil would be blocked in proceeding any further with the Kuwait oil concession. In his reply, the British Foreign Secretary, Sir John Simon, wrote to the American Ambassador on 9 September 1932 reiterating that the previous Sheikh of Kuwait, Sheikh Mubarak, had bound the country to seek British Government approval before granting oil concessions to any foreign agent (Waheem 1982: 220).

[3] For the full text of the KOC concession, see Appendix V.

[4] For more about the history of oil in Kuwait, see the following: Wayne Mineau, *The Go Devils* (London, Cassell, 1958), pp. 177-93; *The International Petroleum Cartel,* Staff Report of the Federal Trade

3.2 STAGE 2 : OIL CONCESSIONS - THE COMMENCEMENT OF THE REGULATION OF FOREIGN INVESTMENT (1932-1960)

After overcoming the British Nationality Clause in 1932,[1] Kuwait was faced with several problems: it was still subject to the 1899 protection treaty with Britain, and was in desperate need of revenue from foreign investment. However, Kuwait still had no specific legal framework to regulate or promote foreign investment. Thus, although the country now had greater freedom to determine its foreign investment policy, it was making decisions without clear directives or boundaries. Most of the oil concession agreements that were concluded at this time appear to have been dictated by expediency rather than by any clear strategies directed at ensuring Kuwait's economic future.

During this period, foreign investors in Kuwait could establish firms which were wholly foreign-owned (i.e. firms without Kuwaiti partners). These firms were established either through concession agreements between the Kuwaiti Government and the foreign firms or through the issuance of a Government licence. An example of this latter practice was the establishment of the British Bank of the Middle East in 1942 (Al Shammari 1980: 25-26). However, most agreements relating to the exploration and marketing of oil were in the form of concessions. Carlston (1958: 260) describes these concession agreements as a form of foreign investment according to which contractual arrangements, made between a host country and a foreign investor, specified the rules of conduct between the two parties for a specific period of time. Ultimately, the provisions of the concession allowed the foreign investor to explore for, and exploit, the mineral resources within an area of the host country. These agreements were the traditional legal means for obtaining the rights for oil exploration and production.

In general, oil concessions are contracts entered into by two parties: a host country which has oil reserves but which, to a large extent, lacks the necessary technology, finance or

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Commission submitted to the Subcommitee on Monopoly of the Select Committee of Small Business, United States Senate (Washington, United States Government Printing Office, 1952); Stephen Hemsley Longrigg, *Oil in the Middle East :It's Discovery and Development.* 2nd ed. (London, Oxford University Press, 1961); Harvey O'Connor, *The Empire of Oil.* (London, John Calder, 1956).

[1] On April 9, 1932, the British Government had agreed to allow Gulf Oil to enter into a joint venture with its company, the Anglo-Persian Oil Company.

marketing outlets, and a foreign oil company which has both the technology and the financial standing to explore and market the oil. The foreign oil company is usually given the right to the ownership of any oil discovered in return for specified royalties to be paid to the government granting the concession. The concession system was originally developed under British colonialism in the early 1900s and was supported by the powers which controlled the Arab world at that time. However, further examination of concession agreements reveals that their role in the development and use of mineral resources was more like that of a sovereign grant. The development usually involved large-scale projects which required considerable amounts of capital. Because of this, the foreign company holding the concession agreement was usually a large corporation with sufficient capital and know-how to deal with the various types of processing and international marketing which were required. Such corporations were usually incorporated in their mother country, which secured their legal personality and the power of contract to hold property rights.

Once the concession agreement system was established in the early 1900s, oil companies then formed joint-venture companies (in which several oil companies invested to form one representative company) and entered the Middle East in large numbers to apply for concessions. If they were successful, these companies then became the actual owners of the concessions. Some writers feel that the concession agreements were engineered to "rob" countries of their mineral resources (Alwan 1982: 36-45). But this argument is not entirely convincing as host countries could have regulated the activities of multinationals more rigorously had they wished to, for example by requiring local incorporation prior to securing a concession. Moreover, it can be argued that concession agreements provided a basis for the progressive development of the oil industry in the Middle East.

3.2.1 Features of the Oil Concession Agreements

Oil concessions were of an economic nature in the sense that any nation granting concessions hopes to promote the discovery and development of its oil resources, thereby contributing to their own national economic development (Sayegh 1968: 31).[1] While the terms of concession

[1] It should be noted that the traditional concession agreement has now given way to more modern forms of

agreements will almost certainly differ according to the host country involved and the particular time when they are signed, certain common elements can be identified in the concessions concluded during the first half of this century: duration, territory, payment, the obligations and liabilities of the oil company, and the scope of their rights (Stevens 1976: 3).

The first element - the duration of concession agreements - has varied widely and at one time extended to as long as 90 years (Abdullah 1970: 252). In Kuwait the longest duration of an oil concession is now 92 years, which was granted to the KOC and is due to expire in the year 2026 (Stevens 1976: 9).

The second common element is the provision made for the territory or area covered by the concession agreement. For example, in the KOC concession, the area included was the whole territory of Kuwait. However, foreign companies retain the rights of eminent domain, which guarantee that their operations will not be disturbed by property disputes with the Government (Sayegh 1968:31).

The third element is the consideration given to the host country by the foreign investor. The terms of payment differ from one agreement to the other but are usually based on a percentage of the actual amount of oil produced. As oil production increased, companies often had to re-negotiate with the host country, a process which often resulted in increased revenues being paid to the country (Stevens 1976: 3-4).

The fourth element is the scope of the rights given to the companies concerning their development of a particular area (Stevens 1976: 4). Companies often proceeded with oil exploration activities at their own risk on the understanding that if they did not strike oil, they would receive no reimbursement of their exploration costs. For instance, it took the American Independent Oil Company (AMINOIL) nearly six years of drilling before it discovered any oil. Between 1949 and 1953, before finally striking oil in Wafra, AMINOIL drilled five dry wells (Winston and Freeth 1972: 181), and commercial production from the Neutral Zone did not begin until 1953 (Lenczowski 1960: 22). However, if successful, companies could market and sell the oil as they liked, as long as they paid the agreed royalties to the Government. Under these conditions, foreign investors often had total control over the

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contract.

exploration, refining and sale of the oil abroad and, in addition, the local distribution of these oil products.

The final feature of these concessions was the stress on the social responsibilities to be assumed by the foreign investors in terms of employing and training Kuwaitis, thereby assisting in the overall development of the country.

An examination of these common features reveals gaps caused by Kuwait's failure to regulate foreign investments in terms which would have enhanced the country's own economic development. Nevertheless, due to the growing international demand for oil, the improved negotiation abilities of emerging independent oil states and the formation of cartels by the oil producers, Kuwait was eventually able to introduce better regulations and new concepts into oil concessions negotiated in the second half of this century. Such new terms included: profit-sharing; relinquishment provisions which allowed companies to return undeveloped areas to the Government; permitting the host country to participate by purchasing shares in the foreign company; granting concessions to explore the country's extraterrestrial (sea) areas; the passing of petroleum laws by the host country; and the establishment of national oil companies (for instance, the Kuwait National Oil Company), international oil agencies (like OPEC) and other entities interested in strengthening the rights of countries whose financial stability depends on oil production (El Ebraheem 1975: 97). In view of all these developments, it became obvious that in order to maximise its oil revenues, the Kuwaiti Government had an urgent need for knowledgeable negotiators in the fields of law, finance, industry and international economics (Al Sabah 1980: 40).

3.2.2 Oil Concessions and the Concept of Economic Development Agreements

It has been argued that contractual agreements with other nations, such as the oil concessions (which until recently have formed the main mode of regulating foreign investment in Kuwait), fall under a distinctive classification known as Economic Development Agreements (EDAs). This position has been proposed in both the academic literature[1] and in some arbitration

[1] See, for example, McNair, "The General Principles of Law Recognised by Civilised Nations", *British*

awards.[1] The argument is that these agreements possess certain characteristics which distinguish them from other state or private contracts.

Essentially, EDAs are supposed to be long-term contracts between developing countries and foreign, private companies incorporated abroad. They often involve the exploitation of natural resources of the host state (MacNair 1957: 3-4) and thereby contribute to the development of the host country through substantial investments and technical assistance (Dupuy in the Texaco case, 53, *ILR*, 389, at 456 and MacNair 1957: 3). They also tend to make provision for the settlement of disputes by means of international arbitration. Another common feature is the insertion of stabilisation clauses which provide that states cannot unilaterally terminate or modify contracts.[2] Proponents of this position argue that given the characteristics highlighted above, EDAs are peculiar in that governments cannot, and should not, be permitted to terminate the contracts unilaterally in so far as they have been internationalised.

These arguments are not wholly convincing because exactly the same principles could be applied to cases where the host nations are developed economies. While it is reasonable to expect the investments of private companies in developing states to be subject to contractual guarantees, there is nothing that distinguishes concessions in these states from those in developed economies. Whether the host state is a developing or a developed economy, the company concerned brings substantial investment and know-how in order to exploit natural resources and it thereby contributes to the economic development of the host country. Again, Professor Dupuy's argument that the EDA classification is necessary in order to provide a

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Yearbook of International Law, 33 (1957), p. 1, at pp.1-4; Bourquin, "Arbitration and Economic Development Agreements", *The Business Lawyer*, 15 (1959-60), p.860 at 860-1; Ray, "Some Reasons for the Binding Force of Development Contracts between States and Foreign Nationals," *The Business Lawyer*, 16 (1960-61), p. 942; Ray Jr., "The Law Governing Contracts between States and Foreign Nationals", *Proceedings of the Institute of Private Investments Abroad* (1961), p.5, at pp.13-18; Verdross, "Quasi-International Agreements and International Economic Transactions", *Yearbook of World Affairs*, 18 (1964), p. 230 at p. 233; Hyde, "Economic Development Agreements", *Receuil Des Cours*, 105 (1960-1), at pp. 282-283; Curtis, "The Legal Security of Economic Development Agreements", *Harvard International Law Journal*, 29 (1988), p.316.

[1] See Texaco Overseas Petroleum Company/California Asiatic Oil Company v. Government of Libyan Arabic Republic, 53 *ILR*, 389, at 455-457; Revere Copper and Brass Inc. v. Overseas Private Investment Corporation, 56, *ILR*, 258, at 271-2.

[2] See the Texaco case (53, *ILR*, 389 at 423) where the stabilisation clause reads as follows: "The Government of Libya will take all steps necessary to ensure that the Company enjoys all the rights conferred by the Concession. The contractual rights expressly created by this concession cannot be altered except by the mutual consent of the parties."

guarantee against legislative uncertainties in host countries (53, *ILR*, 389, at 456) is equally applicable to oil concessions in developed economies. It has been rightly pointed out that as developed economies have the right to terminate and vary their contracts, the sanctity of EDAs is questionable (Bowett 1988: 49-51).

Furthermore, Dr Pogany (1992: 20-41) has shown that the notion of EDAs has not been upheld in state practice or in arbitral awards on a consistent basis. It has been suggested, however, that stabilisation clauses may be enforced to prevent states from terminating contracts unilaterally where they have been concluded for a relatively short period of time.

3.2.3 A Comparison of Four Multinational Concessions

The concessions given to four companies - KOC Limited (See Appendix V for the full text of the agreement),[1] AMINOIL Limited (see Appendix VI),[2] AOC Limited (see Appendix VII)[3] and the Kuwait Shell Oil Company Limited (see AppendixVIII)[4] - will be used here to

[1] In 1934 the Anglo-Persian Oil Company (known today as British Petroleum) and the Gulf Oil Company joined together to form KOC Limited (Kuwaiti Oil Company) (Bergendahl 1985: 4). In the same year, the company was granted a 75-year concession encompassing all of Kuwait, most of its islands and its waters (Mustafa 1969: 17). Today, British Petroleum and Gulf Oil share equally in this concession (El Mallakh 1968: 39). KOC was registered in Britain under the British Company Law of 1929 (Shugair and Thahab 1960: 93) with a capital of 50,000 pounds sterling, equally owned by the two parent companies, and currently acts as an agent of the parent companies (Mustafa 1969: 17).

[2] Rights of oil exploration, investment and utilisation were decreed in 1946 by the state of Kuwait and granted to the highest bidder. In 1948 Kuwait began investing in the Neutral Zone (the area located between Kuwait and Saudi Arabia). Due to its outstanding bid for this area, AMINOIL gained the concession in 1948 (Kalaji 1975: 204). AMINOIL was jointly owned by eight US firms, the primary shareholders being Phillips Petroleum Company and Signal Oil and Gas Company (El Mallakh 1968: 43). The exact breakdown of AMINOIL ownership is:

Phillips Petroleum Company, 37.34%;
Signal Oil and Gas Company, 33.57%;
Ashland Oil and Refining Company, 14.13%;
James S. Abercrombie, 7.07%;
Sunary Mid-Continent Oil Company, 2.94%;
Lario Oil and Gas Company, 1.77%;
Globe Oil and Refining Company, 1.77%;
Pauley Petroleum, 1.41%. (*Twenty Years in Kuwait*: 2)

AMINOIL and Getty Oil Company, both American companies, operate a joint concession in the Neutral Zone. Getty Oil operates on behalf of Saudi Arabia and AMINOIL on behalf of Kuwait. The royalties from the Neutral Zone are combined and divided equally between the two countries (Fenelon, No date: 39). In September 1949, the area of the Neutral Zone concession was increased to include the islands of Khobar, Qaru and Umm Al Maradim and their respective territorial waters (*Al Wattan* , 5 May 1986: 8).

[3] The Arabian Oil Company, an operating subsidiary of the Japan Trading Company, which is a conglomerate of some 60 Japanese firms, was granted a 44-year oil concession covering Kuwait's half of the offshore interests in the Neutral Zone on 5 July 1958 (El Mallakh 1968: 44). The Kuwait Government acquired 10% of the shares in AOC (Bergendahl 1985: 5).

[4] By the early 1960s, eight companies had applied to Kuwait for the concession covering Kuwait's coastline. In 1961, the Kuwait Shell Petroleum Development Company Limited, a subsidiary of Royal Dutch Shell (Shwadran 1973: 419) was granted the concession for a period of 45 years (*Al Wattan*, 5 May 1986, p.8).

illustrate and analyse the common features of Kuwaiti oil concessions as outlined above. Each main feature will be discussed in turn. The comparison of the four examples is valuable in that it demonstrates Kuwait's growing experience with financial negotiation and changes in its attitude towards foreign investment.

Duration

The duration of each concession has varied from company to company, with KOC having the longest period of time. It was usual for concessions to be granted for periods of 25 to 30 years, but KOC was granted a concession for 75 years (Husain 1980: 46). In 1951 the concession was amended and extended for a further 17 years to 2026 (Al Mallakh 1968:39).

Territory/Area

The area granted in the concessions to the various companies has shown considerable variation. The KOC's initial concession covered most of Kuwait, all of its islands and its waters (OPEC document 1974: 117). But in 1962 the concession was amended, with KOC agreeing to surrender 3,961 square miles, more than half of its original concession area (El Mallakh 1968: 39).

AMINOIL's concession included territory in the Neutral Zone (the area located between Kuwait and Saudi Arabia), which in September 1949 was extended to include the islands of Khobar, Qaru and Umm Al Maradim and their respective territorial waters (*Al Wattan,* 5 May 1986: 8).

AOC's concession covers half of Kuwait's Neutral Zone offshore area (over which both Saudi Arabia and Kuwait have rights) as well as the waters connected to, and extending away from, the islands of Waru and Umm Al Maradim (Article 1 of the 1958 Agreement, *Kuwait Al Yum*, 13 July 1958: 81).

Finally, the Kuwait Shell Oil Company's concession extended to the exploration of the seabed and subsoil of the waters and all of the islands belonging to Kuwait, with the exception of those islands (covering 1,500 square miles offshore) on the continental shelf (Schurr and Homan 1971:133).

Royalties and Fees

As specified in Article 3 of the 1934 agreement with KOC, Kuwait was given an initial payment of Rs. 470,000, an annual rent of Rs. 95,000 and royalties of Rs. 3 per ton, and a minimum annual royalty of Rs. 250,000. Taxation was exempted by a payment of 4 annas per ton. Kuwait soon discovered that the royalty paid by KOC was very low when compared to the royalties paid by other concessions at that time (Mansfield 1990: 39). Until 1950, in other host countries payments were much higher than those paid to Kuwait (Mikdashi 1966: 82). Royalties of US$ 0.13 (13 cents) per barrel paid to Kuwait were about 10 cents less per barrel compared to the royalties paid to Iran, Iraq and Saudi Arabia between the years 1946 and 1949. This difference was due to the fact that Kuwaiti royalties were paid in Indian rupees, which, unlike other currencies, were not guaranteed by gold. This rate decreased even more in 1949 to 9 cents per barrel, due to the depreciation of the pound sterling (Mansfield 1990: 39). Consequently, Kuwait re-negotiated to increase its royalties from KOC. A fifty-fifty payment agreement was applied, which paid Kuwait royalties equal to half of KOC's profits from the export of Kuwaiti oil (Crystal 1992: 40).[1]

Having learned a lesson from its agreement with KOC, the Kuwaiti Government negotiated better terms for its concession with AMINOIL in 1948. The company agreed to pay Kuwait an initial payment of US$ 7.5 million and an annual rent of US$ 625,000. Additionally, royalties were to be paid at a rate of US$ 2.5 per ton, and Kuwait retained the right to one-eighth of any profits from local production and refining (Winston and Freeth 1972: 180).

Favourable terms were negotiated with the AOC, which agreed to pay Kuwait an annual rental fee of US$ 1.5 million before the discovery of oil and another million dollars each year after the discovery of oil, as well as a bonus of five million dollars when the production of crude oil reached 50,000 barrels per day. There was also a royalty, calculated on 20 per cent of the posted price for every barrel of oil, as well as for every barrel of natural

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[1] In 1949 Kuwait's future income from this concession was calculated to be £3,000,000,000. Under the 50-50 profit sharing scheme, it was suggested that this figure should have been £50,000,000,000. This demonstrates the unfavourable terms that Kuwait had been subject to in the previous period.

gas and natural asphalt, which were calculated together (Articles 6 and 7 of the 1958 Agreement). The Government of Kuwait also received 10 per cent of the shares in the company in exchange for refining obligations if oil was found in commercial quantities, and provision for the future relinquishment of parts of the concession area.

The Kuwait Shell Oil Company agreed to make Kuwait an initial payment of 7 million pounds sterling (Article 5/A of the 1961 Agreement), and when the net production reached a daily average (over a 30-day period) of 200,000 barrels, an added bonus of 4 million pounds sterling was to be paid (Article 5/C of the 1961 Agreement). The company also agreed to an annual rental fee of 1 million pounds sterling until oil was discovered in commercial quantities, after which a fee of 2 million pounds sterling was to be paid until the commencement of exports (Article 5 of the 1961 Agreement). The Government could take some or all of its 12.5 per cent royalty at one time (Articles 5 and 9 of the 1961 Agreement), and utilise, free of charge, all of the natural gas not used by the company (Article 18 of the 1961 Agreement). After the discovery of oil, the Government would be allowed to purchase a maximum of 20 per cent of the company's shares (Article 23 of the 1961 Agreement). Furthermore, at specific intervals after the discovery of oil, 20 per cent of the unused area was to be returned to the Government (Article 10 of the 1961 Agreement). Additionally, the Government's total income should not fall below 50 per cent of the total oil profits for any given year. If this happened, the company would provide compensation for this deficit by remitting a so-called "make-up payment" to Kuwait (Article 6 of the 1961 Agreement). Kuwait was also guaranteed 57 per cent of the company's oil profits, which was high compared to the usual rate of 50 per cent (Article 50 of the 1958 Agreement; Al Khaususi 1983: 375).

The agreement with the Kuwait Shell Oil Company featured some conditions which were very favourable to Kuwait, possibly because it was signed after Kuwait had gained independence and acquired better negotiating skills. The agreement provided for Kuwaiti participation in the ownership of the company, and gave the Kuwaiti Government the right to buy 20 per cent of the company's shares, with the stipulation that this right must be exercised within 90 days of the discovery of crude oil. The Kuwait Government was also given the

right to appoint one member to the Board of Directors. But if the Government exercised its right to buy 20 per cent of the shares, it could nominate more members to the Board, according to its share in the company ownership (Article 23 of the 1961 Agreement). Furthermore, the company was obliged to use Kuwaiti ports and oil tankers as much as possible, provided that their fees were competitive and appropriate (Article 11 of the 1961 Agreement).

This concession contained another feature which transformed it into a partnership agreement. According to Article 23, after the discovery of oil, the Government of Kuwait was entitled to acquire a 20 per cent interest in the company, and could either take control of 20 per cent of the oil produced or have it marketed through Shell's commercial channels. This was the first time that one of the major international oil companies had entered into such an agreement, thus giving Kuwait genuine partnership status (Schurr and Homan 1971:133).

The Scope of Rights Granted

The scope of rights granted has also varied, with strong evidence of significant gaps in income-generation and promotional measures. For instance, KOC received the exclusive right to explore and produce crude petroleum and its products, as well as the exclusive ownership of the petroleum and the right to do whatever was necessary to carry out the company's operations (Article 1 of the KOC concessions of 1934). It was later discovered that this provision left one of the joint venture partners in KOC-APOC with considerable discretion, in that APOC was allowed to supply for the Gulf oil's requirements using reserves from its concessions in Persia without having to produce any oil in Kuwait (Mikdashi, 1966: 82). This gave APOC great flexibility in its Persian Gulf operations (Al Ebraheem 1975:91-92). Whenever political or economic pressure intensified, APOC would increase its production of Persian oil, thus reducing Kuwait's oil production and still meeting the requirements of its partner, the Gulf Oil Company (El Mallakh 1968: 40). This APOC practice reduced the company's responsibility for finding markets for Kuwait's oil (Mikdashi 1966: 82). APOC was also free to import or export material without being subject to customs or taxation, and it did not have to pay taxes for the facilities inside Kuwait (Al Khaususi 1983: 326).

Similarly, AMINOIL's concession included the exclusive rights of exploration and production of natural gas, crude petroleum and their products (Article 1 of the 1948 Agreement; Al Alam 1978: 259). AOC was also granted exclusive rights of exploration and production of petroleum, and the ownership of all petroleum produced and of any operations related to it. The company agreed to take into consideration previous rights granted to other companies with regard to these territories before exercising their own rights (Article 1 of the 1958 Agreement; *Kuwait Al Youm*, 13 July 1958: 181). But as a result of its increased experience in oil concession negotiations, the Government of Kuwait concluded an excellent deal with AOC when compared to the concessions granted to KOC and AMINOIL (Al Sabah 1980). The better terms could also have been prompted by the fact that AOC was prepared to review the agreement if any other country in the Middle East received a percentage of profit higher than that provided for in the agreement (Article 38 of the 1958 Agreement).

The Kuwaiti Government received 10 per cent of AOC shares and was eligible to purchase further shares in the company after the discovery of oil (Article 12 of the 1958 Agreement). In addition, AOC agreed to use, as often as possible, oil tankers owned by Kuwaiti nationals, provided that their prices were reasonably competitive with those of oil tankers of foreign origin (Article 14 of the 1958 Agreement). The company further agreed that its expatriate employees would live and work according to Kuwaiti laws, and that it would respect Kuwait's rights and authority. The Government for its part reserved the right to deport any company employee not respecting these rights (Article 31 of the 1958 Agreement).

Like the other companies, the Kuwait Shell Oil Company had the exclusive rights of exploration and production of petroleum and the ownership of all petroleum produced (Article 1 of the 1961 Agreement; *Kuwait Al Yum*, No. 311, 22 January1961). It was allowed to carry out research and engage in the exploration and production of oil from the concession areas. It also held the right to refine, transport, transfer and sell oil for local consumption in Kuwait, and export oil outside of Kuwait (Ashoush and Bakhashab 1990: 17). Although the Kuwait Shell Oil concession was granted in 1961, it followed the policy of the pre-1960 era, when there was no requirement for majority Kuwaiti participation.[1] Given these conditions, it

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[1] See sections 3.3 and 3.4 which follow.

is arguable whether the Kuwaiti Shell Oil Company concession of 1961 was a violation of the spirit and letter of the Kuwait Commercial Company Law No. 15 of 1960 (Al Shammari 1980: 38).

The Settlement of Disputes

The arbitration clause of the KOC agreement contained a unique provision which is indicative of the British political influence over Kuwait when the concession was granted. Article 18 of the agreement stated that:

> If at any time during the currency of this Agreement any difference or dispute shall arise between the parties hereto concerning the interpretation or execution hereof, or anything herein contained or in connection herewith, or the rights or liabilities of either party hereunder, the same shall, failing any agreement to settle it in any other way, or after consultation with the British Political Agent in Kuwait or the British Political Resident in the Persian Gulf, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee, who shall be chosen by the arbitrators before proceeding to arbitration.

In essence, this article required the Kuwaiti Government to consult either the British political agent in Kuwait or the British political resident in the Persian Gulf prior to referring a dispute to arbitration.[1] Additionally, the British representative was given the power to appoint a referee if the disputants failed to agree on the appointee. He also had the right to decide the place of arbitration in London if the parties could not agree on an alternative location. It was also agreed that the English version of the agreement would be regarded as the authoritative one in the event that there was any disagreement over translation,[2] indicating the British influence.

All this is in contrast to the arbitration clauses in the concessions granted to AMINOIL, AOC, and the Kuwait Shell Petroleum Development Company, which provided that any dispute which might arise between the Government and the concessionaire should be

[1] Article 31 of the Saudi Arabia-Standard of California contract provides an almost identical procedure for settling disputes. The only significant variation is the provision for place of arbitration. If the parties do not agree on the place of arbitration, then it is agreed that the meeting should be at The Hague, in the Netherlands.
[2] For more about the KOC agreement see Samir Shamma, *The Oil of Kuwait: Present and Future,* 1959, pp. 7-16.

solved immediately through arbitration.[1] Accordingly, when the Government of Kuwait took over AMINOIL's local interests in 1977[2], the company claimed that this nationalisation was illegal according to international law. The dispute was therefore taken to arbitration and the AMINOIL case against Kuwait was settled by an award to AMINOIL in March 1982 (Amin 1991: 207).[3]

Social Obligations

Foreign investors in the oil sector have been obliged to employ and train Kuwaitis. For instance, KOC agreed to this condition, but it was understood that, if there were not enough Kuwaitis available for employment or if they were unsuitable, the company would be allowed to import labour from neighbouring Arab countries. The company also had the right to hire expatriate skilled and technical employees. In 1958 Arab nationals made up about 10 per cent of the total manpower of KOC (Shamma 1959: 34-35), representing a majority of the company's unskilled manpower, while Indians and Pakistanis, employed in administrative jobs, made up about 40 per cent of the total. Although the company was owned equally by the Americans and the British, its work force included only 5 per cent American expatriates compared with 50 per cent British workers. Due to its association with British Petroleum, the management of KOC was completely British (O'Knor 1967: 436). The company also agreed to provide free medical services for its employees (OPEC Document, 1974: 121). Furthermore, British Petroleum and Gulf Oil were to contribute 45,000 pounds sterling per year to fund the costs of educating Kuwaiti students studying abroad. This amount was later increased to 150,000 pounds sterling (Al Alam 1978: 158).

In addition to the preferential employment policy for Kuwaitis, AMINOIL also undertook to construct, within four years of discovering oil, a dispensary and a 30-bed

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[1] For more details about the settlement of disputes in Kuwait see Chapter 10.

[2] For a detailed analysis of the AMINOIL case see, for example, F.A. Mann (1983), "The AMINOIL Arbitration", *54 BYIL* 23, and Lloyds Arbitration Reports (1983), "The Government of the State of Kuwait and the American Independent Oil Company (AMINOIL)", ICSID Arbitration 24 March 1982, *LAR* 1983, 143.

[3] The arbitral tribunal commented on the Arbitration Agreement that Kuwait is "a sovereign state entrusted with the interests of a national community, the law of which constitutes an essential part of intra community relations within the state."

hospital devoted to the treatment of tuberculosis and other diseases. The company also agreed to provide financial assistance to Kuwaiti nationals so that they could attend their choice of institutions of higher learning, a scheme supervised by the Government of Kuwait and the company (Article 8 of the 1948 Agreement).

AOC agreed to ensure that 70 per cent of its workers inside the Kuwait Neutral Zone, and 30 per cent of its workers outside the zone, were Kuwaiti nationals. If the number of Kuwaiti nationals available for hire was not sufficient to achieve this quota, the company then had the right to hire foreigners with preference being given to other Arab nationals. The company also had the right to hire skilled and technical expatriates (Article 1A of the 1958 Agreement). In addition, AOC also agreed to provide a specialised training programme related to all facets of the oil industry, particularly at the supervisory and directorial levels, for its Kuwaiti employees (Article 1B of the 1958 Agreement). Free medical services would be provided to the company's employees and to other Government employees working within the concession area (Article 21C of the 1958 Agreement). The company was also responsible for the offices and housing of its permanent staff, including representatives, policemen, postmen, health and telecommunications personnel. The company was obliged to employ Kuwaiti personnel to be responsible for the care and maintenance of these accommodations, mosques, streets and other facilities (Article 27 of the 1958 Agreement). When the production level of crude oil reached 30,000 barrels per day, the company agreed to construct and maintain a scientific institute whose goal would be to study, explore and improve Kuwait's natural resources (Article 40 of the 1958 Agreement). Finally, Kuwait was allowed to appoint its nationals to occupy one-sixth of the company's purchasing committee (Article 19 of the 1958 Agreement).

The Kuwait Shell Oil Company agreed to recruit and train Kuwaiti employees for all management and operational positions, and to ensure that 70 per cent of its employees were Kuwaiti. If the local supply of Kuwaiti labour was inadequate, the company was allowed to import labour with preference being given to other Arab nationals. The company undertook to make sure that 90 per cent of its employees would be from either Kuwait or other Arab countries. The company was allowed to import only skilled and technical expatriate

employees (Article 15/3 of the 1961 Agreement), and also agreed to give preference to the employment of reasonably priced, qualified Kuwaiti contractors (Article 15/5 of the 1961 Agreement). Once oil was discovered, the company agreed to work with the Kuwaiti Government to prepare a special higher-education programme for the benefit of the children of Kuwaiti employees. When the export of oil began, the company would then implement the programme and would revise it each year. Annually, the number of employees taking advantage of this programme could not be less than 15 per cent of the total number of non-Arab staff employed by the company. In the event that there were not enough eligible Kuwaitis in the company, this programme would then be used to benefit non-Kuwaiti Arabs employed by the Kuwait Shell Oil Company or children studying in Kuwaiti secondary and industrial schools (Article 16 of the 1961 Agreement).

3.3 STAGE THREE (1960 TO THE PRESENT) : POST-INDEPENDENCE REGULATIONS GOVERNING FDI

This section is concerned with regulatory change in the years since Kuwait's independence, but the importance of the formative historical background to independence must be stressed. Kuwait was mainly a merchant nation before oil was discovered, and therefore at this time the level of foreign investment in Kuwait was negligible; hence the need to regulate foreign investors was not paramount. The growth in the level of oil revenues arising from increased royalties and foreign participation led to a rise in the amount of foreign investment coming into Kuwait. After independence, the Kuwaiti Government decided to introduce a series of foreign investment regulations, and this period saw a series of reactionary measures. Kuwait, like many other developing nations, feared that foreign control of businesses and natural resources would hinder its economic development. Therefore, laws were introduced which ensured that commercial operations remained under Kuwaiti control, regardless of whether or not this was in the best economic interests of the country. Some of the major regulations are discussed in detail in subsequent chapters; hence only a summary will be given below in order to provide an overview of Kuwait's emerging legal regime. First, the influence of Islamic Law must be explained.

3.3.1 The Influence of Islamic Law

Kuwait's commercial activities were originally governed by social norms and the traditions of the merchants, as well as by the rules of Islamic *Shari'a* law. (Al-Okaily 1988: 40). However, between 1921 and 1938,[1] a series of economic, social and legal reforms were enacted.[2] The most important of these was the *Majallat Al-Ahkam Al-Adliah* or the Journal of Rules of Justice.

In 1938 Kuwait's first legislative council issued a decree remedying legal shortcomings which had been the subject of complaints and conflicting decisions being issued by Kuwaiti courts. The decision was made to apply the *Majallat Al-Ahkam Al-Adliah* for this purpose (Al Shammari 1987: 30). However, the rules specified in the *Majallatt*concurred with those found in the *Shari'a* and did not differentiate between commercial and civil laws (Al-Masri 1992: 43). This situation arose from the fact that the *Majallat* was based on the laws of the same school of Islamic thought, the *Hanafi.* [3] Nevertheless, Kuwait's economy developed steadily after World War II due to the discovery of oil resources (which were exported for the first time to Britain in 1946). Thus economic and human resources increased, leading to more diverse political and business dealings (Abdel-Reda 1991: 270). In time it became clear that the provisions found in the *Majallat,* especially those regarding foreign investment, were not suitable for use in modern international business relations (Al Shammari 1987: 40).

[1] In 1921 a 12-member council was formed and chaired by the Ruler, who was present at all meetings and consulted about important issues. Administrative councils were established along with the Advisory Council due to the needs of social, economic and cultural development. Expansion in the city and the growth in population made it necessary to enhance municipal, educational and health services. Special departments were then introduced to facilitate necessary utilities (AbdulReda 1991: 268).

[2] For more detail on Kuwait's political system, see Chapter 2.

[3] The most important features of the magazine were:

(a) It did not tackle cases of personal statues - marriage, divorce and alimony; nor did it discuss heritage, wills and *waafs*. Consequently, the Maleki school was applied in such cases.

(b) The Magazine comprised 1851 articles, divided into an introduction and 16 books, namely: sales, rentals, suretyship, assignment, mortgage, deposition trust, donation, usurpation, damage, interdiction, duress. pre-emption, partnership, procuration, conciliation, acquittal, acknowledgement, lawsuits, evidences and oath taking, and administration of the law.

(c) The most important criticism levelled at the Magazine concerns the excessive definitions and examples. Some of the definitions were even naive (e.g. a seller is he who sells; a buyer is he who buys). (Abdel Reda, Abdel Rasoul 1991: 270)

Gradually, regulations which met the demands of modern commerce were introduced. The first of these was Decree No. 3, issued in 1955, which imposed income taxes on corporations operating in Kuwait, whether they operated directly or through an agent, and regardless of where they were incorporated (Article 1 of Decree No. 3 of 1955). Tax rates were fixed as a percentage of the total profits for a specified tax period. The Kuwait Judicature Law No. 19 of 1959 later established "lay" courts with jurisdiction even in personal affairs. This is emphasised in the Commentary to the Law. In the case of a Muslim, the school of Imam Malik is applied in personal affairs cases and the *Majallat* (the old Ottoman Civil Code) continues to be prescribed in civil matters. However, the 1959 Commentary went on to point out the need for basic legislation to stand beside the Islamic principles and provisions of the *Majallat.* The promulgation of modern codes of procedure, criminal law, and commerce quickly followed, including an excellent *Conflict of Laws Code*. Following this, the Commercial Code, Law No. 2 of 1961, based on Egyptian/French principles, was introduced. Finally, the Kuwait Law of Civil Wrongs, Law No. 6 of 1961 (as amended by Law No. 42 of 1961), based on principles of modern civil law, was also promulgated (Ballantyne 1979: 110-11).

A year before independence, Kuwait rejected some more specific Islamic rules pertaining to foreign laws, and on 12 May 1960 issued the Law of Commercial Companies, No. 15/1960 (Al Shammari 1987 : 45). Therefore, in the modern laws of Kuwait, the role of the Islamic *Shari'a* is virtually limited to matters of personal affairs or status (for example, inheritance, marriage, dower, etc.). (Ballantyne 1979: 111).

3.3.2 Underlying Objectives

Kuwait's economy is now heavily dependent on oil,[1] which is being depleted at a steady rate due to current levels of production and export. Kuwait began utilising its oil revenues in earnest in the early 1950s despite the fact that the amounts paid to the Government were not

[1] Oil revenues benefit the country directly through their contributions to Government revenues and national income, by supplying energy and through foreign exchange earnings. Additonally, the oil industry contributes by employing people, thereby ensuring a demand for local products. The indirect benefit to be gained through oil revenues comes from the use the Government makes of the income through investing in development.

very significant at that time. From the beginning, the Government insisted that the revenues must be applied directly for the development of the country, particularly in relation to infrastructure, including port facilities, electrical channels and water resources (Al Fahad Co. et al. 1982: 2).

The main question regarding oil revenues was whether or not Kuwait should invest the bulk of its revenues domestically or abroad. Since investing abroad generally results in higher rates of return over a shorter period of time, this has been regarded as the most promising policy (Gaylani 1977: 44). Before the Iraqi invasion of 2nd August 1990, Kuwait, with its surplus capital, did not feel a pressing need to attract foreign investment.[1] It did, however, recognise the importance of foreign investment as a means of attracting the necessary technological and managerial talent, and of enabling it to deal with international markets but under a regulated system (Bazarian and Fauerbach 1980: 128). Thus, today Kuwaiti economic policy is firmly grounded in the belief that the combination of Kuwaiti capital and the benefits of foreign technology and international experience can help the country to attain its long-term goal of industrialisation (El Zaim 1976: 143).

In keeping with this long-term goal, Kuwait has maintained oil production schedules limiting the exploitation of this resource in order to keep it profitable for as long a period as possible. So far, Kuwait has utilised its oil revenues in many different ways, with particular emphasis on the following:

- investing a large percentage of the revenues to benefit private sector companies established by the Government;
- founding public enterprises, to which KD 2.051 billion has been allocated;

[1] Following the Iraqi invasion, Kuwait's GDP fell sharply in 1990 and 1991. In order to stimulate economic recovery the Government has focused on rehabilitating the oil industry. But while these efforts have been surprisingly successful, oil revenues remain below prewar levels. The combination of declines in oil revenues and in investment income (due to a liquidation of foreign assets) has forced the Government to make difficult choices with regard to the economy. Accordingly, three priorities have been identified: the development of the oil industry, national defence, and the maintenance of living standards. While these measures will undoubtedly be of benefit to the nation's recovery, they also mean that the Government no longer has the means to assist the private sector. This is a reversal of previous Government policy, which used legal and financial measures to ensure that business enterprises prospered and remained in Kuwaiti ownership. For more about oil-based recovery after the Iraqui invasion, see "Kuwait: Oil-based Recovery to Continue in 1993", *Middle East Economics,* October 1992. And for the health and environmental impact of the invasion, refer to A.A. Shatti and S. Harrington, "The Environmental and Health Impact of the Kuwaiti Oil Fires", *Proceedings of an International Symposium held at the University of Birmingham*, 17 October 1991.

- making available money, KD 2.42 billion, which can be loaned to businesses inside Kuwait (of which approximately 25 per cent has been utilised);
- investing in underdeveloped countries in a spirit of economic and political co-operation

(*Journal* of *the Big Competition of the Islamic World* 1987: 41).

3.3.3 Foreign Investments and the Gulf Pact

With the large drop in oil prices in the early 1980s, and various other political and security developments in the late 1970s, the countries of the Arabian Gulf were determined to unite in defence of their common interests. Accordingly, the Unified Economic Agreement of the Co-operation Council of the Arabian Gulf Countries (also referred to as the GCC), of which Kuwait is a member, was formed in 1982 (see Appendix IX). This Agreement assured equal treatment for any citizen of the member countries living in another member country, particularly with regard to his or her commercial activities (*The Decision of the Ministry of Commerce and Industry*, No. 7/1988).

In 1986 a conference was held by the GCC in Vienna concerning "Industrial Investment in the Arab Gulf". The conference concluded that there was a need to make the investment climate of the countries more positive and balanced in order to attract foreign investment. It was noted that there was a need for a standard Gulf investment policy that would:

- resolve any existing irregularities;
- provide for the combining of both foreign and local capital in order to achieve the goals of the various countries;
- ensure the integration of foreign investment as an essential part of Gulf economy and society;
- locate and redesign any financial, legal and banking flaws existing in the current structures so as to allow foreign investors to invest in the Gulf with confidence

  (*Business International SA* 1986:1).

Pursuant to the Union Economic Agreement for the GCC, which Kuwait signed in 1982, Kuwait formed the Organised Legislations of Foreign Investments which gave GCC

citizens the right to purchase shares in Kuwaiti companies (Decree of Law No. 33/1988).[1] In March 1989, during the thirtieth session of the Ministerial Council of the GCC, Kuwait agreed to the Unified GCC Foreign Capital Investment Regulation. This was viewed as the first positive step towards encouraging the GCC countries to participate in raising foreign capital for industrial investment (Al-Sabah 1993: Memorandum No. AS-10/7/3252). However, the Regulation has not yet been introduced in all GCC countries, and it remains ineffective. Therefore, the Kuwaiti Government decided, in order for to compete in international financial sectors, to become a solid financial centre in its own right.

3.3.4 The Social Obligations of Foreign Investors

The present Government of Kuwait feels strongly that the oil being produced today also belongs to the next generation. Because of this concern, in 1971 it created "The Next Generation Reservation system", a fund which currently receives approximately 20 per cent of Kuwait's oil profits on the understanding that this money will be used in the future to replace oil revenues when the oil fields stop producing (*The Explanatory Memorandum of Law of the Next Generation Reservation* No. 106/1976). This policy is probably derived from the terms of oil concession agreements related to the social obligations of oil companies.

The Kuwait Investment Authority (KIA), which administers the fund, stresses that this is the first such fund to recognise that economic circumstances are bound to change and that the consequences must be faced. Since the fund is intended as a substitute for petroleum revenue, secure medium- to long-term investments are desired (Kuwait Investment Authority 1992: 2). The method used by KIA to secure such investments has been to attract foreign investors in enterprises of benefit to both the fund and the investor. Their goal is to manage the fund in order to secure the highest possible yield from national and international commercial investments (Kuwait Investment Authority 1992: 3-12).

The Government of Kuwait has also committed itself to broadening the economy by expanding both the private and Government commercial sectors. For the reasons which have

[1] See Appendix IX for the full text of this agreement.

already been stated, this is an eminently sensible policy. Accordingly, the Government set up the Counter-Trade Offset Programme[1] which has the following specific goals:

- to achieve those economic benefits that it is capable of achieving;
- to work with private companies to stimulate fresh investment opportunities within Kuwait;
- to assist the private sector by cultivating their technological skills;
- to better educate and train its citizens at all levels;
- to market local products abroad;
- to expand its Foreign Aid Programme by encouraging further community participation (Ministry of Finance 1994: 4).[2]

For contracts worth more than KD 1 million (US$3.37million), if contractors do not meet an eight-year time limit for fulfilling the offset obligation, a penalty will be levied (amounting to 6 per cent of the value of the contract). At the same time, the compliance interval can be extended for large projects. It is also provided that offsets with a high training or foreign aid content can take place abroad. Additionally, they can be carried out in the form of several smaller projects. There is also provision for the offset requirement to be met by investments by a third party, and credits earned through the early fulfilment of an obligation may be put towards future offset requirements.[3]

3.3.5 Constitutional Guarantees and Incentives

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[1] The Offset Programme requires that foreign companies having substantial supply contracts with the Kuwaiti Government must invest in Kuwaiti projects that are economically and technologically feasible. Kuwaiti investors are asked to study various investment projects and, if they are consistent with their own investment strategies, join into ventures with foreign businesses. Furthermore, in order to secure essential contributions in the area of investment, technology and management, foreign enterprises (or their local agents) are requested to invest approximately one-third of their supply contracts, onshore or offshore. As well, contractors are given an eight-year operating period, on the understanding that 50% of their debts must be repaid within the first four years (Counter Trade Offset Programme Executive Office 1994: 1-6).

[2] For more details about the Counter-Trade Offset Programme, see Chapter 7.

[3] The team responsible for overseeing the goals of this programme consists of representatives from the Ministry of Finance, the Central Bank of Kuwait, the Kuwait Foreign Trading Construction and Investment Company, the Kuwait Investment Authority and the Kuwait International Investment Company: they have all studied the experience of Saudi Arabia in these matters.

Foreign investors have been given certain constitutional incentives and guarantees[1] regarding their investments. These are extremely important in seeking to attract investors to Kuwait. The incentives and guarantees are based on declarations which establish the general principles on which the modern state of Kuwait is founded. Article 7 of the Constitution declares that Kuwaiti society is built on three beliefs: Freedom, Equality and Justice. Article 29 guarantees the right of personal freedom, and Article 30 recognises the equality of all people in terms of their rights and duties. Article 18 recognises private property and prohibits the violation of personal property by anyone, including the Government. If property is compulsorily acquired for public or similar use, it is promised that compensation will be paid within a year (UNCTAD Report 1988: 22). Article 19 goes even further in prohibiting the confiscation of property except by the judgement of a court of law, and only under certain circumstances (Articles 7, 18, 19, 29 and 30 of the Kuwait Constitution of 1962).[2]

In terms of local investment, Kuwait follows the rules of the Inter-Arab Investment Guarantee Corporation, seeking to ensure that individual Kuwaiti investors are protected against personal investment risks in other countries of the Arabian Gulf (Kuwait Investment Authority 1993: 2). In order to guarantee that there is no discrimination against Arab capital and to ensure that Arab investors have access to incentives, Kuwait became a member of the Arab Investment Convention of 1970 and is also a signatory to the Multilateral Investment Guarantee Agency (MIGA) agreement of February 1987 (Yuwakhim 1993: 1-3). Investors may also note that there are no limitations on the export of money made in Kuwait, and there are no regulations controlling foreign exchange transactions in the country (Kuwait Investment Authority 1993: 2). Thus, restrictions on repatriation, a feature of many developing economies which discourages foreign investors, are absent in Kuwait. However,

[1] Refer to Chapters 6, 8 and 9 respectively for more about the incentives and guarantees offered to foreign investors.

[2] There is no domestic law that clearly specifies the requirements for an expropriation move. However, Kuwait might still regard itself as being bound by an important international arbitration award of 1982. In this dispute, concerning the unilateral termination of a concession agreement with the US firm AMINOIL by the Kuwaiti Government, an international tribunal ruled that Kuwait had to pay an amount, specified by the arbiter, in compensation for this action (Karl 1993). The award in the matter, dated 24 March 1982, is reproduced in *International Legal Materials* 21(1982), p. 976.

there is no doubt that some investors see the social obligations required of them as a substitute for restrictions on repatriation.[1]

3.3.6 The Wives of Foreign Investors

The wives of investors or their employees do not automatically have the right to work in Kuwait. The Commercial Companies Law (CCL) states that a woman's right to engage in commerce is governed by the laws of her home country, and that she must have her husband's permission to work. This is a clear illustration of the influence of Islamic law in Kuwait. However, there is a presumption that a woman is authorised by her husband to work, so that a husband's refusal to permit his wife to engage in commerce is not effective or binding on third parties unless it is published publicly in the *Kuwait Gazette*. Furthermore, the presumption is that wives engaged in commerce have a legal personality that is distinct from that of their husbands. However, wives may be treated jointly with their husbands for financial purposes if the parties so wish, and if the agreement is published in the commercial register (Articles 24 and 25 of the Law of Commerce No. 2/1961).

3.4 THE PRESENT REGULATORY FRAMEWORK: RESTRICTIONS ON FOREIGN INVESTORS

The historical development of Kuwait's foreign investment regulations, and the major sources of those regulations, as outlined above, help us to understand the basis of the country's present regulatory framework. But the key issue is whether this framework, which has obviously developed unsystematically and without overall co-ordination and planning, is appropriate for the economic, social and political conditions of the present time. Since independence, Kuwait has maintained regulations which seek to protect and promote Kuwaiti participation and control of businesses. This aim may be applauded from many points of view, and it has certainly encouraged domestic investment in the economy. However, at the same time it has often served as a serious disincentive to foreign investment.

[1] For more details about this, see Chapter Six .

The problems began nearly forty years ago. The CCL No. 15/1960, which was passed in 1960, regulated the formation, operation and control of organisations belonging to companies operating in Kuwait (Diamond 1989: "Kuwait file" 1). The CCL restricted non-Kuwaitis from establishing businesses inside Kuwait without a Kuwaiti sponsor (Article 61 of Commercial Law 15/1960) and stated that the foreign share in the company must be maintained at a maximum of 49 per cent (GOIC 1986: 23). This 51/49 share ratio was a matter of public policy (_Al-Nazam Al-Aam_) (Al Masri 1992: 199-201) and was intended to confer authority in the company to the Kuwaiti partner (Abdulraheem 1975:171). Additionally, foreign companies could establish branches in Kuwait only if they had a Kuwaiti agent acting on their behalf (Article 180 of the Commercial Law 15/1960). In addition, foreign investors were required to have a Kuwaiti partner who controlled at least 51 per cent of the company's capital (Articles 1 and 2 of Law No. 32 of 1969 regulating licences for business premises).[1] These last two restrictions were intended to protect local businesses from losses arising due to competition from foreign parties, and to allow Kuwaitis to benefit from commercial endeavours (Al Melhem 1993: 4).[2] However, while these laws may have encouraged domestic investment, they may have actually discouraged foreign investors due to the stringent regulations requiring Kuwaiti participation and ownership of businesses operating in the country.

The 1961 Law of Commerce 2/61 was issued to deal with national and international commerce, and to correct any shortcomings found in previous commercial law (Al Okaily 1988: 41). However, it was generally unsuccessful and did not halt the pattern of preventing foreign owners of business ventures from operating in Kuwait. Like the law of 1960, this law also contained the provision that foreign investors could only hold up to 49 per cent of the capital of a company, but went further to add that after a few years the foreign investor would need to divest to a maximum of 25 per cent (Bazarian and Fauerbach 1980: 129).[3]

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[1]Conditions were attached to the licences of establishments dealing with foodstuffs or with dangerous items. Licences were issued to the owner of the establishment, and in the event that another person took over the business from the proper licensee, the new owner had to apply for a new licence in his own name (Webb and van Hoorn, Jr. 1988: 26).
[2] For more details about the main forms of business organisations see Chapter Five.
[3] In yet another move to protect Kuwaiti businesses, in 1964 Law No. 43 was issued to regulate the importation of goods. This decreed that only Kuwaiti nationals or their companies were allowed to register for

The inadequecy of the 1961 Law of Commerce can be seen in the fact that throughout the 1960s and 1970s there was a need to issue laws to cover commerical contingencies. The laws whose provisions, directly and indirectly, concern foreign investments in Kuwait are as follows:

- Law No. 4 of 1962 regarding patents, designs and industrial models
- Law No. 37 of 1964 regarding public tenders, and Order No. 5 of 1979 controlling the tenders of petroleum companies
- Law No. 43 of 1964, which governed the importation of goods by private Kuwaiti nationals and companies of which the majority of capital (51 per cent) was held by Kuwaitis
- Law No. 32 of 1968 regarding currency, the Central Bank of Kuwait and the regulation of the banking industry, as amended by Law No. 130 of 1977
- Law No. 32 of 1969, which controlled licences for business premises
- The Law of Social Security (Law No. 61 of 1976) and resulting Ministerial Orders Nos. 9, 10 and 13 of 1977
- Decree No. 10 of 1979 and Customs Law 1980 regarding trade, control and the fixing of commodity prices
- Law No. 28 of 1980, which enacted the Merchant Shipping Law

During the 1970s, Kuwait underwent a dramatic evolution, both socially and economically. Development could be seen in all walks of life, from the construction of buildings to social services, as well as in changes in living and consumption trends (Kuwait Central Bank 1979: 10-12). Due to these rapid changes, it became evident that the existing laws that continued to govern foreign investment needed amendment, particularly the Law of Commerce No. 2/1961. During the 18 years under the Law of Commerce No. 2/1961, the industry and banking sector in Kuwait witnessed many changes, and the provisions of the Law of Commerce 2/1961 were lacking in many of the areas needed to regulate the activities of the growing commercial and industrial sectors.[1] Therefore, in 1980 a series of laws were

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the importation of goods and material into the country. This meant that foreigners importing goods would have to employ a Kuwaiti agent who was registered for this purpose (Law No. 43 of 1964).

[1] Prior to this new legislation, there had been some attempts to address the deficiencies of the 1961 Law of

enacted which were intended to further develop the laws governing commerce (*Al-Kuwait Al-Youm* 1980: 86).[1] These became collectively known as Law No. 68/1980, which was issued to take the place of the commerical laws that had been in place since the 1960s.

The new legislation incorporated some beneficial reforms. However, one serious oversight in all the commerical laws that have been issued in Kuwait so far is the fact that the transfer of technology remains unregulated, even though this transfer is apparent in both the private and public sectors of commerce. The only provision in the Civil Law Code of 1980 which appears to relate to unfair competition is Law No. 67, which regulates restrictive business practices. Beyond this, the only law which appears to apply is Law No. 4 of 1962, which deals with intellectual properties such as patents, designs and industrial models and restricts their ownership to Kuwaiti nationals. Under this regulation, patents, when issued, are valid for 15 years and may be renewed for periods of five years. If a patent application is refused, it may be challenged in court within 30 days of the rejection. But while these two laws may provide some protection for Kuwaiti businesses, they fail to provide adequate protection for foreign-owned businesses in Kuwait.

The commercial laws of the 1960s and 1970s were based more on expediency than coherent central planning. Law No. 68/1980 tried to address this problem by providing a unified body of commerical law. However, the 1980 review was not based on a clearly stated directive for future economic development, particularly with regard to foreign investment. Like the CCL of 1960 and the 1961 Law of Commerce, the 1980 regulations were protectionist in nature and safeguarded Kuwaiti interests to such an extent that they may have discouraged foreign investors. This situation was acceptable to the Kuwaiti Government as long as it could rely on revenues from the oilfields. However, in the aftermath of the Iraqi

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Commerce. One such example is Law No. 32 which was issued in 1969 to monitor commercial shop licenses. This law was different from previous commercial laws in that it required all foreigners to have Kuwaiti partners, even those carrying on the simplest of activities. Previously, those foreigners with simple commercial operations had been permitted to operate alone. Article 2 of Law No. 32 changed this. It allowed shopkeepers the right to keep their one-year licences, but before they expired, owners were required to obtain legal residence and to take on a Kuwaiti partner prior to renewal (Al Ebraheem 1976: 2).

[1]In addition to the aforementioned laws, the Civil and Commercial Procedure Code, Law No. 38 of 1980 and the Ministerial Resolution No. 82 of 1980 were adopted to regulate the commercial arbitration process. Under these laws, investment disputes are to be handled by local authorities. As well, Kuwait is a party to the 1965 World Bank Convention on the "Settlement of Investment Disputes between States and Nationals of Other States" and the 1958 New York Convention on the "Recognition and Enforcement of Foreign Arbitral Awards" (UNCTAD Report 1988: 24).

invasion of Kuwait, the Government was forced to recognise the need to encourage foreign investment. It follows that what is now needed is a comprehensive review of Kuwait's commercial laws in order to attract foreign capital into the country and thus assist in the process of rebuilding the country.

3.5 CONCLUSION

The importance of the 1960s as a major transition in Kuwait's economic and political development cannot be overstated. In the 1960s, the drive to industrialise Kuwait began in earnest, focusing first on building up the construction industry and later diversifying to focus on the manufacture of consumer products and simpler industries. Since then, Kuwait has come a long way in order to achieve its current level of industrialisation and product sophistication (Saba *et al*. 1982: 2). Industrialisation is seen to be desirable because it turns extra oil revenue into a renewable asset, stimulates growth in the rest of the economy and ensures that Kuwait's economy will continue to thrive in the post-oil years. However, industrialisation carries with it more than just the obvious benefits of diversification of income sources and the correction of production structures. It also advances managerial and technical knowledge and skills, creates challenging and productive jobs, and can help to strengthen the social values of the community[1].

In order to maintain these levels of industrial development, Kuwait is heavily dependent on foreign investment, and this fact has become even more apparent in the aftermath of the Iraqi invasion. Ali Al Hakaim, the manager of Legal Administration at the Kuwait Investment Authority, openly acknowledges that foreign investors occupy a key position in Kuwait's economy. He stresses that new legislation is now being passed with the deliberate aim of attracting foreign investment. Specifically, the tax law has been prepared for amendment so as to remove the deterrents which currently confront foreign investments inside Kuwait (Al Hakim 1994).[2] Such innovations can be applauded, but in addition Kuwait needs

[1] See *Conference of Industrial Investment in the Arab Gulf*, 1986 for a full discussion of the benefits of industrialisation for this area.
[2] This issue will be discussed in greater detail in Chapter Eight.

to formulate policies which respect the development of technology, especially in relation to the oil, industrial and agricultural sectors of the economy.

The need for a review of many Kuwaiti regulations in order to attract foreign investment is further emphasised in subsequent chapters. It is noteworthy that many developing countries have now made an effort to establish a more positive commercial environment for FDI, and this suggests that Kuwait cannot afford to lag behind. The purpose of this chapter has been to examine the main problems in very general terms and from a broad historical perspective. Our subsequent analysis will be more detailed and will subject major aspects of Kuwait's regulatory regime to scrutiny with a view to proposing appropriate reform measures.

CHAPTER FOUR

REGULATIONS FOR SCREENING FOREIGN INVESTMENTS

4.0 INTRODUCTION

A study conducted by the Arab Investment Guarantee Organisation in 1993 concluded that four major factors influence the decisions of foreign investors who are deciding which country to invest in: the political and economic stability of the host country; the procedures for obtaining relevant permits and licences for their business operations; the regulations on the repatriation of funds; and the stability of the local rate of exchange (*Investment Guarantee Bulletin*, No. 70 1993: 1). The second and third of these factors relate directly to the issue of the host country's foreign investment regulations, and in this chapter it is the second factor which is under scrutiny as we consider Kuwait's system for screening and approving the business proposals of foreigners before licences are granted. It will be argued that this system is antiquated, inflexible and often laborious with the result that it fails to encourage and attract foreign investment.

It must, of course, be recognised that few states maintain a completely open door policy for foreign investments.[1] Many developing countries, particularly those which in the past have been under some form of colonial domination, have regulations which attempt to control, and if necessary modify, foreign investments for the purpose of accommodating their own national development plans. Foreign investors are often required to obtain certain approvals or permits before conducting business, and projects will be screened to ensure that they conform to the established criteria (UNIDO 1993: 2-3).[2] Typically national plans usually include requirements for the following in relation to foreign investment projects:

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[1] Sornarajah (1994: 100) comments on the open door policy as follows: "No state maintains an entirely open door policy to all foreign investments. If a state does decided to maintain an open door policy, it is at its option and is not dictated by the law. Even such a state will want to prevent the establishment of hazardous industries or industries that may cause excessive pollution. Developed states are inclined towards the adoption of a more open policy. States of the developing world as well as those of Eastern Europe have administrative controls over the influx of foreign investment." For more about the regulation of the entry of FDI, see M. Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press, 1994), pp. 92-114.

[2] Shihata (1996) comments on 'screening' provision that" all or most proposed investments are subjected to scrutiny or screening by the authorities of the host States, and must receive aformal approval, such as an investment licence, before the investments can actually be made. Pursuant to these provisions, the screening process typically involves an assessment of the projected investment's economic impact and, in particular, of

- an increase in the equity and management participation of enterprises by nationals, given that before independence economic and political power were in the hands of foreigners;

- limitations on foreigners and a preclusion from engaging in certain sectors of the economy in the perceived belief that this is the only way to foster the growth of indigenous businesses in these sectors, or because the relevant sectors are of such vital importance in terms of security that they ought to be controlled by nationals;

- an examination of the nature of the business proposed to ensure that it conforms to the economic objectives of the host nation.

Opinion is divided as to the general wisdom of such screening procedures. In the early stages of international law institutional writers such as Victoria and Vattel advocated complete freedom of entry for purposes of trade (Sornarajah 1994).[1] Thus Victoria believed in "the fundamental human right which inheres in all men to trade with people of other lands and thus fulfil the human urge to community". Some commentators regard the imposition of conditions such as screening on the entry of foreign capital as a major obstacle to foreign investment in developing countries (Fatouros 1962: 38). However, such regulations are not uncommon where certain investments are considered prejudicial to national interests. By contrast, most developed economies (with notable exceptions such as Japan, which limits entry in direct and indirect ways, and Australia, which has screening mechanisms) tend to have an open door policy (Sornarajah 1994: 100). In Kuwait, as this chapter seeks to show, the procedures adopted for screening foreign investments, while motivated by understandable national aims, are excessively cumbersome. Suggestions are made in this chapter as to ways of reducing the problems presently associated with Kuwait's excessively bureaucratic system of administration.

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the economic benefits that may accrue to the host country from the investment."for more about admission of foreign direct investment under national legislation, see Ibrahim. Shihata, *Recent Trends Rela ting to entry of Foreign Direct Investment,* in Heng.L, Kuan.L, Sethupathy.J, Sood. T and Ying. Y ,*Current Lgal Issues in the Internationalisation of Business Enterprises* (Butterworths, 1996.) pp 3-24.

[1] Vattel and Victoria as discussed in D. P. O'Connell, *International Law*, vol. 2 (1970), p. 693.

4.1 THE POSITION IN KUWAIT

If we consider the premises discussed in the previous section, it is not surprising that Kuwait has numerous screening regulations scattered throughout various statutes. From many points of view Kuwait may be categorised as a developing economy. The country gained political independence only in 1961 and is naturally still sensitive to foreign encroachments. Thus major restrictions are enforced. In particular, as explained in Chapter Five, foreigners are precluded from conducting business in certain sectors of the economy (such as real estate) and to a limited extent in joint stock companies (Article 68 Commercial Companies Law, Article 5 Law of Registration of Immovable Property No. 5 of 1959). Furthermore, in sectors where foreign investment is permitted, investors are precluded from conducting business without at least one Kuwaiti national partner, and they cannot own a majority stake. Most commercial activities by foreigners require approval by one Government agency or another. The net result of all these restrictions is that foreign investors are frequently deterred from pursuing applications for approval of their projects.

4.2 THE AIMS OF KUWAIT'S SCREENING PROCEDURES

Kamal Askar (1984: 84) suggests that the aims of the Kuwaiti Government in screening business applications include the following:

i. To provide a means of organising and controlling the process of industrial development so that only industrial projects which can achieve the objectives of Kuwait's industrial development plan are accepted.

ii To provide a means of ensuring that the foreign investment project is not incompatible with the general aims or interests of the state, and that it meets legal and administrative requirements such as environmental criteria, safety instructions, protection from fire, etc.; and furthermore to ensure that any such project is not of a type which is prohibited by the state or prohibited in the private sector (i.e. that it is not of a type which is the exclusive preserve of the state).

iii. To serve as a means of providing Government departments with statistical data and information about new projects, their geographical distribution, their productive

capacity, the number of people employed in the project, the consumption of power and water, etc.

iv. To assist in rationalising, legalising or obtaining benefits or advantages given by the state to industrial projects, the most important of these benefits being the provision of a plot of land, exemption from taxes and customs, long-term loans and easy terms of repayment, etc.

Whilst the first three of these objectives are undoubtedly significant in terms of development criteria, in practice the Ministry of Commerce and Industry (MCI) seems to have emphasised the fourth objective in assessing industrial projects. The extent to which the goals of the MCI are achievable through the procedures presently adopted will now be examined.

4.3 THE SCREENING PROCESS

Although Kuwait strives to attract foreign investments, the procedures for commencing such businesses seem to be unduly restrictive[1]. Four related problems can be identified: too many approvals are required; licences are granted not to the foreign investor himself, but to his local partners; the requisite foreign capital must be imported before the approvals are granted; and the system for obtaining approvals is extremely bureaucratic.[2] Each of these four problems warrants separate consideration. (The fourth will be dealt with in section 5.4.)

4.3.1 Too Many Approvals Required

To the average foreign investor, Kuwait is a state in which freedom to conduct business is not only curtailed by immigration rules but also by the need to obtain several approvals before business can be conducted. For instance, the Law Regulating Licences for Business Premises No. 32 of 1969 stipulates: "No business premises nor office may be opened to carry on a

[1] "In some countries the investment authorities screen all investment applications for approval and require feasibility studies and other evidence of the viability of the project before allowing new investments to be set up. A number of countries, however, have abandoned this approach in favour of very limited or no initial screening, and some have adopted a simple registration system where no evaluation is performed by the investment authority." (UNIDO 1993: 2)

[2] Section 2 of Guideline II of the "Legal Framework for the Treatment of Foreign Investment" (World Bank Group, vol. II, Report to the Development Committee) envisages that host countries "will facilitate the admission and establishment of foreign investments. Particular reference is made in this connection to the need to avoid overregulation and the erection of unnecessary bureaucratic obstacles to admission."

business unless a relevant licence has been obtained and it will only be issued to nationals of Kuwait." (Law No 32 of 1969, *Kuwait Al-Yum* , No. 735). Although most countries regulate the conduct of business, especially industrial ventures, in certain geographical locations (for example in residential areas), it is quite usual for businesses to be set up without having to obtain specific licences. The provision that all businesses require permits for new ventures is no longer reasonable or necessary.

4.3.2 Licences Given Only to Kuwaiti Nationals

Apart from licences to use a premises for business purposes, licences to conduct businesses are only given to Kuwaiti nationals and not to their foreign partners (Article 16 of the Regulations). This is irrespective of the capital or technology which the latter may be contributing. This can create difficulties, particularly if the partners fall out or if the Kuwaiti partner dies. The business may be adversely affected since there is bound to be some delay and difficulty for the foreign partner who has to try to obtain a licence through another partner.

4.3.3 Importation of Foreign Capital before Approval is Given

A state may require that a foreign investor should bring in all the capital or a certain percentage of it from overseas. As Sornarajah (1994: 106) explains:

> A state's interest in ensuring that capital is brought from outside by the foreign investor is to prevent his raising capital on the local markets. If he were permitted to do so, local savings that could be utilised for some project of benefit to the state could be absorbed in serving the interests of the foreign investor. The attraction of local investors to invest in shares in a project with a large foreign corporation will divert investment funds that could have gone to finance local entrepreneurs or local projects. These are economic reasons justifying the discriminatory requirement that the foreign investor should not raise the capital within the host state but bring capital from outside.

Generally, in Kuwait, before licences are granted (Internal Memo, MCI number 71/94, dated November 5 1994),[1] a foreign investor must show that he has paid his share of

[1] "Where a foreign investor agrees to capitalisation requirements and later fails to comply, a right to terminate or otherwise interfere with the foreign investment arises in the host state. This right arises as a matter of the public law of the host state. The exercise of the right cannot amount to an international wrong provided due process standards have been met. The protracted dispute in *Amico* v. *Indonesia* involved this issue"

the capital or that his assets are not less than the value of his contribution at the time of commencing business (Article 3 of the Regulations). The author believes that these requirements act as a serious disincentive to foreign investors, many of whom are not willing to pay up to the full value of their subscriptions in a business at the initial stage. No matter how generous the Kuwaiti immigration laws are in defining "residence", foreign investors may be unwilling to declare themselves resident in Kuwait before their businesses commence, especially when they do not need to be resident in Kuwait to conduct business. Residency has tax implications of which foreign investors may be wary.

4.3.4 Cases where Requirements are Justifiable

There can be no doubt that in certain circumstances licences and permits are perfectly justifiable, especially when similar standards apply in developed economies. The following examples may be used for illustrative purposes. Companies dealing with foodstuffs are obliged to register with the Ministry of Health. Industrial enterprises have to obtain approval from the General Fire Department in the Municipality of Kuwait. Approval is conditional upon the satisfaction of certain fire protection regulations which vary from one industry to another. For the purpose of environmental control, the proposed water, air, drainage and sewage implications of the investment are also reviewed by the Department of Environment of the Ministry of Health. Finally, if the industry is to be located in the Al-Shuayba Area, the investor must obtain approval from the General Department of the Industrial Al-Shuayba Area, which regulates the management and running of industries within its jurisdiction.

Even though such requirements may be reasonable in the cases indicated, there are often unacceptable delays before final approvals are issued. For instance, on average only 5 per cent of the total applications for industrial projects passed to the fire department are approved on their first submission. This is an extremely low proportion, and such delays are always regrettable since time is often of the essence for investors (Askar 1984: 112). Perhaps in a few cases delays are due to the failure of investors to fill in the forms correctly

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(Sornarajah 1994: 106). For an explanation of this case, see 23 ILM 354 (1983) and 27 ILM 1281 (1988). The Indonesia position in challenging the initial award has been explained in Reisman, "The Breakdown of Control Mechanism in ICSID Arbitration" (1989). *Duke LJ* 739 at p. 774.

or to satisfy the prescribed conditions at the time of their first application; but in most situations the delays are due to bureaucratic obstacles. The fact is that foreign investors deserve more secure ways of establishing their businesses, and if complex forms are to be completed, then investors must be offered reasonable assistance.

4.4 THE COMPETENT AUTHORITIES AND THE DECISION-MAKING PROCESS

In many countries, the appropriate administrative agencies promote their own territories as sites for foreign investment, but at the same time they seek to ensure that such investment is consistent with the Government's specific economic development objectives. As Sornarajah (1994: 102) puts it: "The primary task of the administrative agency is to ensure that the foreign investor brings tangible benefits to the host state. The agency will have regard to the impact of the foreign investment on the local economy."

In Kuwait most of the relevant licences are issued by the Ministry of Commerce and Industry (MCI), which consists of three distinct units. The first is the Industrial Development and Planning Department (IDPD), headed by the Assistant Deputy of the Minister for Industrial Affairs. The second is the Industrial Development Office (IDO), which is an advisory office assigned to the Assistant Deputy for Industrial Affairs and empowered to evaluate projects and prepare economic studies of them. The third is the Committee for the Development of Industry (CDI), the final decision-making body. The CDI is also charged with other responsibilities such as the approval of the importation of machinery and equipment, the exemption of such imports from customs duties, cancelling projects (through the withdrawal of licences) because they have not been executed on the appointed date, and the assignment or allocation of industrial plots of land, including any increases in their surface areas (Ministerial Resolution No. 24 of 1987). The screening process is usually done in three stages. Additionally, depending on the project, the foreign investor may have to deal with other Governmental departments.

4.4.1 The Industrial Development and Planning Department (IDPD)

The IDPD ensures that application papers are properly filed and completed with the provision of all relevant information. The Department may reject applications in three sets of circumstances: if the proposed business is prohibited in Kuwait (e.g. in the case of brewing alcoholic beverages); if the business is one exclusively reserved for the public sector; or if the local market is too small to accommodate the consumption of the products in question or is already fully saturated. In reaching its decision, the Department relies on the data available to it, which may or may not be adequate. The proposal is then referred to the IDO, and contact is also made with the competent ministers and Government departments where necessary, for example the Ministry of Oil in the case of chemical projects. Finally, the investor is notified of the decision of the Committee for the Development of Industry (Hana Al Tayyar 1994).[1]

4.4.2 The Industrial Development Office (IDO)

The IDO plays a very significant role given that the Committee for the Development of Industry, in the majority of cases, adopts its recommendations. However, the IDO does not possess any explicit statutory backing for its position in the decision-making process. According to Mrs Hana Al-Tayyar, Director of the IDO:

> The method of work in the office depends upon assigning one project for each person who will be responsible for preparing the report and the recommendation required for the project. The projects are distributed amongst the experts in the office according to their various specialisations. For each expert, there is what we call the `counterpart' who will help the former in preparing the report. The reason for adopting this style of work and preferring it to what is called "team work" is the desire to determine responsibility (though the other method, team work, is regarded as a more efficient method). All projects presented to the Ministry by foreign private investors are processed in the same way, whether the project in question is large or small; namely, the assignment of the project only to one person. (Interview with Hana Al-Tayyar, Director of the Industrial Development Office, 23 December1994.)

The next stage in the process is for the IDO expert who deals with a proposal to file a report incorporating the following: general information about the project; a study of the market and the potential for sales; a technical study; an economic study; remarks and recommendations on decisions suggested by the expert. Invariably, the expert also relies on

[1] These processes are still in force today.

the information and data presented by the foreign investor, which is cross-checked with the statistics and data available to the Kuwaiti Government.

Marketing, Technical and Financial Evaluation

Two factors are important in evaluating the marketing aspects of any business project. The first is the potential scope for selling the product(s) in Kuwait and in neighbouring countries. (Kuwait imposes little or no restrictions on imports and offers no special protection for local production: the inter-relationship between these factors has to be taken into account.) If there is a market for the product, a second factor is considered: the availability of similar products which may be a source of competition. This issue may affect the quality and price of the locally manufactured product. If the productive capacity of the proposed project exceeds the available market, the IDO may advise the investor to reduce his proposed productive capacity (Askar 1984: 50-55).

In evaluating the technical aspects of any project, the IDO usually examines the method of production, its suitability for Kuwait and the price of equipment and machinery. During this process, direct contact may be made with the suppliers in order to compare and verify prices. It appears that the rationale for this is to prevent inflation of prices resulting from any ulterior motives of the foreign investor. Labour issues also have to be considered. The IDO seems to have an unwritten rule that staffing levels in any new project must be kept as low as efficiency permits. This issue can obviously affect the IDO's response to a proposal. The primary elements or materials required for the project are also considered, and the IDO may recommend a review of prices or order the use of local materials where available. The land requirement is also regarded as being very significant. The IDO assesses the surface area requested by the investors and the costs of the proposed buildings and equipment, and recommendations are also made in this regard to save costs and avoid unnecessary expenses. The IDO examines all financial costs, including sales and all the financial needs of the company as reflected in the proposal, and compares these with locally available data. Some economic indications are also extrapolated from the assessment of

previous projects, possibly with a view to assessing the viability of the proposal in order to advise on issues which may reduce profitability.

4.4.3 The Industrial Development Committee (IDC)

The IDC screens applications for feasibility and compatibility in relation to Kuwait's economic programme (Bazarian and Feurback 1980: 129). Composed of twelve members headed by the Minster of Commerce and Industry, the IDC, which meets once or twice a month, is the final stage of screening. It relies heavily on studies prepared by the IDO. Ministerial Resolution Number 24 of 1987 defines the powers of the IDC to include the following:

i. studying the systems and proposals related to the development of national industries by protecting, organising and encouraging these industries and making recommendations thereon;

ii. approving or rejecting applications for industrial licences within sixty days of submitting applications, but stating reasons where applications are refused (Article 9 of Industrial Law No. 6 of 1965);

iii. recommending the revocation of licences or withdrawal of privileges either for failure to commence a project within the time specified in the licence, for changing the purpose of a grant, or for any other breach of the conditions in Resolution 24 of 1987.

In granting or refusing an application, the IDC recommendation is often based on the following considerations (UNCTAD 1988: 23): the economic requirements of Kuwait and the question of whether the products can be consumed locally or exported; Kuwait's social and economic plans and requirements; and the compatibility of the project with public order and the public interest. If the investor's application is successful, the Minister issues an order specifying the conditions which must be observed by the investor.

4.4.4 Criticisms of the System for Obtaining Approvals in Kuwait

It is the author's contention that the system for granting approvals and licences - outlined above - is unduly cumbersome and serves as a serious disincentive to foreign investment. This criticism is even more justifiable at the present time when many states are reviewing their

regulations to make them more investor-friendly in an increasingly competitive global market for foreign investment. The following specific points of criticism need to be highlighted:

1. On average, it may take a foreign investor up to one year to satisfy the requirements and obtain the necessary approvals for a new business venture. To some investors, such a delay will almost certainly be discouraging.

2. There is undue multiplicity of departmental approvals without any clear co-ordination between them. Multiple points of view and opinions are expressed on the viability of the projects. There is little harmony or compatibility between the application forms used by each department or unit; hence it is not clear which issues dealt with in the forms are really important or relevant for consideration. These bureaucratic problems often cause delays. Shihata (1990: 131) rightly argues that bureaucracy leads to an increase in the number of bureaucrats and intermediaries rather than of investors, thus creating a platform for widespread corruption. Often, only the worst sorts of investor survive in such an environment, while serious investors may abandon their plans entirely.

3. There is no guarantee that the evaluations made by Government "experts" are better than those of investors, given that the "experts" are not necessarily familiar with developments in the relevant industries. Where the recommendations of the "experts" are unsound, this could cause substantial losses to the investment in question.

4. The bureaucratic structures may permit Government officials to refuse to co-operate or to give a hearing to the views of the prospective investor.

5. There is also occasional delay in the delivery of services such as electricity and water by the relevant Government agency when the project is approved. This can delay the commencement of production.

6. In some cases unrealistic conditions are imposed on the investor, given the questionable experience of the "experts" whose recommendations are the basis of the conditions imposed.

7. In addition, there are numerous laws and decrees - about 65 in all - regulating industrial activity in Kuwait. Substantial time and costs may be involved in determining the implications of these laws (Talib Ali, no date).

This author believes that the serious problems highlighted above need to be addressed as a matter of urgency and wishes to offer a number of specific proposals for reform, beginning with the idea of a one-stop screening agency.

4.5 A COMPROMISE: A ONE-STOP SCREENING AGENCY

Faced with the growing need to attract foreign investment, many countries accept that they must now simplify their investment laws - for example by removing differences in treatment between foreign and domestic investors, reducing or even removing screening procedures, and even offering positive incentives of various kinds. Only in certain key economic sectors, such as minerals and extraction, is it still common to find case-by-case negotiations (UNIDO 1993: 7).

The one-stop shop or centre is often used by countries in an effort to co-ordinate investment promotion activities.[1] The functions of such shops vary, but usually there is a common concern with investor servicing. These innovations have been particularly successful in countries such as Singapore, Thailand and Malaysia, where a sustained effort has been made to overcome the problems created by foreign investors' lack of familiarity with domestic procedures and local economic conditions. One-stop agencies are essentially concerned with the provision of information; they do not actually issue permits or clearances themselves (UNIDO 1993: 20-24). In the case of Singapore, there can be no doubt that the country's positive attraction for foreign investors is at least partially due to the convenient procedures governing the admission of investments. In Singapore, the Economic Development Board, the main state organ responsible for encouraging and developing inward investment, works effectively and efficiently (GOIC, 1993: 208).

[1] The main reasons for using this type of agency are to do with the generally high costs of promotion activities and the need for consistent advice to be given to potential investors so as to avoid confusion.

The existing decentralised framework for screening foreign investments in Kuwait is costly, often leading to longer periods of negotiation and uncertainty with regard to the outcome. Faced with such difficulties, prospective investors with only a marginal or peripheral interest in Kuwait may choose to go elsewhere. In response to the conflicting claims of the various responsible departments or agencies, other investors may decided that in order to gain approval, they will have to redefine the forms of their investment in ways which are not compatible with the broad national objectives (Weigel 1990: 70).

It is therefore suggested that Kuwait needs a more centralised and co-ordinated approach with an investment authority entrusted with the power to apply a coherent strategy, and that a one-stop independent agency (in one place), with an independent system and independent regulations, is the most appropriate means to achieve this end. This agency needs to be well structured and equipped with regulations to allow it to operate like a private market institution. The regulations should state that approvals will be given within a period of 15 to 30 days after the application is filed. All applications should be examined within the context of Kuwait's overall industrial development strategy.

There is no doubt that the existence of a single specialist agency to deal with all stages of investments would reduce bureaucratic obstacles and facilitate administrative measures, including entry visas and work permits (GOIC 1993: 59). Such an independent agency has proved successful in South Korea and has contributed to the increased level of foreign investments there. The country's Industrial Development Investment Centre (which belongs to the Ministry of Economic Affairs) offers investment services, including the provision of information about the opportunities for investment and relevant Government laws. The Centre also helps investors to deal with the various administrative measures related to work permits (GOIC 1993: 199).

Ideally, the one-stop agency should have an approval unit, an information unit, a follow-up unit and an industrial sector research unit. The proposed functions of these separate units will now be outlined.

4.5.1 Approval

The approval unit should be concerned with all the activities and procedures related to the granting of licences for industrial projects. It should be the only agency or entity with which the foreign investor has to deal in all that concerns the procedures of the project from its inception to the post-operational stage. The unit should be empowered to:

- determine the feasibility of the project by evaluating it from various points of view;
- determine the appropriate location and plot of industrial land for the project;
- establish the appropriate fire -prevention procedures and conditions;
- establish procedures and conditions for the protection of the environment;
- determine the customs privileges (exemptions and procedures) to be granted to the applicant;
- evaluate the fiancial requirements so that the unit can make a recommendation to Kuwait's Industrial Bank concerning the amount of any loan which is required.

4.5.2 Information

The information unit should be concerned with providing investors and relevant Government agencies with information and data related to industries in Kuwait. This function does not presently exist in Kuwait at the level of the MCI or indeed at any other level. The unit must be charged with writing books and pamphlets which set out the investment prospects and regulations (as well as procedures for starting businesses) in Kuwait and for promoting such investments. Such publications, which will be invaluable to investors, are in line with the guidelines of the World Bank for establishing a legal framework for the treatment of foreign investment. It is also intended that such publications will also give host states a chance to re-examine the appropriateness of their foreign-investment procedures. (World Bank Group 1992: 13). The unit should also make use of the most recent information technology to allow access, via computers, to relevant data, rules and regulations governing foreign investment. Using modern electronic communication, there is no reason why this information cannot be accessed easily by companies and potential investors in other countries.

4.5.3 Follow-up

The role of the follow-up unit should be limited primarily to the conduct of the investors' business after the licence is granted. It should offer all necessary assistance in the area of implementation and operation of the business. Feedback from the projects can be useful for the agency, for foreign investors and for the Kuwaiti Government in deciding its future policies.

4.5.4 Industrial Sector Research

The industrial sector research unit should be primarily concerned with the establishment of priority economic sectors as they may be identified from time to time. Surveys conducted by the unit will also provide invaluable information for businesses in those sectors.

4.5.5 The Overall Benefits of Information Centres

The establishment of highly developed information centres, both in Kuwait and in her missions in capital cities all over the world, charged with providing foreign investors with data or relevant information, is highly desirable as a means of boosting the drive for foreign investments. For example, the Economic Development Council (EDC) in Singapore, already referred to above, depends heavily on its offices overseas (33 offices in various countries according to the 1981 figures) to facilitate foreign investment operations. They are scattered and spread over 20 world centres to provide potential investors with all necessary information. They are one-stop shops which provide integrated, complete information to foreign companies, starting from the question of how to initiate a project, and including assistance in making a feasibility study as well as the provision of information about taxes and other incentives. They also offer advice about the methods of dealing with Government departments and provide facilities for visits to Singapore to examine or inspect the industrial areas and the manpower training centres. These offices can also offer assistance in choosing suitable business partners. Their studies have been instructive to the officials of the EDC, who are consequently conversant with the needs of the foreign investor and are therefore well

equipped to help in formulating suitable policies to attract foreign investment (GOIC 1993: 208).

The author accordingly suggests that Kuwait's one-stop agency should have offices attached to the country's foreign embassies so that prospective foreign investors may assess relevant information for any projects which they are seeking to establish in Kuwait. On-line access to computerised information systems would greatly facilitate this process.

4.6 CONCLUSION

The right of a sovereign state to regulate the activities of foreign investors in its territories is recognised in international law. The UN General Assembly 1974 Charter of Economic Rights and Duties of States (Resolution No. 3281, 14 I.L.M. 251, 1975)[1] asserts that:

> "Each state has the right
>
> a)To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities.
>
> b)To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies."

It cannot be denied that the screening of foreign-investment projects is clearly an exercise of Kuwait's prerogatives as recognised by this resolution. However, whilst the aims of Kuwait's procedures are in themselves positive and acceptable, it has been demonstrated in this chapter that the actual procedures involved are inadequate in several important respects.

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[1] The Charter was prepared by the UN Conference on Trade and Development (UNCTAD) whose main function is "to promote international trade ... particularly trade between countries at different stages of development, between developing countries and between countries with different systems of economic and social organisation". The list of economic rights and duties of states includes: the right to engage without discrimination in international trade; the right to participate fully in the international decision-making process in the solution of world economic, financial and monetary problems; and the duty to co-operate in the expansion of world trade. For further discussion of the Charter see: Browner and Tepe, 9 *Int. Lawyer* 295 (1975); Weston, 75 *A.J.I.L.* 437 (1981); White, 24 *I.C.L.Q.* (1975).
Western states and scholars have serious reservation as to whether the Charter reflects customary international law. For more details on the Charter's value see, for example, D. J. Harris (1991) on "Cases and Materials on International Law", 526-528; and "Texaco Overseas Petroleum Co. and California Asiatic Oil Co. v. Libya", 53 *ILR* 389, 171 ILM.I (1978).

Given the increasing competition amongst states to attract foreign investment in today's global economy, many countries have reviewed and reformed their traditional policies and strategies with a view to promoting foreign investment. Some countries are clearly benefiting from this process because they are succeeding in attracting more foreign investment (*Guarantee Bulletin,* No. 41 1989:1). In the main, reforms have focused on four aspects: the investment policy framework; strategies to promote investments; institutional arrangements to facilitate investments; and the criteria and procedures for evaluating the success of promotional activities (UNIDO 1993: 2).

The author believes that it is time for Kuwait to abandon its decentralised and multi-departmental screening procedures. The proposed one-stop agency is a viable compromise in that Kuwait will still be able to screen projects, but foreign investors will not face any undue impediments in establishing their businesses in Kuwait. It is also time to stop requiring foreign investors to import their share of capital for any project before approval has been granted. Finally, there will be many benefits in granting licences directly to foreign investors rather than to their Kuwaiti partners because, as this chapter has shown, there are many serious difficulties associated with the present practice.

CHAPTER FIVE
THE MAIN FORMS OF BUSINESS ORGANISATION IN KUWAIT: A LEGAL AND ECONOMIC ANALYSIS

5.0 INTRODUCTION

The purpose of this chapter is to analyse the present legal regime which regulates Foreign Direct Investment (FDI) in Kuwait with particular emphasis on the various forms of business organisation that are available. The key aim is to see whether these fulfil the needs of foreign investors with respect to the ownership, control and divestment of capital. This is an important issue because common sense suggests that an investor must determine which vehicle is best suited to the type of business he wishes to conduct. It will be argued that the current legal framework of business organisation in Kuwait is not adequate for the purposes of foreign investment, and that, in particular, the Kuwaiti Commercial Companies Law (CCL) No.15 of 1960 must be amended and modified because it has not kept pace with economic and social change. (It has to be stressed that while the analysis which follows highlights the strengths and weaknesses of each type of business organisation, it does not attempt to offer an exhaustive discussion of the operational rules governing the conduct of each business vehicle since such an aim would go beyond the limits of available space.)

Another preliminary point which deserves emphasis - and which is indicative of a major weakness of Kuwait's FDI regime - is that there is not one single statute specifically directed at FDI. Rather, Kuwait has several general laws which regulate investment or commercial activity and which affect both foreigners and Kuwaitis alike. Indeed, there are only a few instances where Kuwaiti laws make references to foreigners specifically. This is fairly conclusive evidence that hitherto Kuwaiti law has failed to address the specific requirements of foreign investors. It further testifies to the unnecessary complexity of Kuwaiti FDI law which continues to be a major impediment to the promotion of the types of FDI which the country urgently requires.

Sections 5.1.1 to 5.2.6.1 below will address the question of access to investment in Kuwait: this involves a consideration of the ease with which the foreign investor can set up a business in Kuwait; the cost of such access; the kind of business in which the foreign investor can engage; and the forms of business organisation he can utilise. It is argued that the general effect of current foreign investment regulations is negative, and that they tend positively to discourage such investment. The issues of ownership, control and divestment are discussed by looking at several specific economic sectors, and an attempt is made to evaluate the Kuwaiti Government's role in managing the national economy. Throughout the discussion in this chapter, the crucial interplay between the various forms of legal regulation of business and economic activity is stressed. This is a particularly significant relationship in an age of increasing economic globalisation since variations in national legal regimes have a direct and far-reaching effect on the way in which FDI is spatially located. Some comparisons with legal regimes in other countries are therefore offered so that pertinent lessons for Kuwait's own future economic development may be learned.

5.1 ACCESS TO INVESTMENT IN KUWAIT

5.1.1 Limitations on Foreigners

To begin with, the issue of legal limitations on foreign economic activity in Kuwait must be clarified. Investment in Kuwait is restricted in the case of foreigners to investments where a foreigner has established a partnership with a Kuwaiti or has registered his business as a Kuwaiti legal entity. Throughout this thesis the problems caused by this basic restriction will be re-emphasised because it is now seen to be an unacceptable obstacle to the encouragement of FDI, especially when compared with the more liberal policies of other developing countries. As a general rule, any foreign investor who has an interest in directly investing in Kuwait, either as a sole trader or through a company which has been incorporated outside Kuwait, must either enter into partnership with a citizen of Kuwait and/or have his business registered as a Kuwaiti legal entity (Article 23 of Commercial Code, 1980). Once a foreign investor collaborates with a Kuwaiti in his business activities, he is permitted to engage in

most kinds of enterprise except in fields like securities brokerage (Article 21 of Ministerial Resolution No. 35 of 1983).

Citizens of the Gulf Co-operation Council (GCC) states are, however, allowed more freedom than non-Kuwaitis in conducting business in Kuwait on account of Article 2 of the Uniform Economic Agreement between GCC States, as promulgated in Law 58 of 1982. (See Appendix IX for the text of this agreement.) Article 2 states that member states agree to treat the citizens of any member state on an equal footing with the nationals of all other GCC states without discrimination or distinction in the specified fields. In practice the implementation of this provision requires Kuwait to conclude separate agreements with the rest of the Gulf states and to pass relevant laws pertaining to their enforcement. Accordingly, the Minister of Commerce and Industry has passed resolutions which permit Gulf Co-operation Council citizens to practise retail trade in Kuwait (Decision No.10, 1987, Kuwait Alyum, No.1702).

It should be stressed that in the analysis which follows any limitations which are discussed do not apply to non-Kuwaitis who are citizens of one of the GCC member states.

5.1.2 The Negative Impact of the Foreign Investment Regime in Kuwait

In order to promote Kuwait's economic development through the diversification of the sources of its income, it is essential to facilitate foreign investment and harness foreign expertise. However, present business regulations tend to have a negative effect. This becomes an increasingly urgent problem as oil revenues continue to dwindle. If we include refined products, the total production of oil and gas in 1989 accounted for 41 per cent of GDP and 91 per cent of export earnings, respectively. These figures remained steady until the end of the first year of post-war reconstruction in 1992, though this represented a 37 per cent drop in nominal terms compared to 1989. Prior to the Iraqi invasion, positive efforts were being made to shift some of this dependence on the oil and gas sectors by building up the industrial

and financial services sectors. Unfortunately, these efforts were only marginally successful (Economic Intelligent Unit 1992-93, Country Profile: 10).[1]

It is clear that the restrictions placed on foreign investors' activities in certain spheres are serious obstacles to Kuwait's further economic development. This is not to suggest that these restrictions are unusual. In other countries, too, investment codes frequently apply only to nationals, and foreigners are often excluded, especially from sectors of national strategic importance or where local control is deemed to be economically esssential. Furthermore, the World Bank recognises that restrictions may be permissible in sectors which are undoubtedly of special local concern (World Bank Group 1992: 12).[2] And it goes further in defending the right of a state to refuse admission to a proposed investment which clearly raises concerns of great national interest (World Bank Group 1992: 5).

While recognising the legitimacy of such restrictions in some circumstances, the key issue to be considered here is the possible negative effect of FDI regulations on a country's economic development. The Gulf Organisation for Industrial Consulting (GOIC) has shown that Kuwait is not an attractive destination for foreign investment compared to other countries of the Gulf Co-operation Council. Evidence for this is provided by the fact that the flow of foreign capital during the four years 1975 to 1978 was basically negative, totalling 345 million dollars. In terms of the influx of new investment, the period 1979-1981 showed the best performance (according to the research of the GOIC). However, from the beginning of 1982, foreign investment withdrawals became frequent, thus explaining why the foreign investment flow during this year was negative. Indeed, the rate of the flow of foreign investment capital into Kuwait during the whole period between 1975 and 1989 was negative. It amounted to 97

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[1] A study of the efficiency of Mexican firms by the World Bank shows that firms with minority foreign shares in most industries were less efficient than wholly-owned Mexican firms, and that majority-owned foreign firms, in turn, were more efficient than wholly-owned domestic firms in most of the industries where both types operated (Weigel 1990: 76).

[2] Brazil is an example of a country which does not have comprehensive foreign investment legislation and institutional infrastructure for screening foreign investment proposals. However, foreign direct investment is excluded from several sectors (e.g. petroleum exploration, exploitation and refining; communications media; and most domestic transport). In addition, a significant part of the computer and associated industries have recently been reserved for domestic companies. Brazil also seeks to influence the decisions of investors through the use of a range of incentives, and also uses Government regulations to prohibit certain kinds of decisions, e.g., the establishment of major new investments in congested urban areas (Weigel 1990: 78).

million dollars annually. This means that, on average, an equal amount of money was withdrawn every year from the total foreign investment in Kuwait. The period between 1975 and 1989 was one of regression and contraction for foreign investment in Kuwait (GICO, 1993: 77-78). This seems to raise the possibility that the strict policy adopted by Kuwait in regulating foreign investment had a generally negative effect on the country's economy. It also seems evident that a major part of this problem is due to the complexities presented to foreign investors by the proliferation of various forms of business organisation, each with its own distinctive legal requirements and, as will be seen, a certain range of disincentives.

5.2 THE MAIN FORMS OF BUSINESS ORGANISATION

All incorporation, management, capitalisation and liquidation of commercial companies in Kuwait is regulated by the Commercial Companies Law (CCL) No. 15 of 1960 and the regulations issued under it. This law, as it now stands, has two major weaknesses: first, it is far from comprehensive; secondly, its provisions are, in some respects, disadvantageous to the foreign investor. The general comments of Dr Ali Al-Hakim are relevant in this context:

> The Companies Law is a fair law, but it is not a comprehensive law. Many things were ignored by the current law, nor did the law give adequate treatment to many matters. The result is that the management of companies has become a complex matter. This is a very important aspect of the law, and the Kuwaiti law, in this respect, has not kept pace with recent developments. It is for this reason that the Companies Law should be reconsidered so that it may keep abreast of modern developments. (Interview conducted with Dr. Ali Al-Hakim, Legal Advisor to the General Investment Authority, by the author, 5 January 1995).
>
> The Companies Law had been originally enacted for the local investor. Now the time has come to amend this law because there are many areas or spheres of activity where Kuwait is in need of foreign experience. It is meaningless, for example, to impose upon the foreign investor a precondition that he should have a Kuwaiti partner. (Interview with Mr Shafiq, Legal Advisor in the Fatwa and Legislation Department, conducted by the author, 3 January 1995).

The current situation is a direct result of past policies and a reluctance on the part of the Kuwaiti Government to recognise the positive importance, under certain conditions, of FDI. Thus, immediately after independence, in 1961, the main concern of the Kuwaiti Government was to foster and protect indigenous investors' capital from dominant control by foreign

investment capital, particularly since Kuwait's economy had been controlled by foreign oil companies. Thus, the CCL was drafted and enacted after the nationalisation of the assets of certain foreign oil companies (see the discussion in Chapter Three), and it was formulated by the Kuwaiti Government in response to the perceived needs of Kuwaitis. In particular, the procedures established for the incorporation and management of companies are based upon certain articles which were made deliberately complex and unattractive for the foreign investor.

Under the CCL (Law No. 15 of 1960; Articles 12, 47, 68, 191 of the Commercial Companies Law; Articles 26 and 27 of the Law of Commerce No. 2 of 1961; and Article 8 of the Industrial Law No. 6 of 1965) all companies must have at least 51 per cent Kuwaiti ownership. Accordingly, foreign investors wishing to conduct business in Kuwait must either become minority shareholders in a Kuwaiti company or appoint a Kuwaiti agent who will conduct business on their behalf.[1] Thus, the two main issues which must now be considered are: (1) the legal basis of different types of company, and (2) the legal basis of different types of agency. To begin with, the three main types of company will be discussed and the distinctions between them will be highlighted.

5.2.1 The Three Main Types of Company: an Overview

Company organisations are generally divided into three categories: first, sharikhat al ashkas or personal companies or partnerships (the French counterpart is the *société de persons*); secondly, *sharikhat alamual* (*société de capitaux*) or capital companies - which, as the Arabic

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[1] The exception to this rule is provided under Law No. 32 of 1959 regarding "simple vocation or small trade". Although it has been suggested by Gerald (1991) that the law does not define exactly what these terms mean, it is arguable that the meaning can be derived from Article 17 of Law No. 68 of 1980, which states: "Individuals who practice a simple occupation or a small trade", who depend on their work to make profits to secure them a living rather than depending on capital, such as vendors and owners of small stores ..." The fact that substantial investments will probably not conform to this definition means that the exception is of little value to foreign investors. A foreign investor wishing to conduct business only for a particular business project of limited duration must enter into a joint venture contract with a Kuwaiti party; the project would then be carried out under the trade licence of the Kuwaiti party. Essentially, as Gerald points out (1991: 322-323), Kuwaiti law does not allow a foreign company to establish its own, wholly owned branch office in Kuwait, and the commercial companies are created for the benefit of local investors.

name suggests, are capital companies whose members or partners are generally liable only for their share in the company - or joint stock companies (sharikhat al-mosahama) (Tamah al-Shammari 1980: 44). The third category consists of mixed companies (sharikhat muktalatah) which are intermediate between personal and capital companies in the sense that they combine, in their structure, both financial and personal elements or considerations (Al Okaily 1978: 113). The foreign investment implications of each company type (and its sub-categories) will now be discussed.

I. Personal Companies

Sharikhat al ashkas or partnerships are termed personal because all members or partners, or the majority of them, are jointly and severally liable for the obligations of the partnership (Al Okaily 1978:. 3). The number of foreign investors in personal companies in Kuwait was 637 at the end of 1995. In each year from 1991 to 1995 the numbers of personal investors in newly established companies increased as follows: 49 in 1991; 162 in 1992; 167 in 1993; 184 in 1994; 75 in 1995 (figures from a list prepared by the Ministry of Trade and Industry, 20 June 1995, at the request of the author).

There are three types of personal companies or partnerships: a) General Partnership (*sharikhat al-tadammun* or *société en nom collectif*); b) Limited Partnership (*sharikhat al-tawsiyyah al-Basita* or société commandite simple); c) Joint Venture (Sharikhat al-Mahasah or société en participation). (Radwan, Abu Zayd 1978: 28-32)

a) General Partnership (Sharikhat al-tadammun)

This is a business structure formed by two or more persons, under a specific name, who are licensed to carry on commercial business. Its members are jointly liable to the extent of all their property for all obligations (Article 4, Law of Commercial Companies, Law No. 15 of 1960). Partners in the company are liable for the debts of the company as if they had personally incurred these debts. Furthermore, no partner may transfer his share to another person without the consent of the other partners (Al Okaily 1978: 133).

Foreign investors must pay careful attention to Article 12 of the CCL, which provides that companies incorporated after this law came into effect, may not transfer the share of a Kuwaiti citizen to a non-Kuwaiti national if such a transfer would reduce the Kuwaiti shareholding to less than 51 per cent of the company's share capital. In addition, there is a further provision that a partner's contribution must be either in money or "money's worth", i.e. in something of equivalent monetary value (Article 14 CCL). This is to prevent the use of Kuwaitis (who do not have any financial commitment to the partnership but who have economic or political clout) as "fronts". Al-Shammari (1987: 102-103) suggests that another reason for this provision is to ensure that the shares of members are quantifiable so as to facilitate the determination of their liability.

The evidence shows that since 1983 general partnerships have been the most common method of conducting business in Kuwait. (The total number was 3,150 by the end of 1983: Al-Shammari 1987: 194). In particular, they have seemed to be the most appropriate vehicle for undertaking medium-range industrial and commercial projects, as well as small projects, in cases where two or more persons know and trust each other and wish to embark upon a joint project. Such partnerships have clearly gained the confidence of commercial and financial circles in Kuwait - a fact which enables companies to obtain such credit as might in fact exceed the amount of their capital. This is due to the fact that the partner's liability for the debts of the company are not a limited liability (Alokaily 1978: 129-130). It is worth noting, by contrast, that western banks have tended to favour limited liability companies when it comes to granting credit.

Generally, it cannot be doubted that control of any business in Kuwait, as well as a large proportion of the profits, lies in the hands of Kuwaitis.[1] On the one hand, Article 13 of the CCL allows for the exclusion of a partner from the profits or losses of the company. (This could have been an attractive mechanism for foreigners wishing to restrict the participation of Kuwaitis or for those who want dormant Kuwaiti partners.) On the other

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[1] In order to achieve control, the foreign investor may have to construct various corporate devices which would no doubt increase costs, and which may be struck down by Kuwaiti courts as contrary to public policy. It is also important to note that although it is not a written regulation, a foreign company holding 49 per cent of the total capital of a company should expect to divest up to 25 per cent after several years (Gulf States Chase World Information Services on Developing Business in the Middle East and North Africa: 129).

hand, the same Article permits the partner who has been excluded from participating in the profit or loss to seek a court order to rescind the partnership. This clearly indicates a number of potential areas of dispute and is the main reason why Article 13 has been unattractive for foreign investors.

b) Limited Partnership (Sharikhat al-Tawsiyyah al-Basita)

There are two types of limited partnerships: simple limited partnerships and limited partnerships by shares. The main difference between the two types is that in the latter case the capital is divided into transferable shares whereas the shares for simple limited partnerships are not transferable. However, limited partnerships by shares are still subject to the general rule applicable to joint stock companies concerning the transfer of shares: at least one of the general partners must be Kuwaiti, and the Kuwaiti share in the partnership must be at least 51 per cent after the transfer. (Al-Shammari 1980: 61-62). This limitation is certainly likely to be unattractive to foreign investors.[1]

c) Joint Venture (Sharikat al-Mahasah)

A joint venture may be formed by two or more natural persons and is peculiar in that the resulting business association has no separate legal personality: it exists only between its members and is not binding on a third party (Article 56 of Law No. 15 of 1960). Persons participating in a joint venture are personally liable. The legal relationship of the third parties to the joint venturers is restricted to the partner(s) with whom such a party has entered into contract directly.

Although foreign investors establishing a joint venture are expected to observe Kuwaiti law (Kassim 1991: 432) and get a clearance that the venture can transact a *bona fide* business, it must be stressed that this vehicle does offer some definite advantages to foreign

[1] Partnerships limited by shares have a mixed character which will be explained subsequently under the third type of commercial companies later in this chapter (see 'Companies of a Mixed Nature', section 4.2.6).

investors. To start with, joint ventures do not need to be published or registered in the Commercial Register. But even more significantly, foreign participation in joint ventures is not limited to 49 per cent as it is in the case of all other Kuwaiti legal entities (Al Fahad & Co. 1982: 12, 19), and there is no legal requirement for any minimum percentage in local ownership for the joint venture (Fox and Gibbons 1991: 6). Accordingly the joint venture allows for a significant degree of fluidity and this is of benefit to potential foreign investors.[1] It should also be pointed out that the joint venture has the unique feature of being invisible with no corporate personality (in the sense in which we say, for example, that a joint-stock company is a legal person subject to certain provisions).[2]

Despite the evident fluidity of joint ventures, foreign investors must realise that such ventures are not allowed to operate in all sectors of the Kuwaiti economy. They are excluded from the banking, insurance, industry, real estate and securities fields (Kasim 1991: 432). The most important spheres of activity for joint ventures are: trading and speculating in stocks and shares, the service sector and building contracts.[3] It appears that the law does not envisage the use of the joint venture form for doing business on a long-term basis. This may act as an incentive or disincentive depending on the particular needs of the investor (Article 56 of Law of Commercial Companies, No. 15 of 1960). At best, what the joint venture does is to allow the foreign investor to do all the work and then to share the profits with the Kuwaiti partner. However, for the foreign investor to be able to deal with Kuwaiti third parties, he

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[1] In terms of management, joint venture companies differ from other companies which delegate management functions to either one manager or to a board of directors. Kuwaiti legislation does not regulate joint venture management; it is the partner's choice as to a suitable method of management for the joint venture company. Indeed, as Fox and Gibbons (1991: 6) point out, under the Commercial Companies Law, joint venture partners can agree on management, liquidation, contributions to capital, accounting procedures, distribution of profit and loss sharing without any legal impediment based on their being foreigners.

[2] If this invisible nature is revealed, then the joint venture turns into an actual joint liability company which has not yet completed the entry procedures for registration in the Commercial Register (see *Majallat al-Qada wa al-Qanun*, *Judiciary and Law Periodical*, Second Year, First Number: 51, session on 14 April 1970, Kuwait Court of First Instance). According to Tama Al-Shammari (1987: 254), some jurists maintain that a joint venture becomes a limited partnership if some of the partners define their responsibilities in proportion to the extent of their shareholding, and do not interfere in running or managing the venture. The joint venture no longer exists once it has successfully carried out the purpose for which it was established or if its duration, which was determined for it, has expired. The same applies if the principle of having several partners is violated or abandoned, or if its capital has depreciated. (Kuwaiti High Court of Appeal, Decision No. 84/1978 trade in 14.2-1981, unpublished.)

[3] In addition, it is possible that commercial companies can use the joint venture as a tool or instrument for developing secret monopolies to protect themselves against competition which could prove destructive of their interests (Al-Shammari 1987: 245).

must shoulder the cost of a Kuwaiti guarantee. Otherwise, he needs to involve a Kuwaiti agent, in which case he might as well have settled for a commercial agency arrangement (if such business could indeed be carried out).

A Critique of Personal Companies

It is clear that personal companies are based mainly upon personal considerations and especially feelings of trust mutually shared by their members. In the majority of cases, they involve agreements between a limited number of persons who are united through blood relations, friendship and family ties. A member of such a company may not transfer his shares to a person outside the company or to the other directors except with the prior approval in writing of all the other directors. Moreover, the company must be dissolved if any of the partners is placed under distraintment or declared bankrupt.

Personal companies are characterised by complicated procedures and adherence to many contractual conditions. This means that they are likely to be difficult for foreign investors to understand. As stated earlier, the laws relating to personal companies were originally passed in the 1960s to provide protection for Kuwaiti capital against possible control or dominance by foreign capital. The present situation, however, is quite different because Kuwaiti businessmen have now become well established in the market. The author therefore believes that a strong case can be made for amending the provisions of the relevant laws to make them compatible with the present needs of the market, and for ensuring that any modifications should include the provision of positive incentives to attract foreign technology and expertise.

II. Joint Stock Companies (Capital Companies)

The second category of business organisation consists of joint stock or capital companies. This is one to which investors subscribe in order to transfer shares, and their liability is limited to the extent of the face value of those shares (Article 63 of Law No. 15 of 1960). Only natural persons may subscribe for shares, and joint stock companies incorporated in

Kuwait have a separate legal recognition from their shareholders and automatically acquire Kuwaiti citizenship (Article 63 of Law No. 15 of 1960).

There are two forms of joint stock companies recognised by Kuwaiti law: closed and public. Closed companies are similar to private companies in the western world in that shares cannot be offered for public subscription, whereas public companies may offer such shares.[1] The number of foreign investors who had shares in public companies in Kuwait in 1995 was 42 (Information supplied by the Ministry of Commerce and Industry, 7 August 1995, in response to the author's request). Generally, foreigners are precluded from purchasing shares in joint stock companies (Al-Shammari 1980: 64). In exceptional cases, however, they may do so if this is necessary to raise foreign capital and to use foreign expertise. In such circumstances, a government licence must be obtained to permit the foreign participation (Article 68, Commercial Companies Law No. 15 of 1960). Where foreign investors are allowed to participate, the equity holdings of Kuwaitis must not be less than 51 per cent and must be divided into equal shares carrying equal voting powers (Article 68, Law No. 15 of 1960).

In the case of insurance companies and banks, foreigners can invest only if there is a need for foreign capital, expertise or know-how. In such cases, the percentage of Kuwaiti shareholding participation in the project must not be less than 60 per cent of the share capital of the company. In the case of insurance companies, approval for foreign participation is given by the Ministry of Commerce and Industries. For foreign participation in banks, the approval of the Central Bank of Kuwait must be obtained (Law No. 51 of 1994, concerning

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[1] The minimum capital of a public company is 37,000KD, while that of a closed company is 7,500KD (Article 89, Law 15, 1960). Gerald (1991: 325) is inaccurate on this point. If all the issued capital has been fully paid up, then the capital may be increased. The rules which govern the original issue apply and are extended to new issues, save that existing shareholders enjoy the right of first refusal of the new share (Article 110, Law 15 of 1960). The capital must be divided into shares of equal value with a nominal value of 100 fils and a maximum of 75KD. Shares may be issued at a premium but not at a discount. Subscription expenses must be covered out of the premiums, and any surplus must be paid into the statutory reserve or the share redemption fund. Shares may be issued for payment in kind provided that such shares are immediately paid up in full (Article 99, Law 15 of 1960).

In essence, as stressed by Al-Shammari (1987: 263-264), public companies aim to raise money from the public, regardless of who the shareholders might be, in order to carry out large-scale financial, industrial or commercial projects. They may issue bonds by public subscription, which will entitle the holder to a set interest, payable on fixed dates and to the repayment of their loan (Article 128 of Law 15 of 1960). Bonds may also carry a bonus repayable on redemption (Article 118 of Law 15 of 1960).

the amendment of some provisions of the Commercial Companies Law No. 15 of 1960). It may be noted that prior to 1994, foreigners were prevented from investing in insurance companies and banks (see Al-Shammari 1980: 46 for the former position). Foreigners may subscribe for bonds and debentures but they cannot convert the debentures they hold into shares unless there is a need for non-national capital foreign investment. This is a matter left to the discretion of the competent government department (Article 68 of the Companies Law, No. 15 for the year 1960).

Given the considerable amounts of capital raised through public subscription, these companies serve as an appropriate vehicle to execute large-scale financial and industrial projects. They are a common vehicle for banking operations, insurance, heavy industry and various types of transport, the extraction of oil and minerals, and other major projects. Such companies now dominate the Kuwaiti economy, and consequently Kuwait, like most countries, has stringent rules concerning their regulation. There are also administrative controls which aim primarily to protect the assets of investors from extortion and to serve the broader interests of the national economy as a whole (Al Okaily 1978: 171-172).

It has to be recognised that in practice most multinationals, because of their large capital base, do not usually need to raise funds by public subscription; so they do not really require vehicles like public companies. Multinationals may also prefer to opt for closed companies because they involve less scrutiny and fewer procedural hurdles.

A Criticism of the Joint Stock Company Regulations

Despite the advantages of joint stock companies as business vehicles, they must be regarded as generally unsuitable for foreign investments in Kuwait for a number of reasons:

i. The fact that only *natural persons* may participate in joint stock companies restricts the direct participation of foreign based multinational firms. The only way multinationals can conduct business through a joint stock company is by appointing a nominee, which has obvious disadvantages. It is the author's view that the CCL must be revised to allow the direct participation of juristic persons, including foreign legal persons, in joint stock companies.

ii. Foreign investors can only participate in joint stock companies if the competent authorities are satisfied that foreign capital, know-how or expertise is needed. The authorities have discretion to determine when the foreign participation is needed. Unfortunately, there are no definite guidelines laid down by statute or published by the competent authorities for governing the exercise of this discretion. Foreign investors would find such guidelines helpful in ascertaining the likelihood of success of their applications. If Kuwait wishes to attract substantial foreign investments it should consider clarifying to foreign investors the fact that any application which is unjustifiably refused can be challenged. Better still, if foreign investors are not made to establish that their capital or expertise is needed.

At the present time, when foreign investments may be in the form of "money's worth", for example in intellectual property licences rather than cash, unduly stringent controls on the mode of contribution of investment capital could discourage foreign investment. Given these restrictions, it is entirely understandable that foreign investors have not found joint stock companies a suitable vehicle for conducting business in Kuwait. Recent figures show that most public joint stock companies in the industrial sector are owned exclusively by Kuwaitis, with varying degrees of Government participation (see Table 1 below). Only a few companies, like Metal Pipe Industries, have foreign shareholders. Again, all closed joint stock companies operating in non-oil industries are solely Kuwaiti owned. Foreign participation in joint stock companies is usually limited to small and simple industries where they hold a minority interest that does not exceed 49 per cent.

TABLE 1 ~ INDUSTRIAL PUBLIC AND MIXED SHAREHOLDING COMPANIES

Company	Year Established	Government's Participation
National Industries Co.	1960	59.50
Kuwait Metal Pipe Industries	1966	28.05
Kuwait Cement	1968	34.60
Kuwait Fisheries	1972	55.60
Refrigeration Industry & Cold Storage	1973	27.60
Auto Industries and Trading	1973	18.40
Gulf Cables & Electrical Industries Co.	1975	44.00
Kuwait United Poultry	1974	39.80
Kuwait Pharmaceutical Industries	1980	51.70
Kuwait International Petroleum Investment	1980	74.90
Shipbuilding and Repair	1974	28.23

Source: Annual Statistical Abstract 1986, Table 234, p. 270

The result of all these restrictions is that foreign participation in Kuwaiti business ventures is often limited to collaborative projects. Public shareholding companies in the industrial sector which are exclusively Kuwaiti owned often make arrangements with transnational corporations for acquiring technical knowledge and assistance, for the supply of materials and equipment, and for other services that they require (Mohamed Sadik 1988: 14). Major Kuwaiti industrial companies often enter into various non-equity forms of association with foreign companies, including turnkey contracts, licences, design and engineering, construction agreements, subcontracts and management contracts (see Table 2 below). The point must be underlined that whilst most investment projects did not require foreign capital

before the Gulf War, the situation has now been transformed and Kuwait is in need of more investor-friendly regulations if it is to rebuild its economic base.

TABLE 2 ~ MAJOR KUWAITI INDUSTRIAL COMPANIES AND FOREIGN COMPANIES WITH WHICH THEY HAVE BEEN ASSOCIATED BY COUNTRY AND TYPE OF ASSOCIATION

Kuwaiti Company / Name & Country of Foreign Company	Type of Association	Area of Work	Plant / Division
Petrochemical Industries Company *			
1. Foster Wheeler (USA)	Turnkey contract 1. Design & Engineering 2. Process licence	Ammonia - 1 Urea - 1 Ammonia - 1 (gas reforming)	(Plant A, Fertiliser Division)
2. Casale (Italy)	Licence	Ammonia 1 (Conversion Process)	
3. Simon Carves (UK)	Process licence	Sulphuric Acid Unit	(Plant A, Fertiliser Division)
4. Stami Carbon (Holland)	Process licence, Design & Engineering	Ammonia Sulphite Unit	(Plant A, Fertiliser Division)
5. Contracting & Trading (Lebanon)	Subcontractor (Construction)		(Plant A, Fertiliser Division)
6. Haldor Topsoe (Denmark)	Turkey contract (Process licence, Design & Engineering)	Ammonia 2 & 3	(Plant B, Fertiliser Division)
7. Stami Carbon (Holland)	Process Licence	Urea 2 & 3	(Plant B, Fertiliser Division)
8. Consolidated Contractors Co. (CONCO) (Lebanon)	Subcontractor (Construction)	Ammonia 2 & 3	
9. Babcock (UK)	Subcontract (Supply & Equipment)	Ammonia 2 & 3	
10. Lurgi (W Germany)	Subcontract (Supply & Equipment)	Ammonia 2 & 3	
11. Chiyoda Chemical Engineering Construction Co. (Japan)	Engineering & Construction	Urea 2 & 3	(Plant B, Fertiliser Division)
12. Stami Carbon (Holland)	Process licence & Design (expansion)	Urea 1	
13. Coppe Rust (Sweden)	Construction (expansion)	Urea 1	

No.	Company	Nature of agreement	Project
14.	Haldor Topsoe (Denmark)	Process licence & Design (a new line)	Ammonia 4
15.	Techni Petrol (Italy)	Turkey Construction (main contractor)	4th Ammonia line
16.	Novopignon (Italy)	Subcontractor	4th Ammonia line
17.	Chicago Bridge (USA)	Subcontractor	4th Ammonia line
18.	CHEM Systems (USA)	Consultant (Studies & Management)	
19.	Tokoyama Soda (Japan)	Main process licence and Engineering	
20.	Hitachi Sozen (Japan)	Construction	

Kuwait Metal Pipe Industries Co.

No.	Company	Agreement
1.	Salzgitter AG (W Germany)	Technical co-operation (technical advice, technicians for supervision, training of company's technicians in factories of the company in W Germany). Agreement was signed on May 1968 and was terminated in the early 1970s. An agreed upon annual fee was paid during the agreement.
2.	American Petroleum Institute (USA)	Authorisation to the official monogram on spiral weld-line pipes. Since April 1970. An agreed upon fee is paid for the authorisation.

National Industries Co.

No.	Company	Agreement
1.	Henkel (W Germany)	Licence for the company's detergent factory to produce Dixan and Persil.

Refrigeration Industry & Cold Storage

No.	Company	Agreement
1.	White Westinghouse (USA)	Technical Assistance in 1976.
2.	York (USA)	Licence for manufacture of central air-conditioning units, since 1979.

Kuwait Chemical Manufacturing Co. **

No.	Company	Agreement
1.	Syres D.S.M. (Holland)	Agreement to acquire right of know-how and technology, 1986.
2.	Not named (Switzerland)	Turnkey contract for construction of the factory in 1980.

Kuwait Melamine Industries Co. ***

No.	Company	Agreement
1.	Chemical (US) with Eurotechnics (Italy)	Licence to provide technology for the company's plant.

* All modifications and/or technical problems which may be encountered after commission are referred to the Process Licencer and Designer for advice.
Plant A was set up in the period 1964-1967.
Plant B was set up during 1969-1972.
Expansion of Urea 1 in 1974; 4th Ammonia during 1979-1985.

** Trial commercial production started 1983.

*** Commercial production started 1980. A feasibility study following technical and financial difficulties which faced the company revealed the unfeasibility of the continuation of the company's activities. Accordingly, the general assembly of the company passed a resolution approving the liquidation of the company effective 11/12/1985.

Source: United Nations Economic and Social Council, 1988, Table 11-3.

III. Companies of a Mixed Nature (Al Sharikat al Mukhtalata)

Companies of a mixed nature are in an intermediate position between personal companies, which are based upon personal relationships, and capital companies, which are based upon financial considerations. There are two types of mixed companies: partnerships limited by shares and limited liability companies. It is interesting to note that the name of a company limited by shares must not be derived from the name of a natural person unless the object of the company is to exploit the patent of that natural person (Article 64 CCL).

a) Partnership Limited by Shares (Sharikat Altawsiah bi al Ashum)

Business organisations of this type are uncommon. According to officials in the Department of Companies and Insurance in the MCI, there have been no more than two partnerships of this kind in the country since the Commercial Companies Law was enacted in 1960 (Al-Shammari 1987).[1] Some jurists maintain that this rarity is due to the difficult procedure for the formation and registration of such partnerships (Al-Khouly, 1970: 601-602; see also Chapter Five).

The existence of the simple partnership seems to make the limited partnership unnecessary. Article 48 of the Companies Law states that the partnership limited by shares is

[1] There is no data from the MCI about the number of partnerships limited by shares in Kuwait. However, following the author's request, the MCI did supply her with the number of public and closed joint stock companies and Alshkhas companies only.

subject to the rules established for the simple partnership. Thus, the rules for setting up both forms of organisation are in fact the same. In certain instances, which are not clearly defined, a partnership limited by shares may be subject to some of the difficult procedures required for the incorporation of an anonymous company (Al-Shammari 1987: 35-36). Not surprisingly, it remains an unpopular vehicle for conducting foreign investments.

b) Limited Liability Company (WLL) (Al-Sharikat that Masauliah Mahdoudah - société a responsibilité limitée)

These companies, otherwise called WLLs (with limited liability), are easy to establish and operate, making them popular with foreign investors. It is perhaps the form of business organisation which is most similar to the private companies limited by shares found in Western Europe and North America (Webb and Van Hoorn 1990: 12-14). A WLL consists of a body of not more than thirty persons. The liability of each member (for its debts) is limited to his share in the capital. The company's incorporation invests it with Kuwaiti nationality and it can maintain its registered office in Kuwait (Article No. 190 of Law No. 15 of 1960).

WLLs are common (their number had reached 4,448 by the end of 1983) because of their limited liability nature. This enables the investor to avoid any potential threat to his assets which are not invested in the company; they are safe from any threat of loss or liability since any partner in the company is liable only to the extent of his shares in the capital.

A Critique of Mixed Companies (WLLs)

Partnerships limited by shares are extremely uncommon and are not attractive for foreign investors for the reasons given above (section A and B of III). Although WLLs are more attractive, there are still certain impediments which limit their use by foreign investors and which may be summarised as follows:

i. Only natural persons may acquire shares in a WLL. This means that most foreign corporations either do not use this vehicle, or they are compelled to appoint nominees as representatives.

ii. WLLs cannot offer shares for public subscription or issue negotiable debentures (Article 185 of Law No. 15 of 1960). This prohibition appears to derive from the fact that investors who opt for WLLs are often interested in carrying out medium and small-scale economic projects which do not need public subscription (Abbas 1961: 189).

iii. The transfer of shares in WLLs is subject to redemption by partners (who must have a first call on the shares), as we shall see below (Article 180 of the Companies Law, 1960). The rationale for this seems to be that WLLs are formed by a limited number of partners who are closely related to, and acquainted with, one another, with feelings of mutual trust amongst themselves. If these companies were allowed to form or raise their capital through public subscription, the result would be the entry into the company of partners who neither know nor trust one another.

iv. WLLs cannot exist in perpetuity; their duration may not exceed twenty-five years. This may also be another reason why WLLs are not allowed to seek public subscription. It may be difficult to distribute such funds when the life of the company is limited.

v. WLLs may not operate in the fields of banking, insurance or investment for third parties (Article No. 187 of Law No. 15 of 1960).

One particular reason why this vehicle may appeal to foreign investors is that because normally at least one manager does not have to be either a Kuwaiti national or a member of the company. The board of directors elects the chairman. Unless the articles of association provide otherwise, only shareholders can be appointed as directors. Given the maximum 49 per cent holding for foreigners, they must therefore remain a minority in any such company. It should be noted that the control and management structures of Kuwaiti companies are

generally similar to common international practice:[1] usually a board of directors or control council is established (this applies to limited liability companies), and directors are elected by a simple majority of the shareholders. Whilst the law does not directly require that the board of directors comprise a majority of Kuwaiti nationals (Article 8 of the Law of Industry is an exception), foreign investors may only secure their position by appointing representatives to the board on their behalf, commensurate with the number of shares held by them (Article 142 Commercial Companies Law, No. 15 of 1960).

The capital for a limited liability company must be not less than 7,500KD (Article 189 of Law No. 15 of 1960), and at least 51 per cent of the capital must be Kuwaiti owned at all times (Article 197 of Law No. 15 of 1960). This is an obvious disincentive to foreign investors who, facing the restriction that they are only allowed minority stakes in WLLs, may be averse to investing without stronger mechanisms for minority protection. In fact, Kuwaiti law on minority protection is in most respects perfectly commendable.[2] It would seem, nevertheless, that the law's main aim in this respect is to ensure that Kuwaiti investors do not abuse their dominant position; it does not actually give control to the foreign investor, nor does it permit him an equal share in the enterprise. A change in the law, making it possible for parties freely to establish their own shareholdings irrespective of the nationality of a shareholder, would be very welcome in the bid to maximise the country's reconstruction efforts (Gerald 1991: 322). Alternatively, the law should provide for different classes of

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[1] I shall concentrate on limited liability companies and joint companies here in the belief that there is not more to be said about partnership beyond what has been said.

[2] For instance, it is the unqualified right of *every* shareholder to bring an action in court for the nullification of any resolution passed by the general meeting or the directors which is in contravention of the law, public order, or the memorandum or articles of association of the company (Article 131, Commercial Companies Law No. 15 of 1960). Article 136 of the same law goes even further for those shareholders holding in total 15% or more of the nominal value of the subscribed capital by permitting them to challenge in court any resolution which they have not agreed to, where such a resolution would be detrimental to their rights and where the resolution provides for an amendment to the articles of association, for the sale or disposal of the enterprise, or for an amalgamation with another enterprise. Again, a restriction exists on the power of the general meeting (except in the case of written consent or a unanimous vote of all shareholders) with respet to: an increase in the financial charges levied on a shareholder or in the nominal value of a share; a reduction in the percentage of the net profits which must be distributed to the shareholders as determined by the articles of association of the company; the imposition of any new conditions, other than those set forth in the company's articles of association, which relate to the competence of a shareholder to be present and to vote at the general meeting; the restriction on a shareholder's right to institute proceedings against all or a number of the directors and to claim damages according to law (Article 133, CCL). If nothing else, these provisions are good for minority protection and could encourage foreign investors to opt for WLLs.

shares with different voting rights, which would permit the partners to control the company as they deem fit.

5.2.2 Criticisms of Forms of Business Organisation

From the preceding analysis of the main methods of conducting business in Kuwait, it would appear that the most convenient way of doing business for the foreign investor may be to appoint a commercial agent or representative (see below, section 4.3). This is not because the law consciously encourages it, but due to the silence of the law on the core implications of agency relationships, such as control and remuneration, the parties do appear to have a greater freedom to satisfy their interests by contract. Besides, a commercial agent or representative can offer the foreign investor a local partner who has valuable knowledge of Kuwait's business culture. Unfortunately, this mode of doing business is hardly appropriate for manufacturing enterprises, and in practice has not actually done much to encourage the growth of foreign investment in Kuwait.

The fact is that in some cases, and for obvious reasons, the foreign investor will prefer to "go solo". However, such a foreign investor is not likely to find any of the modes of doing business currently available to him in Kuwait attractive. They all have disadvantages which the investor can hardly ignore, and as a result the legal regime regulating FDI is simply not able to attract investors in sufficient numbers to meet Kuwaiti development needs. The author therefore concludes that appropriate reforms of the law are urgently required. More specifically it is suggested that the Kuwaiti Legislature should take the following steps:

i. It should amend Article 23 of the Commercial Law Number 86/1980 so that it may be more flexible towards the entry of foreign investors into Kuwait for business purposes. Kuwait is in great need of the technical expertise which these investors can bring with them when they come over to Kuwait.

ii. The Commercial Companies Law, which was passed thirty-five years ago, should be reviewed along the lines earlier suggested, because social and economic life in Kuwait is now

radically different. The provisions of that law should be amended in such a way as to be suitable for modern economic developments in the country. The adoption of a better open-door policy, allowing for more openness towards foreign investment, would be a step in the right direction, one already taken by many countries in the world.[1]

iii. The new Kuwaiti legislation should define the areas of economic activity required for foreign investment in Kuwait, and which the foreign investors would like to develop. A "positive list" for projects should be made clear, allowing the foreign investor to operate in certain areas of activity as opposed to what is included on the "negative list", which specifies those areas or spheres of activity from which foreign investors are excluded. Foreign investors would, in this way, know that there is a clear and well-defined policy adopted by Kuwait, which should guide them along the right road to investment in the country. Such a policy has been adopted by many of those countries which now rank among the most advanced countries in the world from the industrial point of view.[2]

iv. Proceeding from a firm conviction as to the importance of defining the required spheres for foreign investment, the state of Kuwait should provide adequate incentives for those foreign investment projects which are directed at economic development in Kuwait, especially as such projects would involve the transfer of technology, as explained in detail in a subsequent chapter.

5.3 COMMERCIAL AGENTS

We now turn to the legal basis of the various types of commercial agency. The main law governing agency relationships is Commercial Law No. 68 of 1980. Other relevant laws are the Rules Governing Commercial Agencies, No. 36 of 1964, which are consistent with the

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1 China, for example, has adopted major policy changes so that now investment is encouraged through joint ventures or through wholly owned foreign participation in offshore petroleum exploration. In 1984 China also announced new, more favourable treatment for foreign direct investment in 14 coastal cities, including a liberalisation of regulations governing the purchase of inputs and the sale of a proportion of output on the domestic market (IMF 1985: 16).

2 Some countries, such as Nigeria, have established comprehensive lists of industries and their permitted degree of foreign participation, which varies according to an industry's technological complexity and capital requirements (IMF, 1985: 14-15). Other countries, such as Korea, have drawn up lists of priority industries in which foreign investment would be welcome and where it is often eligible for special incentives (GoIC 1993: 179-192).

1980 Law and the Law of Public Tenders, No. 37 of 1964 (Hill and Swanson 1988: 1). The laws permit foreigners wishing to trade in Kuwait without setting up a Kuwaiti business structure to appoint an agent (Webb and Van Hoorn Jr 1988: 18 - 20).[1] However there are three major types of agency, each with its own specific legal provisions: the contracts agency, the commission agency, and the distribution agency.

The first type of agency, the contracts agency, is merely a type of mediation for conducting business deals and has certain characteristics which distinguish it from other acts of business mediation.[2] In order to protect agents from unfair early terminations, Article 275 of Law Number 68 stipulates that the duration of the contract should not be less than five years: "Where the agent is obliged to incur some personal costs, such as to erect buildings for exhibition or warehouses for the goods or installations for repair and maintenance, for which the agent may not easily get compensation if the contract is of short duration".

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[1] There is no statute or regulation which defines the scope of an agent's authorities and duties. However, the Commercial Department of the British Embassy in Kuwait suggests that the main functions of an agent are: (i) to promote the sale of his principals' products or services; (ii) to alert his principals to forthcoming tenders/enquiries; (iii) to pass to his principals details of relevant tenders issued by the Central Tenders Committee (hereinafter the CTC) and of direct enquiries placed by public and private sector organisations; (iv) to submit bids through the CTC on behalf of his principals in response to public sector tenders; (v) to provide technical back-up, servicing facilities, etc. (vi) to maintain stocks of his principals' products; (vii) to obtain visa, make hotel reservations and arrange business programmes for visiting principals; (viii) to provide sponsorship and administrative back-up for his principals' staff who are resident in Kuwait (Commercial Department of British Embassy in Kuwait 1992: 1).

[2] Article 271 of the Commerce Law No. 68 of 1980 defines a contracts agency as "a contract pursuant to which a person undertakes to carry out regularly against remuneration in a certain specified area of activity, instigation and negotiation for the execution of transactions for the benefit of the principal; the agent's assignment may cover the execution and implementation of such transactions in the name and for the account of the principal." Legislation has attached special importance to the question of regulating and organising contract agencies, which have come to play a conspicuous role in modern trade, especially in view of the fact that world industry has expanded and, as a result, big manufacturing companies have now resorted to the practice of using many agents for promoting and marketing their products in various parts of the world. The contract agency is significant in Kuwait's commercial life, representing the main vehicle for business transactions. Consequently local interest groups lobby for better legal protection to be given to agents. (Explanatory note to the Kuwaiti Commerce Law, No. 68 of 1980: 68.)

Yakub Sarkouh (1987: 307) explains the situation as follows: The contract agency is a type of contract for a mediator or peculiar type of middleman to conclude business deals. It has certain characteristics which distinguish it from other acts of mediation. Major business enterprises, such as car, refrigerator and electrcal appliance factories, and wholesalers, appoint some persons or companies to act as agents for the principal for disposing of, distributing and promoting his products. Parties to the agency contract are free to determine the terms and conditions for the agency, including the method of termination. A contract agency can be made to coverthe whole of Kuwait and even the Middle East. Manufacturers and producers often resort to this type of agency whenever they find it difficult to make direct contact with customers. However, in the case of a contract agency for an insurance company for the purpose of concluding deals on its behalf, the agent is called an insurance agent. Contract agencies are also used widely in imports and exports.

Article I of Law No. 36 of 1964 deals with the regulation of business agencies and confines the undertaking of any business agency work in Kuwait to persons who have Kuwaiti nationality, whether legal or natural persons. In spite of the fact that the provision of this Article is very general, the business agency which is referred to often takes the form of a commission agency (Sarkouh 1987: 344).[1] This is the second basic type of agency. A commission agent generally sells products for a commission but does not take title to the products for resale at a profit, like the holder of a distribution agency (the third type). Nor does he actively promote sales, as do both distributors and contract agents. In addition, he does not provide services for a fee, unlike a contracts agent. In general, the legal provisions which apply to commercial agencies, as discussed above, also apply to commission agencies.

The provisions relating to both contract agencies and distributorships are quite different. (Gerald 1991: 324). Article 286 of Law No. 68 defines a distribution contract in the following terms: "Any distribution contract, under which a merchant undertakes to promote and distribute products of any industrial or commercial firm in a specific area, provided that he is the sole agent therein, shall constructively be considered a contract agency." (Article 286, Law No. 68 of 1980.)[2]

Kuwaiti law also recognises "distributorship" as a separate category of commercial agency which is dealt with under the legal provisions applicable to "contracts agency".[3] It should also be pointed out that Kuwaiti law distinguishes between a commercial agent and a

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[1] A commission agency is defined by Law No. 68 of 1980 as a contract by which an agent undertakes to carry out in his own name a legal disposition for the principal in consideration for a remuneration (Article 287).

[2] In a distribution contract, a producer in a certain country gives a merchant (a buyer) in another country the monopoly right to sell certain goods in a definite area of activity. In exchange, the buyer (distributor) undertakes to rely upon the producer (the vendor) as the sole source supplying him with the goods, which are the subject of the agreement, at his will. The contract may not include a condition by virtue of which the buyer commits himself to this, and the buyer (the distributor) would thus be free to buy similar goods from other entities or places. It is understood from this that the contractual bond between the two parties remains subject to the conditions provided for in the contract itself. (Kuwaiti Chamber of Trade and Commerce 1982.)

Webb and Van Hoorn, Jr. (1988: 22-24) point out that the same nationality and registration requirements apply to distributor contracts as to commercial agencies. The provisions about termination are the same. The contract must have a minimum five-year term if the distributor is required to build showroom utilities or warehouses. Distributorship agreements must be exclusive, though the territory can be limited. There are no other substantive requirements for distributorship agreements.

[3] The distinction between a contracts agent and a distributor is that the former's activities include negotiation and performance of contracts on behalf of the principal, while the distributor's activities are generally restricted to promoting, importing and distributing the products of the foreign principal. (Gerald 1991: 322)

commercial representative.[1] The important point here is that the commercial representative is bound to the trader by a labour contract, whereas the commercial agent is not (Ballantyne 1986: 145).

Producers and merchants often give their commercial representatives agency contracts authorising them to sign contracts with others in the name of, and for the account of, employers. Sometimes they empower them to carry out or do legal or financial transactions for their account. If the limits of the authorisation given to the commercial representative are not defined, then the authorisation is considered to be a general one comprising all transactions which the commercial representative is entitled to carry out.

Given the Kuwait Government's policy that Kuwaiti nationals should control both domestic commerce and the activities of foreign companies conducting business in or with Kuwait, the regulations seem somewhat restrictive. As stated earlier, under other types of business vehicles Kuwaiti law seeks to secure adequate protection for the Kuwaiti businessman or tradesman from competition from his foreign counterpart. There is a general ban under Kuwaiti law covering all business agency practice, whether it is an ordinary agency or based upon commission, a contractual agency, or business representation.

Article 1 of Law No. 36 of 1964 states that no one, whether a legal or natural person, can undertake any agency business unless he is of Kuwaiti nationality. Article 24 of the Kuwait Commercial Code No. 68 of 1980 provides that "a foreign company shall neither establish a branch in Kuwait nor perform any business activity in Kuwait except through a Kuwaiti agent".[2] The agent may be either a Kuwaiti national person or a Kuwaiti company.[3]

Commercial agency would thus appear to be the most convenient way for the foreign investor to do business in Kuwait since in practice the parties seem to be free to determine

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[1] The commercial representative is defined in Article 297 of Law No. 68 as "Any person entrusted by a merchant to carry out part of his business activities, whether travelling, at the business premises or elsewhere, who is bound under a contract of employment".

[2] There is an exception to this rule in the case of consultants and architects, who cannot have a local agent, according to the regulations of the Ministry of Planning (Commercial Law No. 68 of 1980, Article 24).

[3] Agency agreements need not be exclusive, as the principal is entitled to appoint more than one agent for the same product and territory. However, unless the parties explicitly agree otherwise, the agent is entitled to be paid for all sales concluded directly by the principal or by a third party in the agency territory (Webb and Van Hoorn Jr. 1988: 2). Consequently, it is safer for an investor appointing a Kuwaiti agent to state whether there is an intention to allow the agent to earn commission, even for sales which the agent has not effected directly.

their interests regarding control, remuneration, etc., by contract. However, it is not suitable for the establishment of manufacturing outfits and this is an important limitation. As can be seen from the above discussion, the fine distinctions between the three major types of agency must also be appreciated by the foreign investor, and the specific choice of agency will clearly depend on the particular circumstances and requirements of the investor in relation to his own business needs.

5.4 OWNERSHIP, CONTROL AND DIVESTMENT

For all foreign investors, issues of ownership and control, and the possibility of divestment, are of paramount importance in making investment decisions. Any likelihood of the expropriation of foreign investments is bound to deter prospective investors, and unfortunately this danger has long been associated with government policies in the less developed countries, usually for reasons associated with political instability and the legacy of anti-colonial attitudes. In Kuwait the need to allow foreign investors to own, control and transfer their investments and assets has to be recognised as crucially important in attracting investment to the country. In a global economy all countries are competing with each other to attract FDI, and all investors will be attracted to those countries which offer the greatest financial and economic security.

5.4.1 Foreign Investment in the Oil Sector

To begin with, the crucially important example of the oil sector may be taken to illustrate the issues of ownership, control and divestment in Kuwait. Three of the five companies which operate under the umbrella of KPC (they are: KOTC, KNPC and KFPEC) have been state-owned since their establishment (Economic Intelligence Unit, 1992-3: 16). The fourth, KOC, was until 1974 jointly owned and controlled by BP and Gulf Oil (see Chapter Three). In 1974 the Kuwaiti Government nationalised 60 per cent of KOC assets, including a refinery and an LPG plant at Al-Ahmadi city. The remaining 40 per cent equity was acquired by the Government the following year (Bergendah 1985: p. 4). The fifth company, American Independent Oil, which was granted a concession in the neutral zone in 1958, was

nationalised by the Government in 1977 and amalgamated with KOC in 1978 (Kuwait Facts and Figures 1983: 40).

1958 saw the founding of AOC, which was granted a forty-four year operating concession. 100 per cent ownership and control was held by Japanese interests until 1974, when the Kuwaiti Government obtained a 60 per cent controlling interest, a share that has remained unchanged (Bergendah 1985: 5). In 1963 PIC, in partnership with BP and Gulf Oil, established a new subsidiary, the Kuwait Chemical Fertiliser Co. (KCFC), and had a 60 per cent interest, with BP and Gulf Oil each controlling 20 per cent. In 1973 PIC took over the remaining 40 per cent shareholding of the other two companies (ESCWA 1988: 13).

TABLE 3 ~ OIL AND GAS COMPANIES

Company		Year Established	Government's Participation (%)
1. Kuwait Oil Tanker Co.	(KOTC) a/	1957	100
2. Kuwait National Petroleum Co.	(KNPC) a/	1960	100
3. Kuwait Oil Co.	(KOC) a/	1975	100
4. Petrochemical Industries Co.	(PIC) a/	1963	100
5. Kuwait Foreign Petroleum Exploration Co.	(KFPEC) a/b/	1981	100
6. Kuwait Petroleum Corporation	(KPC)	1980	100
7. Arabian Oil Company	(AOC) a/	1958	60
8. Kuwait International Petroleum Investment Co.	(KIPIC)	1980	70

a/ Subsidiary of Kuwait Petroleum Corporation (KPC)
b/ Created by the $2,500 million purchase of the US Santa Fe International Corporation in 1981
Source: *Economic Encyclopaedia of the Gulf Co-operation Council* (Second Edition, December 1983)

Although the former owners of these nationalised oil companies still retain an interest in the oil production and consultancy fields (ESCWA 1988: 13), the companies are actually owned and controlled as public sector government utilities (Masoud 1987: 210). (See Chapter Three for more detailed discussion of foreign oil companies.)

5.4.2 Banking and Investment Institutions

Today, seven commercial banks and twenty-eight investment companies operate in Kuwait and it is through them that most business is conducted (see Table 6). The ratio of bank deposits to GDP rose from 64 per cent to 73 per cent during the years 1985 to 1989 (Middle

East Economics 1992: 9). There are only two foreign banks in Kuwait: the *Bank of Kuwait and the Middle East*, and the *Bahrain and Kuwait Bank*, although neither of them has foreign shareholdings since non-Kuwaiti financial institutions are not permitted to operate in the country, nor are they allowed to acquire assets there or participate in enterprises that are Kuwaiti based. The British Bank of the Middle East, which had a concession to operate in Kuwait, was nationalised in 1971. Prior to 1994, all banks in Kuwait had to be organised locally; the majority of equity shares in the banks had to belong to Kuwaitis, whilst the minority ownership was limited to other Arab nationals (Amin 1991: 230).

TABLE 4 - BANKS

Name of Bank	Date Established	Shareholding (%)	
		Private	Government
A. Commercial Banks			
1. National Bank of Kuwait	1952	98.6	1.4
2. Gulf Bank	1961	87.8	12.2
3. Commercial Bank	1961	89.3	10.7
4. Al-Ahli Bank	1968	89.0	11.0
5. Bank of Kuwait and the Middle East [1]	1971	43.0	57.0
6. Burgan Bank	1975	41.7	58.3
7. Bahrain and Kuwait Bank [2] (Branch)	1978	100.0	—
B. Specialised Banks			
1. Real Estate Bank	1973	72.2	27.8
2. Industrial Bank	1973	51.0	49.0
3. Credit and Saving Bank	1960	100.0	
C. Islamic Bank			
1. Kuwait Finance House	1978	67.6	32.4

1 Replaced the branch of a foreign bank (the British Bank of the Middle East) which was given a 30-year concession on 1941.
2 The Bahrain and Kuwait Bank is owned by Kuwaiti and Bahraini private interest (50% each).
Source: Data on shareholding from Central Bank of Kuwait, Economic Report 1985, Table 24,pp.170-171.

As stated earlier, the restrictions on foreign investment in insurance companies and in banks have been amended following the promulgation of Law No. 51, 1994 which modified the provisions of Article 68 of the CCL No. 15 of 1960. This amendment has made it possible for foreign capital to invest in Kuwaiti insurance companies and banks if there is a clear need for such investment and expertise, and provided that the percentage of Kuwaiti participation in the project is not less than 60 per cent of the share capital of the company. The MCI must also approve the foreign participation in the case of insurance companies, and the Central Bank of Kuwait must approve the foreign participation in the case of banks (Law No. 51 of

1994 concerning the amendment of some provisions of the Commercial Companies Law No. 15 of 1960).

The rationale for this is the need to change certain aspects of the structure of the banking system and to consolidate the potentialities and prospects of Kuwaiti banks so that they may use their own abilities, both locally and internationally. The end in view is to give Kuwaiti banks the chance to develop their own executive apparatus so that they can achieve a high degree of efficiency and expertise, and obtain the technical means to keep abreast of modern developments in the banking world. All this has meant that the process of allowing large contributions by foreign banks to the capital of a number of Kuwaiti banks has become an urgent and imperative need. Such contributions would facilitate the transfer into Kuwait of the expertise of foreign banks, and this would greatly activate this important sector and improve the professionalism of Kuwaiti banks.

These considerations apply as well to Kuwaiti insurance companies. Article 68 of the CCL was therefore amended to allow foreign investment capital to contribute to Kuwaiti commercial banks and insurance companies provided that the percentage of Kuwaiti participation is not less than 60 per cent of the share capital. The reason for this is that such a percentage ensures the continued control of Kuwaitis over the management of such companies or banks. It also brings many advantages such as foreign expertise and connections with international markets (Explanatory Note to draft Law No. 51 of 1994). Furthermore, some Kuwaiti banks have retained links with foreign banks. The Credit Lyonnaise, for example, provided the Al-Ahli Bank with a managing director, a deputy managing director and various department heads during its first years of operation (MEED 1967: 864).

5.4.3 Other Service Utilities

As well as the oil, banking and investment sectors, there are other significant state-controlled areas of the economy in the Kuwaiti economy, including telecommunications, electricity, water, transport (including Kuwait Airways), education and health. In total, a considerable percentage of the economy is state-owned at the present time, with the oil sector accounting

for a very high proportion of GDP. On the other hand, financial services, some transport services, construction, and innumerable service industries are predominantly controlled by the private sector. It is also noteworthy that, at the present time, there is very limited manufacturing activity in Kuwait apart from oil refining and petrochemicals, and this fact places significant limits on the economic potential for further development through foreign direct investment.

The Government is involved in several other sectors besides the oil sector. The Kuwaiti state has full ownership of many public enterprise projects, including: the Drugs Factory (attached to the Ministry of Public Health); the Kuwait Milling Company; and the Kuwait Baking Industry Company, which includes a number of bakeries with a daily production level of more than 1.2 million loaves of bread (Masoud 1987: 216-217).

Conventional wisdom in any society inhibits the development of new ideas and strategies which might otherwise help the society and satisfy its needs. Opening up the Kuwaiti economy to foreign investment, therefore, will require both imagination and courage. However, should this step be taken, there are areas where foreign capital and expertise (with the foreign company participating in any profits or losses of the particular project) might be employed to great advantage: toll roads, electricity generation, water, environmental protection services, healthcare, banking, telecommunications and the Kuwait International Airport, not to mention, of course, the oil sector. By attracting such investments, Kuwait's borrowing requirement would be reduced, the need to impose charges for services or even the introduction of taxes would be delayed, and the country's balance of payments could well be helped. There would also be an associated trickle down effect from these projects due to the economic activity generated by them, helping other areas of the economy such as the construction, banking, hotel and retailing industries.

As far as hotels are concerned, the major first-class establishments in Kuwait have always relied on the advice and expertise of international hotel chains for their administration, with seven of these Kuwaiti hotels maintaining contracts (five management contracts and two franchise contracts) with these chains. Under the management contracts, an international hotel chain will receive a percentage of the profits, while under the franchise contracts, a fixed

amount will be paid for its services. Kuwait's Hyatt Regency, for example, paid $250,000 a year under a franchise arrangement (ESCWA 1988: 20) (see Table 5).

TABLE 5 ~ HOTELS BY DATE OF ESTABLISHMENT AND FORM OF RELATIONSHIP WITH INTERNATIONAL HOTELS (1985)

Hotel	Date Established	Relationship with Transnational Hotel
1. Sheraton	1966	Management Contract
2. Hilton	1968	Management Contract
3. Merridien	1980	Management Contract
4. SAS	1978	Management Contract
5. Holiday Inn	1981	Management Contract
6. Marriott a/	1979	Franchise
7. Hyatt Regency b/	1981	Franchise

a/ Became independent in 1987 and changed its name to "As-Salam".
b/ Became independent in 1987 and changed its name to "Kuwait Regency Palace".
Source: ESCWA, 1988, Table 11-9

5.5 PUBLIC SECTOR CONTRACTS

Public sector contracts, especially in construction activities, have an obvious significance for foreign investors who quite naturally will wish, in some circumstances, to bid for contracts. If there are serious obstacles to such foreign participation, then this may have far-reaching consequences for the general levels of FDI. The general rule is that the Government must conduct all its contracts and purchases by public tender (Article 2, Law of Public Tender, No. 37 of 1964). However, if the contract is under KD5,000 (17,500 dollars), the Government is allowed to import goods or enter into a contract without using the public tender system. The CTB (which is attached to the Government's Council of Ministry) is the body responsible for receiving the bids. It may also exempt Government ministries and departments from using the public tender if it is in the national interest (Article 3, Law No. 37 of 1964).[1]

[1] With regard to public tenders for contracts in the public sector, the tenderer must first be approved. Documents must be submitted to the Central Tender Board (CTB) or the particular Ministry concerned to prove that the tenderer is capable of performing the contract. Bidders are required to enter into bonds. Bid bonds are usually 5 per cent of the contract value and performance bonds are 10 per cent. The contractor gets a 10 per cent advance payment to allow him to assemble his equipment and to cover other initial costs. Local banks may also provide finance for the bids.

The CTB may delegate another committee to classify the contractors of public works within four major categories (Article 8, Law No. 37 of 1964): (1) Contractors able to carry out major construction projects to a high standard of engineering expertise whose initial cost is in excess of one million dinars (3,500,000 dollars); (2) companies capable of carrying out projects not in excess of one million dinars; (3) this category includes local contractors capable of work not exceeding 5,000,000 dinars; (4) this category includes local contractors

At the present time the main problem for foreign investors is that they are only allowed to bid for a public tender if they have a Kuwaiti partner or agent. This is a highly significant restriction. Under Article 5 of the previously mentioned law, the foreign company or its partner or agent must register in the classification lists of contractors or importers. According to the National Bank of Kuwait, it serves over 75 per cent of foreign contractors doing business in the country (NBK Advisory Services 1989: 56). Transnational corporations carried out about 38 construction contracts to the total value of 2,389.25 million dollars between July 1977 and December 1979. While the scope of activities varied, contracts involving construction activities alone accounted for 79 per cent of the total number of contracts and the value of these contracts amounted to 71 per cent of total value of all contracts (see Table 6).

Table 6: Construction Contracts worth $10 million or more carried out by Foreign Companies between July 1977 and December 1979

Type of Activity		Contracts Number	Number per cent	Contracts $ million	Value per cent
1.	Construction	30	78.9	1,688.3	70.7
2.	Design and construction	2	5.3	118.5	5.0
3.	Construction and Maintenance	1	2.6	320.0	13.4
4.	Supply of Materials an/or Equipment	3	7.9	222.8	9.3
5.	Installation of Equipment	2	5.3	39.7	1.6
	Total	38	100.0	2,389.3	100.0

Source: Contracts Reported in MEED (July 1977 - December 1979).

Foreign contractors carried out 567 contracts involving various different activities between 1980 and 1985. The total value of 487 of these was 14,974.8 million dollars. The total value of contracts (where the value is known) peaked in 1982, declined steadily in 1983 and 1984 then increased in 1985 up to 41.6 per cent of the level reached in 1982 (see Table 7). The main reason for the decline from 1983 to 1985 was the slowing down of construction

capable of carrying out work whose cost does not exceed 250,000 dinars (875,000 dollars).

activities because almost all basic physical and social infrastructures were completed. Another reason was the decline in oil revenues since 1983 (ESCWA 1988: 25.)

Table 7: Contracts Carried Out by Foreign Firms, 1980 - 1985

Year	Contracts with Stated Value		Contracts with Value not Stated	Total Number
	Number	Value $ Million	Number	
1980	89	2,646.5	12	101
1981	79	2,072.6	11	90
1982	85	4,403.8	16	101
1983	73	2,476.2	19	92
1984	89	1,541.6	18	107
1985	72	1,834.1	4	76
Total	487	14,974.8	80	567

Source: Contracts Reported in MEED in (1980 - 1985).

5.6 INVESTMENT IN STOCKS THROUGH THE KUWAITI STOCK EXCHANGE

Another significant aspect of foreign investment regulations concerns the freedom of investors to purchase stocks through the Kuwaiti Stock Exchange. Article 2 of Stock Exchange Regulations of 1987 defines stock to mean shares and debentures of Kuwaiti Joint Stock Companies, debentures and permits issued by the Government, a Government body or by public institutions or other such Kuwaiti and non-Kuwaiti stock licensed by the market to be negotiable. Yet only foreign investment in securities to the economy's benefit appear to be allowed under these regulations (Article 6 of Ministerial Resolution No. 35 of 1983 Pertaining to Enactment of the Bylaws of the Stock Exchange Market of Kuwait). Furthermore, the scope for foreign investment in Kuwaiti Joint Stock Companies through the Stock Exchange is directly limited by the Commercial Companies Law, CCL. The CCL provides that foreign

investments in the form of shares are only allowed where foreign capital and expertise are necessary and there are no restrictions on foreign participation in that sector of the economy.

There is no clear indication whether foreign investments in debentures and other kinds of stock are affected by the restriction on foreign investments, or indeed by the ceiling placed on the ratio of Kuwaiti foreign participation. This is an example of an area of the law which is characterised by uncertainty and ambiguity. For instance Article 118 specifies that bonds are only issuable if the subscribed capital is fully paid, and that the amount issued should not exceed the company's subscribed capital.[1] It therefore appears that foreigners can invest in bonds.

Foreigners face another impediment in stock exchange transactions: they cannot work as brokers; hence they have to deal only with Kuwaiti brokers. This requirement accomplishes nothing apart from increasing the costs for the foreign investor, who must first engage overseas brokers to deal with the Kuwaiti brokers. This inconvenience and expense could have been eliminated had foreign brokers been permitted to operate in Kuwait either in partnerships directly with Kuwaitis or through Kuwaiti agents. Having said this, however, this is obviously not an appropriate forum in which to examine the implications of investing in Kuwait by means of debentures.

Article 23 of the Kuwaiti Commercial Law was amended to correct the injustices suffered by non-Kuwaiti companies, particularly in the foreign exchange and commodities markets. Now, under Article 23, foreign investors and dealers have been granted the authority to deposit their capital funds in banks or invest in companies.

5.7 THE NEED FOR PRIVATISATION?

In recent years there have been many campaigns for reform in the administration, and attention has been drawn to the underdevelopment of the public sector. In response, privatisation has

[1] Article 118 has a provison: This provision shall not apply to mortgage banks, industrial credit banks and agricultural credit banks.

been invoked as a means of responding to the crisis in the administration. Many people have supported this campaign, especially those who feel that the Government's administrative problems have been worsening, with little hope for radical reform. It seems that there is a growing awareness of the superiority of the private sector in terms of its ability to respond rapidly to the ever changing demands of consumers. This is especially true for people who have had dealings with the private sector at a time when the public sector has been suffering from numerous problems which may be summed up as follows:

i. Administrative underdevelopment and excessive bureaucratic control of an over-extended public sector, which affects the qualitative aspect of the services, the efficiency in rendering these services, and the quantitative provision of those services.

ii. The high cost of public services due to the size of the bureaucracies; the non-existence of competition, as well as the fact that they are not open to market forces and productivity criteria; the weakness or lack of efficient accountancy systems, and the absence of quality controls.

iii. Levels of productivity are below acceptable standards. This is basically due to the fact that no connection is established between returns and the effort expended, as well as the adoption of a policy regarding appointments which does not define the qualifications needed by appointees, or the numbers of appointments which need to be made.

iv. The inability of these Government departments to show original or creative thought, or any concrete innovative spirit, and their inability to keep up with recent developments in technology and automation due to the fact that there are no solid foundations for the choice of good cadres or leaders; the weakness of the methods employed as regards incentives or encouragement of staff; the use of underdeveloped and antiquated methods of training staff and for monitoring their performance.

v. The attempt to achieve social and political aims through the work and activity of this apparatus. This is due to the nature of some of the services required by citizens in these societies, such as welfare services, as well as the need to provide them continuously, irrespective of their real economic costs.

vi. The intrusion of political and family considerations with regard to appointments, nominating cadres or leaders and administrators, methods of accountability or evaluation of their performance (Al-Hamoud 1990: 539).

There is abundant evidence, therefore, to show that the current performance of the non-oil sectors of Kuwait's economy is inadequate, and that two broad priorities must be recognised in terms of future reforms and innovations:

i. The control of the public sector over economic activity needs to be reduced. This control represents, in fact, the state ownership and management of many of the production facilities of commodities and services, especially in the area of public services. The control of the state over local economic activity has several important repercussions of which we should be aware, such as the increase of the relative importance of the public sector's share in the gross domestic product at current prices (75 per cent in 1992); the excessive enlargement of the number of Government employees (the civil servants); the decrease of efficiency criteria in management and the use of resources in the public sector as compared, in some cases, with the corresponding criteria in the private sector (which is controlled and determined by a number of factors, such as competition and the profit motive) (The Central Bank of Kuwait, Economic Report 1990-1992: 24-25).

According to Al Fayez (1995: 3), the reduction of the Government's role in the economy can be achieved:

a) through deregulation, which would free economic activity from all bureaucratic impediments;

b) by allowing the establishment of private economic enterprises that can compete with Government enterprises;

c) by allowing the establishment of new private enterprises that can compete with existing private enterprises. This is particularly true in the case of the finance and insurance sectors;

d) by allowing the private sector to provide the services that the public sector currently provides.

ii. The role of the private sector in the national economy must accordingly be expanded. This would unquestionably help to reduce the control of the public sector over local economic

activity and contribute towards allowing the private sector to play a fundamental role in the local productive process. This is especially important in view of the fact that this sector has increasingly come to play the role of a mediator offering imported commodities to the consumer in the local market. The effect of an expanded role for the private sector in the manufacture of a broad base of exportable goods and in absorbing more of the national workforce, in addition to the improvement in, and rationalisation of, the use of what will be transferred to it from public sector activities as a result of the privatisation programme (The Central Bank of Kuwait, Economic Report 1990-1992: 24-25).

However, privatisation can only have a positive influence if the relevant sectors are open to competition from investors, whether local or foreign, who have capital and expertise. This is an absolutely crucial point which cannot be overstated: there is no point in pursuing a privatisation strategy if unnecessary restrictions on FDI are allowed to remain in force. The existing laws affecting investments and immigration must be revised to become more friendly to foreign investors (Khaled-Alfayez 1995).

5.8 TOWARDS A BALANCED APPROACH

There is no doubt that the attempt to combine or reconcile the various means of attracting foreign investment, on the one hand, and protection of the national interest, on the other, requires foreign capital to be channelled into areas of investment which are likely to enhance the aims of socio-economic progress and of development. This means that the required sectors and activities for investment need to be defined and specified for the foreign investor who will then give priority to those sectors, and who will feel that he is being positively encouraged to invest in them.

Comparisons with the experience of other countries can be illuminating in this respect. For example, South Korea, has adopted a selective policy for FDI to encourage the light processing industries exports sector. Foreign investment was not encouraged to enter the imports replacement sectors such as heavy industry, the pharmaceutical industries, etc. South Korea, it should be noted, did not depend upon foreign investment to a great extent until the mid-1980s: the proportion of foreign investment in the country's GDP was less than 50 per

cent of that in Brazil, Mexico or Argentina. Indeed, one could say that industrialisation and economic growth in South Korea depended basically on the national investors. (GOIC 1993: 180) The proportion of direct foreign investment during the period 1965 to 1985 did not exceed 5 per cent of the flow of foreign capital in the form of loans, credits or grants. In 1985 this policy changed radically as a result of a revision in the law providing incentives for foreign investment (in July 1984), the liberalisation of economic policies of the country, and the use of controls for guiding investment or directing it towards desirable investment sectors, especially in industries requiring the transfer of developed technology or which encourage exports.

The most important of these controls took the form of the Positive List and the Negative List. The Negative List is a list of those industries from which the foreign investor is excluded. The outcome of this policy was that the list of industries in which the foreign investor was allowed to operate increased from 50 per cent in 1980 to 66 per cent in 1984 and to 80 per cent by 1987. On the other hand, the processing industries have adopted a markedly successful policy by opening the door to foreign investment for 97.5 per cent of these (processing) industries. This policy resulted in attracting large-scale investment; and the contribution of foreign capital rose to 65.9 per cent of the total investment in the processing industries, and to 33.3 per cent in the services sector (GOIC, 1993: 180-181).

In view of this evidence, the author believes that Kuwait should also adopt a system based upon a Positive List and a Negative List to definine the sectors in which foreign investors are allowed to invest. This process can be organised in a simple form: the legislation and laws governing these sectors should be clear and uncomplicated so that the foreign investor can easily comprehend them. The sectors to be included in the Positive List should be related to Kuwait's economic development and should require high technology. Sectors to be included in the Negative List should be those sectors which do not rely upon sophisticated technology and which are more labour intensive. The local investor would also have the chance to invest in them.

It is well known that the Kuwaiti authorities originally sought, by imposing certain conditions and restrictions on foreign investors, to protect Kuwaiti investors from

competition. Now it is their duty to define those sectors in which Kuwaitis frequently invest, and include these in the Negative List, already referred to. Sectors, on the other hand, which Kuwaiti investors refrain from entering should be made part of the Positive List so that foreign investors who have the necessary experience and the desire to invest may be given that chance to invest in them.

We may safely state, judging by the realities of the Kuwaiti experience, that the Kuwaiti investor normally tends to invest in the commercial rather than in the industrial sector. As a result it is the industrial sector which is in greatest need of investment since it is particularly conducive to growth and development. It is difficult to see how Kuwait can achieve further development without paying attention to the relatively underdeveloped state of this sector. It is for this reason that Kuwait should adopt a truly open-door approach to this problem by including the industrial sector in the Positive List and by allowing - indeed positively encouraging - foreign investment in that sector. The author believes that this offers a practical solution to Kuwait's current industrial stagnation.

This point of view has been supported by Professor Sornarajah, who pointed out the following:

> The principal reason for excluding foreigners from certain industries is economic and social. The entry of a foreign business giant may thwart the emergence of an entrepreneurial class within the state, which has both economic and social ramifications. However, in the matter of high technology, an area in which local entrepreneurs cannot compete, entry to foreign multinationals should be encouraged, whilst low technology and labour intensive areas are reserved for local nationals.
>
> In Thailand, for example, the Alien Business Law divides business into three sectors. The first consists of such sectors as rice farming and fishing, which are confined to local business. The second may be open to foreign business in collaboration with local business. The third consists of high technology sectors which are freely open to foreign business. (Sornarajah 1994: 102)

The Negative List would include the prohibited projects, i.e. those from which the foreign investor would be excluded because they are public projects carried out by the state or by the public sector. This list would also include what are called restricted projects: those in which the foreign investor would be allowed to invest only after certain developments have taken place in the Kuwaiti economy. The Minister of Finance should allow the foreign investor to

invest in these fields or projects only if certain conditions have been met: one of these conditions being, for example, the exportability of all the products.

With regard to the conditions of local participation in projects launched by foreign investors, the trend in the former communist countries of Central and Eastern Europe (and even in China) is towards removing ownership restrictions and thus encouraging the participation of foreign companies in the local economy. (IMF 1985: 16.) In general, the global trend today is towards greater economic liberalisation. The Andean Pact countries, for example, have removed more barriers against foreign investments. Indonesia has increased foreign ownership percentages, and Malaysia is allowing ownership by those other than ethnic Malays. China has set a minimum share that foreigners may provide (Wagel 1990: 75).

5.9 CONCLUSION

This chapter has reviewed the legal regime in Kuwait governing foreign investment, and the analysis has led to the conclusion that the laws and statutes regulating economic activity in Kuwait need to be reconsidered as a matter of urgency. This should be done in order to provide an appropriate and favourable climate for market forces, and to secure the maximum freedom for local economic activity all over the country, while also inducing foreign investment capital and foreign companies to work in Kuwait. Such a policy would be positively conducive to a higher degree of competition at home, in addition to the considerable benefits to be gained from sophisticated and developed technology, as well as the consolidation of the local spheres of activity so that they may exercise their creative and inventive power (The Economic Committee of the Supreme Planning Council, January 1994).

An examination of the main characteristics of the laws and statutes regulating foreign capital investment in Kuwait reveals that they impose too many restrictions and impede the type of business activity which may be carried out by foreign investors and the vehicles available to conduct the business. The pivotal point of significance for the attraction of foreign capital is not clearly pointed out or explained in connection with what is really required for Kuwait; nor are the conditions laid down for foreign investment. Present laws are antiquated

and stemmed originally from the need to protect the national sovereignty of Kuwait, as well as giving priority to safeguarding the economic interests of Kuwaiti citizens in the first place.What is now needed is a more definitive overall strategy for reform of the regulatory system, clearly based on relevant principles designed to attract the right kind of FDI to Kuwait.

The Kuwaiti Legislature should formulate the relevant laws in such a way as to make foreign investment in Kuwait a means of achieving the objectives of development. This can be done by encouraging investment in such sectors which are likely to strengthen the national economy. The priority should be for new laws to remove the obstacles to development and to provide the best investment climate.

The specific proposals made by the author, in light of the problems discussed in the above analysis, are as follows:

- The establishment of one department or entity for foreign investment, which may be a one-spot agency, as explained in Chapter Four.

- The amendment of the Commercial Companies Laws which were created nearly thirty-five years ago, as they are no longer suitable for modern economic developments.

- The amendment of the Industry Law of 1965 in such a way that it would truly reflect sound strategic decisions, and also positively respond to the new development strategy. The proposed amendment should seek to find a solution to many of the problems and obstacles confronting the existing industries, as well as industrial development in Kuwait.

- The reform of the legal system or institutions and their development so that there would be no discrimination between national and foreign investment.

- The adoption of the system of Positive and Negative Lists in order to define the sectors in which foreign capital would be allowed to invest.

- The encouragement of the private sector in Kuwait to enable that sector to play an active role in local economic activity and to allow it, with Government participation, to own and manage public utilities while stressing the role of the Government (and of the

public sector) in overcoming the problems and difficulties which may hinder private sector activity. A favourable climate should be provided for the dynamic growth of the private sector so that it may be the door through which foreign investment may enter the country.

CHAPTER SIX

INCENTIVES FOR FOREIGN DIRECT INVESTMENT: TARIFFS AND PREFERENTIAL FINANCIAL TERMS

6.0 INTRODUCTION

This chapter and chapters Seven and Eight seek to analyse the suitability of the various direct incentives offered by Kuwait to foreign investors, and to assess the extent to which those incentives have actually encouraged and protected FDI in Kuwait. First, in this present chapter attention will be given to the following incentives: preferential customs duties and tariffs, moves to create a free export zone, support for the repatriation of profits, the provision of low bank interest rates for loans, and access to industrial land. In Chapter Seven the focus will be on the impact of the investment regime on technology transfer and the building of human resources. In Chapter Eight the discussion will focus on the impact of various tax incentives. In all these chapters the aim is to outline those factors which now need to be given priority in the formation of an effective legal framework for attracting FDI to Kuwait. The two subsequent chapters (Nine and Ten) will consider two other major influences on FDI: guarantees against the expropriation of property (Chapter Nine) and the regime for settling investment disputes (Chapter Ten).

6.1 THE IMPORTANCE OF INCENTIVES IN DEVELOPING COUNTRIES

Some inital remarks are needed on the general issue of FDI incentives and their role in developing countries.[1] The general view of specialists is that "The renewed broad interest in FDI spurs the competition among countries for such investment ... ... [and] developing countries seem to be losing their share of world-wide FDI flows. This creates an atmosphere in which developing countries are tempted to enhance their prospects for FDI through special

[1] There is much debate as to whether foreign investment is attracted to host states by the granting of these incentives. On this point see IMF, *Foreign Private Investment in Developing Countries* (Washinton: 1985) pp 16-17.

incentives" (Shihata 1991: 488-489). The key issue, therefore, is what specific incentives are best suited to the achievement of FDI targets and thus to the enhancement of levels of economic and social development.

In Kuwait, as we have already seen, special emphasis has come to be placed on policies which seek to encourage industrial and human development and the diversification of the productive sector to effect an import substitution policy. This is a fairly common emphasis in developing countries. Certainly, evidence supports the conclusion that in Kuwait the key purpose of incentives should be to support and protect that foreign investment which is capable of providing genuine alternatives to imports. For Kuwait this means that the development of the industrial sector must be given priority, for the end in view is ultimately to export the surplus of products following the creation of a fully integrated industrial sector capable initially of meeting the needs of the local market, and subsequently of competing in foreign markets. The point must also be stressed that it is the non-oil industrial sector which lags behind at the present time, and that the impact of incentives on FDI in this sector is now a matter of great concern.

6.2 THE NEED TO ATTRACT FDI

It cannot be denied that over the past four decades consistent attempts have been made to broaden Kuwait's industrial base through economic diversification. This has been seen as a necessary means to achieve a reduction in Kuwait's economic reliance on oil (Al-Mejrin 1993: 7). The shock of the Iraqi invasion accentuated the importance of attaining this goal. The long-term aim is to make economic growth in Kuwait a self-perpetuating or self-generating process, and to maintain a minimum welfare standard for all Kuwaiti citizens. In this context, the 1976-1980 Second Development Plan in Kuwait identified the key objectives to be pursued as follows:

(a) The development of the national welfare system by the provision of training courses;

(b) Diversification of the productive infrastructure, or base, of the national economy as a result of the import of technology into Kuwait, the establishment of industrial projects, and the creation of a climate favourable for private investment in Kuwait's productive sector

(Basiso 1984:73, referring to the Kuwait Institute for Scientific Research seminar, May 1978: 9-10).

During the period of the Second Development Plan, 4.4 billion Kuwaiti dinars or about 38 per cent of the investment funds were devoted to industrialisation, and especially to the priority areas of capital-intensive and expert-orientated industries. While not doubting the level of effort put into attaining these objectives, nevertheless, in practice, the cumulative effect produced by innumerable resolutions and decisions regarding growth and investment is far from satisfactory since there has still not been a coherent and co-ordinated approach to these problems. (Al-Mejrin 1993: 6-8). In particular, the issue of applying the right incentives to attract FDI has not been dealt with properly, and - as this thesis consistently maintains - the importance of establishing an appropriate legal framework for FDI has not really received sufficient attention.

In terms of the various incentives which have been made available for foreign investments, it would appear that the Kuwaiti authorities and most writers subscribe to the structuralist school of thought (discussed in Chapter One) which argues that in order to achieve its goals, Kuwait needs to offer incentives to attract foreign investors along similar lines to other developing economies. (Al-Sherhan 1989: 3). There is also a widespread view that foreign investments are particularly crucial for industrial development in developing economies, so that the latter should carefully choose feasible projects and foreign partners who will contribute to the success of these projects. The conclusions of a major GOIC study (1993: 8) lend support to the recognition of the following priorities for Kuwaiti economic policy:

i. the diversification of the country's sources of income;

ii. the reduction of imports and the increase of non-oil exports;

iii. the training of the Kuwaiti workforce; and

iv. the transfer of appropriate technology into Kuwait.

In order to achieve these goals, the Kuwaiti Government must pay careful attention to the need to establish a favourable and hospitable investment climate. As Al-Sherhan (1989: 13) emphasises:

> In discussing the policy of the Kuwaiti government in creating or providing what is called the suitable climate for the development and growth of the industrial sector, including foreign industrial investment, it was found necessary to point out that such a policy depends, among other things, upon incentives and encouragement in various ways.

The investment climate, however, is not a single, unitary construction. Rather it incorporate a number of distinct elements, and it is the relationship between these elements - and their combined effects - which have to be appreciated.

6.2.1 Factors Affecting the Investment Climate

The Arab Investment Guarantee Organisation defines investment climate as the totality of the conditions and circumstances in which investment operations are conducted (including political stability, legal security and administration, the size of the market, the infrastructure, special geographic and demographic features) and the effects of these conditions or circumstances on the success or failure of investment projects and the movement, expansion or contraction of investment. All these interconnected elements - some of which are constant while others are variable - are central to the overall investment climate. Their interaction with one another often gives rise to new situations, new determinants and new data which are ultimately transformed or translated into incentives or disincentives for foreign capital investment. These various elements constitute the fundamental determinant of foreign investment in any country, either consolidating or undermining its very foundations (The Inter-Arab Investment Guarantee Organisation, no date, No. 7: 9). The importance of the legal framework for investment cannot be overestimated, given that laws are the vehicles or instruments by which the state normally formulates its investment policy or gives expression to its various financial, economic and administrative concerns and interests (Al-Deen 1993: 6-7).

The Inter-Arab Investment Guarantee Organisation study already referred to above (see Section 5.0) identified four main factors which encourage foreign investments, and all policy-makers in Kuwait should take careful note of these factors when considering their strategies for attracting FDI:

1. Political and economic stability;[1]
2. Reasonably easy procedures for obtaining investment licences and easier dealings with official bodies;
3. The freedom to transfer profits or principal investment funds abroad;
4. A stable rate of exchange for the local currency (Investment Guarantee Bulletin No. 70, August 1993.

Other significant factors which have been identified include a stable interest rate, profitability, the protection afforded to investing firms, and the tariff structure (Petrochilos 1989: 12). Furthermore, Kuwait's own incentives cannot be considered in isolation from those of other countries because the global FDI market is now highly competitive. In particular, it is informative to compare Kuwaiti experience with that of other Arab countries since any foreign investors attracted to the Arab World will scrutinise very carefully the various benefits to be gained by locating their investment in individual countries.

6.2.2 A Comparison of Measures to Attract FDI in the Arab World

As a GCC country, Kuwait has adopted three main methods for attracting foreign investment which are reflected in the regulatory legal framework, the incentives for encouragement of such investment, the relative advantage provided by the abundance of energy, and in several treaties which are discussed below. The focus in this section is on the extent to which Kuwaiti regulations to attract foreign investors are similar or dissimilar to those of other Arab countries, and for this purpose some comments will be offered on recent policy developments in Syria, Morocco and Tunisia.

[1] See on this subject Agrawal, Gubitz and Nunnen Kamp 1991: 17; Bennelt and Green 1972: 182-186. It should, however, be noted that other studies have suggested that economic factors outweigh political factors:e.g. Lewis 1979: 59-68.

In the Arab Republic of Syria, a law was issued (Law 10) for the encouragement of foreign investment on the 4 May 1991 and became effective on 10 June 1991. It gave all investors, whether Syrian citizens, Arabs, or foreigners other than citizens of an Arab country, the right to set up investment projects without laying down any conditions regarding any minimum percentage of Syrian participation in the equity. Within six months of the entry into effect of this law, i.e. by December 1991, the number of projects which were agreed upon was about 169, with investments costing nearly 23.8 billion Syrian liras (the US dollar was equivalent to 21 Syrian liras on 31 December 1991). (Investment Guarantee Bulletin, 1 May 1992, Number 58: 6).

In Morocco, a special Ministry for Foreign Investment was set up to help obtain necessary permits or approvals. The problem of currency transfers for both foreign investors and foreign residents has also been eased. In January 1990, the Moroccan Government cancelled the Maghraba (Moroccanisation) law so that a foreign investor is now able to incorporate a company in Morocco without any participation by a Moroccan investor. The Government has also taken the necessary steps to simplify the administrative procedures and arrangements in connection with various sectors, for example through the issue of a tax exemption certificate for the added value for machinery, equipment and commodity furnishings related to the tourist, mining and industrial sectors (Investment Guarantee Bulletin, No. 59, July 1992).

In Tunisia, a unified law to encourage foreign investment has now replaced five previous laws which were concerned with the organisation of private investments. The application of these five laws had revealed a number of systemic defects (Investment Guarantee Bulletin, No. 75, January 1994:3).

Kuwait's lack of a unified FDI law now appears to be a significant weakness when compared with the situation in other Arab countries. Furthermore, there is evidence that foreign investors have mixed views about the attractiveness of Kuwait as a location for FDI, especially in the aftermath of the Iraqi invasion. Thus, in comparing the situation in Kuwait in October 1993 with that in 1992, the Arab Organisation for Investment Guarantees (AOIG) questionnaire (No. 1) reveals that:

i. 39 per cent of the investors said that no change had taken place in the Kuwaiti investment climate;

ii. 32 per cent of the investors said that the investment climate was better than in the previous year;

iii. 29 per cent of the investors said that the investment climate was worse than in the previous year.

Although this questionnaire contains some discrepancies, it does reflect a somewhat negative attitude towards the investment climate during 1993. Over two-thirds of investors perceived either no change in Kuwait's investment climate or an actual deterioration. (Interview conducted by the author with Mr Abdou Taha Ayoub, 7 January 1995). These conclusions can be linked to the results of the Investment Climate Report for 1991 which showed that the main factors favourable to foreign investment in the Arab countries are political stability, freedom in transferring investment profits and capital, the possibility of realising high profits from the investments, and stability in the rate of exchange of the local currencies. (Investment Guarantee Bulletin, No. 60, August 1992). A similar analysis of the situation in Kuwait confirms that these four factors are certainly of key importance, but two further factors are highlighted: the clarity of laws regulating investment, and the ease of procedures for obtaining investment licences and of dealings with Government departments (Zuhair Al-Sa'doun, April 1993, Kuwaiti Society of Accountants and Auditors). As this thesis argues, the last two factors have tended to be neglected in analyses of FDI in Kuwait, and it is precisely because of this that the legal and administrative processes related to FDI now need to be scrutinised.

The full results of the 1993 AOIG questionnaire (No. 2) deserve to be listed because they show quite clearly a number of factors that are favourable to the choice of Kuwait for foreign investment projects. These factors, arranged in the order of their importance, are as follows:

i. Political and economic stability - 16.1 per cent

ii. Freedom of investment profits and capital transfers abroad - 13.6 per cent

iii. The clarity and stability of the Kuwaiti laws regulating investment - 10.7 per cent

iv. Easy procedures for obtaining investment licences - 10.3 per cent

v. The possibility of making high profits from an investment - 10.2 per cent

vi. Availability of the infrastructure and elements of production - 9.8 per cent

vii The stability of the rate of exchange of the local currency - 9.2 per cent

viii. Exemption from taxes and customs duties - 9.1 per cent

ix. Availability of a local partner - 7.2 per cent

x. Other factors - 3.8 per cent

The vast majority of those who stated that the investment climate in Kuwait had worsened (in the AOIG questionnaire (No. 1) about the attractiveness of Kuwait as a location for FDI)[1] were referring to the growing political and economic instability in Kuwait in the aftermath of the Iraqi invasion of the country, and to the wave of political tension thereby caused in the Gulf as a whole. Clearly, the Kuwaiti Government could do little about this, but this reinforces the point that it has now become more urgent than ever to offer potential investors a range of positive incentives. Some respondents to the survey also drew attention to the negative impact of the legal stipulation regarding the necessary participation of a local partner in investment projects. This is a point which has been emphasised repeatedly during the analysis in this thesis.

It is noteworthy that in the survey results, interest in the question of transferring profits and capital abroad takes precedence over making high profits. Also, there are six factors (numbered iii. to viii.) which are favourable to foreign investment and are of more or less equal importance; and these factors account for 60 per cent of the total. What this demonstrates, beyond any doubt, is the fact that there is not a single decisive factor in this respect, but a number of factors approximating to each other in importance and weight (Interview conducted by the writer with Mr Abdou Taha Ayoub, the official responsible for the Investment Climate Reports, 7 January 1995).

If Kuwait is to have an effective industrial strategy, the total range of factors affecting the foreign investment climate must therefore be taken into account. It is simply not good enough to produce a range of uncoordinated measures which are not rooted in clear principles

[1] For this questionnaire see pages 176-177.

and objectives. Hitherto there has been a tendency in Kuwait to produce industrial guidelines on the basis of insufficient preparation and lack of integration; but even more serious is the fact that laws, once introduced, have simply not been implemented properly. Thus, since the passage in March 1965 of the Industry Law, which first provided for the introduction of five-year development plans, most of the plans have not been actualised. This is confirmed by the Government programme which was proposed at the beginning of 1993 in the National Assembly and which sought to set out a new, more clearly defined industrial strategy. It is noteworthy that neither this programme nor the national reform and development paper issued by the Higher Planning Council in March 1992 explicitly refers to the economic plan proposed in the study by the Kuwaiti Scientific Research Institute in co-operation with the Massachusetts Institute for Technology (MIT) during the period between January 1986 and June 1988. The UN Industrial Development Team, which visited Kuwait in the period between 25 May and 4 June 1992, pointed out that the absence of a well-defined industrial policy in Kuwait, the lack of overall economic planning and of a sound strategy for the industrial sector, are serious obstacles to industrialisation (Al-Mejrin, 1993: 54-55). There can be no doubt that foreign investors consider issues of profit and loss in the light of the quantity and quality of the advantages and facilities made available or granted under the provisions of Kuwaiti law and the available infrastructure (Al-Deen 1993: 15).

Legislation is the main channel or vehicle through which a state gives expression to its economic policy in general, and its investment policy in particular. It is therefore necessary to review the legal incentives currently in operation in Kuwait, as well as the other incentives which operate more by convention or tacit agreement than by laws issued by the State. In the remainder of this present chapter the focus is on non-tax incentives, since the role of taxation is dealt with specifically in Chapter Eight. But first of all, some general observations are in order concerning the legal incentives for FDI which are offered in Kuwait, since the whole focus of the present analysis is on the role which the legal regime can play in attracting FDI.

6.3 LEGAL INCENTIVES FOR FDI IN KUWAIT

The most important impediments to industrial growth in Kuwait have already been identified during the course of this analysis. They include, most significantly, the general lack of raw materials (with the obvious exception of oil); the small size of the local market and the scarcity of a skilled local workforce; and the difficulty of obtaining developed technology and of accessing sources of scientific progress (Al-Sherhan 1989: 2). It has therefore been imperative for the Kuwaiti authorities to find different solutions to these problems and to encourage foreign direct investment. As previously indicated, there has been foreign investment in Kuwait since the beginning of this century. However, it is only in the post-Gulf War period that FDI has actually been regulated, and this has been within the broader context of seeking to develop the Kuwaiti economy through a coherent strategy.

FDI in Kuwait in the industrial sector is still regulated by the Industrial Law (IL) No. 6 of 1965 which aims to organise, encourage and develop national industries on a scientific, technical and economic basis. The Government's overall strategy is to encourage investment in "industrial establishments" which are defined as those engaged in transforming raw materials into either finished or semi-processed products. The definition extends to include mechanical operations such as mixing, assembling, filling or packing (Article 2 of IL No. 6).

Industrial licences are granted on the following conditions: the establishment must serve the economic needs of the country; there must be a local market for its products; it must conform to the local requirements of Kuwait's economic and social plan; the products shall not be prejudicial to public order or interest (Article 10 of IL No. 6 of 1965). In this way the Government seeks to encourage an industrial sector based on import substitution.

In taking decisions concerning investment in a particular company, investors are normally guided by the nature of the laws and procedures which are in force and which regulate investment in various sectors, and by the various financial institutions in the country. The following matters are of particular concern to foreign investors:

1. Whether there are limitations on the equity that can be held by foreigners and the protection offered to minority shareholders;

2. Whether there are guarantees against expropriation and whether there are guidelines for compensation in case a public need arises for expropriation;

3. Whether there are restrictions on the repatriation of funds;

4. The nature of the tariff structure and the ease of the process of importation of equipment, machinery and material on which the investor is dependent;

5. The impact of the tax regime (Al-Tamim, April 1989: 1-3).

It has been demonstrated in Chapters Four and Five that Kuwait imposes several unreasonable restrictions on foreign investors, including a minority equity requirement in companies, and cumbersome procedures in registering and obtaining licences to commence business. On the other hand, any establishment licensed to operate in Kuwait as an industrial enterprise, irrespective of the level of foreign participation, is entitled to benefit from the incentives listed in the Industry Law No. 6, which include low interest loans, low rent of land, duty-free importation of materials and equipment, and a tax holiday of up to ten years (Article 14 of the Industrial Law No.6 of 1965; see Gerald, 1991: 329-330). The main need, however, is to consider whether all these incentives are actually effective, and to assess whether legislation which is now over thirty years old is still capable of providing an appropriate investment framework in very different global economic conditions. We shall begin by examining the structure of customs duty incentives.

6.4 CUSTOMS DUTY INCENTIVES

Although arguments may be advanced to justify policies which seek to encourage local production, studies demonstrate that in practice the response of foreign investors varies. Some may decide to invest in a host country in order to retain their local market share through local production rather than lose out to competitors because of protectionist policies. To other investors, the size of the local market does not in itself justify local production.[1] The discussion that follows does not attempt to analyse the full impact of Kuwait's customs duty incentives on the growth of foreign investments; rather, it highlights their overall structure. A more detailed analysis must be left to future studies which may benefit from access to relevant data which is presently unavailable.

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[1] See in general Caves 1980; Agrawal, Gubitz and Nunnen Kamp 1991: 5.

Financial measures and policies supporting industry must always be seen as part of the broader strategies for the diversification of a country's economic base. In Kuwait the most important of these measures and policies are to be found in the Industry Law No. 6 of 1965, the resolutions of the Industrial Development Committee, and the resolution of the Council of Ministers No. 22/76, confirmed on 30 May 1976, which laid down the foundations and rules to be followed for customs exemption and preferential treatment. The two basic incentives here are tariff exemption to promote certain activities and tariff protection for local industries. It is important to try to assess the combined effect of these two elements, but initially it will be helpful to consider each of them in turn, beginning with tariff exemptions.

6.4.1 Exemptions

Exemption from customs duties is one of the essential incentives offered by the Government to the industrial sector, and is granted by a resolution of the Minister of Commerce and Industry pursuant to a recommendation from the Industrial Development Committee and after approval from the Council of Ministers (Al-Sharhan, 1989: 11).

Raw materials and semi-processed goods which are required for production purposes are exempt from import duty for the first five years of operation. This exemption may be granted for a further five years provided that the annual profits during the second five years do not exceed 15 per cent of the paid-up capital. In cases where this threshold is exceeded, the exemption will not apply for that year. Machinery, equipment and spare parts are also exempt from import duty, and local industry exports are exempt from export duties and taxes.

The value of the exemptions granted to the industrial sector in Kuwait between 1979 and 1988 amounted to 27.5 million KD, at the rate of 2.75 million KD annually. The value of exemptions granted to industrial firms in which the Government held shares amounted to an average of 2 million KD annually, whereas the value of exemptions granted in the private sector averaged 750,000 KD annually (Al-Sharhan, 1989: 11). A total of 551 firms were given customs exemption between 1989 and 1994. The cost of their imports during that period totalled 389,000,000 KD for which the total exemptions amounted to 15,500,000 KD (Ministry of Commerce and Industry 1995: 11).

Where a Certificate of Origin showing that products come from other members of the Gulf Co-operation Council can be produced, those products are exempt from customs duties (International Bureau of Fiscal Documentation, Supplement No. 49, April 1990: 31). Article 2 of the GCC Economic Pact Trade Exchange states:

> (a) Agriculture, animal, industrial and primary products of national origin are exempt from customs duties and changes of similar effect.
> (b) Fees charged for specific services such as demurrage, storage, handling or unloading will not be considered as customs duties (provided they are also levied on the domestic product) but will be considered as special service fees.

(Article 2 of the GCC Economic Pact Trade Exchange; see Appendix IX for GCC Economic Agreement).

According to the Gulf Organisation for Industrial Consultancy (GOIC), customs exemption for the imports of machinery and equipment required for industrial projects is rightly regarded as an important incentive. This exemption leads, for example, to a reduction of the investment costs of the industrial project. At the same time, customs exemption for imports of raw materials and semi-manufactured goods leads to a reduction in the operation costs of a project and can thus help to place products in an advantageous market position, both locally and internationally. Tax and customs exemption for exports undoubtedly enhances the ability of the local industry to export products to outside markets. If there is a subsidy or other support for the exports, this can in turn consolidate the competitive position of the export industry in the international market (GOIC, 1993: 175).

With regard to primary materials, semi-manufactured goods, packing and packaging material and assembly parts, customs exemption continues for a maximum period of ten years, which is divided into two parts or stages: the first period is for five years, during which customs exemption will be granted to new industrial schemes and firms or to industrial firms in the process of being established. This is for the products in question and for a period of five years from the date of commencement of their production. For the next five years, the industrial firms may apply every year to the Industrial Affairs Department for further exemption of their imports of the said materials or goods from customs duties. The application must be accompanied by a copy of the balance sheet for the year which has ended,

duly approved and certified by chartered auditors. When the balance sheet has been studied, those firms which have sustained financial losses or which have made net profits of less than 15 per cent of the investment capital will be exempted. As for strategic industries or industries of major importance for the national economy, such as oil and the export industries, the Industrial Development Committee may vary their recommendations. For example, it may be the case that longer periods of exemption are granted (MCI, 1995: 10).[1]

6.4.2 Protectionist Policy Against Foreign Manufactured Goods

After tariff exemption, tariff protection is the second element in customs duty incentives. The CIF value of imports to Kuwait is subject to customs duty at the rate of 4 per cent. In order to protect local industry, the Government may impose restrictions on the importation of certain goods. It has also levied higher duties of 25 per cent on imports which compete with locally produced goods (Al Fahad & Co, 1982: 9). Before 28 November 1978, Kuwait administered a notably protectionist policy. However, some aspects of the protectionist system were subsequently modified to enhance its effectiveness. Most importantly, it was agreed to abolish the maximum customs duties which had been in force and which had amounted to 15 per cent, and to allow the duty to be determined for each industry in accordance with its economic importance.

Protection for local industries through customs tariffs can be applied on commodities and products provided the volume of local production for the commodity in question is sufficient to meet at least 40 per cent of local needs. When applying for such protectionist cover, the industry in question must accompany its application with a pledge to increase

[1] The Kuwaiti Government should realise that these protectionist policies are inconsistent with the GATT agreement now administered by the WTO. Member states are required to remove barriers to trade (such as discriminatory tariffs), especially those against foreigners or foreign products. Since the end of the Second World War, tariffs on industrial products traded among developed countries have been reduced through a succession of rounds of multilateral trade negotiations carried out under the ageis of the General Agreement on Tariffs and Trade (GATT) - now replaced by the World Trade Organisation (WTO). The GATT came into existence in 1948, and since that time "it could be said that over the general range of products trade among the major industrial countries, the process of trade liberalisation through tariff reduction is pretty well at the end of the road" (Hindley and Nicolaides 1983: 12). However, the system or rule embodied in GATT (and now the WTO) has been undermined by a number of countries that resort to non-tariff barriers to trade to solve domestic political and economic problems. "Each government, asked whether it would prefer to be in a world with GATT rules effectively enforced on everyone, including itself, or in world with no such rules, would almost certainly choose the former. Nevertheless, each government, left to its own devices, chips at the foundations" (Hindley and Nicolaides 1983: viii).

production to a level of at least 50 per cent of local needs during the first protection period of five years, and to at least 60 per cent in the event that the protection application is renewed for a further period of five years. Moreover, before the application is made, a full calendar year must have elapsed since the beginning of local production of the commodity in question. (Arab Gulf Co-operation Council: *Industrial Legislation and Regulations in the Countries of the Co-operation Council*, no date: 138)

On 12 August 1985 the Kuwaiti Council of Ministers authorised the Industrial Development Committee to grant protection to factories whose licensed productive capacity covers a minimum of 40 per cent of the market, for a period of three years which may be renewed. To this end, customs duties were imposed, ranging between 10 and 25 per cent, on any imports similar to local products according to the the added value realised by the relevant industry, and according to the following rules:

(a) Industries which realise an added value of 40 per cent upwards are given protection in the form of a 25 per cent duty imposed on the import of like products.

(b) Industries which realise an added value of 30 per cent upwards are given protection in the form of a 20 per cent duty imposed on the import of like products

(c) Industries which realise an added value of 20 per cent upwards are given protection in the form of a 15 per cent duty imposed on the import of like products.

(d) The percentage of customs protection is reduced for industries which have a consumer character in the form of a 5 per cent duty imposed on the import of like products (The Kuwaiti Council of Ministers Resolution of 12 August 1985 and the Kuwaiti Industrial Bank, 1990: 1).

Tariff protection and tariff exemption together form the two major elements of the system of customs duty incentives. Deciding which imported goods and material are to qualify for which category is clearly a most important issue for the Kuwait Government. The key question, however, is whether the effects of existing policies have actually matched the initial expectation of significant industrial development in Kuwait. So far the evidence has suggested that the existing regime has not worked very well, and, as we shall see below, there are mixed feelings about whether the customs duty incentives have really assisted or hindered

the expansion of foreign direct investment. The crucial need is to incorporate policies on tariff protection and exemption within a more coherent and unified FDI regime.

6.4.3 Government Procurement Policies

The Kuwaiti Government's own procurement policies are highly significant for both local industry and foreign investors, and have the potential to act as major investment incentives. However, in practice the system is in need of reform. In law, according to Article XVIII of the Industry Law, priority is to be given to the products of local industry provided that they are similar to foreign products in terms of quality, type and price. Similarly, a resolution was issued by the Council of Ministers on 3 July 1982 giving priority in respect of Government tenders to local products which comply with the local standard specifications of the said tenders in the event that similar foreign products are simultaneously offered. The purpose of this stipulation is to give adequate protection to local production against fierce competition and to increase the opportunities for domestic investors:

> In the supply tenders, priority is to be given, in awarding the contract relevant thereto, to more inexpensive local products if they are in conformity with the requirements of the tender documents, and if their price does not exceed by more than 1% the price mentioned in the tender offering the cheapest products which are similar to the local products, but which are foreign and imported from abroad (Resolution of the Council of Ministers of 3 July 1982).

While these aims and principles are certainly justifiable, there is clearly a danger that in seeking to assist domestic investors, there will emerge comparable *disincentives* to foreign investors. This author proposes that the whole area of government procurement must be seen as one in which it is perfectly reasonable to encourage foreign investors to play a significant role, and that such FDI should not automatically be assumed to be detrimental to Kuwait's own interests.

6.4.4 The Absence of Customs Tariffs Between GCC States

Under the economic agreement signed by the countries of the Gulf Co-operation Council, local Gulf products are exempted from customs duties in the member countries. (See Appendix IX for the Economic Agreement of the GCC.) This arrangement is intended to

induce member states to co-operate and to promote collaboration between Gulf industries. On the other hand, it has negative effects upon the emergent or nascent industries in Kuwait. Saudi Arabia is distinguished in the Gulf as a country making high-quality products, whereas Kuwait is a country still in its industrial infancy. What this means is that the exemption of Saudi products from customs duties renders Saudi industry capable of strong competition against Kuwaiti industry. Consequently it is likely that any Saudi product will be much lower in price than a similar Kuwaiti product. The consumer will evidently be keener on a high quality product which is also cheaper in price, thus preferring Saudi to Kuwaiti products. The key issue here is whether other sources of foreign investment outside the Gulf region are being adversely affected by the preferential tariff arrangements within that region.

Adel Abdullah's study (1991: 507) suggests that the United Economic Agreement of 1981 has not in fact attained its aim of fostering economic integration in the Gulf region. Indeed, some managers doubt whether it has even made the coordination of industries possible. For instance, the Manager of Al Bisher, a Kuwaiti company which manufactures children's plastic sandals and polyethylene for home consumption, complained of unfair competition from plastics firms in Saudi Arabia in so far as they were flooding the Kuwaiti market with cheap plastic bags and selling them for the cost of manufacture, excluding labour and shipping costs, etc. Al Bisher argued that: "The prices for Saudi plastic bags in the Saudi market is actually higher than the prices for these same bags in the Kuwaiti market. The price for a ton of plastic bags in Saudi is 400 KD compared to the Kuwaiti price of 360 KD." Moreover, despite offering the Saudi Arabian Government competitive prices for his plastic bags, the Kuwaiti businessman was unable to secure any contracts in that country because the Saudi Government awarded the contracts to local companies, irrespective of price, in order to protect them from competition. In other words, local manufacture was inadequately protected (Abdullah 1991: 394-396).

Proof that both Saudi and international companies were dumping in Kuwait was also provided by a manager of a hygiene products company which produces babies' and women's products:

> Since we started producing diapers in April of 1986, these other companies have started reducing their prices. For example, one international company located in

Western Europe reduced their prices on 12 July 1986 (only three months after we started production). The reduction was from 4.41 KD to 4.050 KD. The second reduction was on the 19th August, from 4.050 KD to 3.970 KD. The third reduction was on 22nd February 1987, down to 3.690 KD. This was a total reduction of 16% in price.

The manager then gave another example, describing how a Kuwaiti company stopped importing diapers from its usual European and American suppliers (Pampers Diapers Co.) and began sourcing them from a Saudi Arabian company instead, thus avoiding payment of the 15 per cent tax on foreign goods as it is not applicable to GCC products. Six months later the Saudi Arabia branch of Pampers reduced the price by 9.8 per cent from 3.215 KD to 2.990 KD. Furthermore, the company "rented" shelves in Kuwaiti stores and guaranteed the store owners between 5 and 20 per cent commission on the sale of diapers above a specified number (Abdulla 1991: 396-398).

The GCC, in the Unified Economic Agreement of 1981, decided to create a common market with the removal of all trade barriers and customs tariffs as well as common trade policies. These measures came into effect in 1983 with the establishment of the free movement of goods and persons originating in the region (Co-operation Council for the Arab States of the Gulf 1983: 6). In reality, however, countries such as Saudi Arabia and the UAE still give some measure of protection to national as against regional products, which clearly contravenes the spirit of the Agreement and may even undermine it. (Abdulla 1991: 262)

The customs exemption system is of central importance as it may be conducive to attracting foreign investment capital. It should not be forgotten that the main aim of these exemptions and incentives is to induce foreign investments and technological transfer. Thus Ali Al-Hakim, the legal advisor of the General Investment Authority, argues that:

> The customs duty percentage in Kuwait is a low one. It is for this reason that it is rightly regarded as a factor conducive to foreign investment in Kuwait, because the supplier normally takes into account the customs duty when fixing the price for sale. In my opinion, however, it is an incentive for foreign investment because it helps international competition, and also conduces to the process of attracting foreign investment. (Ali Al-Hakim, interview conducted by the writer on 6 January 1995.)

The possibility of further economic integration in the Gulf region, including the development of a common market, clearly has profound implications for the pattern of foreign investment in the region, but so far very little serious attention has been given to this matter. If

the Gulf region is to become a "single" economic and investment area, then it is difficult to know how this will affect the flow of FDI into individual member states, including Kuwait. What is crucially important, however, is for Kuwait to take into account the programme of Gulf economic integration when it is reshaping its own programme of incentives to FDI. This means, in particular, that it must recognise how the incentives offered by other member states compare with its own. In this sense Kuwait is in a very similar position to the member countries of the European Union which have to recognise the need to attract FDI from both other EU and non-EU countries (such as the United States and Japan). In terms of the specific goal of developing the non-oil industrial sector, however, Kuwait must continue to attract FDI from the more industrialised countries outside the Gulf region. The economic integration of the Gulf region, even if it proves to be successful, can never be a substitute for a more global approach to FDI, and this also means that Kuwait must play its full part in the multilateral framework of trade and investment negotiations, for example within the World Trade Organisation.

6.5 FREE ECONOMIC ZONES

The issue of free economic zones is a good example of a policy area which is becoming central to global discussions of trade and investment incentives. On a world scale it is now becoming a trend to carve out special areas in host nations and offer special incentives to investors who choose to commence operations there and to export most of their products. Such measures may include tax and customs duties concessions. Goods leaving the free zone are considered as goods outside the customs area of the relevant states, and are not subject to normal customs control or procedures. Free zones aim to stimulate business activity with a view to increasing the money supply, the creation of opportunities for work as well as obtaining the facilities which render possible the spread of technology in the country (Rotterdam Municipal Port Management, Europe Combined Terminals (ECT) GEM Consultants BV, 1992, General Ports Authority). They also seek to promote exports and earn

foreign exchange for host nations.[1] Host governments usually try to ensure that the infrastructure in such areas is conducive to industrialisation. The areas themselves are often called free export zones (FEZs). There are, however, two types of free zones: zones in which goods are stored before re-exporting them, and industrial zones in which the manufacture of goods is permitted.

By 1987 there were 107 FEZs in 49 countries, and one consequence of this development was that, on a global scale, the competition to attract foreign investment was steadily increasing. Generally, in FEZs no customs duties are imposed on imported raw materials as long as the final or finished commodity is exported abroad. Other incentives comprise exemption from taxes on profits, the provision of services at subsidised prices, the facilitation of procedures in order to reduce or curtail bureaucratic procedures, as well as the provision of other forms of encouragement, such as the freedom to transfer profits and prohibitions against the expropriation of property.

Eight Arab countries have established free zones in their territories at different periods: Jordan, Syria, Egypt, Morocco, Tunisia, the United Arab Emirates, South Yemen and Djibouti (Abou Naji 1989: 344). However, the Arab Organisation for Investment Guarantee reports that the economic effects of free economic zones in the Arab world are minimal. Dr Mohammad Abou Naji argues that there are several reasons for this failure of FEZs, including the prevalence of political instability in the Arab world, excessive bureaucracy, poor infrastructure and improper planning (Abou Naji 1989: 347-348). It must also be recognised that the free zones of Arab countries are competing with other such zones in other parts of the world, many of them offering a greater range of benefits and incentives.

6.5.1 Establishing a Free Zone in the State of Kuwait

Although there have been recommendations for Kuwait to establish a FEZ since 1961, no action has been taken, and this offers us yet another example of positive ideas coming to nothing in a decision-making system which seems to have lacked the capacity to put policy

[1] For the other argument of FEZ see Sammy Adelman (1993), "The International Labour Code and The Exploitation of Female Workers in Export- Processing Zones" in. Adelman. S and. Paliwala. A (ed), *Law and Crisis in the Third World* (Hans Zell Publishers, 1993) pp195-218.

proposals into effective practice. As recently as 1992, the Council of Ministers (Meeting No. 54, 2/92) issued a Resolution (1148) for the formation of a committee to make recommendations on a Kuwaiti FEZ. The Committee stressed that such a FEZ could only succeed if it was clearly designed to:

1. reduce the ports duties for goods which are imported into the free zone;
2. surmount all the obstacles to the free movement of capital and labour in respect of immigration laws and the entry permit procedures of the Ministry of the Interior;
3. provide water and electricity in the free zone at reduced prices;
4. provide various communication services at suitable prices;
5. Modify, cancel or supplement the customs statutes which are currently in force so that the required objectives may be achieved;
6. Take the necessary steps to develop al-Shuwaykh port and to increase the depth of its waterway so that it may hold or accommodate large vessels which cannot enter it at present. This improvement of navigational facilities is likely to bring about the prosperity of the free zone. (Report of the Committee set up by a resolution issued by the Council of Ministers for the study of the establishment of the free zone and proposed alternatives in 1993.)

Several shortcomings in this list should be noted: First, the stated objectives do not include the transfer of sophisticated technology which would help to train skilled labour in Kuwait. Secondly, no specific industries which the State wants to develop are mentioned. Thirdly, the list of objectives does not refer to any particular sector which the foreign investors would be interested in developing. The proposal thus seems to be incomplete and lacking in substance.

An UNCTAD Secretariat Report concluded that Kuwait's proposed free zone should be located near *al Shuwaykh* port, a suggestion which is sound because of the closeness of the port to the city centre (United Nations 1994). Activities proposed in the free zone include storage operations for re-export. Ocean-going vessels ship the goods to the free zones from where they are distributed without any change to their external appearance. It was also

recommended that the Kuwaiti Government and private investors should be allowed to establish relevant facilities on a 50/50 basis (RMPM & ECT 1992). Pursuant to these recommendations, Law No.26 of 1995 was issued, giving the Council of Ministers the power to establish free zones in any designated area. However, no area action has yet been taken.

6.5.2 The Impact of FEZs in the United Arab Emirates

Lessons can be learned from the Jabal Ali free zone in the United Arab Emirates, which offers a tempting package of incentives for foreign investors, including the following:

i. freedom to transfer the invested capital abroad;

ii. freedom to transfer all their profits abroad;

iii. exemption from monetary and financial restrictions;

iv. exemption from business or corporate tax for 15 years;

v. exemption from personal income tax;

vi. exemption from customs duties;

vii. exemption from export duties;

viii. no minimum capital requirement for the company to obtain a licence for carrying out work;

ix. exemption from the condition which stipulates that there should be a citizen of the UAE acting as partner or as local sponsor as part of the system which has been in force in the UAE. This means that the foreign investor can have full ownership of the project set up in the free zone.

The Jabal Ali zone has witnessed the establishment of several important industries which have benefited from its fairly reliable infrastructure, and this suggests that such a zone can contribute something positive to the growth of the industrial sector (Inter Arab Investment Guarantee Corporation, 1987: 79-80). The Jabal Ali zone has become the second most prominent zone in this region of the world, a feat achieved within four years of its being established (Bin Selim 1989: 16). The Kuwaiti Government should look carefully at this

example of a successful innovation because it could then learn how best to implement its own free zone policy.

6.5.3 Kuwait: Recommendations for a Successful FEZ

To make a success of any proposed FEZ in Kuwait, due consideration should be given to the general economic impact of the zone on the country's economy. This must include taking into account the following specific factors: the extent to which the proposed zone will be capable of attracting foreign investments; the possibility of achieving, to a reasonable extent, the transfer into Kuwait of sophisticated technology; and the development of industrial, administrative and financial infrastructure and expertise. Studies should also be conducted to outline measures that will ensure that other industries outside the FEZ are not adversely affected.

It is worth noting that the Dutch Consultants Rotterdam Municipal Port Management and European Combined Terminals (ECT) also recommended the establishment of a FEZ in Kuwait. However, the success of such a project depends on the relaxation of obstacles impeding the movement of foreign persons and goods through immigration controls, custom tariffs and excessive Government bureaucracy, as discussed in Chapters Four and Five (RMPM and ECT Report 1992). In addition, the Government should assist investors in the processing of work permits.

6.6 RESTRICTIONS ON THE REPATRIATION OF PROFITS

In this section we turn to an issue which is always of great concern to foreign investors: namely, the rules governing the repatriation of profits. In fact, Kuwait does not impose any restrictions on repatriating capital and profits except that subsidiaries of multinational insurance companies, according to Decree No. 27 of 1966 as amended and issued by the Ministry of Commerce and Industry, must retain and invest or reinvest 30 per cent of their total premiums received in the previous year in Kuwait as follows:

i. 40 per cent to be invested as savings in banks or other financial institutions in Kuwait;

ii.. a maximum of 25 per cent to be invested in foreign securities;

iii. a maximum of 30 per cent to be invested, if legally allowed, in bonds and securities of Kuwaiti joint stock companies;

iv. a maximum of 15 per cent to be deposited in a current account in a Kuwaiti bank;

v. the balance to be invested in government guaranteed bonds.

(Decree No. 27 of 1966 issued by MCI).

There is some justification for these measures. For instance, the requirement to invest or reinvest 30 per cent of premiums aims to ensure that sufficient funds are held in the country to cover the possible liabilities of people insured by those companies (Al-Shammari 1980: 179, 280). However, the possible negative impact of these requirements on FDI must be considered carefully in the light of available evidence relating to the decisions of foreign investors.

Remittances of profits or dividends are not restricted; nor are there any exchange control regulations in Kuwait. Furthermore, all international commodities are traded on the Kuwaiti market. (Peat, Marwick, Mitchell & Co. 1982: 19). Exchange controls are unnecessary given Kuwait's suplus of foreign exchange reserves, at least before the Iraqi invasion (AlFahad & Co. 1982: 9). The absence of restrictions on dividends and earnings remittances means that international payments and transfers are not limited; nor are receipts from exports, re-exports or invisibles. Foreign workers can also repatriate their salaries (Bazarian and Faubarbach 1980: 129).

UNIDO's view (1993: 5-6), worth quoting in full, is that

> access to local financing and to freely convertible foreign exchange is widely sought by investors, and in particular by foreign investors. Limitations in the access to local financing, coupled with restricted foreign exchange convertibility, adds greatly to investment risks and to operating costs, and it undermines investors' confidence in the operating business environment. In the extreme, an investment simply becomes a speculative venture where the investor risks hard currency funds in an uncertain foreign exchange environment, and few serious investors are prepared to engage in this. Most governments accept this reality and many act to follow economic and currency policies which allow investors access to local borrowing and which provide a degree of foreign exchange stability and convertibility. (UNIDO, 1993: 5-6.)

The point about foreign exchange is very important since such exchange is essential for exporting firms in order to purchase imported goods and services. These firms are normally

net earners of foreign exchange, and therefore providing them with additional foreign exchange does not result in a net outflow of funds; rather it is necessary to earn further foreign currency. The firms will continue to need foreign exchange even at times of critical national shortage - which are fairly frequent in developing countries. To win these investments, it is essential that access to foreign exchange is available at all times and that the Government's credibility on this point is well established (UNIDO, 1993: 5-6). The author takes the view that the absence of restrictions on foreign exchange is good because it can promote the two-way flow of investment capital, encourage foreign investment, and is a very attractive incentive to invest in Kuwait.

6.7 GOVERNMENT SUPPORT FOR INVESTMENT ANALYSIS

Much of the above discussion has revealed the importance of sound investment analysis in attracting the right kind of FDI to Kuwait. To begin with, it has to be recognised that such analysis, if it is to be thorough, can be expensive, and this raises the question of who should bear the costs involved. At present the Kuwaiti Government contributes to the expenses incurred by investors when assessing the economic viability of their projects. (It does so on the basis of Article XVI of the Industry Law No. 6 of 1965.) Final recommendations are made by the Industry Development Committee, and formal approval is given by the Minister of Commerce and Industry. However, where the project proves successful, its owner undertakes to bear all expenses of the relevant research and studies. If the project fails, the Government bears half the expenses incurred for the purpose of research (Article XVI of the Industry Law No. 6 of 1965).

These feasibility studies are more than anything else a means of devising projects fit for implementation, and of determining their requisite order of priorities. The study of these proposals by the relevant departments and competent authorities helps to create the necessary machinery for the implementation of chosen projects (Gulf Co-operation Council, no date : 94). It is therefore strongly suggested that, in line with this practice, Kuwaiti authorities should not content themselves solely with the provision of data and information for those who

are interested in these projects. They should also guide the investors looking for profitable investment spheres towards those specific areas or opportunities opened up in the industrial sector. To this end, a list of suitable projects aimed at sustaining Kuwait's development plans should be prepared, and investors who seek to embark on such projects should then be offered incentives.

6.8 ACCESS TO INDUSTRIAL PLOTS

Under Kuwaiti Industry Law, owners of industrial firms subject to the provisions of the law may apply for a plot of land to be allocated for industrial purposes. Applications are made to the relevant department after agreement has been reached with the Minister of Finance and Industry (Article XV of the Industry Law No. 6 of 1965). These industrial estates or plots of land are let to the applicants who pay standard token rents at the rate of 50 'fils' per square metre for contracts which were signed prior to the annexation of the area, both administratively and structurally, by the Al Shou'ayba Area Department. These rents were then modified from January 1980 and increased to 150 fils per square metre (annually) in the Central Industrial Al-Shu'ayba Area, and 75 fils per square metre (annually) in the Abdullah Port Area (AL- Mez'el, 1980: 49).

This system may appear to be sensible and helpful. However, one particular problem deserves attention. Industrial investors can easily obtain industrial plots, yet some investors abuse the system by using the plots for purposes having nothing to do with industry - for example storage. This has prompted the Government to place severe restrictions upon the use of industrial plots to the purposes specified in applications (Askar 1984). What is now needed is an assessment of whether these restrictions have worked, and whether they are still necessary.

In addition to making industrial plots available, the Government provides services at incentive rates amounting to 2 fils per pico/hour, which are reduced to 1 fils for projects set up

in the Al Shou'ayba Area. Water is priced at 125 fils per hundred gallons with the exception of water supplied for projects set up in the Al-Shou'ayba Area, which is priced at 25 fils per hundred gallons, and 40 fils per hundred gallons for the expanded Shou'ayba area. The price of gas amounts to 16 fils per thousand cubic feet (Gulf Co-operation Council, no date: 100-101).

6.9 BANK LOANS

In all forms of investment, domestic and foreign, the availability of bank loans on favourable terms can act as a major incentive. Many developing countries now have a policy that enables local banks to provide loans with easier terms of repayment for industrial investors. This is to encourage the use of savings funds in productive investments, thus realising profits equivalent to what is obtained in other spheres of economic activity (Al-Yousuf and Jamal 1989: 17). For all developing countries, therefore, effective policy decisions have to be implemented concerning the facilities that those countries' own banks may make available to potential investors.

The Kuwaiti Industry Law (Article XVI) states that "the proprietors of an industrial firm or corporation, in the event that they have established new industries, shall have priority in obtaining the Kuwaiti Industrial Bank loan after the consent of the Minister of Finance and Industry. The Bank shall define the terms and conditions of the said loan." The Kuwaiti Industrial Bank is currently carrying out this task, with the Government providing a loan earmarked for the support of industrial development at an interest of 2.7 per cent for 15 years. In addition to the traditional or conventional terms for the grant of loans (as in the cases of the industrial licence and the consent mortgage), the project is taken by the bank as security, and attention is also paid to the results of the prior feasibility. Other conditions which apply are as follows:

1. The project should be set up in the territory of the State of Kuwait.

2. With regard to the size of the loan, the maximum should not exceed 50 per cent for new projects, the investment capital of which should not be less than half a million Kuwaiti dinars. It can amount to 65 per cent for projects with an investment capital which exceeds one million Kuwaiti dinars. For extension projects, a loan can amount to 80 per cent of the additional investments.

3. The interest rate ranges from 5 to 7.5 per cent annually. It is 5 per cent for new projects; 6 per cent for extension projects; and 7.5 per cent for industrial services projects and financial restructuring of companies. Repayment is as follows:

(a) From the date of incorporation and for two years from the beginning of production only interest is paid; thereafter interest and capital instalments are paid;

(b) The duration of repayment of a loan differs according to the circumstances of each project provided that the repayment period shall not exceed ten years from the date on which the loan in obtained. (Al-Yousuf and Jamal 1989: 210).

It has been pointed out by the Chairman of the Board of Directors and Managing Director of the Kuwaiti Industrial Bank that from 1973 (when it was established) to 1993, the Bank provided industrial loans for 416 projects whose investment costs amounted to 633 million Kuwaiti dinars. The Bank provided finance amounting to 336 million Kuwaiti dinars which represented 53 per cent of the total investment costs. The investment finance of the Industrial Bank represented nearly 60 per cent of the actual capital of the processing industry from 1982 to 1988. Moreover, the production of the industrial projects financed by the Bank accounted for 74 per cent of total industrial production (Al-Yousuf 1993).

The author is of the opinion that the fundamental aim of industrial finance is industrial growth, and that since that industrial growth has not been forthcoming in Kuwait, the Bank cannot be said to have fulfilled its *raison d'être*. Dr Kamal Askar, the economic advisor for the Arab Planning Institute in Kuwait, has confirmed the validity of this criticism. In his opinion, the Kuwaiti Industrial Bank attaches more importance to profit-making than to industrial development *per se*. For instance, industrial investors who would ordinarily have obtained loans or funds at a low rate from the Industrial Bank are forced to resort to commercial banks

to obtain funds for up to 20 per cent of the sums needed for their projects. This fee is the sum prescribed by policy for such investors to pay as a deposit to the Industrial Bank before they secure contracts and funds are released to them. Given the Bank's reliance on Government loans for most of its funds, the Bank's annual profits, which in 1980 amounted to 2.7 million Kuwaiti dinars, can be mainly attributed to the difference between the interest rate paid by the Bank on Government loans (3 per cent) and the interest rate charged by the Bank on the industrial projects loans (5 to 7.5 per cent) (Askar 1984: 241 and 292).

6.10 CONCLUSION

Most of the significant investment incentives offered by the Kuwaiti Government were originally earmarked for the promotion of projects exclusively by Kuwaiti industrial investors and were not introduced to attract foreign investors. The foreign investor in Kuwait has been in a position to benefit from the incentives with which have been outlined above only if he has a Kuwaiti partner. The laws restrict the equity of the foreign partner to only 40 per cent, with the rest allotted to a Kuwaiti partner (See Chapter Five). As already proposed above, it would be better if the foreign investor were legally allowed to own fully the project he wants to set up without the restriction of having a Kuwaiti citizen as a partner. Reiterating this point, the legal advisor of the Legislation and Fatwa Department has stated unequivocally that "just as the State gives support to the local investor, so it should also give support to the foreign investor" (Mr Shafiq Hassan Zaki, in an interview conducted by the writer on 7 January 1995).

It is the author's considered opinion that the absence in Kuwait of a well-defined, reliable and, above all, *unified* strategy to which the country is fully committed in the interests of industrial development has had - and continues to have - a negative affect on policy formulation. For example, the type of industries required for the diversification of the sources of income have not been defined. Without such a definition, Kuwait is unable to attract sufficient high - quality investments in the industrial sector.

There is no doubt that through her customs tariffs, policy on ease of repatriation of funds, attractive bank loans and tax laws (to be discussed in Chapter Eight), Kuwait's incentives to attract FDI are steps in the right direction. However, the major shortcomings of these measures, particularly in comparison to the more favourable conditions amongst Kuwait's Arab neighbours, need to be addressed. It is also time for Kuwait to implement recommendations and Ministerial resolutions to establish a free export zone. Whilst there is no guarantee that these measures in themselves will immediately attract more FDI to Kuwait, there is reason to believe that they will certainly make Kuwait more attractive for foreign investors.

In general the key argument to come out of this chapter is that investment incentives need to be seen as part of a coherent, overall national industrial strategy, and that such a strategy must be based on actual evidence relating to the impact of incentives on the pattern and growth of FDI. This evidence can be drawn not only from the experience of Kuwait, but also - in comparative terms - from the experience of other countries, including those in the Gulf region. It also has to be stressed that an industrial strategy, once devised, must be implemented effectively and must not be blocked by any failings in the administrative process. In the past, as we have seen in this chapter, the Kuwaiti Government has all too often formulated policies and actually promulgated new legislation only to fail at the implementation stage. As we shall see in Chapter Eight, such pitfalls can also have an adverse effect on the success of tax incentives in attracting FDI.

CHAPTER SEVEN

TECHNOLOGY TRANSFER AND BUILDING HUMAN RESOURCES

7.0 INTRODUCTION

Kuwait's system of FDI regulation has a direct impact on the role of foreign investment in developing the country's economy and contributing to the attainment of key developmental goals. In this chapter the particular issues of technology transfer and the building of human resources - which, it is widely agreed, are key dimensions of the impact of foreign investment in any country - are examined in some detail. The general argument here is that the present system of regulation in Kuwait does not permit the optimisation of technology transfer and human resources development, and that this is to the detriment of the country's economic and social well-being.

The interaction between investment and technology has become central to debates on the impact of FDI. UNCTAD (1994) reports that since the 1980s there has been a noticeable increase of FDI in the developing countries, and that such investment will soon exceed official development assistance as the most important source of foreign finance. It already amounts to nearly one third of the net resources flow (UNCTAD 1994: 94). Developing countries are focusing more and more on the need actively to promote FDI in order to increase the flow of foreign management, technology, capital and access to foreign markets. They also see this as essential for their development, both economically and socially, and there has been a growing appreciation of the significance of FDI for the improvement of the human resources situation in their own societies (Weigel 1990: 77).

It is now widely appreciated that FDI plays a major role in the transfer of technology to countries in need. It brings with it important new production techniques and processes as well as organisational skills and know-how. However, there are several factors which in practice hinder the transfer of technology. One of these is the shortage of crucial resources

(manpower or capital) in the recipient countries (Langrish 1972: 69-72).[1] This factor is particularly important in the context of this study because, although Kuwait does not lack capital, the country is critically short of manpower. And this fact is bound to have a negative impact on the level of success in harnessing imported technology to help achieve the country's developmental goals.

7.1 THE NEED FOR REGULATORY CHANGE IN KUWAIT

For Kuwait to benefit fully from the transfer of technology and investments, a range of new laws and regulations are required to improve the capacity to acquire appropriate technology (taking into account the country's primary needs) and to promote the development of human resources. As stated by UNCTAD (1985: 14):

> Successful technological development and, in the long term, technological transformation, depend crucially on the existence of an appropriate legal framework which will promote a favourable and beneficial environment for the transfer application and development of needed technologies.

In order to appreciate the need for a new legal framework, it is first necessary to look in some detail at the process by which foreign technology is presently transferred to, and used by, Kuwait as a host country. This process has various particular aspects which need to be scrutinised. To begin with, in section 7.2 below, the focus is on the importance of the relationship between the export of technology into Kuwait and the foreign investment requirements for the country's development programmes. It identifies and discusses the main problems and makes a case for changes. It pays particular attention to the technology that has been deemed suitable for Kuwait by some authors and Government advisors. Section 7.3 deals with the system of patents, its significance in facilitating technology transfer, and the problems currently related to the operation of this system in Kuwait. Section 7.4 discusses the question of trade marks as a channel of technology transfer, while issues of copyright and designs are treated in sections 7.5 and 7.6 respectively. Section 7.7 deals with one of the

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[1] For more about other factors delaying transfer of technology, see Langrish _et al._, *Wealth from Knowledge*, London, Macmillan, 1972.

specific strategies Kuwait has adopted for the acquisition of technology, known as the Offset Programme. This represents an attempt to stipulate conditions for foreign investors in respect of the transfer of the technology that policy-makers consider to be needed in Kuwait. This is an important issue because the choice of technology is bound to have an impact on the country's economic growth. Section 7.8 continues the discussion of the legal implications of the Offset Programme. Section 7.9 brings together a number of specific recommendations for reform of the procedures and regulations governing foreign investment projects with specific implications for the transfer of technology and the development of manpower. Finally, Section 7.10 takes a more detailed look at the current human resource problems faced by Kuwait.

7.2 TECHNOLOGY TRANSFER AND FOREIGN INVESTMENT

Foreign direct investment is the single most important vehicle for the transfer of technology, bringing with it up-to-date knowledge of processing techniques, product design and packaging, communications technology and market development (Shihata 1991: 480). This is true not only for developing countries, but also for transfer between the USA and Europe. For these reasons, considerable attention has recently been paid to the role of FDI as an instrument of economic development and change, and as a vehicle for transferring management skills and technical know-how to host countries (Kojima 1978: 138). With regard to the creation of job opportunities, the spread of technology and industrial development, FDI has come to be accepted as a positive developmental factor for host countries (UNCTAD 1994: 94). In Indonesia and Taiwan, for example, FDI has produced significant results by its effect on cancelling costs associated with acquiring the information necessary for entering world markets. Countries such as Ireland, Singapore, Malta, Mauritius, Hong Kong and Mexico have benefited from the local presence of transnational corporations (TNCs) in their territories during the last fifteen years (World Bank for Reconstruction and Development, 1991: 22-23).

The transfer of technology and know-how takes place more quickly and efficiently through FDI than through imports, licensing or consultancy arrangements. From the foreign

investor's point of view, returns must offset the costs of production in a foreign location, costs which arise out of the need to adjust to the differences in economic, social, legal and cultural conditions. As David Carr (1979: 2-4) points out, in order for FDI to serve as an efficient mechanism for the transfer of technology, there are a number of important requirements:

1. the expertise must be closely guarded in order to ensure that it is not imitated or diffused too quickly;
2. the technology must consist of *on-going* new knowledge, products or processes and must not be simply a 'one-off' transfer;
3. the expertise must incorporate the *ability to use* the technology efficiently, as well as the technology itself.

These requirements can be met (respectively) through efficient intellectual property systems (involving appropriate regulations governing patents, trade marks and designs), research and development schemes and training schemes respectively.[1]

7.2.1 The Choice of Appropriate Technology

The choice of appropriate technology for the purpose of development is not easy. Developing economies often face two particularly significant problems: knowing where to look for relevant technology and compensating for the absence of good negotiating skills. This latter factor can result in inadequate maintenance arrangements, the absence of research and development and training schemes, and poor access to markets. Most purchasers from the developing countries enter the technology market as the weaker parties in matters of bargaining. The purchaser's country may well lack the structures and experience that are necessary to provide the technical expertise or knowledge needed for successful negotiation. In particular, the most difficult decision to be confronted is that of choosing which type of technology to acquire if more than one type is offered (Asker 1984 : 65-66).

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[1] However, the problem of choosing the appropriate technology is not an easy one. To begin with, most of the received analysis is in terms of two factors of production, typically capital and labour, thus ignoring other important aspects, such as the role of management, skilled labour, materials, power, etc. Since these factors are also scarce in developing countries, capital-intensive technologies which save on these factors may be suitable (Morwetz 1974: 491-542).

Without the adoption of maintenance arrangements, Kuwaitis cannot carry out the routine maintenance and repairs of the imported technology, and machinery will fall into disrepair. Without research and development facilities, Kuwaitis cannot conduct research into vital areas, particularly in the oil and petrochemical industries, including research into the use of petroleum by-products. Fresh ideas and innovative discoveries can result from this new scientific knowledge and this can, in turn, improve local capabilities. Without the provision of marketing know-how, the ability of Kuwaitis to market products competitively will remain inadequate. Like most developing economies, Kuwait needs to learn how to plan, organise, co-ordinate, control and manage marketing strategies (Al-Ali 1988: 25-26).

According to Al-Ali (1988: 45), it is not only important to choose appropriate technology; it is also important to develop local skills to acquire this technology, and this has direct implications for human resources policy. The first aim means that an effective mechanism for choosing appropriate technology must be devised and adopted as part of the country's national plan. It may also be necessary to adopt schemes which will ensure the eventual use of local raw materials to decrease dependence on foreign resources. In addition, the Government must devote funds to research and development (R&D), focusing on the application, adaptation and absorption of imported technologies. The Government should also reduce customs duties and make loans available to prospective investors.

7.2.2 Mechanisms for the Transfer of Technology

Several channels may be used to transfer technology, including intra-firm technology transactions, joint ventures and turnkey projects of licensing arrangements. Developing countries tend to favour the process of technology transfer through TNCs because such enterprises are at the forefront of technological innovation and are able more easily to transfer their expertise from place to place by bringing together the necessary managerial, technological and entrepreneurial skills (Quinn 1969: 149-150). Generally, TNCs prefer the intra-firm channel for new technology, since here the particular firm retains the technology in order to keep control over it (Lall and Streeton 1977: 34-36). Intra-firm agreements usually

impose high royalties and contractual restrictions on the use and disposal of the technology and its resultant products by the subsidiary. As wholly locally-owned enterprises (as distinct from subsidiaries of TNCs) are not usually direct recipients of foreign technology, the degree of effectiveness of the transfer of technology to the host country through this channel may sometimes be measured by the extent to which the technology is imitated by the local companies (UNCTC 1985: 120-121).

A joint venture mechanism may be an appropriate way of transferring technology in cases where TNCs see the loss of control over the technology as being relatively inexpensive, especially where the technology is dated or less firm-specific (Franko 1982: 13-14). Sometimes the joint venture may be ineffective because of the limitations imposed by specific terms and conditions of the agreement on the local partner's role, i.e. the latter may be reduced to that of a shareholder (UNCTC 1985: 122).

Alternatively, the mode of transfer could be in the form of the export of already-manufactured capital goods, patents, or by through licensing or technical assistance contracts. Transferring technology can also be achieved by relocating entire production systems. All these methods can be implemented through FDI. A foreign investor may choose to locate a plant in the host country, or may grant a licence to its local subsidiary, or may choose both options in partnership with a local enterprise in the host country.

7.2.3 Regulating Technology Transfer

Despite the role of TNCs in contributing to technological advancement, many developing countries are wary of attempts by the TNCs from developed economies to impose undue conditions which may hinder their efforts to acquire foreign technology and use it successfully. As Sornarajah (1994: 47) points out

> There were many restrictive clauses introduced into the transfer agreement which prevented the transferee from obtaining full benefits of the transfer. They were intended to maximise the benefit to the transferor but their indirect effect was to hurt the host economy. Thus, there were restrictions on the export of goods manufactured with the technology, grant back provisions which required that the new inventions or adaptations be given over to the transferor, tie-in clauses which required associated

products to be purchased only from the transferor and similar restrictions controlling the use of the technology.[1]

TNCs are sometimes criticised for transferring unsuitable technologies, exploiting existing situations for their own benefit, not investing enough (if at all), adapting existing technologies without bringing greater profit, and taking advantage of their competitors (Johnson 1970: 26; Erikson and Ladman 1976: 3).[2] Consequently, some developing countries have endeavored to mitigate such adverse effects by regulating licensing agreements, by requiring registration, and by encouraging foreign direct investment in the form of joint ventures (UNCTC 1985:120-121). For instance, some host state governments have endeavoured to make joint ventures a more effective channel for technology transfer, and have sought to strengthen the position of the local partners by regulating the terms of joint venture agreements and joint venture licensing arrangements (UNCTC 1985: 122).

In this respect it can be useful to examine the regulatory mechanisms in other countries because this may reveal useful lessons for the reform of the existing system of regulation in Kuwait. To take just two interesting examples: In South Korea the importation of technology is regulated by the Foreign Capital Law of 1966, amended in 1973. When transferring foreign technology, it has to be ensured that this contributes directly to the development of the

[1] Sornarajah (1994: 46-47) states that the studies also indicated that the nature of the technology which was exported was often disused and hazardous. The extent of the harm to the environment caused by the exports of such technology was identified in these studies, and there have been dramatic examples of the potential harm to both life and the environment that such disused technology could cause. For example, "the Bhopal disaster, caused by a gas leakage in a plant set up by a multinational corporation, involved colossal damage to life and property. Such instances indicate that multinationals often use technology which they are not permitted to use in their own home states in developing states because it is cheaper to do so and there are no regulations or supervision to prevent the use of such harmful technology. The need for control of such export of hazardous activity has been demonstrated often as a result of the environmental and other harm caused by multinational corporations."

[2] Detlev F. Vagts (1970) expresses the following view about the effect of technology transfer to host countries: "Even though recognition is spreading that technology may have damaging effects both on the culture and the ecology of a nation, technological development generally enjoys a high priority. A host country will ordinarily pursue three objectives: (1) to maximize imports of current technology; (2) to develop its own base for future research activities and (3) not to pay too much for either (1) or (2). In pursuing these goals a government often will find itself forced to deal with MNEs. However, it may fear that due to the scale of the MNE's research base local initiative will suffer, either because the MNE monopolizes the available market or because it employs all qualified local personnel. Furthermore, the government may feel frustrated by the MNE's tendency to keep its information to itself. Other costs of inducing foreign technological inflow include permitting foreign influence on or the control of developing countries." For further discussion of the effect of technology transfer to host countries, see Detlev F. Vagts, "The Multinational Enterprise: A New Challenge for Transnational Law", *Harvard Law Review* 83, 1969-70; and Detlev F. Vagts, "Law and the Multinational Enterprise", in Y. Ghai et al., *The Political Economy of Law: A Third World Reader*, Oxford, Oxford University Press, 1987.

economy (e.g. by improving the balance of payments), that it is profitable, and that local materials and the local labour force will be utilised (UNIDO 1972: 57-60). Secondly, Brazil, through its Normative Acts, has amended the law relating to technology transfer to achieve tighter control on imported foreign technology (UNCTAD, 17 August 1984: 6-7).

In contrast to these two examples of South Korea and Brazil, there are, strictly speaking, no special Kuwaiti regulations governing the importation of foreign technology. However, there are some more general regulations on the transfer of technology to be found in the Industrial Law Decree No. 6 of 1965 which requires the screening of technology licence agreements. An individual project will be approved and a licence granted by the MCI if the project is considered to be one which will meet the economic and social needs of Kuwait. It has to be stressed that licences can only be granted to Kuwaiti nationals. Although "Kuwaiti nationals" here includes legal bodies incorporated in Kuwait, it must be noted that the level of equity participation of foreigners in such bodies is limited to 49 per cent. (See Chapter Five; also Art. 191, Commercial Companies Law, 1960) This requirement is specifically designed to give Kuwaiti nationals control over all enterprises and operations in Kuwait. None the less, it is doubtful if this requirement alone can ensure effective local development of technology or encourage the transfer of technology. As part of the screening procedure, all Government contracts and purchases are scrutinised by the Central Tenders Committee (CTC). Tenders are advertised in the major local government magazine and evidence must be produced to show that the tendering company is capable of executing the project. (For screening of foreign investment projects, see Chapter Four, sections 4.3 to 4.4.)

In an interview conducted by the author, Dr Ali Al-Hakim, the Legal Adviser to the General Investment Authority, pointed out that, while there are no clear-cut laws in Kuwait regarding the transfer of technology, it is certainly possible for Kuwait to benefit from the process of technology transfer through the participation of foreign investors in local projects. (For example, Kuwait has taken an important step in organising the process of technology transfer by the offset method which will be discussed in more detail below.) However, the transfer of technology should take place in such a way as to open up wider prospects and

possibilities for foreign investors in Kuwait (Al-Hakim 1994, second interview conducted on 1 June 1995).

It seems, therefore, that it is not entirely accurate to assert that there is no law for the transfer of technology in Kuwait. In practice technology is transferred into Kuwait through technology-transfer contracts which are subject to the will of the parties involved. Like any other economic contract, these contracts are such that the stronger party is always able to impose his will on the weaker party which is in need of technology. A new law is therefore required in Kuwait to regulate the process of technology transfer in view of the many and diverse kinds of technology, expertise and know-how which Kuwait needs (Dr Hosni Al-Masri, lecturer, University of Kuwait, interview conducted on 6 January 1995). As argued by Al-Sabah, "effective local participation in industry that is crucial for the economic development of the country should be of relatively greater weight than equity participation" (Al-Sabah 1983: 72).

7.2.4 Factors Affecting Technology Acquisition

The extent to which TNCs are able to transfer technology according to the terms indicated above depends on a number of factors, including: the specific channel adopted for the transfer; the particular content of the transaction (in terms of the level of control retained over the technology); the degree to which the host state's technological infrastructure is developed; the extent to which domestic enterprises effectively assimilate the imported technology; and the degree of political stability in the host state (UNCTC 1985: 128).

Various reasons have been suggested for Kuwait's general failure to acquire sufficient foreign technology. Behbehani *et al*. (1981: 15) believe that "Technology selection in Kuwait will have to be very carefully attuned to achieving maximum diversification, through strengthening bilateral sectoral links, and contributing to a development and growth process that is constrained by shortage of human resources." However, these authors have not given any clear indication of how these aims may be achieved. Al-Ali's empirical findings (1988: 273) suggest that difficulties are often experienced in Kuwait in managing the imported technology and in adapting it to local needs.

Other factors which often hinder the transfer of technology to Kuwait include a shortage of trained manpower, little or no understanding of the new technology, a slow rate of take-up of the technology, and a low standard of proficiency in the personnel handling the acquired technology. In addition, the levels of capital available since the Iraqi invasion have diminished. In many developing countries, basic technology usually exists at a low level (Hansen 1982: 429). Consequently, it may be difficult for any willing foreign investor to impart a new technology to local workers when the basic skills required to understand the technology is lacking. Furthermore, subsidiaries conduct very little independent research and development and, therefore, there are no significant links with the local scientific and technological system (The Science Policy Research Unit of Sussex 1972: 29-33). The example of the major oil companies is instructive in illustrating some of these basic problems of technology transfer. Prior to the nationalisation of their assets in Kuwait, the oil companies contributed little to developing local R & D capabilities. They excluded themselves from an active role in training Kuwaitis, and generally added little to the creation and development of Kuwaiti technological capabilities (MEED, 10 June 1966: 257). The situation has still not improved to any significant extent.

Another factor which tends to limit the impact of FDI on the transfer of technology is Kuwait's low participation rate of local labour and professionally qualified personnel. There are only a few local professionals directly involved in technology transfer and the general workforce has not attained high educational standards. Furthermore, the training of the local workforce is not regarded as a priority in many transfer of technology agreements; hence only small training budgets are allocated. Moreover it has been suggested that the situation is exacerbated by the low standard of Kuwaiti educational institutions (Al-Ali 1988: 157).

To sum up, there is abundant evidence to show that at present Kuwait does not have a sound policy on technology transfer. To ensure that FDI leads to technology transfer, some of the current policies need to be reviewed.

7.3 PATENTS

The transfer of knowledge and technology is a process which takes place within a legal framework of regulation and the protection of what is usually called intellectual property. During the last century the issue of the establishment and control of patents has become a particularly significant matter in relation to the internationalisation of the economy, especially - in recent years - within the context of the spread of transnational production. In this section the aim is to clarify the structure of patents regulation in Kuwait and to consider the impact of this structure on foreign direct investment.

To begin with, some care needs to be taken in the specification of what the term 'patent' actually signifies. The World Intellectual Property Organisation (WIPO) defines a patent as:

> "A legal enforceable right granted by virtue of a law to a person to exclude, for a limited time, others from certain acts in relation to a described new invention; the privilege is granted by a government authority as a matter of right to the person who is entitled to apply for it and who fulfils the prescribed conditions." (UNCTAD and WIPO 1975: 1)[1]

The patent system is of obvious significance for developing countries like Kuwait for at least two reasons, both of which have direct implications for the success or failure of technology creation and transfer:

(a) For investors and innovators, the protection and rewards offered by the patent system play a highly significant role in encouraging research and development activities.

(b) The system affects the host country when importing commodities consisting of either patented products or which incorporate patented processes in their production (United Nations 1964: 39).

In law the exclusive right of a patentee only applies to the patent within the country which grants the original patent, and all subsequent dealings concerning the patent are

[1] Kuwait Law No. 4 of 1962 clarifies that a patent is granted for "any new invention utilizable in industry, whether it concerns new industrial projects, new industrial methods and processes or a new application of known industrial methods and processes".

governed by the laws of that country. Prior to 1883, the protection of foreign patentees depended mainly on reciprocal arrangements between states. In practice the many differences in national legislation meant that foreign investors encountered major obstacles in foreign countries when attempting to protect their inventions (Hamza 1984: 52-53). It soon became obvious that there was a need to simplify, reduce and standardise rules in different countries in order to provide uniform protection for inventors. In the nineteenth century, the rapid development of manufacturing industries, communications and commerce meant that a whole series of new economic relations and interests among nations emerged. Thus, as international trade became increasingly important for the major developed economies, it became more and more urgent to create national regimes of exclusive rights in industrial and intellectual property to protect the work of inventors and technological innovators. At the same time, many countries felt the need to make use of knowledge and experience from countries which had already enacted industrial property rights. This was why the International Union for the Protection of Industrial Property (Paris Union) was established by the Paris Convention in May 1883 to regulate the protection of patent rights (United Nations 1964: 13).

The Paris Convention has been revised many times,[1] most recently in 1967 in Stockholm. The Convention is not limited to patents but extends to all kinds of industrial property, including also "utility models, industry designs, trade marks, service marks, trade names, indications of source or appellations or origin, and the repression of unfair competition" (United Nations 1964 E13861/Rev. 1; see below, sections 6.4 to 6.6, for further discussion of trade marks, service marks, copyright and designs). The Paris Union was established to overcome the obstacles which a system of exclusively national patents posed to international trade in industrial goods and technology. Member states gave and received patent protection within their territories on a completely mutual basis, and this was clearly a major step forward in developing an international system of regulation (Anderfelt 1971: 1). However, this system is complex because it is based on both formal rules and the

[1] The Convention has 81 parties, most of them developing countries. Yet there are still about 60 developing countries which are not parties. Even so, these non-parties have been greatly influenced by the Convention's provisions. For further discussion of the International Patent system, see Ulf Anderfelt in *International Law and Developing Countries*, Martinus Nijhoff, The Hague.

accumulation of various practices. As the United Nations (1975), in "The Role of the Patent System in the Transfer of Technology" (TD/B/AC 11/19/Review 1), has pointed out:

> It is the practice of international relations in the matter of the legal protection of inventions, resulting from, and governed by, both national legislation defining the treatment to be granted to foreigners and international treaties concerning such treatment. It should be emphasised that a country's laws defining the rights of foreigners form part of the international system even when, as in the case of several developing countries, the country is one of those which are party to no international treaty on the subject, for such laws form the basis upon which in practice inventions are protected in more than one country.

In other words, it is not possible to evaluate the patent system which applies in a particular country such as Kuwait purely by reference to formal codes of law. Rather it is necessary to analyse the actual implementation of law in practice and the administrative - often highly bureaucratic - processes through which that implementation is carried out.

7.3.1 Opposing Views of the Relevance of the Patent System

Opinion is divided on the relevance and effectiveness of the existing international patent system in relation to the current needs of developing economies. Vaitsos (1987: 304-316) argues that the Paris Convention favours the patent holders (usually from the developed countries and controlled more and more by transnational corporations) and operates against the interests of third world countries because it tends to block their own research and innovation efforts. In particular, the existing system does not stimulate manufacturing activity since patent holders use patent rights to control imports and exports and prevent competition. Patent rights are also used to advance the overall strategies of transnational corporations and to divide the world into protected markets. The Paris Convention, with its basic principal of "national treatment" tends to prevent poor countries from devising appropriate commercial and technological policies, and this in turn aggravates the inequalities between the economic institutions of rich and poor countries. The few provisions which are supposed to balance the rights of patent holders are too vague and restricted.

Vaitsos also highlights the power that a transnational corporation derives from its ownership of a patent, particularly in the transfer of technology: an issue which is becoming

increasingly important for all developing countries. Patents often provide property rights which enable the exercise of power over technology transfers, production, marketing, and the sale of raw materials and machinery. Licensing agreements governing the use of technology prevent third world countries from taking full advantage of the technology because "they inhibit growth, the penetration of foreign markets, the adaptation of the technology and the localisation of staff" (Ghai et al. 1987: 277; Vaitsos 1978: 304-316)[1]. On the other hand, Anderfelt (1971: 1) believes that

> The extension of patent protection to foreigners has two different types of cost-effects. The first is that costs to society of granting patents in general are merely increased, and the second is that new types of costs are incurred. To the first group belong the costs of monopolies that are created when exclusive rights are granted. The effect of such a grant is in principle the same whether patents are held by nationals or foreigners, provided the inventions are exploited locally. To the second type of costs belongs that which may arise when the foreign patentee works his invention abroad, although it could have been exploited locally.[2]

The situation relating to patents in Kuwait is even more ambiguous because the country is still not a party to the Paris Convention, and this fact will almost certainly deter some potential foreign investors. Furthermore, there is another serious difficulty in that Kuwait's own laws are both inadequate and have besides not been properly implemented. Officially the relevant laws in Kuwait are Law No. 4 of 1962 and the Law of Patents and Regulation No. 15 of 1965. Unfortunately, the Patent Law of 1962, which was further amended by Regulation No. 15 of 1965, has not come into force since it was issued.

The non-application of the Kuwaiti Patent Law was confirmed when Resolution No. 34 was passed by the Minister of Commerce and Industry on 21 February 1993, providing for the setting up of a committee to establish a patents and industrial drawings registration

[1] The Report of the Secretary-General of the United Nations (1964: 50) on "The Role of Patents in the Transfer of Technology to Developing Countries" has concluded that "In the final analysis, the question of patents must be seen - and dealt with - in the broader context of facilitating the transfer of patented and unpatented technology to the developing countries, and enhancing the ability of the latter to adopt and use such foreign technology in the implementation of their development programmes."

[2] Anderfelt (1971: 1) goes on to state: "Since developing countries extend their patent protection to foreigners not in order to get reciprocal benefits abroad but to encourage the inflow of foreign technology, the first type of cost mentioned above is of little concern to them. This leaves the second type of cost to be dealt with, i.e. the disadvantages that might be incurred in cases in which the patented invention is not worked locally but abroad, supplying the home market via exports."

system. The committee reported that a patent law and regulations had been passed in Kuwait but that they had not come into force. (Ministry of Commerce 1993).

Mr Nafl Al-Dawsary, Director of the Licences Department in the Industrial Registry, has further explained that :

> The reason why this law has not been applied is due to administrative problems, including, for example, the fact that no budget has been allocated for the licences department in the industrial register. Carrying out all the measures provided for by the law, and conducting the required research, all this would require a large number of staff, whereas what we have here is only one member of staff employed in that department. The reason why there are no full-time staff, and why there is no interest on the part of the state in this department, is that the main thrust of Kuwait's policy is commercial and industrial development. Interest in industrial development only started in the Eighties. However, in view of the fact that Kuwait is a commercial state, not an industrial one, Kuwait did not provide the required structure necessary for the application of the patent law. (Interview conducted with the author on 7 January 1995)

It would also appear that the non-application of the patent law in Kuwait is probably due to its obvious irrelevance. The negative consequences of this unsatisfactory situation are far-reaching, especially in relation to technology transfer. As Mr Al-Dawsary has pointed out, since the Gulf War of 1991, large numbers of foreign investors from allied countries have been attempting to conclude investment contracts with the Kuwaiti authorities. But, because of the inadequacies of the Kuwaiti patent law, Kuwait failed to bind these investors, under the provisions of the relevant contracts, to transfer the latest technology which they had attained. It is now becoming clear that the question of technology transfer can no longer be ignored and should be linked to an urgent and fundamental review of the patent law (N. Al-Dawsary, interview conducted with the writer on 7 January 1995).

At least the Kuwaiti Government has recognised, in a 1993 policy paper, that the granting of patents undoubtedly has an effect, both directly and indirectly, on the process of speeding up technical and industrial progress in the country, as well as encouraging Kuwaitis to carry out and develop economic projects utilising such patents and the inventions involved. The paper acknowledges that many countries are now careful to organise patents, from the point of view of their substantive or procedural nature, in such a way as to realise the principal objectives which are being sought, and that there are obvious lessons here for Kuwait (Department of Licences and Industrial Register 1993: 2). The situation in practice seems to

be that today Kuwaiti law does contain some common features of modern patent laws, but some crucial gaps remain (N. Al-Dawsary, 7 January 1995).

7.3.2 Patentable Inventions

Not all inventions are patentable under Kuwaiti law[1]. To be patentable, an invention must be new, and it must also be capable of industrial application regardless of whether or not it is related to new industrial products, new industrial methods and processes or a new application of known industrial methods and processes (Article 1, Law No. 4 of 1962). An invention is considered to be new if it has not been publicly used or published in Kuwait and if no application for the same invention has been filed within a period of twenty years prior to the application (for a patent on the invention). However, an invention is only "published" if there is sufficient local information available to experts in the field (in Kuwait) to work the invention (Article 3, Law of 1962). Hence the test for "newness" (novelty) is local to Kuwait and is not universal in the sense of prior publication or use of the invention anywhere in the world.

Some inventions, such as chemical inventions relating to foodstuffs, medicines or pharmaceutical products, are not patentable in themselves, but the chemical processes or special methods involved in their manufacture are patentable (Article No. 2 of Law No. 4 of 1962). A Kuwaiti process patent for medical, pharmaceutical or food inventions has a term of ten years from the filing date. Other Kuwaiti patents have a term of fifteen years from the filing date, although they may be extended for another term of five years if the invention has special significance and the patentee has not obtained adequate profits for exploiting the patent (Article No. 12 of Law No. 4 of 1962).

[1] The discussion which follows analyses the patent law in Kuwait as though it were actally being enforced today.

7.3.3 Procedural Issues

A patent system will only work well if it is properly and efficiently administered. In the case of Kuwait there are reasons for being concerned about bureaucratic blockages in the administrative process. Patents are supposed to be dealt with by the Trade Marks Control Office within the Ministry of Finance and Economy (Article 23 of the 1962 Law). They are granted to any person who can present a certificate attributing the invention to himself and a statement about the entitlement to restrain others from exercising such rights. Patents are granted to:

(i) foreigners residing in Kuwait or having industrial or trading enterprises in Kuwait;

(ii) nationals of countries dealing with Kuwait, based on reciprocity (but as Kuwait is not party to the Paris Convention, it is not clear whether any foreigner is entitled to a patent under this heading);

(iii) companies, societies, institutions or groups of industrialists or merchants established in Kuwait, or in countries which treat Kuwait on a reciprocal basis and which are considered legal entities;

(iv) public departments.

(Article No. 5 of Law No. 4 of 1962.)

The explanatory note to the Patent Law No. 4 of 1962 states that foreign investors have the right to apply for patents on any of the following three conditions:

(i) they should be resident in Kuwait;

(ii) they should have industrial or commercial corporations in Kuwait;

(iii) they should belong to countries which offer Kuwait similar treatment, or reside in countries with which Kuwait has signed agreements on similar treatment, or should have a business or commercial premises in any such country.

(Explanatory note of the Patent Law and Industrial Drawings and Models No. 4 of 1962.)

A patent application may be submitted by a commercial firm or by a foreign investor who resides in Kuwait, but the home countries of non-resident foreign investors and overseas-based businesses have to allow Kuwaitis to apply for patents in those countries

(Article 5). A process exists which permits interested people to oppose applications for patents (Articles 21 and 22 of Law No. 4 of 1962). Article 24 grants special powers to the General Commander of the Armed Forces to oppose patent applications or to offer to buy inventions which relate to defence or are of military value. There are also provisions which regulate the rights of employers and employees in respect of inventions developed in the course of their relationship.

7.3.4 Examination of the Invention

Although Article 18 of Patent Law No. 4 of 1962 has some formal procedural requirements (Explanatory Note to the Patent Law, Industrial Drawings and Models No. 4 of 1962: 71), these only stipulate that the documents to be filed with the application must be properly completed. A full description of the working of the invention must be provided (to a sufficient standard to enable experts in the field to operate the invention), and claims concerning the originality of the invention must be substantiated. However, Al-Ali (1988: 255) points out that there is no systematic examination of the invention to ensure that it is novel, no consideration of the previous technical testing requirements, nor any allowance for theoretical or practical considerations regarding applications of the invention in real life. As a result, patent rights have been granted for inventions whose claims are unproven. This amounts to a major failure of the system. Opposition to the granting of an application must be made within two months of its publication and decisions may be challenged in local courts.

7.3.5 Shortcomings of the Law

It is the author's opinion that, compared with the minimum standards required by the Trade Related Aspects of Intellectual Property Rights Agreement (TRIPS) administered by the World Trade Organisation (WTO), of which Kuwait is amember, the Kuwaiti patent law is lacking in some important respects and is thus a major disincentive to foreign investments. It is also badly administered. There are many specific reforms which are now needed. For instance, Kuwait must amend its laws to incorporate the TRIPS provision that developing countries are now obliged to grant product patents for pharmaceutical products as well as for

processes (Article 27, TRIPS). As for the duration of Kuwaiti patents, fifteen years is rather short and the author believes that it would be reasonable to extend the period to twenty years as a guarantee of the patentee's right to utilise his patent. This suggestion is even more relevant now that TRIPS stipulates a minimum patent duration of twenty years from the filing date.

Another difficulty that may be experienced if the 1962 law is applied concerns the ill-defined rights of a patentee. Article 10 provides that a patent is vested in the owner and that no other person has the right to use the patent by any methods. The key question that must be raised is whether the phrase "use by any methods" includes the importation and the offering for sale of products made through the working of the invention. In order to avoid difficulties that may arise from this ambiguity, it would be better for the law to be amended clearly to reflect the internationally acceptable rights which patentees may exercise.

Another weakness of the present law is that it does not specifically outline the civil remedies for infringement. For instance, there is no recourse for the owner of the patent to recover compensation for the infringement. Foreign investors would probably prefer to have a statutory procedure enabling restitution rather than having to fall back on general principles of loss and compensation. It should be noted, however, that the infringement of a patent is a criminal offence punishable by imprisonment for a period not exceeding two years and/or a fine (Article No. 46 of the Patents Law).

The Trade Marks Control Office may, in certain cases, issue a compulsory licence to someone if the patent holder refuses to assign the right of exploitation to that person, or if the assignment is conditional upon the payment of a large sum of money. Such compulsory licensing is granted provided that the patented invention was not exploited in Kuwait within three years of the date of the patent being granted, or if exploitation of the patent was suspended for two consecutive years. While it should be noted that the compulsory working or licensing of patents is internationally acceptable under TRIPs, the Kuwaiti provisions are not clear as to whether importation of a patented product will constitute sufficient working of the patent in Kuwait for the purposes of the compulsory licensing regime.

Given all this indisputable evidence, the main need is for the Kuwaiti state to be committed to applying the laws it issues efficiently and comprehensively. Such an enforceable patent law would almost certainly help to attract foreign investments. Without meaningful attempts to apply the law, the law is simply unable to contribute to the area of activity for which it has been promulgated. In most countries, patent laws are passed in order to encourage inventions and to guarantee for the patentee all the rights related thereto, including the right to utilisation or exploitation, with a view to contributing positively to the process of technology transfer and thus to economic development. It is now time for the Kuwaiti Government to recognise the positive ways in which an efficient patent system can help to achieve these desirable goals.

Further support for this view was offered in the 1975 report issued by the UN Department of Economic and Social Affairs, UNCTAD, and the World Intellectual Property Organisation (WIPO):

> The principal function of patent legislation is seen in both developed and developing countries as not only the natural right of the inventor, but as an incentive to encourage invention and to promote economic development. It is by having such legislation that there can be prompt and adequate disclosure of any new technology but also by having an exclusive position, be it only for a limited time, there is a good chance of having a reasonable profit on investments in research, development and production. (UNCTAD and WIPO 1975: 2.)

It is therefore clear that Kuwait requires a modern law regulating the process of technology transfer in order to facilitate the socio-economic development of Kuwait, and that this law must incorporate relevant provisions relating to patents. Adequate guarantees and inducements in connection with foreign investors who want to protect their patents can undoubtedly play a key role in meeting the requirements of Kuwait for speedy development. In this respect one positive step which may be noted is that Kuwait has recently approved the unified patent law for the Gulf Co-operation Council countries. Among the aims and objectives of this law are the transfer and adaptation of technology and the encouragement of such local technologies as would be suitable for the needs of the area (*Journal of Protection of Industrial Copyright, Majallat "Himayat al-Milkiyya al-Sina iyya*", 23, February 1990).

Among the most important consequences of the unified law is that it makes possible the granting of patents and their effectiveness in every member country of the GCC, as well as

the establishment of two offices for supplying a project with periodical literature, computers, and the necessary expertise, and for examining applications which are submitted in this regard. One of these offices is to be in King Abdul Aziz City for Sciences and Technology in Saudi Arabia, and the other is to be established in the Kuwait Institute for Scientific Research. The unified law makes it possible for the inventor to apply for either office for inspection or examination, and also gives member states the option to determine the task to be assigned to each office (Dousse, 1988: 11-15).

Having more than one system of obtaining patents, directly through national offices and indirectly through international arrangements, is not a new situation. However, in each case, the patent is actually granted in the end by the national office. The question which inevitably arises in this context is: How can Kuwait agree to have in its territory one of the two offices for examining patents for nationals of the Gulf Co-operation Council countries when the Industrial Registration Department, which is concerned with the registration of patents, is incapable of carrying out its required role on behalf of Kuwaiti citizens?

7.4 TRADE MARKS

Trade marks - like patents - are an important issue for foreign investors, and the protection of trade marks in Kuwait has generally not been dealt with satisfactorily. Prior to 1961 trade marks were not protected at all by statute but reliance was placed on the general ethos which dominated the country's business and commercial practices. Thus it was a commonly established principle, in the spirit of fair, honourable competition and in accordance with the principles of justice in these matters, that one tradesman should not use the trade mark of any other tradesman's goods. The first statutory rules governing trade marks were enshrined in Articles 68 to 92, Section Two, Chapter Two of the Commercial Law No. 2 (1961) which defined the nature of trade marks and the procedures required for their registration. The regulations for the administration of the relevant provisions on trade marks were contained in Article 92 of the same Law. In 1980, however, the 1961 Law was amended by the current Law No. 68. Section Two of the Third Chapter of the new Law includes, in Articles 61 to

85, provisions which cover trade marks and the procedures relevant to their registration. In reality, though, the 1961 regulations are still in force since the 1980 Law made very little changes to those earlier provisions. The changes that were made stemmed from the view that the 1961 Law was not appropriate to deal with modern developments in the transfer of technology.

A trade mark is defined as anything "that takes a distinctive form of words, signatures, letters, numbers, drawings, symbols, addresses, stamps, illustrations, engravings, inscriptions or any other sign or mark or a set of them if used or meant to be used in distinguishing goods or products as indicating that they belong to the owner of the mark because of its manufacture, selection, trading or exhibit for sale" (Article 61 of the Kuwait Commerce Law No. 68 of 1980). This text is similar to the provisions of Article 68 of the repealed Commercial Law 2 of 1961. It must be noted, however, that some marks may be unregistrable, including:

1. marks without any distinctive feature or marks made up of statements representing the customary names given to such goods;
2. marks which are contrary to public morals and order, or which are identical or similar to religious symbols;
3. marks which tend to mislead the public or cause confusion as to the origin of the goods;
4. public emblems pertaining to the State, the United Nations or its institutions, to another State on the basis of reciprocity, or to symbols of the Red Crescent or Red Cross and similar symbols (Article 69, 1962 Law).

All these marks, according to the law, are unregistrable, but clearly the relevant definitions leave a lot of scope for interpretation. For example, it is not entirely clear how those trade marks which are "contrary to public morals and order" are to be identified. This lack of clarity can only cause anxiety to potential foreign investors.

7.4.1 Service Marks

As far as service marks are concerned, the situation in Kuwait is even more unsatisfatory because the present law does not permit their registration. Further confusion is caused by the problem of clearly distinguishing between a trade mark and a service mark. The World Intellectual Property Organisation (WIPO 1977: 27) has tried to offer some assistance here by stating that: "A trademark is a sign which serves to distinguish the goods (as does the 'service mark' with regard to services) of an industrial or a commercial enterprise ... The sign may consist of one or more distinctive words, letters, numbers, drawings, pictures, etc. It is generally necessary for effective protection that the mark be registered in a government office." Since Article 6 of the Paris Convention requires the countries of the International Union for the Protection of Industrial Property to undertake to protect service marks, Kuwait will eventually have to amend its laws accordingly if it hopes to be party to the Convention. In any case such an amendment cannot be delayed if this gap in the law is to be remedied. (See Sarkouh 1992-1993: 20-23).

This need has also been stressed by the vice-chairman of the Trade Marks Department, Mrs Mouza Al-Khashan, who has pointed out that:

> The fact that the Commerce Law No. 68 of 1980 did not mention the category of services in Article 61, which defines trade marks protected by law, has caused many problems and has given rise to many legal disputes in this respect. In order to find a solution to this problem, a bill was introduced for the addition of services to the statute so that the economic development requirements can be met, and demand for these categories of services satisfied, whether from inside or outside Kuwait. The Council of Ministers issued a resolution by which categories of services would be added to the list of categories for which the law ensures protection of their trademarks. (M. Al-Khashan, interview conducted by the writer on 7 January 1995).

7.4.2 Non-Use

A brief comment is required on the question of the non-use of trade marks. At present the registration of a trade mark may be cancelled if the trade mark has not been used for a period of five consecutive years from the application's original submission date except where the owner of the trademark is able satisfactorily to justify its non-use (Article 77 of Law No. 68 of 1980). Nonetheless, it is arguable that this Article may have an adverse effect on foreign investment. This is because it offers inadequate protection to potential foreign investors who,

as a preliminary and precautionary step, register their trade marks in a country in which they may wish to trade while they conduct their business feasibility studies and negotiations. This process may take longer than five years, in which case their trade mark protection will have expired.

7.4.3 The International Protection of Foreign Trade Marks

As already indicated, Kuwait is not a party to the Paris Convention for the Protection of Industrial Property, nor to any other treaty or convention relating to patents or trade marks other than the WTO code that includes the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).[1] This does not, of course, preclude the possibility of any mutual or bilateral agreements between the State of Kuwait and other countries for the protection of trade marks. However, by far the best solution would be for Kuwait to ratify the Paris Agreement and subsequent amendments to it to protect the rights of Kuwaiti citizens and make it easy for them to enjoy legal protection in foreign countries. As only parts of Paris Agreement are to be applied by Kuwait according to the TRIPS Agreement.

7.4.4 The Way Forward

On the basis of the evidence presented above, the author believes that the Government of Kuwait must now reconsider the rules and provisions designed for the protection of trade marks, and should develop and update them in the form of a more modern law. Such a step could prove to be very important in facilitating the transfer of modern technology to Kuwait. Being a party to international agreements on trade marks, such as the Paris Agreement of 1886 and the Madrid Agreement of 1891 and subsequent amendments, should help to provide a

[1] The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), which forms part of the WTO Code, incorporates much of the Paris Convention. See, for example, the TRIPS Agreement article 1 (3), which states that" Members shall accord the treatment provided for in this Agreement to the nationals of other Members. In respect of the relevant intellectual property right, the nationals of other Members shall be understood as those natural or legal persons that would meet the criteria for eligibility for protection provided for in the Paris Convention (1967), the Berne Convention (1971), the Rome Convention and the Treaty on Intellectual Property in Respect of Integrated Circuits, were all Members of the MTO members of those conventions." See also article 2 (1) that states, "In respect of Parts II, III and IV of this Agreement, Members shall comply with Articles 1-12 and 19 of Paris Convention (1967)." Also article 2 (2) in this Agreement states that "Nothing in Parts I to IV of this Agreement shall derogate from existing obligations that Members may have to each other under the Paris Convention, the Berne Convention, the Rome Convention and the Treaty on Intellectual Property in Respect of Integrated Circuits."

viable framework to attract foreign investments and technology transfer. These needs are now more important for Kuwait than at any previous time in the country's history.

7.5 COPYRIGHT

Kuwait is not party to either of the two most significant multilateral treaties dealing with copyright: the Berne Convention and the Universal Copyright Convention. Although Kuwait does not have its own copyright law, there are now copyright provisions in Kuwait following a regional agreement of the League of Arab States (The Arab Agreement for Protection of Authors'Rights, Baghdad 5.8 Moharram, 1402 A.H. [2-5 November 1981 AD] - The League of Arab States, The Arab Organisation for Education, Culture and Sciences, Department of Culture).[1] Works protected include literary, musical, artistic, cinematographic, radio and television works (Article 1). There is no formal requirement for the eligibility of works; hence it is not clear whether non-original works are to be included. It must be stressed that only nationals or residents of Arab states are protected. However, foreigners may be protected if their work is published in Kuwait, provided that the country of origin of the foreigner has a reciprocal arrangement with Kuwait (Article 26). Kuwait will clearly have to enter into more treaties and extend copyright protection to more foreigners in order to encourage foreign investment.

Kuwaiti law recognises the concept of the divisibility of copyright. Not only does it allow the transfer of copyright; it also permits the transfer of various rights in each copyright to different persons (Article 17). Apart from photographic works, which have a term of ten years from publication, other works have a term of twenty-five years (Article 19). It is curious to observe that the law does not indicate how the terms of other works will be calculated, or whether this will be according to the life of the author or the date of publication. To avoid possible problems in the future, an amendment should be passed to give such an indication.

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[1] See Law No. 16 of 1986 concerning Kuwait becoming a party to the Arab Agreement for the Protection of Authors'Rights, published in Kuwait Al Yum, 1657, 30 March 1986. Kuwait is a party to the Treaty but the Treaty is not applied on a consistent basis in Kuwait.

The copyright owner has the following exclusive rights: to copy the work in all material forms, including cinematography, photography or recording; to translate, alter, quote or musically arrange the work; to transmit the work to the public by performance, acting, radio or television broadcasts or by any other means (Article 7). The inclusion of the phrase by "any other means" suggests that third parties can be restrained from all forms of use whether mentioned in the law or not and whether or not known today or still to be developed in the future. If this is the case, the provision will be welcomed by foreign investors. Authors of works also have moral rights to claim authorship and to prevent disparaging alteration of their works (Article 6).

One serious weakness of the present law is that it fails to specify the remedies for infringement. This is a lacuna which makes the law ineffective. An amendment is necessary to grant owners specific remedies such as injunctions, damages, seizure orders and the like. Most importantly, Kuwait should either bring the regional agreement into force (with the suggested amendments), or should pass an entirely new copyright law as part of efforts to attract FDI and technology transfer.

7.6 DESIGNS

The relationship between the design process and technological innovation is vitally important, and the protection of designs is an issue which cannot be ignored in any modern system of investment regulation. There is no specific statute on designs in Kuwait, but relevant provisions are contained in some articles of the Commercial Companies Law 1961. Article 35 provides that every arrangement of lines or shape of body with or without colours for use in industrial production by automatic, manual or chemical means is deemed to be an industrial design or model. However, protection arises only through registration. Applications may be made to the Trade Marks Office and up to fifty individual designs may be contained in one application (Article 35). The duration of a design right is five years in the first instance, but it is possible to extend this for two further terms of five years each. The transfer of designs is also recognised, though an assignment of a design right which is not registered cannot be used as proof against third parties (Article 41). It must be noted, however, that there is no

indication of the nature of the right of an owner; nor is there any specification of the remedies available. No design law is complete without such provisions; hence it is suggested that Kuwait must amend the laws accordingly.

7.7 THE OFFSET PROGRAMME

Given the extensive damage to the Kuwaiti economy following the Gulf War, the Kuwaiti Government needed to adopt stringent policies to promote reconstruction. These included a major innovation - the Offset Programme (*Al-Watan* 1994) which was adopted under Resolution No. 694 of the Council of Ministers on 27 July 1992. The Resolution approves the principles and suggestions contained in the study submitted to it in connection with the "counter obligations" of foreign companies under the Offset Programme (Resolution issued by the Council of Ministers, No. 694, 26 July 1992):

> The term "offset" is defined as the obtaining of particular rights or financial and strategic commitments from foreign companies and agencies that provide imported goods and services to the government of Kuwait. Under the offset program, foreign companies signing large supply contracts with the Government of Kuwait are required to invest inside or outside the State of Kuwait in projects that are both technically and economically viable. Kuwaiti investors from both the private and public sectors are invited to study the investment projects and to participate with foreign companies in those judged suitable and pursuing national objectives.
> (Counter Trade Offset Programme Executive Office, 1 February 1994)

The Offset Programme is a simple concept which involves foreign suppliers investing a given percentage of a contract's value in the client country. It is not a new concept in the sense that it has previously been practised by some other Gulf region countries. The specific terms and conditions vary substantially from country to country, as can be seen when one compares the "plough-back" figure of Kuwait's 30 per cent requirement with the UAE's 60 per cent on defence contracts and Saudi Arabia's 35 per cent requirement. In Kuwait, contractors have an eight-year time limit in which to fulfil the investment obligation. Failure to do so incurs a penalty of 6 per cent of the value of the supply contract (Hindley 1994: 5).

The Offset Programme's main objectives are to provide needed contributions to management, technology and investment, and to promote and stimulate the private sector.[1]

[1] Charles J. Menans, in a report prepared at the request of the Ministry of Finance on 13 October 1993, has

Under the Programme, foreign companies entering into big contracts with the Kuwaiti Government, with a value of not less than one million dinars, are obliged to re-invest 30 per cent of the contract either in an investment fund specially set up by the Government, or in joint ventures with Kuwaiti investors from the private sector or from the Government-controlled sector, according to the value of the project (Counter Trade Offset Programme - Executive Office, no date: 3-25, ser. no: 950218 GLFNL).

With regard to Government contracts whose value ranges from one million to five million dinars, 30 per cent of the value has to be put into the investment fund which it is planned to establish for this purpose. This means that the Offset Programme has not yet been applied to contracts where the value is less than five million dinars. Its application will be possible once the procedures have been completed for the establishment of this fund.

As for contracts with a value of five million dinars upwards, the foreign companies are required to reinvest 30 per cent in joint ventures in which Kuwaiti citizens take part and which are economically viable and useful to Kuwait. According to Abdullah Al-Mansour (1994 : 9), when it was first introduced, the Offset Programme was applicable to all contracts. Owing to procedural and executive impediments, however, it was divided into three stages. The first stage involved contracts signed with the Ministry of Defence, since such contracts are not subject to public tender. Given that Government tender contracts, as a rule, are made by the appropriate channels through the Central Tenders Committee, the offset obligations are always stipulated in the contracts based upon these tenders, and are included among the conditions laid down by the Committee. This procedure requires the consent of the relevant authorities.

In view of the fact that the purchase contracts for military equipment entered into by the Ministry of Defence are exempted from subjection to, or control by, the Central Tenders Committee, offset obligations have been applied to contracts of five million dinars upwards

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listed the assumptions underpinning the Offset Programme's guiding principles as: "1. It is assumed that the guiding principle behind the Offset Program is to let free market forces rule wherever and whenever possible so as to maximize the real economic benefit to the State of Kuwait. 2. The Offset Program can be viewed as a set of artificial market actions which should achieve a balance between: i. Forcing a Counter-Trade Offset Obligation on contractors receiving economic benefits from doing business with Kuwait. ii. Attracting contractors, through various incentives, to establish strong and viable businesses within or outside Kuwait in association with Kuwait nationals for the ultimate economic benefit of the State of Kuwait." (page 4) Charles J. Menans, "Counter-Trade Offset Program: Analysis and Options Report", prepared for the Kuwaiti Ministry of Finance, 13 October 1993 (unpublished).

without regard to the framework of the Government's Tenders Committee rules. As for military purchase contracts with a vlaue of less than five million dinars, this programme is not applied at present because the investment fund has not been established (Al-Moulah 1994: 44).

7.7.1 Relevant Projects and Businesses

The foreign funds derived from the Offset arrangements can only be invested in certain stipulated projects. The joint ventures being carried out under the programme must clearly be seen as useful to the Kuwaiti economy. This means, for example, that they must be effective in bringing about the required development, education and training of the country's manpower resources, and should also help in transferring technology into Kuwait as a main pillar of national development. Foreign capital and foreign expertise should also be utilised in bringing about the economic recovery of the country (Counter Trade Offset: 1994).

The Offset Programme applies to foreign companies and to local companies who act as agents for foreign companies. All the companies involved must invest in general projects within and outside Kuwait. The programme defines suitably qualified operations as follows:

> All Kuwaiti purchases and exports produced in Kuwait, investments inside and outside Kuwait which are commercially feasible and bring economic benefits to the State of Kuwait, shall be accepted against the obligations of the prime contracts. (Section on "Content of the Programme", Part Five of the Offset Programme.)

The Offset Programme's goals are certainly desirable from Kuwait's point of view, but the question which must be asked is whether, in practice, the Programme has actually achieved those goals.

7.7.2 Criticisms of the Offset Programme

The Offset Programme has been widely criticised. One observation is that "perhaps it is the only programme in the world that allows companies to invest outside the country. We made this condition to make it more attractive to foreign companies." (See the statement of the

Senior Finance Ministry official Madouh,"*Offset Draws $658 Million*", KT, 28 February 94). Others argue that serious consideration should have been given to investment inside Kuwait, rather than giving the other party to the contract, namely the foreign investor, the freedom to choose the location for reinvestment. The rationale for the second view seems to be that the objectives of this programme include securing contributions necessary for technology and administration in Kuwait, and fostering investment in projects of education and scientific research and the development of manpower resources.

Another criticism is that the penalty for breaching the offset obligation (6 per cent of the contract costs) is not high enough to constitute an effective deterrent. Thus the editor of the Kuwaiti newspaper *Al-Qabas* argues that the foreign investor could purposely create difficulties or obstacles in order to avoid the 30 per cent reinvestment. (For instance, he may actually prefer to pay the 6 per cent fine.) However, the rationale for this penalty appears to be an attempt to using moral persuasion, rather than legal means, for enforcement. One senior Finance Ministry official, Al-Madouh, pointed out that the imposition of a 6 per cent fine for failure to carry out the commitment is not intended as merely as a source of revenue. Rather it is to emphasise the seriousness of the implementation of the offset system obligations. Mrs Sarah Al-Douwaysan, the Assistant Deputy of the Finance Ministry Accounts Department, stated that the main purpose is to induce the foreign investor to reinvest inside Kuwait. It is noteworthy that all the companies with which agreements of understanding have been signed are international companies which have a world-wide reputation. (*Al-Qabas*, 18 May 1994, No. 7513: 14):

> Our motivation in establishing the programme is not to collect money from those companies. We just want them to invest in Kuwait in order to motivate the private sector and create more business opportunities here. We want foreign companies to come here to train and educate our nationals and to bring advanced technology into the country (*KT*, 28 December 1994).

We should always bear in mind that the signing of the offset agreements with foreign companies legally entails the investment of 30 per cent of the value of the contracts signed between these companies and the various ministries of Kuwait. Such reinvestment aims to achieve the activation of the private sector, the diversification of income, and the development

of industrial technology. This is a step in the right direction if we bear in mind that such companies and projects are of great importance to Kuwait.

7.7.3 Unresolved Issues

In relation to the Offset Programme, questions are bound to be posed concerning the nature and type of industrial projects, investment and marketing opportunities needed by Kuwait, and the issue of whether proposed projects have been properly considered, and in particular whether there have been detailed feasibility studies of these projects indicating the required share capital, primary materials and manpower. It is also crucial to know whether these projects will actually serve the basic interests of the national economy, for example through the creation of job opportunities for Kuwaiti youth, and what type of industrial technology will be required for Kuwait's development through the Offset Programme.

In an interview, Hisham Al-Juhail stated that Kuwait has signed many contracts containing offset provisions. For example, the Ministry of Finance has entered into an agreement with four foreign arms suppliers: GM Hughes Electronics ($27.6m) in November 1992 (USA); Raytheon Corporation ($98m) in January 1994 (USA); Aerospatiale of France ($5m) in December 1993; and GKN ($308m - the highest offset deal so far) in July 1994 (Hisham Al Juhail 1994). Madouh, the Manager of the Offset Programme, indicated that the Ministry had also signed a letter of commitment with two other US companies, General Dynamics Corporation for $210m and T-Com USA for $12m. "We have initial understanding with them, but have not yet set a date for signing a memorandum of agreement," he said (*Kuwait Times*, 28 February 1994).

These contracts which Kuwait has signed with foreign companies are expected to be followed by the implementation of related projects which must be submitted to the relevant authorities in Kuwait for an examination of their likely consequences in terms of economic recovery, industrial technology transfer, the training of Kuwaiti cadres, or the creation of job opportunities for Kuwaiti youth.

7.8 LEGAL IMPLICATIONS

A number of very significant legal issues arise from the Offset Programme. First is the question of whether the agreements signed constitute legally binding contracts which are enforceable in Kuwait and abroad. In this respect, the adequacy of the available remedies becomes important because there may be no incentive to fulfil a contractual obligation if the burden of any remedy that may be awarded is likely to be less attractive than the consequences of a breach. If contracts are enforceable, then questions of applicable law and the jurisdiction of courts must be determined. Assuming these issues are resolved in favour of Kuwait, another question may arise concerning the actual privity of contract between the supplier, the Kuwait Government and a third party who is supposed to execute the Offset Programme. A final question is whether the contracts will lead in practice to the transfer of foreign technology.

A brief description of the procedures involved in concluding an offset agreement will be useful at this point. There are four key stages: the supply stage; the Memorandum of Agreement stage; the approval stage; and the performance stage. During the first (supply contract) stage, the foreign contractor is primarily engaged in pursuing and winning a supply contract. Once this is done and the contract is signed, the offset obligation is effective and the next step is to sign the Memorandum of Agreement (MOA) with the Ministry of Finance. The foreign contractor acknowledges the offset obligation in the MOA, and then enters the approval stage during which he will conduct relevant studies to enable him to prepare and submit to the Executive Office a concept paper, a proposal and, finally, a business plan which in due course will be the foundation for the fulfilment of the offset obligation. This leads to the performance period during which the contractor fulfils his offset obligations (CTOP/EO. Guidelines for the Counter Trade Offset Programme, Ministry of Finance, No date : 8-9).

For the purpose of illustration consideration will be given here to four supply contracts between the Government of Kuwait and each of the following: Hughes Aircraft Systems (USA), the Raytheon Company (USA), Aerospatiable Missiles (France) and GKN Export

Services (UK).[1] All of these examples featured two sets of agreements with some common features: the presentation of proposals to the Kuwaiti Government for vetting and approval; the signing of an agreement upon vetting of the proposal; a degree of flexibility in the sense that changes may be made subject to agreement, but the 30 per cent fees are not negotiable; and provision that the execution of the proposed projects is to be managed by the supplier, with supervision being exercised by the Kuwaiti Government through half yearly and annual reports, with the possibility that the Kuwaiti authoritities will impose a penalty on, or award an incentive to, the supplier, depending on how well the project is being executed.

The fact that the second contract is indefinite may make the whole contractual agreement unenforceable. Thus, in the case of the four illustrative contracts mentioned above, the agreement signed is more of an offer for the supplier to submit another offer in the form of a proposal which may then be agreed upon by the parties. Accordingly, in this situation, there can be no valid contract until there is an acceptance of the offer (proposal) made by the supplier to the Government. This in turn means that no supplier can sue the Government for failure to accept its proposals. An offer for an offer is simply not binding.

Common experience in offset programmes around the world suggests that the Memorandum of Agreement (MOA) is usually not fully enforceable and is often a source of conflict or dispute between governments and supply contractors, leading to time-consuming arbitrations both within and outside host countries. Often penalties exist only in theory. (CTOP.EO, The Memorandum of Agreement Position Papers, Confidential Paper, March 26, 1994, Ministry of Finance: 1.)

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[1] GKN's proposed waste project earns $1,180,500,000 in offset credits towards the firm's offset obligations of $300,000,000. Though the implied return-on-equity (ROE) is only 7.8 per cent, the waste project's large capital investment in the first two years of $150,000,000 amounts to 50 per cent of GKN's total offset obligations - representing an initial cash investment of 15 per cent versus the 3.6 per cent implied in the contractor's investment decision model - rewards the British company with close to $900,000,000 in credits in the first two years.

If the initial investment is adjusted to the 3.6 per cent initial cash investment of the joint venture that the contractor's investment decision model implies, then GKN earns $381,000,000 credit after 8 years. Though they still have a low return-on-equity number, the British firm benefits from an investment in Manufacturing, an Economic Activity Area with an above-average Macro-Factor Score of 3.5. (Counter Trade Offset Program Executive Office(CTOP-EO), "The Combined Credit Multiplier Method", position paper prepared for the Counter Trade Offset Program Advisory Committee, Ministry of Finance, 13 April 1994.)

The indefinite nature of the agreements, as illustrated by the four examples listed above, extends to a right to change anything in the agreement apart from the 30 per cent investment provision. The Council of Ministers Decision No. 694 provides no guidance on the form and content of the MOA. Under the guidelines, foreign contractors are given latitude to adjust the document to their circumstances. The relevant clause in the standard MOA form states that "The Memorandum of Agreement may be amended, supplanted, modified or terminated at any time at the instance of either side by negotiated agreement of the two parties firsts mentioned." The MOA only provides a general framework within which the contractor will be called upon to fulfil his obligation. It is no more than an agreement to agree that the contractor will participate in the programme. Even if the agreements are valid contracts, such indefinite terms may be used by either party to frustrate the agreement.

In the same vein, it is regrettable that there is no guidance on what kind of proposal may be submitted that is likely to satisfy Kuwait's developmental requirements. One wonders why a foreign supplier should have to shoulder the burden of determining such an issue. As the French Military Attache, Guy Courtin, noted in a CTOP-European Union meeting held in mid-February 1994, supply contractors do not understand the economic development needs of Kuwait and usually do not know how to create profitable business opportunities that will benefit the country (CTOP-EO, offset obligation on contracts below KD 5 million: Position Paper prepared for the CTOP-EO in the Ministry of Finance, 26 March 26 1994: 4). It would have been better if the Kuwaiti Government had published a list of projects and called upon each supplier to agree to execute one of them.

The suitability of the project managers (the suppliers) and the project supervisors (Kuwaiti Government officials) is questionable. The four companies studied here appear to be only interested in supplying defence weapons: they are traders rather than investors. They may not be well suited to identifying, executing or managing agreed projects. For instance, the project managed by GKN Services clearly states that the company does not have to be an equity holder in the venture to carry out the proposal. Kuwaiti officials may also lack the requisite skills to supervise such projects. It may be better for third parties to be appointed to manage and supervise them. To this end, further agreements may be signed to ensure that

there is privity of contract (a legally binding relationship) between the Government, the suppliers, the foreign investor executing the project and the project managers and supervisors. Failure to do so may prevent any agreement from being enforced against third parties.

Even though a contract may be enforceable in law, it is clearly pointlesse to sign a contract with a penalty for default if that penalty is not commensurate with the benefit which the defaulting party may obtain if he defaults. This is why the penalty of 6 per cent of the tender contract fee for failure to execute the Offset Programme is unreasonable.[1] The excuse that Kuwait may black-list such contractors for default is untenable as they would have acquired substantial benefits without any costs. Given that in most circumstances goods are to be supplied over a period in excess of two years, it is reasonable to expect that parties who default should be penalised within the period in question on the assumption that payment for the goods is spread over the prescribed period. However, in practice, as there is no clear indication as to how Kuwait is to make its payments, it cannot be asumed that payments will be spread over such a period. Furthermore, in the case of GKN Services, there is no indication that the arrangement is not a one-off supply contract, which means that once the supplier has received payment, Kuwait would find it very difficult to ensure that 30 per cent of the value is invested. This is clearly a complex problem, but one possible solution is to adopt a method common in project management and finance, which is to ensure that at least 30 per cent is paid into an account either in or outside Kuwait, but to which both the supplier and the Kuwaiti Government are joint signatories. Kuwait has enhanced security if the 30 per cent can only be disbursed whenever the two signatories sign jointly.

Although the basic objectives and principles of the Offset Programme must be endorsed, the particular regulatory legal framework which has been established is not conducive to the formation of new businesses. As is shown in Chapters Five and Eight, the Commercial Law (CL) and the Tax Laws of Kuwait hinder the development of on-going joint

[1] Note that only one of the agreements under study (GKN) specifies a 6 per cent penalty. Clause (6) states: "GKN has read, understands and agrees to comply with section (X) 'penalties' of the Guidelines and it is agreed that penalties leviable on GKN for non-fulfilment of the commitment shall be 6% of the unfulfilled portion of the commitment." (Clause 6 of GKN MOA (TOP) dated 9-7-1994). None the less, it is submitted that if enforceable at all, the 6 per cent penalty will be applicable to all the agreements given that this is clearly set out in the Offset Programme schedule itself.

venture enterprises by foreigners. A progressive income tax (the higher the income, the higher the tax rate) targeted at foreign investors is a disincentive to foreign joint ventures. Furthermore, as Kuwaiti nationals are not taxed, feelings of unfairness and discrimination may be borne by foreigners (CTOP-EC Commercial Law and Taxation: Position paper, Ministry of Finance, 26 March 1994). Positive suggestions are presented in Chapters Five and Eight as to relevant changes which might be made in these laws to address a range of weaknesses: There is presently inadequate protection for minority shareholders; foreigners cannot hold a majority stake; and the registration process is unduly burdensome. These factors translate into higher start-up costs. The potential effects are as follows:

a) Supply contractors faced with a choice of establishing new ventures in an unfavourable environment may choose to pay the 6 per cent penalty.

b) Supply contractors may hesitate to introduce the types of technology relevant to Kuwait's needs (Counter-Trade Offset Programme Executive Office, Commercial Law and Taxation: Position Paper, 26 March 1994: 1).

Certainly, the Offset Programme has the capacity to contribute to Kuwait's economic development, especially in the area of promoting the development of the private sector, education, scientific research and training of Kuwaitis (Counter-Trade Offset Programme Executive Office, 13 April, 1994, pp. 6-8). Thus Clause 3 of the standard MOA provides that "the company will provide: High Technology, Technical Assistance, Education and Training, Marketing Assistance and Research and Development". But there is a further clause which states that clauses may be deleted where appropriate. Thus, apart from the Aerospatiale Missiles MOA, all the other MOAs either specifically excluded this clause or do not mention it at all. The basic framework for all MOAs should ensure that the technology development elements referred to in Clause 3 must not be left to the bargaining strength of the parties. Although this would incur increased negotiation costs, it would also tighten the language of the MOA and ensure that the goals of the programme are fulfilled. Finally, it is noted that none of the four Agreements under scrutiny specify the applicable law or the country whose courts have jurisdiction. This is left to some unspecified agreement "between the counter-trade offset programme Executive Officer and the contractor".

To be fair, it has to be admitted that most of the points highlighted above are based on the assumed default of the foreign supplier. However, in practice the Kuwaiti Government or officials may themselves cause difficulties and could easily frustrate the agreement if, for instance, the necessary permits for the project to be executed are delayed or refused. To this end, it is noted that only GKN Services have protected themselves in the sense that the Kuwaiti Government is obliged to obtain such permits for the projects.

7.9 RECOMMENDATIONS

The above analysis has made a number of criticisms of Kuwait's present regulatory system. In an attempt to show how existing weaknesses can be overcome, the author offers the following specific recommendations:

1. that an industrial investment department or agency should be established and entrusted with the task of preparing a list of the industrial projects which can be established in Kuwait;
2. that these projects should be submitted to the private sector in order to ascertain the extent to which private participation or investment will be forthcoming;
3. that an attempt should be made to inquire or research into the views and opinions of the industrial companies operating in Kuwait as to their future projects and possible forms of expansion;
4. that foreign companies should be asked to submit a list of the projects in which it is possible for them to offer investment. The projects required should be industrial projects entailing the transfer of technology and the development of manpower resources.

Kuwait certainly has the financial resources to enable it carry out the required tasks on such terms and conditions as would seem appropriate in its dealings with importers and contractors from the major western companies. It should therefore seize the chance in these favourable circumstances to bring about the desired goals of industrial development and the creation of investment opportunities for the diversification of its economy. This type of industrial development is to be preferred to the policy of concluding grandiose agreements

which cannot be implemented inside Kuwait, thus making investment outside Kuwait a seemingly desirable but far from acceptable proposition.

7.10 HUMAN RESOURCES

As already emphasised, Kuwait, unlike other developing countries, has an abundance of capital but a shortage of human resources, which means that the country depends heavily on foreigners for most of its labour requirements. The development of the country's socio-economic structure is undoubtedly hindered by the unbalanced distribution of indigenous and foreign workers as this promotes a dependence on foreign manpower and obstructs the development of local capabilities. Thus Kuwait's population balance and labour requirements are of great concern as these are issues that can affect policy objectives and serve as constraints on development. Ultimately oil wealth must be transformed into human resources and, with this in mind, Kuwait's labour structure and composition represent a major area for development and reform (Chouchi and Al Qudri 1988: 1).

One of the major objectives of economic development in developing countries is the sustained growth of the Gross Domestic Product (GDP). To achieve this goal, it is generally assumed that the employment rate must rise and that this must be accompanied by an increase in the level of productivity per worker. The situation in Kuwait, however, is radically different in that GDP growth is not Kuwait's foremost objective. Existing per capita income levels provide a sufficiently high standard of living for Kuwaiti nationals. Therefore GDP non-oil growth should be seen mainly as a means of achieving diversification of the country's income base and reducing dependency on oil income (World Bank 1981: A45).

Not only does the Kuwaiti workforce contain a higher number of foreign workers than most economies; there is also a conspicuous shortage of technical and managerial skills. This has resulted in local Kuwaiti consulting and service companies having little effective involvement in the processes of technology transfer. (Al-Ali 1988: 280). The foreign labour-force, which accounts for 70 per cent of the total population and 82 per cent of overall labour in the country, has emerged as a major problem in Kuwait. At the same time, the local labour force has revealed its weaknesses and its lack of experience.

7.10.1 Factors Affecting the Low Participation of the Kuwaiti Labour Force

The low degree of Kuwaiti participation in the labour force derives from a number of factors including Government policies (written and unwritten), the fact that women are not encouraged to work, the large proportion of youth in the population and the relatively poor educational facilities.[1]

> Abdel Rasoul Al-Moussa (1992: 148) argues that:
> The proportion of Kuwaitis working in the private sector is hardly more than 2%, whereas non-Kuwaitis account for almost 98% of that sector. It is clear from these percentages that the Kuwaiti element is almost absent from the private sector which is dominated by non-Kuwaiti elements. This is an unnatural situation for a country which has Kuwait's economic status in the world. The reason for this state of affairs is that the government does not have any well-defined strategy by which it can assess the needs of the country and the security aspects of the emerging problems which affect society or threaten its structure as a result of increasing reliance upon foreign labour. There is no law specifying the number of personnel who may be recruited from non-Kuwaiti sources by each company or corporation, depending on the nature of the work to be done. This lack of precision has led, in turn, to the recruitment of large numbers of people having nothing to do with the work required, and thus becoming what may be called a liability on society.

Similarly, Twafig Al-Bahar asserts that the Kuwaiti Government must itself be blamed for the failure to employ Kuwaiti labour in many parts of the economy. The private sector has suffered because the Government has offered employment to such a large number of its own citizens in the various ministries and departments. Conditions of employment are much more secure in the public sector, and therefore the private sector has seemed less attractive to workers. Al-Bahar goes on to point out that this situation has actually got worse since the liberation of Kuwait from Iraqi invasion because during that time the Government has actually increased the wages and salaries of its own employees, and this has resulted in a further movement of workers away from the private sector. (Tawfiq Al-Bar, chairman of the board of

[1] Looney (1994) pointed out that" Problems of mobilising human resources in the country were not only limited to training and acquiring new skills and attitudes towards certain jobs; they also included reforming the wage structure by skill and occupation, upgrading the educational infrastructure, as well as integrating women into the labour force. A major problem facing planners in Kuwait was the increasing signs of an unemployment problem among Kuwaiti graduates." (Robert E. Looney, *Industrial Development and Diversification of the Arabian Gulf Economies*, JAI Press, 1994, p. 197.

directors of Worba Insurance Company, Interview conducted with him by *Al Qabas*, 6 June 1994, No. 753:17).

> Salah Al-Ali (1988: 191) has further stated that:
> there are three main reasons why Kuwaitis form a low percentage of the workforce. First of all, women are not encouraged to work. Further, some members of the population are not included in the figures because they are classified as being of inadequate means. Finally, a large proportion of the population is under 15 years of age. Kuwait has come to realise that these young people could provide the answer to future labour requirements if they were properly educated and trained, thus reducing the country's dependence on expatriates.

Another issue to contend with is that educational training in Kuwait is generally deficient. In most sectors of the economy, the application of science and technology is greatly hindered by the shortage of trained manpower (Al-Sultan 1983: 78-84). Fortunately, the Government has committed itself totally to expanding and improving local educational facilities in order to eradicate the problem of illiteracy; but, despite this commitment, illiteracy still stands in the way of economic and social development. This problem is highlighted in the Ministry of Planning's long-term forecast that by the year 2000 the number of skilled workers will not exceed 67,500, while the requirement for skilled manpower is expected to be 167,500 (Behbehani 1981: 9-15).

7.10.2 Measures Introduced to Redress the Imbalance

In order to redress the imbalance between foreign and local staff, various policies have been adopted. Kuwaiti law is now geared towards the employment of Kuwaitis rather than expatriates in all companies. For example, Article 8 of Ministerial Order No. 99, 1993, concerning the Regulation of Labour in the National Sector, requires that any company wishing to use expatriate staff must prove that there are no Kuwaitis qualified for the positions to be filled. Also, Kuwaiti nationals must account for not less than 25 per cent of the total employed in such company, although this percentage may be reduced by the Minister of Trade and Industry if there are an insufficient number of Kuwaitis available (Article 21, Law of Industry, 1965). Although Kuwaiti law does not specifically state how key staff posts or executive management positions should be distributed between expatriates and Kuwaitis,

Article 8 of the Law of Industry requires that the manager of an industrial enterprise shall be a Kuwaiti national.

The criticism must be made that these laws do not really tackle the central issue, which is that foreign investors need to be subject to appropriate forms of regulation. This is not merely a matter of the provision of employment for Kuwaiti citizens (a problem which does not actually exist in the first place). Rather foreign investors should be encouraged, by a range of appropriate incentives, to offer suitable training to Kuwaitis. Article 22 of the Law of Industry, 1965, contains the sole existing reference to training. It requires co-operation between an industrial enterprise and the State in any programme laid down by the State for technical training or for carrying out industrial studies and research. This provision has only had a limited effect because it does not specify that foreign investors should add to or enhance the skills and abilities of their staff. Because it is vague, it may be interpreted as referring only to training in the area of industrial studies and research, and not to training in the area of management skills.

7.11 CONCLUSION

As this chapter has demonstrated, Kuwaiti laws do not specifically regulate technology transfer. However, some provisions in the Commercial Companies Law of 1960 are indirectly relevant. An example is Article 191 of the Act which states that no foreigner can establish a business enterprise without at least one Kuwaiti partner who must hold at least 51 per cent of the shareholding (Article 191 of Commercial Law 1966; and see Al Melham 1993). This requirement gives Kuwaiti nationals control over enterprises and their operations in Kuwait, although by itself it is insufficient to bring about effective local transfer and development of technology. As Al-Sabah (1983: 72) notes, "Effective local participation in industry that is crucial for economic development of the country should be relatively of greater weight than equity participation."

It appears that hitherto various legislative initiatives have failed to recognise the basic purpose of technology transfer, which is to develop local capabilities. This lack of understanding can also be seen in the procedures used to acquire technology. It is therefore

suggested that local consultancies and educational institutions, such as Kuwait University and the Kuwait Institute for Scientific Research (KISR), should be involved and consulted to a far greater degree by recipient organisations on the selection of appropriate technology and appropriate methods for the transfer of technology. Al-Ali (1988: 157) makes the point that the Kuwaiti educational institutions "were found to be weak in their activities. As a result, firms have sought advice and technical and scientific assistance from foreign experts. Of those firms exporting technology to Kuwait, some have been dealing with Kuwait since the 1940s." Government policies relating to education, industrial training and technology clearly need to be revised if there is to be a more successful transfer, adoption and diffusion of technology in Kuwait. The Government must make it a priority to improve education and training through the application of appropriate technology, and, if necessary, relevant legal guidelines must be framed to support his goal. The manpower requirements of the country must also be used as a basis for such an approach. The Government's role in the transfer of technology is important in that its policies are aimed at guiding the transfer process.

UNCTAD suggests the following useful guidelines for the transfer of technology, and they may certainly be endorsed in the case of Kuwait:

"1. The creation of institutions and the provision of finance to help develop national technology;

2. The formulation of a science and technology policy which should be understood by potential suppliers and recipients;

3. The support of designs to adapt and improve upon the required technology." (UNCTAD 1975: 37).

It has to be recognised that FDI is the single most important means of acquiring the transfer of technology. Kuwait should by now have acquired major foreign technologies and have developed its local capabilities to sustain and maintain at least some elements of technological independence. However, actual achievements haven fallen short of these desirable goals. This is partly because progress requires more than merely income growth and a fair and equitable distribution of income. It also requires active participation on the part of Kuwaitis in the development process, particularly in areas such as management, technological

innovation and, most importantly, industrialisation. The Kuwaiti Government should therefore use the law to encourage the adaptation of foreign technology in such a way that it remains attractive to foreign investors. Among other things, the law should require the development of local manpower and the diversification of indigenous industrial capacity. The law should also endeavour to eliminate the adverse effects of foreign investment without, however, discouraging the flow of foreign investment which is, at this time, crucial for Kuwaiti development.

CHAPTER EIGHT

TAX INCENTIVES AND FOREIGN DIRECT INVESTMENT

8.0 INTRODUCTION

In this chapter the discussion of Kuwait's incentives for foreign direct investment continues with an examination of various tax incentives. Many countries have chosen to use tax laws as an instrument to attract FDI, although there is disagreement as to whether tax incentives *per se* have actually had much effect on the decisions of investors.[1] Ahmad Sharaf Al-Deen (1993: 22-24) suggests that they have probably not been very effective for two main reasons: First, there has been inadequate understanding of how best to introduce and administer taxation policies; and secondly, problems have been caused by excessive administrative bureaucracy.[2] We shall see that both these factors have played a significant role in the case of Kuwait's tax regime.

To begin with, then, an historical perspective on the development of Kuwait's tax regime will be helpful. This analysis will show that one major source of Kuwait's current tax problems is the negative legacy of past experience.

8.1 THE EMERGENCE OF KUWAIT'S TAX REGIME

Part of Kuwait's difficulty in terms of its tax regime is that taxation (in its modern form) is a relatively new concept in Kuwait, and the country has therefore not developed an appropriate

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[1] See on this point Ahmad Sharaf Al-Deen, "The Role of Tax Treatment in the Encouragement and Guidance of Foreign Investment", *The Egyptian Magazine for International Law*, vol. 40, 1984, pp. 221-223. See also Shihata. "Promotion of Arab and Foreign Investment - General Remarks", in S.El Nagger, ed., *Investment Policies in the Arab Countries* (IMF Publications, 1990), pp. 127-129; and Shihata, "Promotion of Foreign Direct Investment - A General Account, with Particular Reference to the Role of the World Bank Group", in *ICSID Review*, vol. 6 no. 2, Fall 1991.

[2] Shihata (1991: 489) states that: "Most incentives take the form of customs exemptions and tax benefits. Some countries (particularly those where macroeconomic conditions are not attractive) are extravagant in granting such exemptions instead of ensuring that more appropriate economic policies are in place and taxation levels, applicable to all concerned, are not so extensive as to curb new investments or lead to tax avoidance by investors ... Experience has shown that such fiscal or similar incentives often represent an unjustified sacrifice by the country's treasury since they rarely play an important part in investment decision-making (although they are naturally welcomed by investors); they merely increase the profits of investments that often would have been made in any case."

legislative and administrative capacity to deal effectively with tax issues (Al Rashed 1992: 63). The only taxes which were traditionally applied in Kuwait were customs duties of 1 per cent *ad valorem* imposed by merchants themselves.[3] This increased to 10 per cent as Kuwait's financial reputation grew, and in 1932 a substitute tax was imposed on commercial and industrial shops of all types. When Kuwait started exporting oil in 1946, the revenue from oil became the country's major source of income. As a result, most of the previously established taxes were abolished (Al Rashed 1992: 63-65). On 29 December 1951 a decree was passed which imposed "an income tax equal to 50 per cent of the income of corporations engaged in the production, purchase and sale of petroleum" (Al Shammari, 1980: 180). According to Al Rashed (1992: 65), this was basically an artificial tax law applicable only to Kuwaiti oil companies' concessions.

The provisions of the new tax law were not viewed as inequitable by the oil companies.[4] The reasons for this are complex. Prior to the 1951 decree, the profits made by oil companies were not taxed, but the companies still had to pay royalties to the Government. In order to obtain immunity from tax in their home countries, the oil companies actually favoured the introduction of a new, coherent tax law to replace the system of royalty payments. In fact, the oil companies themselves proceeded to draft the new tax legislation which was subsequently emulated by some of the Gulf States (Baker 1986: 141-145). Thus, as Sol Picciotto (1992: 42-43) points out, somewhat ironically Saudi Arabia's tax laws were drawn up by oil company advisors who wanted to secure their eligibility for tax credits. In Kuwait the situation was different in as much as any new legislation required British

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[3] These customs duties were intended to assist the Government at that time. A European traveller, Pelly, observed that Kuwait did not impose any type of taxes except for what was paid by the merchants, which reached 20,000 riyals per annum. Duties were subsequently levied at a rate of 2 per cent because of the complacency of the merchants and other wealthy people. (See Al Muzinie, *Zakat and Taxes in Old and Modern Kuwait*, That Al Salasel Publications, 1984, p. 26 (in Arabic).

[4] Al Rashed (1992:65-66) states that: "The first corporation income tax law in Kuwait was introduced in 1951 as an artificial tax law to be used only by the Kuwait oil company concessionaires on the basis of a claim for double taxation relief from USA and UK income tax authorities." On this see, for example, Public Record Office, F.O. 271/EA15310/72, and also Bilovich (1982), ch. 1.

Government approval, since Britain was the Protecting Power.[5]

At first the oil companies accepted the new laws - which they had helped draft - as being in their own interests, but this was only until their home countries began to disallow tax immunity. Thus, for the purpose of British law, the proposed Kuwaiti tax law did not qualify as a general income or profits tax on the oil companies. When the British Government subsequently took a firm stand on disallowing the oil states' tax for the purpose of granting immunity from tax in the UK, America followed its example (Picciotto 1992: 45). The oil companies in Kuwait could therefore not write off or claim relief from taxes in their home countries on account of the taxes paid under the Kuwaiti legislation, the latter being discriminatory in that it applied only to oil companies.

The oil companies decided to lobby for double tax relief and this, in turn, brought about new legislation in 1955 which applied equally to all companies (Baker 1986: 144-145). In 1955 Income Tax Decree No. 3 was issued to replace the 1951 tax law and this remains the main corporation tax law now applied in Kuwait. Act No. 26 of 1967, relating to tax collection from certain petroleum companies, and Act No. 34 of 1970, relating to income tax and advance payment operations, are two notable amendments to Act No. 3 of 1955 (Al Rashed 1992: 66). The fact remains, however, that the bulk of this legislation is now over forty years old, and even the amendments are over twenty-five years old. This suggests that further reform and consolidation are overdue. This will become apparent if we look at the existing legal framework in more detail.

8.2 THE INCOME TAX DECREE NO. 3 OF 1955

The historical importance of the Income Tax Decree (ITD) No. 3 of 1955 has already been established above. Article 1 states that "a tax is imposed on any body corporate, wheresoever

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[5] A British official minuted a meeting (21 July 1952) with Mr Bartholomew, who was an oil company advisor and formerly a US State Department official, who was described as the author of the Saudi and Kuwaiti laws and was at that time drafting those of Bahrain. (Public Record Office(PRO) File FO 371/4236, p. 179 in Picciotto 1992: 42).

incorporated". Al Rashed (1992: 67) points out that the ITD considers this provision "to include any body corporate carrying on trade or business in Kuwait, either directly or through an agent, and also includes any body corporate carrying on trade or business in Kuwait as an agent for others". In the official gazette, *Al Kuwait Alyum,* No. 91, the term "body corporate" is said to signify an association formed and registered under the laws of any country or state which is recognised as having a legal existence entirely separate from that of its individual members.

Consequently, this Kuwaiti income tax law only applies to juridical persons, although it is by no means clear whether it applies only to *foreign* juristic persons. The argument posited by the Income Tax Director, in the declaration published in *Kuwait Today*, No. 91, is that "since there is at present no law in Kuwait providing for the incorporation and registration of such bodies, the expression 'body' or 'corporation' applies only to other companies and corporations registered abroad" (Al-Najjar 1982: 294). In the same declaration, he also suggests that "no income tax shall be demanded from any foreign body or corporation which is carrying out its activity or business in Kuwait through an agent who is not himself a corporation or body".

According to the Legislation and Fatwa (Formal Legal Opinion) Department in Kuwait, the provisions of this declaration demonstrate that the Kuwaiti income tax imposed under Decree 3 of 1955 applies only to juridical persons who are carrying out their work or business in Kuwait, which means the companies and corporations mentioned in Article I of the Decree. Taxes are to be levied on the profits made by these companies and corporations, and natural persons are not subject to these levies, even if they obtain profits from those companies or corporations in return for their participation. This provision applies universally and irrespective of the nationality of the natural persons involved. (Fatwa issued by the Legislation and Fatwa Department on Income Tax, No. 2/3591, dated 9 April 1980). This practice has continued to date despite the Commercial Companies Law No. 15 of 1960, which provides (Article II) that all companies, with the exception of joint-stock companies, have a juridical or legal character (Abd Al-Hadi Al-Najjar, 1982, p.295). In the present author's

view, the position of the Kuwaiti Income Tax Director is untenable since it is discriminatory and hence inequitable.

Another critic of the position taken by the Kuwaiti Income Tax Director is Al-Rashed (1992: 67), who argues that the position may have been tenable in 1955, but only because at that time no legislation existed for establishing commercial companies in Kuwait, and therefore the provisions could only be applied to foreign companies. However, after 1960 it became possible to incorporate companies in Kuwait under the Commercial Companies Law (CCL) of 1960.

> In the same vein, Al Shammari (1980: 181) forcefully argues that:
> It is not clear what was the intention of the legislature. Was it intended to exempt the national companies from the income tax until the enactment of a national law regulating the formation and registration of such companies (which was enacted in 1960)? Or was it intended also to exempt them from the income taxes? It seems to me that the legislature had not intended to exempt the national firms from the income tax, but rather it had felt that because there was no national law providing for the formation and registration of firms or associations. Thus, it was difficult to decide or determine whether one was dealing with a firm or with another type of business. The legislature has, however, indicated its intention when it enacted the Industrial Law No. 6 of 1965, where it authorised the Minister of Commerce and Industry to exempt the national and local industries from all taxes. This indicates that the legislature did not intend to exempt local companies from the income tax.

In practice, however, the Kuwaiti Government regulations do exempt local companies from all income taxes, and accordingly foreign investors will certainly feel that they are being discriminated against. Indeed, such discriminatory treatment between Kuwaitis and non-Kuwaitis may be held to be against international law which requires that a host state must treat both nationals and aliens equally under its laws (Harris 1991: 493-494),[6] and that foreign investors are entitled to fair and equitable treatment (Sornarajah 1994: 218, 219). This is made clear, for example, in the guidelines drafted by the World Bank Group which emphasise the protection and standards of treatment owed to the foreign investor by

[6] D. J. Harris, in his book *Cases and Materials on International Law*, Sweet and Maxwell, 1991, states that "The treatment of aliens (or, more accurately, the treatment of the nationals of other states) is as controversial a subject as any in international law. The controversy stems from a difference of approach between those states that consider that there is an 'international minimum standard' of treatment which must be accorded to aliens by all states irrespective of how they treat their own nationals and those that argue that aliens may only insist upon 'national treatment', i.e. treatment equal to that given by the state concerned to its own nationals."

the host state.[7] However, it is at least arguable that customary international law no longer endorses an unqualified ban against discrimination (Asante 1988: 667).[8]

> In this context Dr. Abd Al-Hafiz Abdullah Eid (March 1994: 282) notes that:
> The income tax in Kuwait has, from the outset, been imposed on juridical persons working in Kuwait whether they are owned by foreigners or by Kuwaiti citizens in conformity with territorial taxation. None the less, it has been an established custom, in the Tax Department of the Ministry of Finance, to levy tax on only foreign companies or their branches working in Kuwait. This is despite the fact that the legislature was committed to giving equal treatment to both Kuwaitis and foreigners as equality is rightly deemed to be one of the principles adhered to in the legislation. The failure to tax local businesses has resulted in the reduction in the amount of tax collectable, an important source of income.

In the light of all this indisputable evidence, the present author believes that the income tax provisions of Kuwaiti law are in need of comprehensive and urgent revision, and that their base must be broadened to meet the country's development needs. Since it presently discriminates between the local and foreign investor, the law cannot be described as a major incentive to foreign investment even if, as Al Najjar notes, it is still reasonably effective in practice, despite its basic ambiguity and the lack of adequate judgments regarding its scope (Al Najjar 1984: 202).

Dr Eid (1984: 282) also argues that the Income Tax Decree must be given much clearer legal formulation. He also notes that many problems were caused by the laws being written originally in English and then inaccurately translated into Arabic. This is all the more plausible if we consider the text in the light of the terminology which is now established and recognised in public finance. Hosny Al-Masri also suggests that the law of 1955 needs modification and that the wording needs to be made much more precise, taking into account the poor quality of the present English translation. It is simply not satisfactory that many diverse interpretations of the text of Law No. 3 have been given by the Director of the Income Tax Department because of the lack of textual clarity. (Hosny Al-Masry, interview with the writer on 7 January 1995.)

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[7] See World Bank, "Legal Framework for the Treatment of Foreign Investment" (vol. 11: Guidelines, 1992). The text of the guidelines is reproduced in (1992) 31 I.L.M. 1363.

[8] For more about the treatment of aliens see Amerasinghe, *State Responsibility for Injuries to Aliens* (1976); Dunn, *The Protection of Nationals* (1932); Eagleton, *The Responsibility of States in International Law* (1928); Freeman, *The International Responsibility of States for Denial of Justice* (1938); Jessup, *A Modern Law of Nations* (1946).

8.3 TAX RATES, BANDS AND EXEMPTIONS

The tax rate has previously been determined on the basis of bands in a progressive tax system. However, it must be pointed out that the rate is still calculated in Indian rupees, a position which, although probably justifiable in 1955, is now untenable. It is time for the rate to be fixed in the national currency (Al-Najjar 1982: 295).

The tax exemption is represented by no less than 70,000 rupees, roughly equivalent to 5,250 Kuwaiti dinars, so that the first band, which ranges from 70,000 rupees to 250,000 rupees (18,750 KD), has a tax rate of 5 per cent. The rate increases gradually by 5 per cent for each band until it reaches a band which ranges from 4,000,000 roubies (300,000 KD) to 5,000,000 rupees (375 KD with a tax rate of 5 per cent). For bands above 5,000,000 rupees, the tax rate is 50 per cent (Article II, Y, Tax Law No. 3, 1955).

As already stressed. no taxation is levied on individuals in Kuwait, and only the portion of profits attributable to a foreign partner or shareholder in a partnership or joint venture is taxable. Thus, corporate income tax is payable on the following:

(a) The net profits of a foreign corporation in so far as they relate to operations in Kuwait;

(b) The portion of net profits of a Kuwaiti shareholding or limited liability company which is attributable to the foreign corporate shareholders;

(c) the portion of net profits of a Kuwaiti joint venture which is attributable to foreign corporate shareholders.

In addition, a 5 per cent tax is levied on a joint stock company's net profits, which is payable to the Kuwait Foundation for the Advancement of Science. This tax is not imposed on a limited liability company because all its shareholders are natural persons (Amin 1991: 153).

To illustrate the actual impact of these rules and regulations, details may be given of the income tax actually paid for April at the financial year 1992-1993 (listed according to the nationality of the various companies):

British companies 28030/- KD

French companies	16055/-	KD
US companies	155254/250	KD
German companies	11611/-	KD
Other companies	17452/837	KD
Total	***228403,087***	***KD***

If the income tax payments for April at the financial year 1992-1993 are listed according to the type of activity carried out, then the situation appears as follows:

Contractor companies	47515/787	KD
Commercial companies	129259/-	KD
Insurance companies	17875/300	KD
Hotel companies	22071/-	KD
Services companies	5545/-	KD
Other companies	6137/-	KD
Total	***228403/087***	***KD***

(Ministry of Finance : April Report 1992-1993, prepared by the Follow-Up an Levy Section, Tax Department, Tariq Al-Safran)

8.4 WRITING OFF OR CARRYING OVER TAX LOSSES

The question of writing off or carrying over tax losses from one year to another is of vital significance for any company. This matter was not dealt with clearly or effectively by the Income Tax Decree (ITD). For example, the Decree did not take into account the extent to which expenses incurred by one establishment differed from those incurred by a sister company. It also allowed losses to be carried over without restricting them to a given number of years - a fact which enabled some companies to evade tax on the pretext of having incurred successive losses (Al-Najjar 1982: 295). Under Article 7 of the Decree, the losses sustained in one year are to be deducted from the income of the next year or years: "Any relief under this article shall be given as far as possible in the first subsequent taxable period within the said following taxable periods and so far as it cannot be so given then in the next taxable period and so on." Al Rashid (1992: 84-85) comments that:

The last three words, "and so on", meant that potentially, endless exemption into the future was granted for any taxable period as long as it could cover its losses, even if these losses were 20 or 30 years old. Eventually, such provision would not only affect the tax collection for some years, but would also allow uncompetitive companies to stay in the market by claiming loss relief.

In order to clarify the implications of the provisions of Article 7, let us suppose that a certain taxpayer lost an amount in the region of 150,000/- KD in a given financial year, and then made the following profits in subsequent years:

First year:	10,000/- Dinars (profits)
Second year:	20,000/- Dinars
Third year:	25,000/- Dinars
Fourth year:	30,000/- Dinars
Fifth year:	40,000/- Dinars
Sixth year:	50,000/- Dinars

The taxpayer may, in this case, carry over from his loss 10,000 dinars in the first year, 20,000 in the second year, 25,000 in the third year, 30,000 in the fourth year, and 40,000 in the fifth year. The remainder, which is 25,000 dinars, will be carried forward to the sixth year. He will pay tax on the amount remaining from his income in the sixth year, which is 25,000 dinars. The losses which may be carried over at the same company and business are calculated on the basis of the taxable income from operations carried out in various fields by the taxpayer (Eid 1994: 282).

Eid (1986: 26-27) states that the Kuwaiti Legislature has demonstrated an excessive liberalism on the issue of what losses can be carried over, since it has not specified the period after which such deductions must cease. This omission may tempt enterprises to exaggerate their losses, and may also have a bearing on the position and protection of enterprises incapable of competition. Eid also maintains that the period for the carry-over of financial losses should be specified, and that restrictions should be imposed on the arbitrary or excessive use of the right to carry over losses. One way of doing this would be to restrict the

carry-over right to new enterprises, the aims or objectives of which are consistent with the country's development.

As if acknowledging this point, the Ministry of Finance in 1981 requested the Legislation and Fatwa Department's view on the rights that should be accorded to corporate taxpayers to carry over financial losses. The key questions to be answered were: Should the right be available to all enterprises, or should it be a privileged subject to the discretion of the Ministry of Finance? Should the carry-over continue from year to year without any limit? The Department concluded that: (1) the taxpayer should be permitted to request carry-over of his financial loss to the next year on condition that the statement presented by him on the taxable period of the financial year is approved; (2) the Ministry should respond positively to such a request or application by the taxpayer. The deduction of the loss which has been carried over should take place from the next financial year, and, if this is not possible, then from the following financial year, etc. (3) the Ministry's approval of a request for a carry-over to the next financial year should not be limited to a fixed number of taxable financial years. Deductions should be permitted until the full extent of the loss has been accounted for. (The Legislation and Fatwa Department: Fatwa issued by the Legislation and Fatwa Department, No. 2/4159, on 24 June 1981).

8.5 DISPUTES WITH THE TAX AUTHORITIES

The determination of taxable income has always been a major source of disagreement between taxable entities and the Taxation Department (Al Rashed 1995: 85). This raises the issue of how such disputes are to be resolved, and it has to be recognised that foreign investors will wish to be satisfied that the procedures are accessible and fair. Under Article 13 of the Decree, in cases where disputes cannot be resolved and if parties agree, the matter may be referred to arbitration. However, the legal ramifications of such a reference to arbitration remain uncertain. (See Chapter Ten for further discussion of Kuwait's arbitration system.)

Al Rashed (1992: 87) argues that as taxation raises issues of state sovereignty, the final decision in a dispute with the tax authorities should be made by the Appeal Court rather

than by arbitration, a procedure likely to have international dimensions. In his view, it would be better to go through a lower court then to an appeal court in order to avoid the sensitive issue of sovereignty becoming central to the process.

As the above examples have shown, the Income Tax Decree contains extremely ambigous provisions and lacks any explanatory memorandum. Such a clarification would be useful for those who have to apply the Decree's provisions (Al Rashed 1992: 68-84). Furthermore, as has been emphasised already, Kuwaiti tax law is not a comprehensive law. No regulation has been issued clearly and unequivocally defining or specifying the way in which tax is to be levied. The introduction of such a regulation would help to reduce conflicts and disputes which arise in the course of the application of the tax rules. The present law does not even give a definition of what is meant by a "permanent" firm or establishment. It is for this reason that the law is in need of fundamental revision so that it can accommodate modern developments occurring elsewhere in the world and can help to attract FDI more effectively (Ali Al-Hakim, interview conducted by the writer on 7 January 1995).

Even though in the past several amendments and ministerial orders have been issued in an attempt to eliminate loopholes (Al Rashed 1992: 84), several studies have pointed to the continuing inadequacy of the ITD Act and the scope for disputation. For example, a Commission of the International Bank of Reconstruction and Development (IBRD) made recommendations for reforming Kuwaiti tax law and stated that:

> Despite the wealth of the economy during the last decade, a comparatively small amount of industrial investment has been made by Kuwaitis. Consequently, the commission suggests that the Government either raise the amount of net income to which the maximum rate applies or considerably reduces the maximum tax rate. The commission does not believe that the return on capital likely to be earned by companies in Kuwait producing for the export market, which are those in which foreign investors are likely to be interested, will be so high as to make this proposed reduction in the income tax unreasonable. (IBRD 1962: 10).

8.6 TAXABLE INCOME

The rules governing the definition and composition of taxable income in Kuwait are complex and are not at all easy to understand, even for experienced foreign investors. To begin with, Kuwait applies the principle of "global income" in administering income tax, i.e. all income

from all sources is totalled for each tax payer and that sum is subject to a single progressive rate. Taxable income is defined as the gains of a corporate entity derived from carrying on a trade or business in Kuwait. Accordingly, capital gains are counted as income (Al Rashed 1992: 72).

Business activities which are taxable include the following:

(a) The purchase and sale of property, goods or related rights in Kuwait, and the maintenance of a permanent office in Kuwait once the purchase and sales contracts are executed;

(b) The operation of any manufacturing, industrial or commercial enterprise in Kuwait;

(c) The leasing of property in Kuwait;

(d) The rendering of services in Kuwait, excluding the purchase of property, goods or rights (Article No. 2 of ITD Section (i)).

It should be noted that the purchase of property or goods does not in itself constitute a taxable activity. Only income which has been earned from local activities and sourced in Kuwait is taxable. Income from activities conducted partly within and partly outside Kuwait may be regarded as income derived from Kuwait unless the two activities are sufficiently separated in type (International Bureau of Fiscal Documentation, *Supplement No. 34*, August 1986: 34). Foreign investors will note that the Kuwaiti Tax Department has applied the ITD to "foreign companies" since 1977, but - remarkably - there are no official guidelines available defining a foreign company for tax purposes.

In accordance with the Decree establishing the Kuwaiti Foundation for Advancement of Science in December 1976, Kuwaiti shareholding companies (*societés par actions*) must pay to the Foundation a minimum of 5 per cent tax on their net annual profits. This amounts to an additional tax burden which can affect foreign investors. It should also be pointed out that Kuwaiti nationals - i.e. *not* foreign investors - are subject under Islamic Law (*Shari'a Islami yyah*) to a religious levy called the "Zakah" or "Zakat". This levy applies to all their assets which are growing or have growth potential, for example invested assets exceeding a set minimum, including holdings in companies. The exception to this is when these companies themselves pay the Zakat in respect of their assets, because the Zakat may not be

applied twice to the same source. The Zakat is levied on capital goods, properties, and profits or incomes. A reduction is made if difficulties are encountered in production. When the Zakat is applied, the rate becomes 2.5 per cent, but all assets are included. (Report from the Public Institution of Investment, 26 August 1992). By contrast, the Zakat is paid on an optional, or voluntary, basis by Kuwaiti investors. Furthermore, the amount is small compared to the tax which is applied to foreign investors and therefore does not really amount to an excessive tax burden.

The main weakness of the Kuwaiti tax regime is that it offers no positive, direct encouragement to the establishment of new industrial projects even though it has been recognised that such projects are essential if the country's economic development goals (in terms of diversification and growth) are to be met. Thus, Al Mejrin (1984: 277) comments that "there is no specific tax incentive to promote successful projects in the industrial sector or to encourage national industrial investment. On the contrary, the only incentive in the manufacturing sector is for foreign investors, who are exempted from all taxes for ten years. Hence the Act is not applied to any Kuwaiti enterprise as long as it is registered in Kuwait." Clearly, this is a major failing of the present system.

8.7 THE GENERAL INADEQUACIES OF THE EXISTING TAX LAW

As we have seen, Kuwaiti tax legislation is out of date and is simply not geared to promoting modern development requirements, particularly in terms of incentives and especially in relation to industrial projects. The ITD's contribution to the promotion of local industry has been negligible, and the only incentive to establish a manufacturing base in Kuwait, with or without the collaboration of foreign investors, is a ten-year total exemption from taxes. This exemption, however, was not included in the ITD and, in fact, has been granted under the provisions of the Industry Act of 1965. The ITD is badly structured and does not encourage foreign investment. Subsequent tax rules are contained in amendments or appendices to the Decree rather than in new Decrees. The ITD was promulgated over forty years ago and it is now time for it to be replaced with a new, defect-free, tax law (Al Muzaini 1984: 196-202).

In a study conducted by Al Rashed (1992: 209), it was suggested that, apart from Government administrative procedures and the lack of skilled labour, the most important problem encountered in Kuwait relates difficulties with the tax system. This conclusion is endorsed by Shafiq H. Zaki, who (in an interview with the author) stated that: "The Kuwaiti tax law has been in force since 1955. Technically it is a very backward, undeveloped law. Far from being clear in its provisions, its application is also difficult" (Mr Shafiq H. Zaki, the Legal Advisor in the Legislation and Fatwa Department; interview conducted by the writer on 6 January 1995).

On the other hand, the comments of Ibrahim Shihata, Vice-President of the World Bank, are instructive:

> It is neither practical nor useful for a country to try to encourage foreign investments by means of tax exemptions and similar financial incentives in the absence of a proper environment for successful investment in general. Such an environment cannot be established solely on the country's national, human and financial resources; it depends basically on the degree of confidence in its national economic potential. That confidence, in turn, rests on many factors where facts and illusions sometimes overlap and where national, political and, at times, purely psychological considerations interplay. The greatest influence on that confidence seems to be macroeconomic policies and the extent to which they respond to changing realities. Such policies profoundly affect the balance of payments and the State budget and, consequently, exchange and interest rates and the rate of inflation. Also to be taken into account are policies relating to labour legislation, taxation, and even those that affect the training and productivity of workers. In other words, to address investment promotion one has ultimately to be concerned with the country's management of its economic resources and the overall organisation of production, distribution and consumption, both in the legislative context and, more important perhaps, in practice. (Shihata 1990: 128.)

Section 9 of Guideline III contained in the Report to the Development Committee of the World Bank, on the Treatment of Foreign Direct Investment, recommends "best practice" concerning fiscal incentives and tax exemptions, and it now seems reasonable to compare the Kuwaiti system with these "best practice" guidelines. In fact the present exemptions and incentives in Kuwait certainly do not meet the requirements of an appropriate overall investment policy. Indeed, foreign investors may regard a regime which incorporates tax holidays and then increases tax rates to offset the lost revenues as unstable and unpredictable. According to Section 9 of Guideline III, "reasonable and stable tax rates provide better incentives to investors". The key point, following the World Bank's investigation, is that where the host state opts for fiscal exemptions, they should be available to foreign and

national investors on an equal basis and with a minimum of bureaucratic discretionary power (World Bank Group, Vol. II, 1992). As we have seen, the system in Kuwait has not fulfilled this basic requirement.

8.8 PROPOSALS FOR A NEW TAX REGIME

The author believes that there is an urgent need for a complete overhaul of Kuwait's tax regime. More specifically, Decree No. 3 of 1955 should be repealed, and a new decree should be issued providing for complete equality between Kuwaiti and foreign investors and avoiding the numerous ambiguities inherent in Decree No. 3 which have been described in this chapter.

To begin with, corporations which import technology into Kuwait, or which recruit 40 per cent or more of their workers from the local, i.e. Kuwaiti, workforce, or which export 50 per cent or more of their production should be exempted from tax for a period of three years. After this period they may be exempted from tax for another period of three years if the number of Kuwaiti workers in the firm has increased to 60 per cent, or if the firm exports 70 per cent of its production abroad.

The initial period of tax holiday should be extended if the percentage of local component machinery and equipment used exceeds 60 per cent and the percentage of local staff participation and of research and development exceeds 40 per cent.

. The tax incentives to be allowed to foreign investors should be related to factors such as the importation of developed technology to Kuwait, the training of skilled labour from amongst the local workforce, and the export of industrial products. A close connection, in other words, should be established between tax incentives and Kuwait's need for industrial development.

8.9 TAX TREATIES

Bilateral and multilateral tax treaties have to be included in any assessment of a country's taxation regime. Increasingly such treaties are used to establish incentives and eliminate ambiguities and inconsistencies. Thus treaties between capital-exporting and

capital-importing countries are now one of the most commonly used devices for eliminating double taxation. Fatourous (1962: 222) comments that "This device helps to a great extent in encouraging foreign investment in the developing countries generally."

The most significant tax treaties to which Kuwait is a party include: the Multilateral Agreement between Countries of the Arab Economic Union Council, signed on 3 December 1973; the Double Taxation Agreement with France, signed on 7 February 1982; and the Agreement between Kuwait and Cyprus, signed on 15 December 1984. Kuwait is also a party to a number of agreements which are limited to the taxation of profits from air or shipping transport operations (see Baker 1986: 151). General double taxation treaties have also been concluded with Germany (4 December 1987), Italy (17 December 1987), The People's Republic of China (25 December 1989), Belgium (10 March 1990) and Romania (26 July 1992).

Additional measures have been taken following an Agreement with Cyprus with a view to avoiding double taxation in respect of the tax imposed on income arising in one of the two contracting countries, and also to prevent tax evasion (Explanatory Note to Law No. 17 of 1986 regarding the approval of the Agreement concluded between the State of Kuwait and the Government of the Republic of Cyprus for the avoidance of double taxation, in *Kuwait Al Yum,* No. 1685, 21 September 1986). Furthermore, measures have also been taken, following the Agreement with Italy, with a view to the development of commercial and economic relations between the two countries. (Explanatory Note to Law No. 40 of 1990 regarding the approval of the Agreement concluded between the Government and State of Kuwait and the Government of the Republic of Italy for the avoidance of double taxation, in *Kuwait AlYum,* No. 1881, June 1990).

Al Sheikh (1984: 69-70) has scrutinised the impact of double taxation treaties and has concluded that they do succeed in attracting foreign investors to Kuwait. This is because, under such treaties, monies earned by foreign enterprises are taxed at source in Kuwait while the investor's home country grants him relief from taxes on income which has already been taxed in Kuwait. Another device which has to be noted is the 'tax sparing' or 'tax credit' method used by industrialised countries such as Japan, the United States of America and the

United Kingdom, where relief is granted on income from developing countries. The investor, under this method, may offset taxes paid at source in foreign countries against his home country's taxes.

> Sol Picciotto's view of bilateral tax treaties (1992: 38, 62, 317) is that they are:
> a rather crude method for achieving harmony between tax systems. The increasing sophistication of forms of financing of capital investment poses continually new issues for tax authorities in attempting to ensure national and international tax equity ...
>
> More generally, it is becoming harder to maintain, as do some commentators, that the tax treaty is no more than a link between two domestic tax systems, creating special exemptions and a special internal tax regime for international transactions, but in no way substituting a common tax regime governing the international transactions between the contracting states ...
>
> The co-ordination of tax systems ... aims to establish international equity for investment by attempting as far as possible to reconcile the perspectives on equity of the source and residence jurisdictions. In doing so, the contracting states seek approximate reciprocity, or a fair bargain in the revenues surrendered between the governments in order to encourage investment. However, they do so only so far as they consider it necessary in order to remove tax impediments to international investment. Treaties should not, therefore, be interpreted on the assumption either of item-by-item reciprocity (Osgood 1984, pp. 284-6), nor that they aim to produce better tax treatment for reciprocal foreign investment than for equivalent domestic investment.

Double taxation avoidance agreements entered into by Kuwait serve to protect Kuwaiti nationals from the penalties of double taxation. This is the case, for example, with the Double Taxation Agreement with the People's Republic of China according to which, if a resident in Kuwait owns capital items subject to tax in China, then Kuwait may impose tax on those items and related income, and may grant an exemption in respect of taxes imposed under Chinese domestic law. In this case, Kuwait may deduct from the assessed taxes the tax paid in China. On the other hand, if a resident in China earns an income in Kuwait, the amount of tax due to be paid in Kuwait may be deducted from the Chinese tax imposed on that resident. When the earned income in Kuwait is in the form of dividends paid by a company resident in Kuwait to a company resident in China, and the latter company owns not less than 10 per cent of the shares of the company paying the dividends, then, when the deduction takes place, the tax paid in Kuwait by the company paying the dividends should be taken into account (Article 24 of Decree of Law No. 32, 1990; the Agreement between Kuwait and the People's Republic of China for the avoidance of double taxation, published in *Kuwait Al Yum*, No. 1878, 1990).

To take another example, Article 23 of Law No. 117, 1986 (the double taxation clause in the Agreement between Kuwait and Cyprus) provides that:

> Each contracting State's law shall govern the taxation of income, regardless of where it is derived, except where the Convention expressly states otherwise. Where income derived from one of the contracting States is subject to tax in both contracting States, tax relief shall be given. In the case of Kuwait, tax payable in Cyprus on profit, income or gains arising in Cyprus shall be deducted from any Kuwait tax payable in respect of such profits, income or gains. In the case of Cyprus, tax payable in Kuwait on profits, income or gains arising in Kuwait shall be deducted from any Cyprus tax payable in respect of such profits income or gains. However, this is subject to the existing provisions of the law of Cyprus regarding the deduction from tax payable in Cyprus of tax paid in a territory outside Cyprus, and to any subsequent modification of those provisions - which shall not affect the general principle thereof - and unless a greater reduction on relief is provided under the laws of Cyprus. (Article 23 of the Decree Law No. 117 of 1986; Convention between the Government of the State of Kuwait and the Government of the Republic of Cyprus for the avoidance of double taxation, *Kuwait Al yum,* No. 1685 of 21 September 1986).

As another example, we may take Article 24 of the Agreement between Kuwait and the Federal Republic of Germany which states that:

> Tax in the case of a resident of the Federal Republic of Germany [FRG] shall be excluded from the basis upon which German tax is imposed. Any item of income arising in the State of Kuwait and any item of capital situated within the State of Kuwait which, according to this agreement, may be taxed in the State of Kuwait. The FRG, however, retains the right to take into account in the determination of its rate of tax the items of income and capital so excluded.
>
> In the case of income from dividends, the foregoing provisions shall apply only to such dividends as are paid to a company (not including partnerships) being a resident of the FRG or by a company being resident in the State of Kuwait at least 10 per cent of the capital of which is owned directly by the German company. For the purposes of taxes on capital, there shall also be excluded from the basis upon which German tax is imposed any shareholding, the dividends of which are excluded or, if paid, would be excluded according to the immediately foregoing sentence from the basis upon which German tax is imposed.
>
> The tax paid under the laws of the State of Kuwait and in accordance with this Agreement on income and capital shall, subject to the provisions of German tax law regarding credit for foreign tax, be allowed as a credit against German income or corporation capital tax payable on such items of capital.
>
> Tax shall be determined in the case of a resident of the State of Kuwait in accordance with the provisions of the domestic law of the State of Kuwait.
> (*Kuwait Al yum*, No. 1785, 1988).

The legal advisor of the General Investment Authority in Kuwait stresses that the double taxation avoidance agreements have a great role in encouraging foreign investment. He states that by entering into these agreements, Kuwait wants to facilitate both large-scale Kuwaiti investment in foreign countries and FDI in Kuwait. Thus, mutual benefits are

obtained, serving the interests of both the Kuwaiti investor in the countries with which the agreements have been signed, and of the foreign investor in Kuwait. Kuwait seeks to realise certain advantages such as the exemption of both foreign and Kuwaiti investments from tax imposed on interest, capital gains and profits from property and on income. On the other hand, the foreign investor in Kuwait will derive benefits in so far as the application of Kuwaiti income tax to foreign investment is concerned (Ali Al-Hakim, interview conducted by the writer on the 6 January 1995).

In terms of incentives towards FDI, Al-Hakim's positive viewpoint may appear to be justifiable. However, there must be serious reservations since none of the bilateral tax treaties between Kuwait and other countries clearly offer any general tax incentives. Instead, they only aim to protect investors from double taxation and to effect co-operation for enforcing fiscal regulations between Kuwait and the relevant countries. It is therefore not clear how, in practice, these treaties impact on foreign investors, and further detailed scrutiny of this matter - on the basis of systematic research - would be very useful.

One additional important point is that in double taxation treaties entered into between Kuwait and certain states, nationals of the contracting states concerned are also protected against discriminatory taxation. Examples include Article 25 of the Convention between Kuwait and Cyprus, Article 24 of the Agreement between Kuwait and Italy, and Article 25 of the Agreement between Kuwait and China. Article 25 of the Agreement between Kuwait and Cyprus, which covers non-discrimination, states:

> The nationals of a contracting State shall not be subject in the other contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. (*Kuwait Al yum*, No. 1681 of 1986).

This could be interpreted to mean that foreign investors' share of profits in Kuwaiti companies would not be liable to taxation since their Kuwaiti partners are not taxed on their shares. If so, this would appear to suggest that the treaties have achieved a great deal, but much depends on the way in which Article 25 is interpreted.

Sol Picciotto tries to clarify the matter as follows:

> The non discrimination clause requires each State to ensure equivalent tax treatment for nationals of the other State (including entities formed under its laws), as well as for local enterprises and permanent establishments owned or controlled by residents of the other State with its own nationals in a similar situation ...
> Tax treaties attempt to deal with the problem of overlapping tax jurisdiction by allocating tax rights and granting exemptions which restrict national taxation in a number of respects, In particular, they restrict taxation at source to the business profits of a permanent establishment ...
> In practice, States attempt to retain their freedom to change their domestic tax laws, without unreasonably violating treaty obligations. (Picciotto 1992: 310-311.)

The present author takes the view that one of the reasons that Kuwait has resorted to the policy of concluding bilateral agreements is for the legitimate purpose of avoiding double taxation in order to overcome the fundamental defects inherent in Tax Law No. 3 of 1955. This offers further confirmation that the Law in question is in need of fundamental revision if it is to match the actual economic circumstances of the present time. The problem with having a large number of separate bilateral agreements is that they cause immense confusion and complexity, and they do not compensate for the advantages of having a single, coherent and unified set of regulations.

8.10 CONCLUSION

This chapter has emphasised the inadequacies and failings of existing tax law in Kuwait from the point of view of the incentives those laws offer to foreign investors. The Income Tax Decree No. 3 of 1955 is now out of touch with the reality of existing social and economic conditions, and attempts to amend the law since 1955 have been insufficiently integrated and comprehensive. Amendments are scattered in several different legal sources, and it is difficult for any foreign investor to appreciate the overall implications of the country's tax regime.

It has to be recognised that any tax system offers both penalties and incentives to investors. In order to attract FDI, Kuwait should repeal the Decree of 1955 and introduce a new law, clearly written and properly translated, which sets out a new range of appropriate incentives while keeping penalties to a minimum. Attention should be paid, in particular, to ending discrimination between Kuwaiti and foreign investors, and giving generous tax exemptions to those foreign investors who promote technology transfer to Kuwait, employ

Kuwaiti workers and/or whose products are exported. There should be clarification of rules governing the carrying over of losses from one year to another for the purpose of tax concessions.

Finally, the proliferation of bilateral and multilateral tax treaties needs to be consolidated and embodied in more general and easily understood regulations. In fact most of these treaties have not been concerned with general tax incentives but have concentrated on the avoidance of double taxation. This weakness needs to be remedied in future. It is also important that such treaties should conform to the internationally accepted conventions of fairness in dealing with foreign investors. If not, then Kuwait will be perceived to be treating such investors in an unfair and discriminatory manner, and the result will be that much potential foreign investment will be lost to other countries. Indeed, there is abundant evidence to show that Kuwait has already lost valuable foreign investment to other countries with more satisfactory tax regimes.

CHAPTER NINE

GUARANTEES AND SAFEGUARDS CONCERNING FDI

9.0 INTRODUCTION

As explained in the preceding chapters, a number of major impediments have affected the flow of FDI to Kuwait. However, in recent years Kuwait has made an effort to attract FDI by reducing some of these impediments and providing incentives to create a more suitable investment climate.

This chapter deals with the question of legal guarantees and safeguards in relation to FDI, and seeks to examine how these guarantees and safeguards influence the decisions of potential foreign investors. In particular, attention is given to the role of bilateral and multilateral treaties and protection against nationalisation and expropriation. As the World Bank (1992) points out, investors tend to favour states where all investors are treated in "a fair and equitable" manner, irrespective of their origin. El Sheikh (1984: 85) also highlights the fact that in order to reassure investors and encourage the investment of foreign capital, developing countries frequently do provide guarantees for the security of such investments.[1]

9.1 GUARANTEES FOR FDI UNDER KUWAITI LAWS

In an attempt to allay the fears of foreign investors concerning the likelihood of the expropriation of property, many developing countries have given guarantees against expropriation without appropriate compensation. In some cases these guarantees are included

[1] Sornarajah (1996) comments on the role of protection on incoming foreign investment that "States act unilaterally to confer protection on incoming foreign investments in the hope of attracting more foriegn investment in the future . Home states of foreign investors as well as foreign investors themselves take measures to ensure that there is protection of their investment from risk. The risk against which protection is usually sought is the risk of the use of sovereign power by the host state to change the conditions under which the foreign investment was intended to operate at the time of entry or to end the foreign investment through expropriation. Most unilateral measures are aimed against the elimination of such risk or in the event of the risk materialising, ensuring adequate remedies to the foreign investor". For mor about unilateral measures of investment protection see M. Sornarajah, *Host and home country Attitudes to Foreign Investment Protection*. In Heng, L et al.,,*Current Legal Issues in the Internationalisation of Business Enterprises* (Butterworths, 1996), 25-47.

in a country's constitution (Yoon Park 1986: 122-123), but in other cases they are provided through primary or secondary legislation, or through national investment laws. These guarantees involve restrictions on interferences with private property through nationalisation or expropriation[1] except where this is for a justifiable public purpose. In such cases expropriation or nationalisation must be conducted in accordance with law and suitable compensation must be paid.

The General Assembly of the United Nations, in Resolution 626 (7) of 2 December 1952, recognised the right of a state to nationalise property owned by foreigners. This right derives from the principle of state sovereignty and the inherent right of the state, in accordance with the objectives and principles of the United Nations Charter, to the free utilisation and exploitation of its natural wealth and resources. This principle has been elaborated and reaffirmed in a number of subsequent General Assembly Resolutions.[2] However, international law also recognises that a person shall not be deprived of his property arbitrarily without compensation[3]. The taking over of foreign property must be non-discriminatory and necessary for a legitimate public purpose. Precisely what is to be understood by such a purpose is, of course, always difficult to know since notions of legitimacy vary from country to country according to the specific circumstances involved.

[1] Article 10 of the Declaration of the human rights of individuals who are not nationals of the country in which they live, differentiates expropriation and nationalisation: "Expropriation, or the compulsory taking of private property by the state, is a phenomenon that has become especially important in international law with the spread of socialism and the emergence of the post-colonial state. If the typical nineteenth- century case was the occasional taking of the property of a single foreigner in the context of a particular project or dispute, today it is the general expropriation by law of enterprises with a view to their public management in the national interest. It is normally in this last context that the twentieth-century term 'nationalisation' is used. Whereas expropriation and nationalisation are sometimes treated as separate concepts."(See D.J. Harris, *Cases and Materials on International Law*, 1991, p.524). However, nationalisation and expropriation are not two distinct terms in International Law. Thus, this Chapter uses the terms interchangeably.

[2] Resolution No. 1803 of 1962 on Permanent Sovereignty over Natural Resources declares that "The rights of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the state concerned ..." (G.A. Resolution 1803, XVII, G.A.O.R., 17th Session, Supp. 17: 15). See also D. J. Harris (1991) on "Cases and Materials on International Law", 524-525.

[3] Resolution No. 1803 of 1962 (see note 2 above) recognises the right to expropriate foreign property and considers compensation requiremens when it states that "Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognised as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation in accordance with the rules in force in the state taking such measures in the exercise of its sovereignty and in accordance with international law." (G.A. Resolution 1803, XVII, G.A.O.R., 17th Session, Supp. 17: 15).

It should also be noted that various (UNCTC) investment guarantee schemes seek to protect investors against political risk and are operated by most developed countries. These schemes insure against problems arising from the inconvertibility of local currency for remitting dividends, expropriation and loss caused by civil conflict (UNCTC, Series No. 2, 1990: 33). However, the issue of expropriation and loss in other conditions - where there is no civil conflict - is not covered by these schemes.

In general, it cannot be doubted that if developing countries wish to attract larger flows of inward investment, they need to improve the investment climate and reduce the fear of political risks. In this respect, the creation of the Multilateral Investment Guarantee Agency (MIGA) comes as a very positive policy initiative (Shihata 1988: 26). The basic purpose of MIGA is to encourage appropriate foreign investment, and the methods utilised for this purpose include investment guarantee operations, consultative/advisory work and technical assistance to its developing members as well as investment promotion activities (Shihata 1991: 503). As Shihata explains:

> MIGA's guarantee program covers all types of FDI, including non-equity forms of FDI under certain conditions. It also extends to foreign portfolio equity investments. Furthermore, it covers investments of host country nationals where the investment funds are transferred from abroad. As a result, MIGA may be in a position to support country funds by insuring their holdings in eligible investments against non-commercial risks.

Kuwait signed the convention establishing the Multilateral Investment Guarantee Agency on 6 March 1987, ratified it on 6 July 1987, and became a member on 12 April 1988 by paying its initial subscription to MIGA's authorised capital. The official memorandum of the Agency about the assessment of legal protection in Kuwait includes the following statement:

> According to Article 12d (iv) of the MIGA Convention, before issuing an investment guarantee to a prospective investor, MIGA must satisfy itself that the host country has adequate investment conditions, including the availability of fair and equitable treatment and sufficient legal protection for the investment that may be covered by the agency. Paragraph 3.16 of MIGA's Operational Regulations stipulates that an investment can be regarded as having adequate legal protection if it is protected under the terms of a bilateral investment treaty between the host country and the home country of the investor. When there is no such treaty, adequate legal protection should be ascertained by the agency in the light of the consistency of the law and practice of the host country with international law. If the Agency is not satisfied with the

investment protection in the host country, it shall only issue coverage after MIGA has conducted an agreement with the host country under Article 23b(ii) of the convention.

The conclusions reached in the Memorandum about legal protection in Kuwait were as follows:

> The investment for which the investors seek insurance is not shielded by a bilateral investment protection treaty. However, the relevant national laws appear to provide a sufficient level of protection, in particular with regard to the repatriation of capital and the settlement of disputes. Moreover, there is no record that the Kuwaiti government had treated foreign investors inappropriately in the last decade. On the other hand, Kuwait could still improve investment conditions for foreigners by allowing for majority-shareholdings and by specifying more precisely what "just" compensation in case of an expropriation means. Furthermore, Kuwait could sign a legal protection agreement with MIGA under Article 23b (ii) of the convention.

Thus, Kuwait does now offer some guarantees for foreign investors. Furthermore, in principle the legal protection of foreign capital investment is actually embodied in the Kuwaiti Constitution of 1962. This is not expressed explicitly, but it is implied by various Articles of the Constitution which state that Kuwaiti society is built on three pillars: Justice, Freedom and Equality (Article 7 of the Kuwaiti Constitution of 1962).[1] Article 30 guarantees personal freedom, and Article 29 secures equality for all people before the Law in terms of rights and duties (Articles 29-30 of Kuwait's Constitution of 11 November 1962).[2] It might reasonably be argued that these statements should be seen as offering some protection for foreign investors.

Furthermore, the right to own property is clearly recognised by the Constitution. Thus, Article 18 states that private property is inviolable and may only be legally expropriated if compensation as laid down by law is paid and if the property is used for the public's benefit. According to this Article:

(i) Expropriation may not take place except in the public interest and provided that reasonable and fair compensation is paid;

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[1] Article 7 of the Constitution of the State of Kuwait states that: "Justice, Liberty and Equality are the pillars of Society; co-operation and mutual help are the firmest bonds between the citizens."

[2] Article 29 and 30 of the Constitution of the State of Kuwait states: Article 29 -"All people are equal in human dignity, and in public rights and duties before the law, without distinction as to race, origin, language or religion." Article 30 - "Personal liberty is guaranteed."

(ii) Public confiscation of money is forbidden;

(iii) Private confiscation of money is not possible except pursuant to a decision of a court.

Law No. 33 of 1964 elaborates the rules governing nationalisation, confiscation and expropriation. This states that:

(i) Expropriation, requisition or confiscation is not possible except in the public interest, in return for fair and reasonable compensation;

(ii) The pricing committee shall estimate the amount of compensation;

(iii) The person affected may object by presenting his views to the Grievances Committee, which includes one of the judges of the Central Court;

(iv) The resolution of the grievance committee regarding the amount of the compensation shall be final (Law No. 33 of 1964).

9.2 EXPROPRIATION IN KUWAIT: SOME HISTORICAL OBSERVATIONS

States which have expropriated foreign-owned property in the past may be anxious to give guarantees against future expropriation and thus to limit any apprehension on the part of foreign investors. For example, the former communist states are generally striving to create a new image, and have discarded the communist ideology which was associated with nationalisation and state ownership. China's Foreign Enterprise Law, to take another example, gives a guarantee against expropriation and states that if any expropriation occurs, full compensation will be paid. Such guarantees are particularly needed in countries previously perceived to be high-risk countries due to their former expropriation or nationalisation policies (Sornarajah, 1994: 95).

The expropriation or nationalisation of foreign-owned property in Kuwait can be traced back to the 1960s, when there was an increased awareness of the need to broaden the country's source of income and to increase benefits from, and control over, foreign oil companies. In 1970 a bill was passed by the Majlis Al Umma (Kuwaiti Parliament) stipulating that oil companies operating in Kuwait had to pay income tax in advance. Oil royalties were increased in 1966, while income tax was amended the following year. As a

result of these measures, foreign oil companies had to pay roughly $250 million in income tax and concession fees for the period 1960-1967 (ESCWA, 1988: 5).

By 1974 the Kuwaiti Government had entered into agreements with BP and Gulf Oil to take over 60 per cent of the two companies' interests in KOC (Kuwait Oil Company) (Law No. 9/1974 relating to the Participation Agreement between the Kuwaiti Government and BP-Gulf Oil, Article 1, published in the official gazette, *Kuwait Al Youm*, No. 982: 2). In 1975, however, the Kuwaiti Government nationalised the remaining 40 per cent of equity held by BP and GULF in KOC. This resulted in Kuwait having almost total control of its oil industry, with foreign participation in the exploitation of oil being restricted to AMINOIL (American Independent Oil Company) and AOC, who were jointly responsible for a total of 5 per cent of Kuwait's crude oil output (ECAWA, 1988: 6).

AMINOIL had been granted an oil concession in Kuwait in 1948, the original duration of which was to be for a period of 60 years. In 1977 the concession was terminated by Kuwait when a Decree Law (No. 10) was promulgated, vesting in the state "all the interests, funds, assets, facilities and operations of the company, including the refinery and other installations relating to the ... company". The Decree Law also stipulated that a compensation committee should be set up to "assess the fair compensation due to the company and what the company owed". However, AMINOIL decided not to co-operate with this committee and contested the Decree Law's legality. The case was then referred to arbitration under a special Arbitration Agreement.[1]

The Tribunal decided[2] that it was required to apply Kuwaiti law, which incorporated various rules from international law governing the legality of an expropriation. In the Tribunal's view, AMINOIL's complaints - that Kuwait had no right to terminate the concession prematurely - were unfounded: the nationalisation did satisfy the requirement that it should be non-discriminatory and for a public purpose. The Tribunal then had to decide

[1] Article III (2) of the Arbitration Agreement stated that the Tribunal was to be composed of Professor Hamed Sultan, nominated by the Kuwaiti Government, and Sir Gerald Fitzmaurice, nominated by Aminoil. The President was to be Professor Paul Reuter, appointed by the President of the International Court of Justice.
[2] "The law governing the substantive issues between the Parties shall be determined by the Tribunal, having regard to the quality of the Parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world."

whether the nationalisation was inconsistent with the stabilisation clauses in the original contract, and, if the nationalisation was lawful, what compensation would be payable to the oil company. As far as the stabilisation clause was concerned, the Tribunal held that it did not specifically prevent nationalisation. Furthermore, according to the Tribunal, a state could forfeit the right to terminate a state contract prematurely. It also considered that indemnification of AMINOIL had to be based on its legitimate expectations, and felt that a reasonable rate of return on its investments was one such expectation.

International tribunals have handed down numerous awards regarding the applicability of principles of international law to cases of expropriation. In the AMINOIL case, the Tribunal relied on General Assembly Resolution 1803 (XVII) of 14 December 1962 dealing with the issue of Permanent Sovereignty over Natural Resources[1] as partial justification for their view that the sovereign right of the State to nationalise foreign property took precedence over the stabilisation clause, and that the proposed compensation fulfilled all the required conditions. (Asante 1988: 589).

Paragraph 95 of the Tribunal's award stated that:

> Contractual limitations on the state's right to nationalise are juridically possible, but what that would involve would be a particularly serious undertaking which would have to be expressly stipulated for, and be within the regulations governing the conclusion of state contracts; and it is to be expected that it should cover only a relatively limited period. In the present case, however, the existence of such a stipulation would have to be presumed as being covered by the general language of the stabilisation clauses, and over the whole period of an especially long concession since it extended to 60 years. A limitation on the sovereign rights of the state is all the less to be presumed where the concessionaire is in any event in possession of important guarantees regarding its essential interests in the shape of a legal right to eventual compensation.

The Tribunal valued AMINOIL's Kuwaiti enterprise, including fixed and non-fixed assets and "legitimate expectations", at $260 million. AMINOIL's liabilities to the Government

[1] Article 4 of this resolution states: "Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognised as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the state taking such measures in the exercise of its sovereignty and in accordance with international law." The reference to the rules applicable in the expropriating state is of course the most unfortunate feature of this Resolution. In the present case the point was not material because the Tribunal held that the law of Kuwait had adopted and included the rules of international law. (See, for example, Mann 1984: 181).

under the "Abu Dhabi formula" were appraised at $123 million, leaving a balance of $83 million owing to AMINOIL at the time of the take-over. Calculating interest and inflation at July 1982, AMINOIL was awarded nearly $180 million in compensation. (Redfern 1985: 65-110 & Mann 1984 :213-221).

The situation of a loss of an investment sustained as a result of war, revolution or civil strife is more complex. Guarantees are not usually provided in national legislation promoting FDI and, for that reason, investors frequently resort to national or multilateral schemes of insurance against non-commercial risk (Abdel Rahman Taha 1990: 102). Such multilateral schemes now include MIGA, established in 1985[1] and discussed above. Kuwait participates in these schemes including, for example, the Inter-Arab Guarantee Corporation (IAGC) which was founded to provide private Arab investors with insurance against certain non-commercial risks in other Arab countries. (Law No. 37 of 1972, in *Kuwait Al yum* No. 884). The insurance available from the IAGC covers nationalisation, seizure, expropriation, restrictive regulations, military actions, revolutions and *coups d'etat* (Buseem 1980: 125-126). Kuwait is also a party to the International Convention for the Settlement of Investment Disputes (Decree Law No.1 of 1979).

9.3 KUWAITI DISCRIMINATORY RULES

The laws governing investment in Kuwait offer the foreign investor less favourable treatment than the Kuwaiti investor. As already explained, a foreign investor may conduct business in Kuwait only in partnership with a Kuwaiti national, with the foreign partner holding no more than a 49 per cent share in the enterprise. Furthermore, a foreign investor is not allowed to own land and, therefore, property. Foreign investors are also discriminated against as regards tax insofar as they are liable for tax on their share of the company's profits whereas Kuwaiti investors are not (see Chapter Eight). Other than these discriminatory measures, however, the same standards of treatment are legally applicable to both foreign and local investors and, although this does not represent an incentive for foreign investment,

[1] Draft Convention Establishing the Multilateral Investment Guarantee Agency (8 March 1985), 24ILM 692 (1985).

it is not necessarily a significant disincentive. The Kuwaiti Government is answerable to the foreign investor insofar as it is liable to pay compensation if it interferes with his legitimate interests.

In addition to these agreements, Kuwait has concluded several bilateral investment agreements as well as multilateral agreements aimed at establishing certain guarantees for foreign investors from contracting states.

9.4 BILATERAL INVESTMENT TREATIES

There is no single law regulating foreign investment in Kuwait. What we have, instead, is a set of laws which contain insufficient provisions governing foreign investment. This may partly explain why Kuwait has resorted to a policy of concluding bilateral investment treaties (BITs)[1] in order to give the foreign investor some guarantees which have not been incorporated in the country's domestic laws.[2] (This situation is similar to that relating to Kuwait's tax regime, discussed in Chapter Eight, where bilateral and multilateral treaties have been used to compensate for the inadequacies of existing tax law.) In an interview with the author Dr Ali Al-Hakim, the Director of the Legal Department and also Legal Advisor to the General Investment Authority, said:

> "There is no special law encouraging foreign investment. The rules regulating foreign investment are scattered here and there in the Kuwaiti laws. In order that the foreign investor may easily invest in Kuwait, there should be a single frame of reference for the companies instead of the many procedures which we have at present. Kuwait's entry as a partner in numerous bilateral and multi-lateral agreements gives, however, great reassurance to the investor." (Ali Al-Hakim, interview conducted by the writer on 6 January 1995).

[1] Shihatta (1991), in "Promotion of Foreign Direct Investment - A General Account, with Particular Reference to the Role of the World Bank Group", in ICSID Review, 6 (2), 488, explains the relation between BITs and FDI as follows: "BITs are bilateral treaties which contribute to creating a stable and predictable regime relating to foreign investment. Often recurring provisions in these treaties include a 'national' or 'Most Favoured Nation' (MFN) treatment clause, a statement of the conditions of expropriation and the standard for compensation, and a mechanism for the settlement of investment disputes."

[2] Istvan Pogany in "Bilateral Investment Treaties; Some Recent Examples", an article published in the ICSID Review, 2 (2), Fall 1987, p. 472, comments on the usefulness of BITs in promoting FDI: "Through various guarantees to foreign investors, including the encouragement of investment, the avoidance of performance requirements, the free transfer of profits, the payment of appropriate compensation in the event of expropriation and the provision of effective techniques of dispute settlement, BITs can contribute to the establishment of a favourable legal climate for foreign investors. For LDC economies, starved of know-how and capital, BITs represent a useful means of promoting foreign direct investment."

Most bilateral investment treaties seek to tackle not only the problem of protecting foreign investment, but also that of promoting it (UN E/C 10/1991/5: 10). Kuwait has concluded such treaties with the United Arab Emirates, Tunisia, Morocco, Pakistan, China, Italy, Turkey, France, Hungary and Poland. Moreover, in November 1989, it concluded an investment promotion agreement with the American government, acting for the Overseas Private Investment Corporation (Decree Law No. 54 of 1989 and see Joachim 1993: 2).

The primary aim of entering into bilateral agreements with other countries is to provide protection and guarantees for foreign investment. The agreement entered into between Kuwait and China on 23 November 1985 was signed for just this purpose:

> The Government of the State and the Government of the People's Republic of China ... desiring to create favourable conditions for greater economic co-operation between them and in particular for investments by investors of one contracting State in the territory and maritime zones of the other contracting State. Recognising that the encouragement and reciprocal protection under international agreements of such investments will be conducive to the stimulation of business initiative and will increase prosperity in both contracting States. (Decree Law No. 129 of 1986, in *Kuwait Al Yum*, No. 1689 of 1986).

Article III of the bilateral agreement signed between the State of Kuwait and the Republic of Hungary, and Article IV of the bilateral agreement signed between Kuwait and Romania contain provisions to the effect that each host country should give the investments of the other country treatment no less favourable than that given to the investments of investors belonging to a third country. The two Articles have excluded from the most favoured country principle such advantages as are derived from membership of a customs union, economic union, economic free zone, or any similar international agreement which may arise in the future (Decree of Law Number 37 of 1992, and Decree of Law No. 27 of 1990).

Article VII of the two treaties provides that investments in either country shall not be confiscated or put under sequestration except in accordance with legal proceedings. The Article contains guarantees required for these investments against any measures of nationalisation or expropriation or any other measures or procedures having a similar effect. The Article categorically states that such measures shall not take place except in accordance

with legal proceedings or specific conditions and terms, and that they shall be accompanied by immediate, adequate and effective compensation.

Article VIII guarantees the free transfer of the proceeds of any investment, the selling and winding-up of the investment, compensation payments and interest (if due), as well as guaranteeing the entry of citizens of either country who are allowed to work in connection with any interest. The admission of the funds earmarked for the running and maintenance of investments is also guaranteed.

Article 6 of the Treaty between Kuwait and China give the host State the right to impose restrictions under certain circumstances, such as in cases of fundamental economic imbalance, for up to six months with the provison that 50 per cent of the funds are transferred to the investing country within the six-month period. In the KWT and the KRT there are no such provisions.

Article X of the treaty between Kuwait and Hungary (KHT) has committed the two countries to providing effective means for confirming claims and implementing rights in connection with investment agreement licenses and assets. The Treaty between Kuwait and Romania (KRT) does not include such a commitment.

With regard to the settlement of investment disputes, Article X of the KRT and Article VII of the KHT refers to the processes of settlement of disputes or differences arising between the host country and the foreign investor. The two Treaties express a preference for amicable settlement of disputes, preferably within six months (under the KCHT and KMT) or three months (under the KRT). These agreements provide for such conciliation or arbitration as the parties concerned may agree upon. Failing such agreement, conciliation or arbitration will take place under ICSID. Disagreements are not to go through the courts of the host country. In the KCHT, provision is made for disputes to be referred to the appropriate administrative authority of the host State or, by prior alternative arrangement, to its courts. In the KRT, however, disputes are to be referred to the local court. None of the above agreements include a right of diplomatic protection except where the host country fails to accept rulings on disputes which have gone through the proper channels.

9.5 MULTILATERAL TREATIES

Kuwait is a party to several multilateral investment protection treaties, such as the Agreement for the Encouragement, Protection and Guarantee of Investments, concluded under the auspices of the Islamic Conference Organisation and signed by Kuwait on 18 October 1981 (Law No. 20 of 1983 in *Al Kuwait Al Yum,* Issue No. 1467, 1983). Article 2 of this Agreement provides that "Foreign capital which is invested shall have adequate protection and guarantees. The host countries provide the facilities and incentives needed by investors who are carrying out their investment activities therein."

Chapter 2 of this Treaty assures free movement of capital and free access to investment opportunities in various fields. Chapter 3 guarantees the foreign investor security, with the exception of freedom from expropriation when it is in the public interest, provided that the expropriation is effected legally and without discrimination and that compensation according to the law of the host State is paid to the investor. The level of compensation is to be determined by the courts of the host State, but can be referred to arbitration by the foreign investor. Article 11 reserves the right to transfer investment capital or net returns in the currency of the investment or in any other currency. The right to dispose of invested capital is guaranteed by Article 12. In Article 13 the foreign investor is guaranteed compensation for injury caused by a breach of his rights, whether intentional or otherwise, by the host State. Articles 16 and 17 of the Treaty contain tentative dispute settlement procedures, indicating which disputes may be referred to the courts of the host State or to arbitration.

Kuwait is also a party to the Unified Agreement for the Investment of Arab Capital in the Arab Countries (Law No. 26 of 1982). Under Article II of this Agreement, "the countries which are parties thereto shall within the framework of its provisions guarantee the free movement of Arab capital between these countries, and encourage and facilitate the investment of that capital according to the economic development programmes and plans in the countries which are parties thereto, and in such a manner as to bring benefit both to the host country and to the investor".

It was stated in the explanatory note to Law No. 26 1982 (which was published in *Kuwait Alyum* No. 1403) that Kuwait signed this Agreement for two main reasons: First, it

was always supportive of efforts to consolidate Arab economic integration by removing impediments against the transfer of Arab capital between the members of the League of Arab States. And secondly, there was no conflict or clash between Kuwait's Arab/international obligations and accession to the unified Arab agreement for the investment of Arab capital in the Arab countries. (Explanatory note to Law No. 26 of 1982). It should be emphasised that this Agreement gives expression, among other things, to the conviction of the governments of the countries which are members of the League of Arab States that the creation of a climate suitable for the investment of Arab economic resources in the field of joint Arab investment requires an explicit set of principles and rules within the framework of a clearly defined, unified and stable legal system. Such a system should facilitate the transfer, use and investment of Arab capital inside the Arab countries in such a way as to serve the aims of growth and development in these countries and improve their citizens' standard of living. The possible limits or boundaries of such a system depend upon the extent to which it proves possible to create a kind of Arab economic "citizenship" or identity with common characteristics, whereby the Arab investor will be treated, irrespective of his nationality, according to the same legal provisions applicable in any Arab country to its own citizens. This will be accompanied by the acknowledged principle of the free movement of Arab capital inside the Arab countries and by the protection of that capital by means of guarantees and safeguards against non-commercial dangers through the aid of a special judicial system. This will be in addition to the advantages, privileges and facilities which may be granted by the host country to foreign investment within the framework of its own sovereign laws. (The Unified Agreement of Arab Capital in the Arab Countries.)

Articles 1 to 4 of this Agreement state that the key goal is to facilitate the transfer and movement of Arab capital for investment inside the Arab countries with a view to consolidating total Arab economic integration and comprehensive development. Articles 5 to 15 set out details of the treatment to be afforded to Arab investors. The privileges provided for in the Agreement exceed any given by any signatory to the Agreement to its own citizens, other than in fields which are limited to a country's own citizens, or in which foreigners are forbidden to operate.

Articles 18 to 24 assign to the Economic Council of the Arab League the task of supervising the implementation of the Agreement. They also assign to the Arab Organisation for Investment Guarantee the task of insuring the funds invested under the Agreement. Articles 25 to 36 provide for the settlement of disputes arising out of the application or implementation of the Agreement by amicable means or through arbitration according to the procedures set forth in the appendix to the Agreement, or by judicial settlement whether by resorting to the courts of the State in which the investment project is carried out or through the Arab Investment Court which is to be established on the basis of the Agreement (Explanatory Note to Law No. 26 of 1982, published in *Kuwait Al Yum*, No. 1403).

Decree No.15 of 1989[1] applies the economic cooperation agreement entered into by the Gulf states and the EEC to Kuwait. Article 7 of the Agreement expresses the contracting parties' commitment to encourage and jointly protect investments in order to arrive at the mutual improvement of the conditions of investment. The Agreement also aims to encourage, develop and diversify the commercial exchanges of the parties as much as possible, and to investigate methods of surmounting the commercial barriers to the exportation of products by each contracting party to the markets of other parties (Article 1). Article 3 of the Treaty provides for the Most Favoured Nation treatment until the commercial agreement provided for in Article 11(1) is concluded.[2]

Article 19 of the Treaty provides for non-discrimination against contracting nationals, firms and companies and the universal application of a national treatment standard, but the effectiveness of this provision is doubtful. In their joint declaration regarding Article 19, the Gulf Cooperation Council States expressed the view that their obligations do not provide for the revocation of their laws or regulations if these are clearly necessary to protect their basic security interests. However, such laws and regulations will

[1] Decree No.15 of 1989 concerns approval of the Agreement between the European Economic Community and the Arab Gulf States Co-operation Council 1989.

[2] See the Declaration by the Community regarding Article 4 of the Treaty as pertaining to Article 11(2). The Declaration however extends to Article 11 (3): it seeks to define the scope of the MFN contained in this Article, viz. customs duties and all kinds of taxes inclusive of the method of collecting those taxes and dues, regulations pertaining to customs rescission, transit, stores and trans shipments, direct and indirect taxes as well as other local taxation regulations pertaining to payments, inclusive of the credits of foreign currencies and the transfers of said payments, regulations pertaining to sale, moving distribution and the use of goods in the local market. The application of the foregoing is however restricted by Paragraph 2 of the Declaration.

be applied so that they conform with the States' general obligation under Article 16 to take all suitable measures to secure the performance of all specific Treaty obligations. This is a very ambiguous undertaking, and it is significant that in its reaction to the joint declaration, the EEC expressed that view that the principle of impartiality (or non-discrimination) would secure the proper application of the Treaty. (See Letters Exchanged Regarding Article 19 as annexed to the Kuwaiti Law No. 15 of 1989.) Thus the parties do not appear to have reached an agreement on the nature and extent of the obligations created under Article 19. For example, it is not clear whether the Article entitles investors from the EEC to participate in enterprises in the Gulf States as though they were nationals of these states, or whether in fact this is excluded under the security exemption clause.

A further agreement, concluded between Kuwait and the Gulf Co-operation Council, envisages the creation of a free market for contracting states for industrial and natural health products and animal products. The Agreement provides for national treatment for eligible products (Article 1, *The Consolidation Agreement of the Economic Council of the Co-operation Council,* 1981). This Treaty promotes cross-border investments and in a roundabout way stimulates foreign investment because it indirectly expands the "Kuwaiti market" in so far as foreign investors conducting business in Kuwait have access to a larger market under the Agreement. Article 28 states that the provisions of this Agreement replace similar provisions in bilateral investment agreements (Law No. 58 of 1982, published in *Kuwait Alyum*, No. 1443, on approval of the Unified Economic Agreement).

Although Kuwait has no specific laws governing the treatment of foreign investment, the various bilateral and multilateral investment treaties are observed where applicable. While it is possible that the incentives in these treaties can help to promote foreign investment, in practice they are not sufficiently comprehensive. The Government should offer a broader range of incentives and should enter into more detailed treaties which are appropriate in today's circumstances.

Park (1986:122-123) observes that there are industrial countries which negotiate bilateral investment treaties specifically to create a stable legal and economic framework for FDI. Such investment may be very vulnerable to the risks of expropriation, wars,

revolutions and insurrection, or to the need to control the transfer of currency, particularly where the investment is in developing countries and because of the nature of the plant and machinery involved in such investment. Investing in developing countries often gives increased rates of return; however, the risks mentioned above can obstruct economic development and have a dterimental effect on the international allocation of resources. There are two recognised methods of decreasing the perception of political risk: legal protection and investment insurance, both of which are mutually supportive.

Shihata (1988: 13) points out that many developing countries have adopted codes favourable to foreign investors and have concluded bilateral investment agreements with capital-exporting countries which offer protection for investments. Although these codes and agreements may sometimes be unclear, and their application unpredictable, their existence does at least indicate a government's desire for a stable investment environment, and this can only enhance investors' confidence.

Pogany (1987: 457) offers the following comment on the significance of BITs:

> BITs offer a range of guarantees to foreign investors with a view to stimulating the flow of foreign investment. Such benefits usually comprise the extension of most favoured nation (MFN) or national treatment to foreign investors operating in certain sectors, permitting the repatriation of profits and other returns, laying down conditions governing expropriation by the host-state, and prescribing methods of dispute-settlement. A number of BITs also prohibit or discourage performance requirements.[1].

9.6 THE MULTILATERAL INVESTMENT GUARANTEE AGENCY

Decree Law No. 2 of 1987 approved Kuwait's accession to the Agreement for the Establishment of the Multinational Investment Guarantee Agency (MIGA). The explanatory note to this Decree states that the International Bank for Reconstruction and Development wanted to set up the Agency with a view to encouraging the flow of investments for productive purposes between the member countries, and in particular to developing countries.

Shihata (1988: 1-17) states that MIGA was established to complement the World Bank Group's private sector efforts in the reduction or elimination of non-commercial deterrents to FDI, and especially to alleviate investors' concerns about political risks. Shihata (1991: 503)

[1] See Istvan Pogany for more details of Bilateral Investment Treaties: "Bilateral Investment Treaties: Some Recent Examples" in *ICSID Review*, 2 (2), Fall 1987, 457.

also states that: "The underlying concept is the encouragement of appropriate foreign investment. MIGA carries out this mandate through investment guarantee operations, consultative/advisory work and technical assistance to its developing members as well as investment promotion activities."

To this end the agency undertakes:

(i) to issue guarantees, including participation in insurance and re-insurance against non-commercial risks in favour of investments which flow from the member countries to any member country;

(ii) to carry out any appropriate, supplementary activities which aim at encouraging the flow of investments to the developing countries, and also amongst themselves;

(iii) to exercise any other secondary or minor powers whenever necessary or desirable to serve its purpose.

Kuwait's accession to this Treaty would certainly confer benefits and create a more secure basis for foreign investor confidence. This would be fruitful, productive and rewarding if sufficient guarantees were provided by the Agency. Participation in MIGA could contribute greatly to Kuwait's knowledge of the trends and problems of investment, especially in the developing countries, and safeguard its joint ventures. (Explanatory note to the Decree Law No. 2 of 1987, concerning the approval of Kuwait's accession to the Agreement Establishing the Multinational Investment Guarantee Agency.)

Kuwait is a party to the Arab Investment Convention of 1970 through which every Arab country exporting capital seeks to encourage investments in other Arab countries. Arab countries endeavour to provide all facilities for the investment of Arab capital according to their individual development programmes. The Convention obliges the member states to treat Arab investments without discrimination in all fields open to them so that they enjoy the same treatment as that afforded to national investments. This can include extending any special advantages given to foreign investments to national investments. Host countries also undertake not to nationalise or confiscate Arab investments working in fields open to them.

Kuwait entered into an investment guarantee agreement with the USA in November 1989 (Decree Law No. 54 of 1989). The explanatory note to this Decree points out that the

conclusion of the Agreement was due to the desire of the Governments of Kuwait and the USA to strengthen economic co-operation between the two countries and, in particular, to encourage the participation of private American companies in projects which would transfer modern and sophisticated technology to Kuwait. Both sides, it was stated, were fully aware of the importance of investment guarantees in encouraging investment. The aims of OPIC are to support economic growth in the developing countries through the encouragement of American foreign investment. To this end, the Corporation offers financial facilities and insurance against certain non-commercial risks for citizens of the USA who are willing to carry out projects or investments in those developing countries whose governments enter into agreements with the American Government. The scope of the Agreement is limited to projects and activities confirmed or approved by official Departments of the State of Kuwait. Moreover, this Agreement is not prejudicial in any way to the sovereignty of the State or its right to issue laws regulating foreign investments. The provisions of the Agreement call for negotiations to settle differences or for resort to arbitration. (Explanatory note to the Decree Law No. 54 of 1989, *Kuwait Al Yum*, No. 1844.)

9.7 KUWAIT AND THE GCC COUNTRIES: A COMPARATIVE REVIEW

There are many significant differences between the approaches of Kuwait and of the other Gulf Co-operation Council States to foreign investment. On balance Kuwaiti regulations are certainly less friendly towards foreign investors than the regulations of neighbouring states, and this must be regarded as a cause for concern.

Whereas the Kingdom of Saudi Arabia, the State of Qatar and the Sultanate of Oman each have special legislation specifically devoted to regulating foreign capital invested in their countries, the States of the United Arab Emirates, Bahrain and Kuwait do not. Their regulations are contained in provisions which are located in various different legislative enactments.

Each country stipulates requirements regarding FDI which further its own perceived development objectives. Saudi law specifies that foreign capital must contribute to the development and transfer of technology. Qatari law prioritises technical assistance and

know-how, managerial expertise, job creation and foreign exchange. A further requirement is that the local needs of agricultural products must be met. Omani law stresses that investment capital and projects must meet the legally imposed development criteria (Fadel Nayel 1988: 2-3).

Regarding ownership, Bahraini and Kuwaiti company law limits subscription in companies to nationals unless foreign capital or experience is needed. This exception still requires local participation of not less than 51 per cent (GOIC, 1986, Appendix B: 15-16; and see Gerald 1991: 322). The same exception is found in the company law of the United Arab Emirates and of Qatar (Pepper 1992: 45). Saudi Arabia, on the other hand, stipulates 25 per cent local participation (IAIGC 1981: 66) and Oman stipulates 35 per cent if the enterprise is to be licensed (IAIGC 1981: 71).

The Saudi Foreign Capital Investment Regulations allow a ten-year tax holiday for industrial and agricultural projects and a five-year tax holiday for other projects (Pepper 1992: 38). Oman is extremely liberal in its tax policies. Any project with foreign capital which is classified as an economic development project is exempt from income and revenue taxes for a period of five years. This exemption is renewable from the date of licensing or registration, or the commencement of production (Fadel Nayel 1988: 9).

Bahrain is an attractive country for investment for many reasons: investments are tax-free, there are good communications, and there is cheap natural gas and skilled manpower. The Government does not impose income tax or restrict the amount of foreign equity invested. Remittance to the home country of capital, profits, earnings, dividends, royalties and interest is not limited, and there are very attractive incentives to investors. There is also the added incentive that capital equipment which is imported in order to establish a new industry is not subject to import duty (GOIC, Appendix B, 1986: 15-16).

The UAE Federal Government offers many incentives in order to stimulate the steady development of industrial and commercial enterprises, including tax holidays and the waiving of customs duties on imported capital equipment and raw products. It also subsidises finance for industrial companies. Each Emirate imposes different qualification requirements for FDI (GOIC, 1986, Appendix B: 42-43). In Qatar, qualifying for exemptions and

incentives is easy, particularly if the proposed project falls in a current area of national priority. There are legal precedents in respect of the principal requirements (Pepper 1991: 340).

9.8 CONCLUSION

As the author has already emphasised in Chapters Six and Eight, the policy of the Kuwaiti State in achieving the goals of industrial development cannot be divorced from the provision of incentives and protection to FDI, whether through tax concessions or other guarantees and safeguards. At present, the State of Kuwait has no sound industrial strategy seeking to attract foreign investment in order to serve the goals of Kuwaiti development. In particular, as discussed in this chapter, the need to offer secure guarantees against possible loss of investment (through expropriation, nationalisation or other major political upheaval) has not really been addressed. Most of the guarantees which have been considered here have simply not produced the required results. Evidence for this is provided by the fact that, since Industry Law No. 6 of 1965 was enacted, Kuwait has remained deficient in technology and skilled labour. The lack of adequate guarantees and protection must have contributed to this failure.

The State should now make strenuous efforts to overcome the obstacles which have been hindering foreign investment. This can be done if Kuwait succeeds in creating an investment climate which attracts foreign investment, and this must include adequate legal safeguards against the possible loss of such investment. To this end, a new industry law should be issued to replace Law No. 6 of 1965, reflecting the needs of Kuwait's new industrial strategy and responding to the requirements of that strategy for growth and development. The programme of incentives and support of industry should be tied to the policy of employing Kuwaiti labour, for which training programmes should be laid down to increase efficiency and to improve workers' skills. This can be achieved by a guided structure of investment guarantees which will establish relevant connections between the proportion of Kuwaiti labour employed and the level of protection conferred on a foreign investment project. It has to be realised that no investor will be attracted to Kuwait if there is

any serious likelihood of the investment being lost or taken over. In today's world investors have an enormous choice of countries in which to invest, and Kuwait must therefore realise that it has to offer highly competitive inducements if it is to succeed in attracting higher levels of foreign investment in the future.

CHAPTER TEN

THE SETTLEMENT OF INVESTMENT DISPUTES

10.0 INTRODUCTION

As already explained in previous chapters, foreign investment in Kuwait is regulated by a range of municipal laws, treaties, contracts, etc., all of which have provided some incentives for the foreign investor. In the present chapter the emphasis shifts to the regime for settling investment disputes, which is a very important consideration in the creation of an attractive environment for foreign investment. The particular focus of attention here is the role of judicial settlement and arbitration as vehicles for settling investment disputes in Kuwait.

10.1 SOURCES OF KUWAITI LAW

A brief review of the main sources of Kuwaiti law will facilitate an understanding of the issues surrounding judicial settlement and arbitration. The primary sources are: Islamic law, the Constitution, tribal tradition and local customs (Amin 1991: 77).[1] The Constitution and *Shari'a* are theoretically superior to other laws (Amin 1991: 95),[2] from which it follows that any law which is inconsistent with either the Constitution or *Shari'a* will be void to the extent of its inconsistency. However, in practice, these two sources of law often have less impact than their theoretical superiority might suggest (Pepper 1994: 260).

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[1] Certain general principles of international law have also been incorporated in Kuwaiti law. Harris, D.J (1991) in *Cases and Materials on International Law*, (London: Sweet and Maxwell), stated that "Interpreting Article III (2), the Tribunal (Arbitration Tribunal of AMINOIL CASE) decided that it was required to apply Kuwaiti law, of which international law- with its rules governing the legality of an expropriation- formed a part." (p 553). On this point Alan Redfern (1985) in "The Arbitration Between The Government of Kuwait and AMINOIL" in 55 Brit.Y.B.Int'l L (BYIL) 65, also stated that "The tribunal, in the Kuwait arbitration, was not tempted to take the path of 'transnational law'. It preferred instead to look for a solution to the proplem which faced it in the law of Kuwait, of which international law formed part."

[2] The important thing to note is that the Constitution recognises the *Shari'a* as a principal source of law. In Qatar and the UAE, it is also a principal source, but its relevance is enforced by the Judicature Laws issued in the UAE under the Constitution. In Saudi Arabia and Oman there are virtually *Shari'a* jurisdictions.

The extent to which the rules of *Shari'a* can be brought to bear on commercial transactions with foreign investors who are not familiar with *Shari'a* is often a concern of such investors. Commercial transactions in Kuwait are generally governed by legislation with only minimal influence from the Shari'a. Shari'a mainly applies in areas of family law, personal status and other related matters. (Edge 1991: 11). In international transactions, as William Ballantyne (1985-1986: 209) has observed, *Shari'a* is not "appropriate in many respects to what the world has made of commerce. In this, it may well be that commerce, not the *Shari'a,* is at fault - but the fact remains." None the less, Ballantyne also suggests (1985-1986: 208) that:

> There are distinct signs of a reassertion of the *Shari'a* law; the trend is now to react against the sudden importation of Western codes into these countries through, of course, Egypt, whose system was based upon the French. It is now felt in many quarters that this was done too hastily, and that the proper way now is to have a close look at the *Shari'a* and to extract and incorporate into legislation such principles as may be adapted to modern commercial conditions.

A further point of uncertainty to be kept in mind is that, with the exception of Kuwait and Bahrain, there are important lacunae in the secular legislation relating to arbitration, and that therefore the relevance of the *Shari'a,* and the extent to which it may be relied upon to fill any such gaps, must be ascertained in any given case.

10.1.1 Conflict of Laws

Kuwait is unique among the Gulf States in having a Code of Conflict of Laws governing issues arising in the courts. Regarding contracts, "the basic principle of *autonomie de la volonté*, i.e. the right of the parties in general to choose the law to govern their contract subject to the overriding rules of public policy" applies in Kuwaiti law (Ballantyne 1986: 157-159). However, foreign law will not be applied if it conflicts with Kuwaiti rules of public policy and morals (Law No. 5, Article 73). The reference to public policy - as will be discussed later - is drafted in general terms and may be considered to refer to both substantive rules, such as those pertaining to betting or gambling, and the basic rules of a fair trial, such as respect for the right of defence and equality of treatment of the parties. (Saleh 1984: 262) Since the parties can never derogate from the application of rules concerning public policy,

they are prohibited from arbitrating matters related to those rules (Saad 1981: 13). Issues related to public policy or public order are thus outside the scope of the arbitration tribunal.

Generally, where contracting parties share a common domicile, the applicable law for their contractual obligations is the *lex domicile.* However, the *lex domicile* is inapplicable where the parties have chosen the law by which they wish their relationship to be governed. In cases where the domicile of the parties is different, the law of the place where the contract was made governs contractual obligations (Law No. 5, Article 59). Clearly, the basic principle of the system is to rely on the implicit agreement of the parties. Exceptions to these rules do however exist. In the case of real estate contracts, for instance, the applicable law is that of the place of the location of the property (Law No. 5, Article 59(2)). Contracts concluded in stock exchanges or public markets are governed by the law of the place where they were made (Law No. 5, Article 60).

Regarding litigation outside Kuwait, parties to private contracts are permitted to have a choice regarding the foreign jurisdiction clause, with the exception of commercial agency transactions which have to be submitted to Kuwaiti courts (Saleh 1994: 259). One of the difficult areas derives from the principle established by the Council of Ministers' ruling that State entities are subject to Kuwaiti law and forum, while disputes are governed by Kuwaiti Courts (Huneidi 1992: 75). This seems to suggest that forum jurisdiction or foreign choice of law clauses in contracts with Kuwaiti state entities are invalid. At the time of writing, this decision has yet to be the subject of judicial interpretation.

The circumstances of each dispute dictate the preferred method of settlement. Most major contracts have a governing Law which specifies the applicable law and the place in which any dispute will be settled. The contracts themselves frequently state whether future disputes will be settled by arbitration or by litigation in the national or regional courts or will be submitted for arbitration.

10.2 LITIGATION

In considering the process of litigation in relation to disputes arising from foreign investment transactions, the first possible course of action is to submit the dispute to a court of law. Indeed, it seems reasonable to argue that, if the parties wish a dispute to be resolved by a binding decision, they should normally have recourse to the established courts of law rather than to a specially created arbitral tribunal (Redfern and Hunter 1991: 23).[1] The preferred method of settlement is dictated by the circumstances of each dispute. In general, major contracts are governed by a clause which specifies the applicable law and the place in which any dispute will be settled. Often contracts themselves specify whether future disputes will be settled by arbitration, litigation or conciliation. Disputes are often litigated in the national or regional courts when they cannot be resolved by any other means of negotiation, or else they are submitted for arbitration.

10.2.1 Litigation in Kuwait

Although Kuwait was under British colonial rule for about six decades, the British common law system has had very little influence on the development of legal systems in Kuwait and in the other Gulf States (Edge 1991: 10).[2] In 1961 the British-Kuwaiti Treaty of Protection of 1899 was replaced by a Treaty of Friendship (Amin 1991: 96)[3]. Neither the British common law nor British statutes now operate in Kuwait (Ballantyne 1985-1986 and Amin 1991: 96). Before granting independence to Kuwait, British political agents did not wish to replace the British courts and judges (which were imposed in Kuwait prior to independence) because they

[1] For more details on Litigation, see Kern (1980), "International Arbitration v. Litigation", *Journal of Business Law*.

[2] By the British Order in Council 1953 which was promulgated under the terms of the British Foreign Jurisdiction Act 1890, British courts in Kuwait exercised Jurisdiction over all British subjects, British protected persons and foreigners, while the Kuwaiti local courts exercised jurisdiction over the nationals of Kuwait and of the following countries: all Gulf Emirates, Oman, Yemen, Egypt, Iraq, Iran, Jordan, Lebanon and Syria. The extra territorial jurisdiction of the United Kingdom came to an end with Kuwait's repealing of the order in Council of 26 May 1961. When the British jurisdiction came to an end in 1961, the State of Kuwait began to develop its own legal system (Amin 1985: 274-275).

[3] For more details about the political history of Kuwait, see Chapter 2.

wanted to emphasise that the rules governing commercial transactions in Kuwait were compatible with and acceptable to British notions of fairness and justice (Edge 1991: 10).

Until 1959, two years before its full independence from the United Kingdom, Kuwait remained faithful to its traditional religious and customary laws and its legal system, which for the most part remained uncodified (Amin 1991: 96). The provisions of the Ottoman Majallat were also applied in Kuwait before independence. Following independence, however, Kuwait began to lay down the foundation of a new legal system (Al-Ahdab 1990: 363). In fact a basis was provided by the Judiciary Organisation Law No. 19 of 1959 which was drafted by an Egyptian lawyer and hence drew on various Arab judicial practices judged to be suitable for Kuwait (Amin 1991: 248). The Civil Law, which to some extent protects the rights of foreigners in Kuwait, derives from an attempt by the old Emir in 1961 to attract foreign investment to Kuwait through a modern legal system (Edge 1991: 12).[1] The Minister of State for Legal and Administrative Affairs, Salman Al-Daige Al Sabah (1980), summarised the codification efforts as an attempt to reconcile the Civil Code with the spirit of the *Shari'a*::

> That which most characterises the eminently high level of our Civil Code is the fact that its provisions are in perfect harmony with those of the Moslem Figh and its different schools, to such an extent that there is no provision which could be attributed to one particular school. None of these provisions is contrary to the tolerant spirit of *Shari'a,* but at the same time they profit from the progress made in the field of modern legal thought as concerns statutory law and the new methods which it employs.

Under the Constitution of 1962, the process of decision-making and governance in Kuwait was institutionalised in Article 79, which provides that a law cannot be promulgated without having been passed by the National Assembly and having received the Royal Assent (Abdel-Reda 1991: 267-274).

10.2.2 The Court System in Kuwait

The court system of Kuwait has been developed and extended since independence. (Edge

[1] The following were among the laws issued: (a) The Civil Code issued on 1 October 1980 as well as several other laws relating, amongst others, to legal action (Law No. 61/1961), to ownership of real estate (Law No. 39/1976), and the resting of real estate (Law No. 35/1978); (b) The Code of Civil and Commercial Procedure, issued on 4 June 1980, which replaced the old code of 1960 (Al-Ahdab 1990: 363).

1991: 13). The Law Regulating the Judiciary, which was issued by Decree 19/1959,[1] laid the foundations for the establishment of the courts (Ballantyne 1986: 66).[2] The courts orginally consisted of four chambers: the Chamber of Personal Status; the Civil Chamber; the Commercial Chamber; and the Criminal Chamber (Al-Ahdab 1990: 364). However, this changed in 1980 when a new Code of Civil and Commercial Procedure was issued by Law No. 78/1980 (dated 4 June 1980). An amendment to the Judicial Organisation Act was issued in 1981 (Law No. 67/1981). The number of chambers under this law is no longer limited but may be varied according to need. (Al-Ahdab 1990: 364). Today there is a hierarchical structure of courts of first instance staffed by a single judge; the High Court of Appeals, which has a bench of three judges, and the Court of Cessation, which is the final court of appeal in cases dealing with personal status and contractual matters. (Amin 1991: 279).

The notion of the administrative contract, taken from Egyptian law, has been developed by the civil courts into an important tool in the control of contracts between businessmen and public authorities in Kuwait (Edge 1991: 14). In this regard, however, Government agencies do not generally subject these contracts to Kuwaiti law alone. Even so, it is unlikely that investors would be alarmed by this possibility. As Ian Edge (1991: 13-14) has observed:

> This fear is misplaced ... Kuwaiti Law has a deep-rooted moral nature which runs through almost every provision in the law. This moral nature is in the law to help the weaker party ... where there is no economic equilibrium between the parties to the contract. The almost total freedom of contracts in English law is not so easily accepted in Kuwait, only because they realise that total freedom between unequal parties can result in unequal and unfair contract terms. Here Kuwait in a way tries to help redress this balance.

10.3 ARBITRATION

Litigation is not significant in terms of investment disputes in Kuwait.[3] Much more important is the role of arbitration, which will therefore be dealt with here in more detail.

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[1] Amiri Decree No. 19/1959 (later modified by several laws). There was also a Law No. 5/1961 regulating the legal relations with a foreign party and Law No. 40/1972 relating to appeals to the Court of Cessation and the proceedings to be followed in such appeals.
[2] Civil and commercial proceedings were governed by a Law of 1960.
[3] The attitude of foreign investors to Kuwait's legal system is discussed further below.

10.3.1 The Concept of Arbitration

First, it is necessary to clarify the meaning of the term "arbitration". Harris (1991: 909) states that: "If the word 'arbitration' is taken in a wide sense, characterised simply by the binding force of the pronouncement made by a third party to whom the interested parties have had recourse, it may well be said that the decision in question is an arbitral award." In its origins, the concept of arbitration as a method of resolving disputes was simple. As Holdsworth (1964: 187) explains:

> The practice of arbitration therefore comes, so to speak, naturally to primitive bodies of law; and after courts have been established by the state and a recourse to them has become the natural method of settling disputes, the practice continues because the parties to a dispute want to settle them with less formality and expense than is involved in a recourse to the courts.

Arbitration has also been defined as an "agreement to refer the relevant dispute to a certain person or certain persons in order to settle the said dispute without resorting to the competent or relevant court" (Al-Wafaa 1974: 15). It is, however, interesting to note that legislative provisions covering arbitration rarely attempt any definition, although relevant procedures and rules as well as the conditions which are relevant to the judgments and awards of arbitration are stipulated (Sarkhouh 1986: 13-14). Suffice it to say that the parties to an arbitration must consent to this method of proceeding. The Higher Court of Appeal in Kuwait defines the consent to arbitration as being "a contract by virtue of which agreement is made as to the referral of disputes which arise or have arisen between the parties to a person or several persons to settle such disputes, instead of referring them to the relevant court". (Judgment of the Higher Court of Appeal in Kuwait, 17 June 1974; the relevant provisions are Articles 173 to 188 of the Procedural Law of Kuwait.)

Schwarzenberger (1976: 195) adds the following explanation of the difference between arbitration and judicial settlement (litigation):

> The only difference ... lies in the method of selecting the members of these judicial organs. While in arbitration proceedings this is done by agreement between the parties, judicial settlement presupposes the existence of a standing tribunal with its own bench of judges and its own rules of procedure which parties to a dispute must accept.

An interesting question arises as to whether it would be possible to apply the procedural Law (KCCP) which organises the judicial system in Kuwait to problems of arbitration. It has to be realised that there are no explicit provisions in Kuwait covering arbitration *per se*. The legal nature of arbitration should be examined in order to reach a solution to this question,[1] and this involves first of all considering the two basic types of arbitration.

10.3.2 Types of Arbitration

The two basic types of arbitration are domestic and international.[2] The first is concerned with purely domestic or national matters. The second deals with issues that transcend national boundaries and which Judge Jessup called "transnational".[3] Amongst states with a developed law of arbitration, it is recognised that there may be more freedom in international than in domestic arbitration. This is because domestic arbitration, involving proceeedings between citizens of the same state, is bound to be more firmly controlled by the state in question. There are two factors which determine whether an arbitration is genuinely international: first, the arbitration must involve "the interests of international trade"[4]; and secondly, the parties involved (whether individuals or corporate entities) must be of different nationalities, or reside or be based in different national locations. Some national systems of law have adopted the first criterion (the nature of the dispute), while other systems have adopted the second (the parties to the dispute). (Redfern and Hunter 1991: 14-15).

By examining the two distinct types of arbitration, it is possible to assess the extent to which the existing arbitration procedures in Kuwait have provided guarantees to create an

[1] The relevant Articles are 254 to 263 of Chapter Three of the Amiri Decree No. 6 of 1960 concerning the issuing of the Commercial and Civil Procedures Law, as well as Articles 173 to 188 of Chapter 12 of the Commercial and Civil Procedures Law issued by decree No. 38 of 1980 in the State of Kuwait.
[2] Redfern and Hunter (1991) define the term International Arbitration as involving parties from different countries involved in an international dispute.
[3] Judge Jessup used the term "transnational" to describe those rules of law, whether local, national or international, which govern cross-border relationships and transactions. See Jessup , "Transnational Law", *Storrs Lectures on Jurisprudence* (Yale Law School, 1956).
[4] This is the definition used in Article 1492 of the French Code of Civil Procedure, Decree Law No. 81-500 of 12 May 1981.

atmosphere of confidence amongst foreign investors towards domestic arbitration. At present, little use is made by citizens or foreigners of domestic arbitration in Kuwait, a fact which is not unconnected with the shortcomings associated with arbitration in Kuwait. At the same time, the resolution of the Council of Ministers, No. 11, 1988, that international arbitration may not be provided for in official contracts concluded between the State of Kuwait and foreign contractors, seems to corroborate the view that Kuwait has little confidence in international arbitration. Such negative attitudes towards international arbitration serve as a major disincentive to foreign investments. Given the Kuwaiti Government's preference for local as against international arbitration, the Government itself stands to benefit from local reforms.

10.3.3 The Nature of Arbitration in Kuwait

Arbitration is an extremely useful process where some technical expertise is required, or where greater flexibility than is available before a court is desired (Shaw 1991: 654).[1] Arbitration has several advantages in the settlement of commercial disputes.[2] First, it is much less cumbersome and time-consuming than the complex process of adjudication. Secondly, arbitrators take great care to avoid any kind of publicity for the disputes, the parties involved or preparatory discussions which precede the arbitration (El Sheikh 1989: 303). Thirdly, the parties to the dispute have more scope for control of the proceedings than in the case of judicial proceedings. For example, they can exercise some choice in deciding who the

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[1] Note, for example, that in the *Argentina-Chile* case of 1966, the tribunal consisted of a lawyer and two geographical experts, 38 *ILR*: 10.

[2] Franklin, C. Jesse Jr and Andrew, P Loewinger in "Planning for Dispute Resolution in International Franchising Relationships"in *International Business Lawyer*, Vol.25, No 5, May1997, explain some of the advantages and disadvantages of Arbitration when they state that "The advantages of arbitration compared to litigation include: (1)a greater likelihood of award enforcement in signatory states under the New York Convention; (2) greater speed and lower cost than litigation (typically); (3) a limited discovery and motion practice; (4) the informality of the process; (5) the secrecy of the results; (6) the ability to ensure the qualifications and selection of the arbitrator; (7) the potential for non-traditional legal and equitable resolutions; and (8) a limited right to appeal from arbitration that fosters finality. The principal disadvantages of arbitration compared to litigation include : (1) the infomality of the process often allows otherwise irrelevant issues and evidence to be considered; (2) a decision-making process that has a perception of an overwillingness to compromise at the expense of strict legal interpretations ; (3) the broad grant of authority may yield unacceptable results that are non-appealable; (4) the use of arbitration may not avoid traditional litigation. (p 223).

arbitrators should be, and can help to determine the place and language for the arbitration proceedings. They can even contribute to the definition of procedural rules. (Janis 1995: 310)[1]

Arbitration is regulated in Kuwait by Articles 173 to 188 (Chapter 12 of the Second Codex) of the Civil and Commercial Procedure Code of 1980 (KCCP). This law details not only the procedural rules but also the substantive ones. Even though the whole Procedural Law comprises 304 Articles, the relevant arbitration provisions still appear inadequate. The author suggests that there should be an arbitration law independent of the Kuwaiti Commercial and Civil Procedural Law, and that the provisions of the proposed arbitration law should regulate all aspects of arbitration and its proceedings.

An experienced arbitrator, who has also served as a former Dean of the Faculty of Law in Kuwait, also supports this view. She suggests that:

> There should be an independent law for arbitration. This is all the more necessary as it was covered only by sixteen articles of the Kuwaiti Commercial and Civil Procedural law. These articles, far from being an integrated arbitration law, are evidently incomplete and full of gaps. Therefore, there should be a separate and independent law for arbitration in the light of which procedures relating to arbitration should be organised. (Interview conducted by the author with Ms. Badriyya Al-Awady on 7 September 1995.)

10.3.4 The Development of Arbitration in Kuwait

In order to understand the present situation as well as the possibilities for future development of arbitration as a means of dispute settlement in Kuwait, it is necessary to examine the historical background. The system of arbitration in Kuwait has its origins in Islamic law, the *Shari'a*, which has been closely connected with international trade. There are many verses in the Holy Qur'an calling for arbitration in the settlement of disputes, but the basic principle was laid down in the following:

> "Verily! Allah commands that you should
> render back the trusts to those, to whom
> they are due; and that when you Judge
> between men, you Judge with Justice.
> Verily, how excellent is the teaching
> which He (Allah) gives you! Truly

[1] On the general advantages of arbitration, see C. M. Schmitthoff, *International Commercial Arbitration*, Oceana Publications (1974).

Allah is Ever All-Hearer, All-Seer."

(Surah 58. An-Nisa).[1] (Al-Hilali and Khan 1993, 137)

This approach has found clear expression in the Kuwaiti legal system. Kuwait's domestic legislation, containing the first embodiment of the Kuwaiti rules and regulations on arbitration, was issued in 1938 and consisted of 26 articles.

10.3.4.1 The Evolution of Kuwaiti Arbitration Laws

In order to find the first clear emergence of arbitration in Kuwaiti legislation, it is necessary to consult the provisions of Article XXXIX of the Amiri Decree No. 1/1959 which came into force on 1 November 1960. This law empowered a judge, with the prior approval of the Higher Judicial Council, to be an arbitrator in any dispute involving relatives and brothers-in-law or sons-in-law and relations up to the fourth degree. The law was in accordance with the framework of optional arbitration rules under the Commercial and Civil Procedural Law which was issued immediately after the Decree regulating the structure of the judiciary, No. 6/1960, and put into effect from 1 November 1960 (Al-Atify 1995: 7). Articles 254 to 266 of that Law pertain to the organisation of arbitration processes, and an amendment was subsequently made (No. 3/1971) which added Article No. 164, providing for the establishment of one or more arbitration committees in a court presided over by a judge to be appointed by the court, or by two merchant members to be chosen by the Chamber of Trade and Industry. The Chamber also laid down special rules for a permanent arbitration committee.[2]

In 1980 the Kuwaiti Government issued another law - Law No. 38 - relating to the Commercial and Civil Procedural Law. Chapter XII of the original Law (Articles 173 to 188) define the system, structure, conditions and procedures governing arbitration (Shibab 1986:

[1] The Prophet Mohammad himself had agreed to be an arbitrator in a dispute which was referred to him. More precisely, he had appointed an arbitrator and had approved the decision given by the latter on the dispute. He also counselled a tribe to have a dispute arbitrated.

[2] It may be noted that some professional bodies have their own particular systems of arbitration. The Kuwait Engineers' Union, for example, has laid down arbitration rules for the settlement of disputes in connection with installations, etc., which would require special procedures (Sarkhouh 1986: 23).

210). However, in the new Law the Kuwaiti Legislature sought to expand the scope and function of the judiciary in undertaking arbitration as defined in Article 264. The purpose of the new Law was also to enlarge the definition of those who may sit as arbitrators to allow not just merchants but other specialists in technical or scientific fields, such as medicine, engineering, labour, etc., to be recruited. The underlying aim here was to improve the quality of arbitration, especially where a dispute is not confined to matters of commerce (Al-Deen 1995: 8).

The point has been made by the Director of the Fatwa and Legislation Department in Kuwait, who argues that the old Civil Procedures Law No. 6 of 1960 did not in fact accommodate international arbitration procedures. This was an important limitation of that legislation, and the same could also be said of the new Law, No. 38 of 1980, which left the settlement of international disputes to specific mutual or bilateral agreements between Kuwait and any other foreign entity, or to contracts concluded by the State of Kuwait with foreign parties (Abdel-Rida 1994: 1).

In hindsight it has to be stressed that Kuwaiti arbitration, in its original form, was not very effective. This is why the Kuwaiti legislature introduced more simplified procedures, with new principles and rules, in Law No. 11/1995, Concerning Judicial Arbitration in Commercial and Civil Procedures (Al-Atifi 1995: 10). Farouk Ali Al-Deen, Counsellor at the Kuwaiti Court of Appeal, has explained the main reason why Law No. 11 for 1995 was issued:

> It is in our judgement an optional system in its essence. Disputes which arise between the contracting, contending parties imply by definition that there is inherent animosity or repulsion which would scarcely incline them to agree to choose arbitration as a means of settling differences between them. The fact that the majority of arbitrators are not members of the judiciary has more often than not made disputants feel uneasy about that system of arbitration, for they are accustomed to having full confidence in the basic judicial system, or the judiciary, which serves them, although its procedures may take a long time. (Al-Deen 1993: 10.)

Judges are now able, in an optional capacity, to carry out arbitration in accordance with Article XXVI of Decree No. 22/1990, Concerning the Organisation of the Judiciary, which became effective on the 1 September 1990. Article IV cancelled the provisions of the

Amiri Decree No. 19/1959 related to the Organisation of the Kuwaiti Judiciary (Al-Atify 1995: 10).

10.3.4.2 The Role of the Oil Companies

As might be expected, the first generalised use of the arbitral concept in State contracts occurred in Middle Eastern oil concession agreements. The reasons for this were noted by OPEC's former Secretary-General:

> ... in general, there is considerable international support for the opinion that for the settlement of trade disputes arbitration is preferable to judicial procedure even where domestic differences are concerned, for reasons which seem to be universally recognised; arbitration is less rigid, less costly, and less dilatory than the normal judicial procedure. Furthermore, persons who invest capital on a large scale in a foreign country feel more secure on having an assurance that, if a dispute arose between them and the host country, they would not be subject to the strict legal system of the country of which they are often ignorant, and which they may fear may be applied with less than complete impartiality, in cases involving foreigners. (Rounai, no date: 35-36.)

As a general rule, oil concessions provide that disputes between the concessionaire and the producing country which are not settled by negotiation or mutual agreement should be resolved by arbitration. This provision originated in the earliest oil concession granted in the Middle East in 1901 to D'Arcy by the Persian Government and has been followed in most subsequent concession agreements during the twentieth century. (Cattan, 1967) The system of arbitration in international investment transactions developed further as more oil reserves were discovered and exploited. Contracts with oil companies generally provided for reference to arbitration in the event of a dispute between the companies and the State of Kuwait (see Sarkhouh 1994: 23-24). In general, the foreign oil companies preferred international arbitration to other forms of dispute settlement, and they insisted on arbitration clauses being included not only in the contracts for oil exploration, but also in public works and suppliers' contracts. For instance, the concession agreement signed on 18 June 1948 between Sheikh

Ahmad Jaber Al-Sabah, the present Ruler of Kuwait, and the American company, AMINOIL, provided for arbitration in Article 18. Consequently, when the Kuwaiti Government issued a decree - Law 124 - on 19 September 1977, terminating the AMINOIL Company's concession

before its scheduled date of expiry, the company invoked the arbitration clause. An arbitration panel was then formed, with the chairman being chosen by the President of the International Court of Justice. All oil concession agreements between 1934 and 1961 included such arbitration clauses. However, it must be stressed that litigation under Kuwait's judicial system had still not been structurally developed by this time (Abdel Reda, 1994: 3).[1]

The arbitration clauses in the concessions granted to AMINOIL, AOC and the Kuwait Shell Petroleum Development Company all provided that any dispute between the Government and the concessionaire should be immediately dealt with through arbitration. By contrast, the arbitration clause of the KOC Agreement contained a unique provision which reflected the high degree of political influence of Britain over Kuwait at that time. According to Article 18, the Kuwaiti Government would consult with either the British political agent in Kuwait or the British political resident in the Persian Gulf before referring a dispute to arbitration. The British representative had the legal power to appoint a referee should the parties fail to agree on an appointee, and it was stipulated that the place of arbitration would be London if no alternative could be agreed. Finally, it was emphasised that in the event of any disagreement over the translation of texts, the English version would be regarded as authoritative.

10.3.5 Types of Kuwaiti Arbitration

It can be seen that the historical development of arbitration in Kuwait has led to some confusion and uncertainty. At the present time there are basically four distinct types of arbitration which must be distinguished:

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[1] On this point see Article XVIII of the concession agreement of the Kuwait Oil Company Limited, dated 27 December 1934; the provisions of Article XIX of the concession agreement of Shell Oil Investment Limited dated 15 January 1981; Article XXXIII of the concession agreement of the Arab Oil Company Limited dated 5 July 1958.

1. Arbitration pursuant to Articles 173 to 188 of the Code of Civil and Commercial Procedure of 1980;
2. Institutional arbitration undertaken by the Chamber of Commerce. This is a form of arbitration which is oriented towards conciliation rather than arbitration proper;
3. Arbitration by the Ministry of Justice;
4. International arbitration.

In general Kuwaiti law still regards arbitration as an exceptional method of settling disputes. First of all, it can take place only in matters where conciliation is permitted and where the parties are legally entitled to dispose the right in question (Article 173 of the Kuwaiti Civil and Commercial Procedure Code of 1980; Huneidi 1989: 20). Arbitration may be carried out in accordance with the law or by "sulh" (Saleh 1984: 262), but only arbitrators named in the original Arbitration Agreement are empowered to arrive at such a "sulh". (In this respect Kuwait is unique among the States of the Gulf Co-operation Council.) This provision is clearly a form of restriction, but it is the only one in Kuwait which applies to the stage at which arbitrators may become conciliators (Ballantyne 1985: 210).

Where arbitration is by law, the arbitrator is bound to determine the dispute according to the relevant substantive law and the procedural rules of the Civil and Commercial Procedure Law. Where the arbitration is by "sulh", there is no obligation to apply these substantive rules (Article 176 of the KCCP) if the parties specifically exclude such application. (Article 182 of the KCCP), but a further provision makes it clear that the right of the parties in this respect does not extend to rules relating to public policy (Article 182(2) of the KCCP).

10.3.5.1 Optional Arbitration under the KCCP (Kuwaiti Civil and Commercial Procedure Code) of 1980

Before embarking on the arbitration process, the party who is initiating arbitration must prove the existence of the original Arbitration Agreement (El-Fatah and Osman 1985: 2). Parties may agree to arbitration of either one particular dispute or of all disputes arising from the implementation of a contract (Huneidi 1989: 20). The parties are permitted to create rights and duties by themselves and to determine the way in which their disputes are to be settled, but

this liberty is restricted and certain conditions must be fulfilled in order to validate such an agreement (Saad 1981: 10).[1]

According to the first paragraph of Article 173 of the Commercial and Civil Procedural Law,[2] arbitration awards must be in writing. Article 183 (second paragraph) further stipulates that the award should be written in Arabic unless otherwise agreed by the parties, in which case an official translation must be provided when the award is filed. This insistence upon an Arabic text is in accordance with the provisions of Article XV of the Law Organising the Judiciary, No. 19 of 1959, which confirmed that Arabic is to be the official language of the Kuwaiti courts. However, should either of the contending parties or any of the witnesses not know Arabic, then their statements are heard in court with the help of a translator.

A. Ouster of Court Clauses in Arbitration Agreements

Article 173 of the KCCP permits a valid Arbitration Agreement automatically to oust the jurisdiction of the courts over a dispute which it was previously agreed would be referred to arbitration. If one of the parties does not abide by the Arbitration Agreement, it is clear that the only remedy available to the other party is to seek the specific performance of that Agreement. (However, such a breach will not give rise to any claim for damages or any sort of monetary compensation.)

A complex situation may arise if the contract incorporating the arbitration clause is deemed to be null and void. Although no statute provides an answer to this problem, some remedies can be sought under Article 186 of the KCCP. Furthermore, some scholars have argued that the arbitration clause must survive the termination of the contract, presumably onthe grounds of the doctrine of separability of provisions, but this view has itself provoked

[1] Parties may agree to resort to arbitration if the agreement to do so is reached prior to the disputes, or in disputes prior to agreement as to referral to arbitration. The agreement may be in the form of a condition in the contract, or in a future agreement. In the second case, the agreement may be independent of the contract which is concluded by the parties involved - a fact which would lie behind any potential dispute.

[2] Where contending parties have legal capacity, they can choose the arbitrator or the two arbitrators under the first paragraph of Article 174 of the Commercial and Civil Procedural Law. An arbitral court may then be set up and the arbitration process can take place according to the procedures agreed upon by the contending parties. Finally, the arbitral court issues an arbitral award putting an end to the dispute which was the subject of arbitration (see Sarkhouh 1986: 26-27).

some criticism (Osman 1985: 2-3). The fact is that the law does not draw any distinction between arbitration clauses or agreements made in advance of any dispute (referred to in English law as "an agreement to refer") and the submission of an existing defined dispute (Saad 1981: 10).

Article 285 of the Commercial Code provides that the competent courts for any dispute relating to a commercial agency or distributional contract will be those of the place of performance of the contract. According to Saleh (1984: 258-259), "This provision does not exclude the validity of arbitration clauses and arbitration agreements relating to agencies and distributorships since the rules relating to the court's jurisdiction laid down in Article 285 are drafted as an exception to the general jurisdictional rules *ratione loci* and not as a matter of exclusive jurisdiction."

Under Articles 282 and 285 of the Commercial Code, the judge is obliged to evaluate any indemnity due to the commercial agent or distributorship, notwithstanding any agreement to the contrary. Al Ahdab (1990: 369) suggests that the implication of this provision is that any agreement which ousts the jurisdictions of the courts is void, whether the agreement is made before or after the dispute has arisen. But, by contrast, Saleh (1984: 259) states that "this provision might invalidate an arbitration clause inserted in a contract or commercial agency on distributorship but not as a submission to arbitration made after a dispute has arisen". This kind of debate about the specific implications of certain legal provisions demonstrates the potential for confusion which presently surrounds Kuwait's arbitration system.

B. Interim/Interlocutory Orders

There is also a difficulty with regard to the power of the arbitrators to make certain orders to preserve or protect the parties to a dispute. Article 173 of the Code provides that the Arbitration Agreement shall not include interlocutory, precautionary or urgent measures unless the parties specifically authorise the arbitration tribunal to pass such measures. However, such measures, if issued, can only be enforced and executed by a competent court since the Arbitration Tribunal lacks the necessary enforcement machinery. The only exception to this is

where the arbitration is assigned directly to the Panel of Arbitrators of the Ministry of Justice established in accordance with Article 177 of the Code.

The Model Law of the UN Committee on International Commercial Law, adopted on 21 June 1985 (in the presence of representatives of 61 countries), contains some important provisions relating to arbitration, but Kuwait has not yet adopted that Law. It is worth noting, however, that the Model Law, in Articles 8 and 9, empowers an arbitral tribunal to adopt temporary procedures of protection if requested to do by one of the parties to the dispute. (At the same time the Model Law permits an exclusion of such provisional measures where the contending parties had agreed otherwise; see Herman 1985: 6).

It was precisely to clarify and improve the legal position that the Kuwaiti Commercial and Civil Procedural Law No. 38 of 1980 was amended in 1995 to empower "the arbitration panel to settle urgent questions of the subject of the dispute, unless it is explicitly agreed otherwise by the contending parties" (Law No. 11 of 1995, Article V). But this provision seems only to pertain to arbitration in the Ministry of Justice.

C. Arbitration under Bilateral Investment Treaties

In addition to Kuwait's own statutes relating to arbitration, the Government has entered into a number of bilateral and multilateral treaties with various countries with a view to encouraging investment in Kuwait, and these treaties contain various articles which deal with the settlement of investment disputes. Among them, for example, is the "Agreement between the State of Kuwait and the Russian Federation for the Promotion and Reciprocal Protection of Investments", which was signed on 21 November 1994. This Agreement seeks to create favourable conditions for the development of economic co-operation and the flow of capital between the State of Kuwait and the Russian Federation (Elucidatory Note, Bill No. 29 of 1995).[1] Articles 9 and 10 deal with the settlement of disputes which may arise between the country in which the investment is located and an investor possessing the nationality of the other country in relation to the interpretation or application of the treaty. Such disputes are to be settled amicably within six months, either in accordance with an agreed procedure between

[1] The text of the Treaty is on file with the author.

the parties or through an *ad hoc* arbitration tribunal established in accordance with UNCITRAL Rules.[1] The virtue of these statements is that they are at least precise and lacking in ambiguity.

D. Language

Opinion is divided on the merit of the requirement in the Commercial and Civil Procedural Law that Arabic should be the language used for drawing up arbitration awards. Criticising this provision, Isa Huneidi (1992: 73) argues that

> If the contract is a construction contract written in English with all correspondences, claims, counter-claims written in English, then one can anticipate the insurmountable problems encountered by the party applying for arbitration. The party concerned has to face the problems of having an accurate translation, spend substantial amounts of money on translation and then have the translated material notarised by the Ministry of Justice. Above all, he has to encounter the challenges by the other party of the accuracy of the translated documents. All these steps are expensive and time consuming, a fact which derogates from the viability of arbitration.

On the other hand, William Ballantyne (1980: 18) suggests that "Arabic is a rich and adaptable language; there has been a great deal of standardisation of terms in recent years; although certainly much remains to be done. However, there is no need to be afraid of using the language in a modern commercial contract." Agreeing with Ballantyne, Professor Ibrahim Fadlallah (1981: 10) states that

> "It is to be noted that it is the foreign language that prevails over Arabic as the language of arbitration in contracts which are drawn up in two languages. This is regrettable since it is possible that the lawyer acting for the Arab party, or the Arab contracting party himself, may not have a good knowledge of the foreign language, or that communication between the Arab party and his foreign lawyer may be difficult."

The present author is of the view that Arabic should indeed be the language of communication in Kuwaiti courts, and it should certainly be used for the award or judgment. At the same time it is important that steps should be taken to establish a Government department for the translation of contracts. Such a department should also carry out

[1] Article 9 of the Agreement between Kuwait and the Russian Federation. For more details about bilateral and multilateral treaties, see Chapter 9.

simultaneous and consecutive translation in the courts, for which a token price should be charged. A period of 15 to 30 days should be allowed for the completion of the required translation, depending on the size and difficulty of the material to be translated. It is important to specify the duration required in order to avoid unnecessary delays which may be caused by alleged problems over the length or difficulty of the legal translation. Such translations should be authenticated by the embassy of the country to which the non-Arab foreign party belongs.

E. Foreign Investors' Attitudes towards Local Arbitration

There can be little doubt that at the present time foreign investors do not have much confidence in the Kuwaiti legal system, and the national authorities often distrust such investors and regard them as exploiters. This amounts to a critical situation based on mutual suspicion and lack of trust. Al Ahdab (1990: 783) suggests that in general developing countries "regard arbitration as foreign justice while developed countries generally distrust the capacity of Third World countries and their ability to settle such disputes which might arise out of international commerce".

Foreign investors prefer international to Kuwaiti domestic arbitration for a variety of reasons. The former Dean of the Faculty of Law in Kuwait, who is a Kuwaiti arbitrator, highlighted the following factors: ignorance of Kuwait's national laws, a feeling that the investor's own national laws provide more guarantees, and the fear of prejudice or lack of impartiality in any dispute involving a Kuwaiti as a contracting party (Badriya Al-Awady, interview conducted by the writer on the 7 September 1995). On balance, however, criticisms of the Kuwaiti legal system must be regarded as misplaced (Edge 1991: 10). This became clear during seminar discussions held in London on the subject of doing business in Kuwait, when one participant asked: "Is it a good idea as a UK contractor to submit one's contract to Kuwaiti law and just to refer one's disputes to the Kuwaiti court system? Is it quick? Is it cheap? Is it effective?" The general answer elicited from Karen Burk, a British Kuwaiti-based lawyer, was that if one was quite happy to sign a contract under French law and submit to French courts, there should be no particular objection to signing a contract to submit any

dispute to the Kuwaiti courts (Burke 1991: 73). At the same seminar, Isa Huneidi (1991: 15) argued that:

> The Kuwaiti law is fairly developed as far as contract law is concerned and, to be frank with you, I would advise my clients if they had to choose between Kuwaiti law and English law for a contract in Kuwait, to opt for Kuwaiti law. This is not to say that there is deficiency in English law - far from it - but because of certain concepts which make Kuwaiti law preferable from the contractor's point of view. It is the concept of fairness and attention to the weaker party and the deliberate attitude of the judges in Kuwait in interpreting Kuwaiti law provisions.

The foregoing analysis seems to suggest that the Kuwaiti system of arbitration is reasonably good in practice, but that foreigners are not favourably disposed towards it. As already pointed out, there are only 15 Articles of the Commercial and Civil Procedural Law which deal with the question of organising or regulating arbitration. The fact is that these articles do not constitute an independent law and are insufficiently clear, straightforward and easy to apply. This scares away the foreign investor, and this is precisely why, in the present author's view, the Kuwaiti legislature should introduce reforms in the area of arbitration by enacting a law providing for clear and easy procedures in conformity with modern conditions. A new, independent arbitration law, distinct from the Commercial and Civil Procedural Law, is therefore needed to streamline the whole process of arbitration and reduce its complexity and expense. With such a law, there would be greater confidence in domestic arbitration, which is an essential prerequisite for attracting foreign capital investment. Here again better translation facilities would be of great help. As a matter of urgency the Kuwaiti legislature should make available official and authorised translations of all relevant Kuwaiti laws. These translations are needed as a better alternative to translations carried out on a purely commercial basis, and should be clearer and more accurate. For the foreign investor, knowledge of Kuwaiti laws would enable him to compare and contrast them with the laws of his own country or of the arbitration centres.

Efforts should also be made to follow up all problems, cases, claims, etc. encountered by the foreign investors through the establishment of suitable departments to which such investors can go for assistance. At present one major problem for investors is that the Kuwaiti Government does not attempt to settle claims during an intermediate situation. At the end of

virtually every project, contracts have long lists of claims variations or extra payments (Callahan 1985: 3). Nevertheless, foreign investors in general do prefer to reach an amicable settlement of disputes, and this process could be greatly facilitated by greater flexibility on the part of the Government, related to better dispute settlement mechanisms.

10.3.6 International Arbitration

10.3.6.1 Foreign Investment and International Arbitration

The point has already been stressed that foreign investors often prefer arbitration, especially international arbitration, to local litigation since they have little confidence in the legal systems of many host nations. A foreign investor who decides to resort to court proceedings will be obliged to have recourse to the courts of the defendant's home country, that is in terms of his residence or place of business. To foreign investors this court will be foreign in nature, character and origin, and as a claimant, the foreign investor will not be able to brief lawyers of his own nationality but instead will have to use the services of local lawyers. He may find that the court is unaccustomed to international commercial transactions, and that its law and practices are inadequate. In situations of this kind, recourse to international arbitration is generally seen as more acceptable as a way of solving any disputes which cannot be settled by negotiation (Redfern and Hunter 1991: 26).

The President of the Association Arabe de l'Arbitrage International sums up the conflicting attitudes of foreign investors and developing host states as follows:

> (a) The conflict between developing countries who need foreign help, notably with private investments, for the implementation of their development projects on the one hand, and foreign investors on the other hand who are afraid for their capital and wish to avoid non-commercial risks which might arise out of administrative, political or legislative steps taken by the host countries.
>
> (b) Developing countries deem that justice must be given by their State courts and they should not be treated as if they were not able to do so. Thus, they do not accept giving the investors the right to take measures against them in the courts of another country, notably that of the investors, nor before international tribunals." (Al Ahdab 1991: 2.)

This means that the provision of dispute settlement procedures tends to emphasise the primacy of the national courts and tribunals. Article 59 of the UNCTC Draft Code, however, goes on to state that where the parties so agree, "such disputes may be referred to other mutually acceptable dispute settlement procedures".[1] From the point of view of developed states, the main need is to allow for the "neutral" settlement of disputes by tribunals which sit outside the host state. However, developing states tend to see overseas tribunals as being inclined to apply norms formulated by jurists from capital-exporting states which are favourable to investment protection, and that the much vaunted neutrality of the arbitration system in the developed states is but a mirage. Again, an irreconcilable difference in attitudes is apparent (Sornarajah 1994: 210-211).

10.3.7 Institutional Arbitration

10.3.7.1 Kuwaiti Arbitration Institutions

Arbitration in Kuwait can be *ad hoc* (the most popular form) or organised under the auspices of an institution. In *ad hoc* arbitration the procedures are contained in an arbitration deed entered into by the parties who have a great deal of flexibility in the conduct of their proceedings. The appointment of the arbitrators is initially left to the free and exclusive determination of the parties themselves (Bryan 1991: 60). Under the second form of arbitration the main institutions which operate in Kuwait are: the Kuwaiti Chamber of Commerce and the Ministry of Justice, and also the Kuwaiti Society of Engineers (KSE), which has established special rules governing disputes which come under its authority (Saleh 1984: 255). Where a dispute concerns very complex and technical matters, there might be some advantage in seeking arbitration under the KSE rules (Burk 1991: 73). This facility has been used by the Government in contracts with consultants (Totterdill 1991: 73). The first two institutions will be considered in more detail.

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[1] See UNCTC, Work Related to the Code of Conduct on Transnational Corporations and other International Arrangements and Agreements, E/1989/28 Rev. 1 (1989).

A. Arbitration and Conciliation under the Auspices of the Kuwaiti Chamber of Commerce (KCC)

Arbitration under the KCC is conducted on the basis of a law issued on 28 June 1958 which may also be used by non-members of the Chamber. The contracting parties who are in dispute may agree upon this method of arbitration, but there must be a relevant clause in their agreement stating that the parties agree to submit to arbitration and to any award made by the Chamber. The tribunal consists of merchants rather than jurists (Al Ahdab 1990: 366). The KCC registers arbitration issues submitted by the parties to arbitration (Chamber of Commerce Law, 28 June 1959, Article 6) and the settlements of those arbitration disputes submitted to it (KCC Law, 28 June 1959, Article 11). The personality of the arbitrators is important as it is oriented towards conciliation rather than arbitration proper. The procedure is secretive, and the award, which often confirms an amicable settlement, is thus understandably not accessible to third parties (Pepper 1991 : 260-261). Non-members are often sceptical of arbitration under the KCC, since it is perceived to defend the commercial and industrial interests of its members, particularly as the procedure is carried out under chairmen appointed by the Chamber without a controlling judge (Bryan 1991: 68).

B. Arbitration under the Auspices of the Ministry of Justice (MoJ)

On the basis of Article 177 of the KCCP, the parties may refer their dispute to an established arbitration tribunal in a Kuwaiti court of first instance. This panel, constituted by the administrative control of the Ministry of Justice, is composed of a judge appointed by the court of first instance (as its President) and two other members who must be merchants or persons with special qualifications chosen from an accredited list prepared in accordance with the Decree of the Minister of Justice No. 82 of 1980 (Saleh 1984: 254). However, the Explanatory Memorandum to the KCCP states that:

> The legislature has thought it useful to enlarge the composition of this tribunal so that it is not limited to merchants only. Thus, disputes which need other specialisations or practices, such as engineering, medicine, etc., may be referred to this tribunal. This is why the legislature gave the Minister of Justice the mission to establish - by decree - the lists of specialists as well as the rules and procedures relating to the constitution of this list and methods of appointment of the members of the arbitral tribunal from these lists in light of the speciality required in the dispute referred to the tribunal. Moreover, and due to the fact that it is presided over by a counsellor or judge, certain prerogatives

have been granted to this tribunal which are not usually granted to arbitrators. (Explanatory Memorandum to the Code of Civil and Commercial Procedure: 196).

This arbitration is free of charge and the KCCP arbitral rules of procedure apply. The tribunal enjoys some privileges, such as (i) charging fines on witnesses who fail to testify or to appear; (ii) ordering third parties to produce documents necessary for the arbitration; and (iii) issuing judicial order commissions (KCCP Article 177 read in conjunction with Article 180). Furthermore, the tribunal's decision is not subject to appeal (Article 186 of the KCCP). However, like other abritral awards, it can only be enforced after an "exequatur" order is obtained from a court (Article 184 of the KCCP). Ibrahim Saad rightly criticises this requirement as being inconsistent with the enforceable character granted to interim measures taken by the same tribunal by virtue of the imperium of its chairman-judge. According to Saad, this imperium should operate so as to make the final award immediately enforceable (Saad 1981: 22-23).

For obvious reasons, many attempts have been made to amend these regulations, including the Law prepared by the Ministry of Justice and passed by the Kuwaiti legislature on 19 February 1995. Article I states that arbitration panels or bodies should be established in the Court of Appeal, each consisting of three members of the judiciary and two arbitrators, one to be chosen by each party to the dispute. This means that in all cases representatives of the judiciary will form the majority on any such arbitral panel. The same Article also provides for the choice of one arbitrator by each party from a list already prepared by the Arbitration Department of the Court of Appeal, without any restriction of any sort being imposed on either party. It should be noted that the arbitral panels or bodies will be established for two years from the entry of the Law into force, and that the sessions will be held in the Court of Appeal (Article I of Law 11, 1995).

This new Law seeks to abolish Article 177 of the KCC Procedures Law No. 38 of 1980.[1] It is to be welcomed as a positive attempt to remedy the defects arising from the

[1] The reason for abolishing Article177 of the KCCP, as stated by Law 11 of 1995, was that: "The afore-mentioned Article 177 has apparently aimed at encouraging the litigants to refer their dispute to the said bodies. However, the practical application of the provisions of the said Article has revealed the reluctance of the litigants to refer their disputes to the said bodies. This may be due to the popular conception that the

Commercial and Civil Procedural Law, and to tackle the question of dealing with summary actions in connection with the subject of a dispute unless the two contracting parties explicitly agree otherwise (Article V of Law No. 11 for 1995, still in the form of a Bill). Furthermore, Article VI seeks to deal with the question of promptly settling any application to reject a member of the arbitration body. The provisions of this Article make it clear that the Court of Cessation is concerned with settling any such problem of rejection, and that any judgment as to the dismissal of such an application cannot be contested in any way (Elucidatory Note to Bill No. 11 for 1995).[1]

If the new Law is generally a step forward, nevertheless it is subject to criticism because Article XII provides that it shall apply to the arbitration bodies mentioned in the Article in much the same way as the provisions of the Commercial and Civil Procedural Law apply in those areas where there is no conflict with the said Law. This suggests that in practice the provisions of the Procedural Law will continue apply to arbitration despite the fact that it is not a complete or integrated Law. The author therefore believes that the Legislature should issue a special Law regulating the whole process of arbitration, and not simply a Law limited to the question of organising the Department of Arbitration in the Ministry of Justice.

It should also be noted that the proposed Law does not give a time limit within which the award must be made (Article VII). This is in contrast to the provisions of Article 181 of

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voluntary arbitration proceedings in general, and the judicial proceedings in particular, fail to achieve the required result, viz., prompt or rapid settlement of the arbitration disputes owing to the time required, in the initial stage, for the choice of the arbitrators, and also the implications of the demand for rejection or refutation on the part of either party, namely the suspension of the arbitration proceedings pending the outcome of deciding upon the said demand;....... all these things are tantamount to sheer waste of the time and effort expended in taking all the said proceedings." (Elucidatory note on the judicial arbitration bill in the Commercial and Civil Articles, No. 11 for 1995.)

[1] What is also made clear by the said provisions is that the submission of any such application for the rejection of a member does not entail that the arbitration proceedings should be suspended. Conversely, it is stated that, if the rejection is approved, this shall not affect the validity of the arbitration proceedings or the arbitration body; in other words, there shall be no interruption or suspension of the arbitration proceedings as a result of the rejection applied for against any member. The validity of the judgments made by the arbitration committee will be ensured. The provisions of the said Article also make it clear that in the event that a judgment is made as to the rejection of any arbitrator, or in the event of his dismissal or exclusion for any reason, another arbitrator shall be appointed by following the same procedures which had been previously followed (see Elucidatory note to Bill No. 11 for 1995). The bill also seeks to rectify the defects in Article 178 of the CC Procedures Law covering the methods used in appointing or dismissing the arbitrator. Article 178 states that proceedings shall be suspended where a party opposes the choice of an abitrator until the application is considered. The proposed law states by contrast that the proceedings of the case should continue in spite of the submission of any application for rejection of one of the arbitrators in order to avoid interruption.

the Commercial and Civil Procedural law, which states that "if the two contending parties do not lay down, in the agreement they reach, a condition as to a date for the award, then the arbitrator shall issue his award within six months of the date on which the two parties to the dispute are notified of the convening of the arbitral tribunal". There is a danger that this omission in the proposed Law may prolong the period of the dispute unnecessarily, and the present author therefore suggests that this problem must be rectified before the Law is enacted.

The Law's provisions regarding cost-free arbitration have been criticised by Fuad Al-Majid, Director of the Fatwa and Legislation Department, who has stated that non-payment by the claimant or the respondent of any fee for the arbitration means that legal charges are wasted. This may affect the amount which is claimed because the claimant will not pay any proportion of the amount claimed as a fee for arbitration (interview with Fuad Al-Majid, 3 September 1995).

If the Commercial and Civil Procedures Law has made arbitration optional or voluntary between the parties to the dispute, Law No. 11 for 1995 has apparently provided for something quite different. Article II of the Law would give people the power to force the Government or various Ministries to submit to arbitration in disputes which arise between them and other parties. It states quite explicitly that the Government and the Ministries "shall be committed to arbitration" (Article II, Law No. 11 of 1995). Interestingly, this Article has been criticised for deviating from the traditional concept of voluntariness of arbitration. Sayyed Badr, the legal advisor in the Fatwa and Legislation Department, contends that this is a major shortcoming of the proposed Law since it "allows individuals or legal persons to constrain or force the government to resort to arbitration and not to the law. This means depriving the government of the opportunity to resort to the judicial system of the country. This compulsion imposed by the law is unnatural" (Sayyed Badr, interview conducted by the writer on 2 September 1995).

Similarly, Fuad Al-Majid (1995), Director of the Fatwa and Legislation Department, has stated that

> previously the two parties had the option to appoint arbitrators. The arbitration procedures are stated in the Commercial and Civil Procedures Law. These procedures

did not change in the new Law. All that happened is that some new administrative organisation took place, whereby the Government was forced to enter into arbitration when the second party applies for arbitration. The Fatwa and Legislation Department has its own view of this point. The original assumption was that the parties in dispute have the option to choose ordinary litigation or arbitration. Now, when one party has the option unilaterally, or when the Government is bound to enter into arbitration when this is chosen by the second party, then this is regarded as indicative of negative aspects of that law.[1]

The problem is further compounded by the fact that in Kuwait there are currently various bodies with powers to arbitrate. Of the function and role of the arbitration section in the Fatwa and Legislation Department, Sayyed Badr stated that, according to the law of its establishment:

it represents the ministries, departments, organisations, bodies, etc. in all legal cases or proceedings initiated by them or against them, of whatever shape or form, or at whatever instance. The Fatwa and Legislation Department offers legal services to those departments whether these services are Fatwas (official legal opinions), revision or checking of contracts, formulation of legislation or laws defending the interests of the public treasury at home and abroad. The role of the Fatwa and Legislation Department is to represent these entities at courts as well as in foreign arbitration and foreign courts. It represents the State and defends its interests. (Sayyed Badr, interview conducted by the author, 1995.)

In addition to this Department, there are also the following: the Department of Arbitration in the Ministry of Justice, the arbitration carried out in the Chamber of Commerce and Industry, and the arbitration under the Kuwaiti Society of Engineers (see above section 10.3.7.1). These organisations, it must be stressed, are autonomous and are not bound together by any ties or relations. This author believes that they would serve a better purpose if they were

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[1] In a memo sent by the Fatwa and Legislation Department to the Secretary-General of the Council of Ministers in connection with the inspection of the Bill regarding Law 11 for 1995, the following points were made: "The compulsory arbitration added ... to the third clause of Article II of Law 11 for the year 1995, and which compels the ministries, government departments and general legal persons to accept arbitration in disputes arising between them and these individuals, when the latter ask for the said arbitration, if the dispute had not already been subjected to the process of the law, would be a great deviation from the constitution. For it would be tantamount to a gross breach of equality or imbalance between individuals and the State before the law in favour of the individuals. For the latter only can compel the State to accept this arbitrary arbitration and deprive it of the chance to submit the dispute to the natural judiciary.
To determine arbitration for individuals with the justifications aforementioned would be a violation of equality between the State and the individuals before the law or thejudiciary, and would imply that the State is deprived of its right to resort to the ordinary processes of the law against its will. We should in particular bear in mind that the amendment which is being studied did not abolish the right of the State to resort to ordinary processes of the law in any dispute between it and the individuals, if the State wanted to do so or promptly took that step." (Unpublished memo, No. 2054, on 1 October 1994; and memo, No. 1147 on 5 June 1995).

merged together in one centre, thus making things easier for the foreign investor. Any information he seeks regarding arbitration would be readily available (for example in a booklet of instructions for foreign investors explaining the various types of arbitration available).

10.3.8 Regional Institutions for the Settlement of Disputes

Kuwait recognised regional arbitration when it became a party to the Inter-Arab Agency for Investment Guarantees Agreement in 1974. This Agreement includes an Appendix on the settlement of disputes which gives full details of the procedures relating to the settlement of any dispute by means of conciliation. If conciliation fails, then there is a resort to arbitration.[1] The disputes which may be referred to arbitration are: disputes on the interpretation and implementation of the Convention (Article 34 of the Convention); disputes on issued investments (Article 35 of the Convention); and disputes relating to insurance contracts (Article 36 of the Convention) (Article 1 of the Inter-Arab Agency for (Investment Guarantee Agreement). This agreement became effective on 1 April 1975 and was ratified by all the Arab countries.

Kuwait is also a party to the 1974 Convention on the Settlement of International Disputes between Arab Host Countries and Nationals of Other Countries. This Convention is concerned with the settlement of disputes which arise directly from an investment between the Arab host country or one of its authorities or administrations and nationals of other Arab countries, natural persons or corporations (Article XX of the Agreement: Decree Law No. 82 of 1976). The clear aim is to create a favourable climate encouraging the growth of Arab investments in Arab countries. The settlement of such disputes is first by conciliation between the parties involved. Arbitration according to rules and regulations set forth and mentioned in this Convention are resorted to if it proves impossible to settle the dispute by conciliation. The regulation and implementation of the rules of conciliation and arbitration are the responsibility of the Council for the Settlement of Investment Disputes and the Secretary General of the Council according to the clauses of the Conventions.

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[1] It should also be noted that the Convention does not mention arbitration directly but refers to the Appendix joined to which there is a set of arbitration rules starting with conciliation and finishing with arbitration.

Kuwait also became a party to the Agreement for the Implementation of Judgments and Awards (1952) and the Unified Convention for the Investment of Arab Capital in Arab Countries (1988). The former agreement is concerned with the implementation of judgments issued in any Arab country, whether they are issued by arbitral or judicial processes. Kuwait also ratified the Arab Riyadh Agreement for Judicial Co-operation (1983) which also covers the implementation of arbitral awards issued in any country which is a contracting party within the territory of other contracting countries (Haddad 1989: 4-6).

10.3.9 International Commercial Arbitration Institutions

Some institutions have a mandate which is clearly international in scope and which deals with disputes arising between parties located virtually anywhere in the world. Perhaps the best known of these international institutions is the International Chamber of Commerce (ICC), Court of Arbitration.[1] ICC arbitrations are held all over the world and under any law of the parties' choosing. The ICC also conducts conciliation under its separate Rules of Conciliation (Lew and Stanbrook 1990: 50).

The ICC Court of Arbitration[2] is composed of lawyers and businessmen of international reputation. It does not itself hear cases but appoints arbitrators. Usually, there is either a sole arbitrator or three abitrators, two of whom are appointed by the parties concerned and the third, the chairman, by the Court. Unless otherwise agreed by the parties, the nationality of the sole arbitrator or the chairman of the three-man arbitral tribunal is different from that of the parties to the proceedings (Article No. 2 of the Rules of Arbitration, in ICC Rules of Arbitration; and Kronfol 1972: 140).

The Court of Arbitration is now the preferred international arbitration institution, handling between 600 and 700 cases a year (Lew and Stanbrook 1990: 50). The place of arbitration may be chosen by the parties, but the ICC Court may settle the issue if the parties

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[1] The Court of Arbitration of the International Chamber of Commerce has its headquarters in Paris.

[2] Article 1 of the ICC Rules of 1986 states that: "The Court of Arbitration of the International Chamber of Commerce is the international arbitration body attached to the International Chamber of Commerce. Members of the Court are appointed by the Council of the International Chamber of Commerce. The function of the Court is to provide for the settlement by arbitration of business disputes of an international character in accordance with these Rules."

do not (Article 12 of the Rules of 1988). The freedom to choose the place of arbitration may be one of the most important advantages of arbitration, and in about 70 per cent of the cases before the ICC the parties stipulate the place of proceedings (Craig, Park and Paulsson 1990: 196-201). When the ICC Court of Arbitration determines the place, it does so in part by weighing a number of factors, including convenience to the parties, the language and law of the contract, and attributes of national legal systems, such as neutrality and attitudes towards the enforceability of arbitral awards (Janis 1995: 314).

The present ICC Rules of Arbitration were adopted in 1975 and are quite flexible, seeking to accommodate both the adversary trial procedure of common law and the inquisitional procedure associated with the codified law systems. According to these Rules, if the parties have failed to agree on the applicable procedural law, it is for the specific arbitral tribunal selected for the case in question to decide by choosing between the procedural law of the place of arbitration, some other procedural law or no specific law, referring to general principles of law or establishing their own procedural rule (Lew and Stanbrook 1990: 50).

The arbitrators are required to make their award within six months from the signing of the terms of reference, though the Court may decide to extend the time period (Article 18 of the Rules of Arbitration, in ICC Rules 1988). If there are three arbitrators, then decisions may be made by majority vote (Article 19 of the ICC Rules). The arbitrators also decide how the costs of the arbitration will be allocated between the parties (Article 20 of the ICC Rules). After rendering its decision, the arbitrators have their award scrutinised by the Court of Arbitration. However, it is not the Court's task to review the tribunal's substantive determination of law or fact. Rather, it is concerned only with matters of form and the need to ensure that the award is in a condition suitable for enforcement in municipal legal proceedings (Article 26 of ICC Rules of Arbitration; and Janis 1995: 15 and Craig, Park and Paulsson 1990: 196-201). The administrative charge and arbitrators' fees are calculated according to the ICC scale of fees and the amount in dispute (Article 15 of the ICC Rules of Arbitration), and the ICC requires a substantial deposit before the arbitration is commenced (Article 25d of the ICC Rules of Arbitration 1988).

Normally Kuwait resorts to international arbitration under the auspices of the ICC if disputes with foreign companies are involved. Indeed, as Sayyad Badr (1995), the legal advisor in the Fatwa and Legislation Department, has pointed out: "foreign companies always stipulate that Kuwait has already accepted the principle that the International Chamber of Commerce in Paris to solve disputes that may arise between them".

The other institution of arbitration which is international in scope is the World Bank's International Centre for the Settlement of Investment Disputes (ICSID). This was established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, which came into force on 14 October 1966 (Article 1 of the ICSID Convention).[1] The main purpose of the Centre is to serve as a special forum for the conciliation or arbitration of investment disputes, thus making a contribution to encouraging greater flows of capital to developing countries (Shihata 1986: 267-268)[2].

An ICSID arbitration is governed by international law and not by national systems of law. Thus the arbitration is truly delocalised or denationalised. The exclusion of national law from any control of an ICSID arbitration is made plain in the provisions of the Washington Convention governing the challenge, recognition and enforcement of ICSID awards (Redfern and Hunter 1991: 48). Shihata states that the services that ICSID offers have become known for their neutrality, effectiveness and relatively low cost, and that parties have increasingly made use of ICSID facilities for the resolution of disputes by conciliation or arbitration.

ICSID has standing panels of conciliators and arbitrators, some appointed by the contracting states, others chosen by the President of the World Bank. In any case, the parties agree among themselves as to which persons from these panels shall conciliate or abritrate their dispute. Alternatively, if there is no agreement, each party may name one of three

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[1] As of 30 June 1991, 106 States had signed the Convention of which 95 had also deposited their instruments of notification (ICSID, 1991, Annual Report, p.12). For the text see I.L.H. (1965), p. 524; 5,75 U.N.T.S.159 (done at Washington on 18 March 1965; entered into force 14 October 1966).

[2] The ICSID Convention gives private investors direct access to an international forum (Shihatta 1986: 69). The jurisdiction of ICSID is limited in that one of the parties to the dispute must be a contracting State and the other party must be a national of another contracting State. However, ICSID will also administer proceedings which fall outside the scope of the Convention, e.g. because one of the parties is not a contracting State or a national of one. In this case, none of the provisions of the Convention will be applicable, and the proceedings will be conducted under a special set of rules known as the Additional Facility Rules (Davidson 1992: 4).

conciliation commissioners or arbitrators. Conciliation commissions and arbitral tribunals are judges of their own competence and proceed according to the Convention and rules of procedure elaborated by ICSID (575 U.N.T.S., 159, Arts. 5, 12-16, 28-31, 36-40, 411, 44; and see Janis 1995: 317)

Article 42 limits the freedom of the arbitral tribunal with respect to the applicable law, directing that "the Tribunal shall decided a dispute with such rules as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable". From this provision it seems that, in substance, such disputes are and remain mainly disputes under municipal law. According to the draftsmen, the term "international law" as used in this context should be understood in the sense given to it by Article 38 (1) of the Statute of the International Court of Justice, with allowance being made for the fact that Article 38 was designed to apply to inter-State disputes (ICSID Report for the Executive Directors 1965: 15; and El Sheikh 1989: 314). Nor may the tribunal avoid rendering a decision by entering a *non liquet* on the ground of silence or obscurity of the law (Article 42 (2)). This discretion is reinforced by Article 38 dealing with the requirement for a valid award which states, *inter alia*, that the "award shall deal with every question submitted to the Tribunal and shall state the reasons upon which it is based". Furthermore, the tribunal may be permitted to make an equitable award (*ex aequo et bono*), but only if the parties so agree (Article 42 (3)).[1]

ICSID arbitral tribunals are empowered to make awards by majority vote. "Each Contracting State is obliged to recognize an award rendered pursuant to [the ICSID] Convention as binding and [to] enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State," thus giving ICSID

[1] Lamm and Smutny (1996) comments on the awardes of ICSID that" The Awards of ICSID tribunals have taken aflexible approach towards determining the existence and scope of consent for the sbmission of disputes to ICSID arbitration. They have taken asimiler approach in regard to determining the existence of agreements made pursuant to the nationality of Juridical persons which are nationals of the state party to the dispute. The objective requirement of foreign control of such juridical persons as aground for such agreements has nevertheless not been disregarded." (see Carolyn B. Lamm and Abby Cohen Smutny, in "The Implementation of ICSID Arbitration Agreements " in ICSID Review, Vol. 11, No 1, Spring 1996, pp 64-85.)

awards (in theory at least) a greater potency even than arbitral awards encompassed by the 1958 New York Convention (Janis 1995: 318). The awards may be reviewed and even annulled by a committee appointed by the Chairman of the Administrative Council of ICSID, but this is a procedure of questionable merit that, in practice, has threatened the reputation of ICSID for efficiency and fairness (Riesman 1992: 46-106 and Janis 1995: 318).

Twenty years after the approval of the ICSID Convention, the World Bank proposed the establishment of MIGA, an agency specifically charged with the promotion of amicable settlements of investment disputes. It is generally believed that ICSID and MIGA will together help to establish greater mutual confidence between states and foreign investors. If this is the case, then both ICSID and MIGA will make an important contribution to the promotion of foreign investment for the purposes of Kuwaiti development (Shihata 1989 : 279). But it is too soon to be certain that this will be the outcome, and in the case of Kuwait certain difficulties may be encountered.

Most significantly, Kuwaiti law does not distinguish between national and international arbitration. However, it does consider that any arbitration made outside Kuwait is foreign, even if it applies Kuwaiti law and is between Kuwaiti parties. This kind of arbitration is governed by the provisions relating to the enforcement of foreign judgments (Al-Ahdab 1990: 366). Kuwait has also acceded to the New York Convention of 1958 relating to the Recognition and Enforcement of Foreign Arbitral Awards. By virtue of Decree No. 10 of 1978 (issued in March 1978), the New York Convention thus became part of Kuwaiti national legislation. This Agreement is applicable in Kuwait "just like any other domestic laws of the State" (Abd Al-Rida 1994: 2). According to Abd Al-Rasoul Abd Al-Rida (1994), Director of the Fatwa and Legislation Department in Kuwait,"The government of Kuwait has always easily and promptly carried out any awards against it, whereas it encountered in the case of foreign arbitration awards made in its favour, difficulties and obstacles in carrying them out."

The New York Convention is in fact widely recognised as the most important

international treaty relating to international commercial arbitration.[1] However, its operation has not been without practical difficulties. This is primarily because of the lack of a uniform approach by the courts of various contracting states to the grounds on which enforcement may properly be refused under the Convention (Redfern and Hunter 1991: 63). The Convention presupposes enforceability provided that the party seeking enforcement supplies the duly authenticated original award or certified copy of the award, the original arbitration agreement (or a copy) and - if in another language - a certified translation (Article 4 of the New York Agreement). The other party (the defendant), however, can avoid enforcement if it shows that the arbitration agreement is invalid, that the defendant was unable to present its case, that the award goes beyond the terms of the submission to arbitration, that the arbitration tribunal was not composed, or that the procedure was not conducted in accordance with the agreement of the parties. Furthermore, an award is not binding on the parties if it has been set aside in the country where it was made. Enforcement can also be refused *ex officio* when the subject matter of the dispute is not arbitrable under the law of the country where enforcement is sought, or when the enforcement of the award would be contrary to the public policy of the country in question (Lew and Stanbrook 1990: 55; and Article 5 of the New York Agreement).

The New York Convention is intended to apply to *international* rather than purely domestic arbitration agreements (Article 1 of the New York Agreement), and it is in this sense that the Convention has been interpreted by national laws implementing the Convention, such as those of the United States and the United Kingdom, and by the reported decisions of national courts of law (Redfern and Hunter 1991: 63). A country which is party to the Convention, without any reservation, is expected to enforce every arbitration award rendered in the territory of another country. However, more than thirty countries have adopted the Convention with a reservation requiring reciprocity, so that a foreign award will be enforced only if it is made in the territory of another contracting state (i.e. a party to the Convention). The Convention allows room for another reservation: that only awards concerning commercial matters will be

[1] A comprehensive study of the operation of the New York Convention has been undertaken by Van den Berg, *The New York Arbitration Convention of 1958* (1981).

enforced (Article 1 of the New York Agreement; and Lew and Stanbrook 1990: 55). As far as Kuwait is concerned, it should be noted that it had already accepted the principle of international agreement before it became a party to the New York Agreement.[1]

10.3.10 The Kuwaiti Government's Attitude towards International Arbitration

As made clear in this chapter, arbitration in Kuwait has passed through many complex phases. It used to be conducted by committees of artisans formed to settle disputes arising between artisans or craftsmen. The Sheikh of a tribe used to settle disputes among tribe members. The situation remained largely unchanged until Kuwait entered the modern age, when arbitration was finally regulated by statute - the Commercial and Civil Procedural Law No. 38 of 1980 - and by the various oil agreements and bilateral agreements for investment protection. Kuwait now faces the question of whether its current system of arbitration can boost foreign investor confidence and persuade investors to resort to domestic arbitration.

Our examination of the two basic types of arbitration (domestic and international) available to foreign investors in Kuwait is intended to show the extent to which arbitration procedures currently applied in Kuwait provide sufficient guarantees. There is in fact no provision in Kuwaiti law which either forbids or authorises State agencies to resort to arbitration. However, most academic writers consider that such agencies can resort to arbitration, and in this respect it has been noted "that most contracts entered into by the Kuwaiti Government, Kuwaiti companies and Kuwaiti nationals with a foreign party contain a clause providing that any disputes which would arise out of these contracts shall be settled by way of arbitration" (Al-Ahdab 1990: 368). Some commercial matters are excluded from arbitration, such as disputes concerning the ownership and validity of patents which are subject to the criminal law (Commercial Code Articles 92-95). However, under Article 554 of the Civil Code, financial aspects of these matters may be resolved by means of conciliation and, therefore, by arbitration.

[1] The most significant arbitration proceeding to which Kuwait has ever been a party was the American Independent Oil Company, Aminoil. This arose as a result of the nationalisation of Aminoil by Kuwait in 1977. Formed in 1947 by a consortium of US independents including Philips Petroleum, AMINOIL and Signal Oil and Gas (Amin 1991: 260).

The point has been stressed in the above analysis that Kuwait's accession to a number of both regional and international agreements provides incontrovertible guarantees for the foreign investor, both Arab or non-Arab, allowing resort to any centre of arbitration of which Kuwait is a member. However, in spite of these many agreements which indicate Kuwait's acceptance of both regional and international arbitration, Resolution II of 1988 was passed by the Council of Ministers and abolished all clauses or conditions concerning international arbitration in contracts concluded between the Government and foreign companies unless exceptions are made by special resolution from the Council of Ministers.[1] In an interview with the author, Sayyed Bader stated that because of the many problems and disputes in which Government departments were involved, the position of the Government was not very strong in international centres. It was for this reason that the Fatwa and Legislation Department proposed to the Council of Ministers that the international arbitration clause should be abolished in all international contracts. The nature of international arbitration, it was felt, was excessively time-consuming and expensive. Abolition of the international arbitration clause duly followed, and only litigation was permitted as a method of resolving disputes. This decision has been extremely controversial, and there are many who fear that it has presented new obstacles to the attraction of foreign investment.

As already indicated, Kuwait is generally opposed to international arbitration[2] on the grounds that heavy expenses are normally entailed by such proceedings. However, this justification cannot be taken seriously. The fact is that in the past Kuwait has lost a significant number of arbitration cases. At the same time Mr Fuad Al-Majid, Director of the Arbitration

[1] By imposing this condition as to the resort to litigation, an unnecessary obstacle is created in so far as foreign investment is concerned. The resolution of the Council of Ministers states that it was intended to help in avoiding any dispute between the government and the foreign contractors. It also added that if during the implementation of any such contract, should any circumstances arise calling for the acceptance of international arbitration conditions, the government department concerned should submit a memo accompanied by the opinion of the Fatwa and Legislation Department, so that the Council of Ministers should decide what should be done in this case (see Council of Ministers, 1988, p.1).

[2] The Resolution of the Council of Ministers states that in the event that the international arbitration clause is accepted, the following should be observed:
"Great care should be taken in choosing arbitrators within the limits allowed for this purpose. Emphasis should be placed upon efficiency, practical experience, and international repute. The choice of arbitrators should take place with the consent of both the relevant Minister and the Fatwa and Legislation Department. Agreement is to be reached with solicitors known for their efficiency and ability. This is to take place with the approval of both the relevant Minister and the Fatwa and Legislation Department. The conditions laid down in the agreement should ensure good defence for the government at the successive stages of the legal proceedings.(Resolution of the Council of Ministers No. 11 for 1988).

Section of the Fatwa and Legislation Department, has pointed out that a single case of international arbitration costs the Kuwaiti Government no less than 7 to 8 million US dollars, whereas any case in Kuwait's high court, summary court or appellate court would cost several thousand US dollars. Thus the cost of arbitration is certainly of some significance. Originally, the Kuwaiti Legislature conceived of such litigation as the general or basic rule to which arbitration was the exception. This was undoubtedly a retrograde step, and this author believes that Kuwait should now amend the texts relevant to domestic arbitration so that the necessary reforms can be made to keep pace with the modern view that acceptance of arbitration is a necessary condition or guarantee for foreign investment.

It is for this reason that the present author believes that it would serve a much greater purpose if the Kuwaiti Legislature were to present an independent law covering the question of legislation, the provisions of which should be presented easily and without undue complication. Such a law could be called "the Kuwaiti Arbitration Law" (KAL) and should, in this case, be accompanied by an authorised translation into foreign languages for the benefit of non-Arab investors who are not acquainted with the Arabic language or terminology. Such a law can be developed without too much diffciulty by drawing upon other sources, such as the model law prepared by the United Nations under the general heading of International Trade Law (see above section 10.3.5.1). A number of countries, including Egypt, have strengthened their conception of arbitration by studying this Law. In this way Egypt has widened the scope of its own legislation, bringing it up to the same high standard of the best legislation in the field of arbitration. This step was taken when the Cairo Centre sent its proposal to the Ministry of Justice in 1986. The proposal was to set up a committee for preparing a bill for commercial arbitration on the pattern of the model law prepared by the UN Committee on International Trade Law, and approved by the General Assembly of the UN in 1985. The bill was passed, No. 27 for 1994, and became effective on 22 May 1994. This new law, as previously mentioned, was modelled upon the UN proposed law, though there were some variations due to the need for general conformity to the pattern of Egyptian legislation, and by required consistency with the Egyptian legal traditions and with the

methods of legal formulations with which the Egyptian Legislature is more familiar (Fadlallah 1987: 1-2).

The model law brings together arbitration and conciliation rules from the different legal, social, economic and political systems throughout the world. It amounts to an invitation by the United Nations for countries to adopt the law as their international commercial or arbitration act instead of issuing acts which are specific to them but which do not tally with other laws, thus making their arbitration systems incompatible with other international arbitration systems throughout the world. The model law respects the legal systems of the different countries of the world and all arbitration laws which are applied in them. Its issuance and ratification would give more security to international arbitration and free it from any obstacle which could hinder a settlement of disputes relating to international commerce. It would also open the way to a much easier implementation of solutions for settling disputes. This international approach to arbitration evolved with the needs of international commerce and the perceived need to respect the legal systems of all countries. The United Nations General Assembly, moreover, confirmed in its Resolution No. 40/72 the extent of the bond between arbitration and foreign investments as well as the economic and commercial relations between the different countries of the world (Al-Ahdab 1993: 17-18).

With the introduction of a Kuwaiti Model Law (KML) for arbitration, Kuwait would be able to overcome the problems associated with the previously mentioned Resolution of the Council of Ministers. Therefore, the present author believes in the importance of establishing an international centre for arbitration handling claims and resolving disputes. This centre could be called the" Kuwaiti International Centre for Settlement of Disputes" (KICSD) and should bring together both Kuwaiti and international lawyers. It would house translation bureaux or offices charging a reasonable fee for the translation of contracts from and into Arabic. These bureaux should be provided with reliable translators for translating the arbitral awards or arbitral proceedings inside the courts. The proposed Centre should have convivial chambers for arbitration so that the atmosphere would be more like a 'club', encouraging disputants to solve their problems in a friendly spirit. It is also proposed that the Centre should have committees representing institutions and ministries for following up the contracts

concluded with foreign investors. It is hoped that the establishment of this kind of international centre would make Kuwait a pioneer in the field of arbitration, infusing foreign investors with confidence and trust in local courts, as well as putting an end to Kuwait's problem in the sphere of international arbitration.

10.4 THE AWARDS

As a general rule, unless the parties agree otherwise, an arbitration tribunal must pass its award within six months from the date notifying the parties of the first arbitration session. It is, however, up to the parties to agree either expressly or implicitly to extend the date of the issuance of the award; otherwise any award rendered after the expiry of the original or extended period will constitute a ground for nullity (Article 181 of the KCCP). Article 181 states that:

> If there is no stipulation by adversaries in their arbitration agreement on a date for the award, the arbitrator shall make the award within six months of the date of notification of the parties to the dispute of the arbitration sitting, otherwise any of the parties to the dispute may refer the dispute to the court or continue with the litigation before that court if the case was already filed with it.
>
> If the dates of the notification of the parties differ, effect shall be given to the later date of notification.
>
> The adversaries may agree expressly or implicitly to extend the date whether it was fixed by agreement or law, and may also authorise the arbitrators to extend it to a certain date.
>
> The date shall also be suspended whenever a dispute before an arbitrator has been suspended or interrupted. The date shall resume from the date the arbitrator learns of removal of the cause of suspension or interruption and if the remainder of the date is less than two months it shall be extended to two months.

The point must again be emphasised that Kuwaiti law distinguishes between arbitration proper and "amiable composition" (see above section 10.3.5). The rule permitting a majority decision is applied to both kinds of arbitration (Al-Ahdab 1990: 380).

10.4.1 Enforcement of Arbitral Awards

The method of enforcement of an arbitral award in Kuwait depends on whether it is regarded as a Kuwaiti award or a foreign award. An enforcement of Kuwaiti and foreign arbitral

awards will be examined below in the light of Articles 199-200 of the KCC Procedures Law, the provisions of the New York Agreement of 1958 and other relevant treaties.

10.4.1.1 Foreign Awards

Any award made outside Kuwait is, by definition, a foreign award (Article 200 of the KCCP). The enforcement of foreign awards may be requested on the basis of either domestic law or the relevant international conventions and bilateral treaties (Pepper 1991: 265). The conditions of enforcing a foreign award are the same as those which apply to the enforcement of a foreign judgement (Article 200 of the KCCP read in conjunction with Article 199). The Kuwaiti judicial control will differ according to the nationality of the award. If it is from one of the States party to the New York Convention, the court will apply the rules of this Convention. Otherwise, the foreign award will be subject to the procedures laid down for the enforcement of foreign judgements as expressed in Articles 199-200 of the KCCP.

10.4.1.2 Enforcement of Foreign Arbitral Awards under Articles 199-200 of the KCCP

Should the award be considered foreign and if the New York Convention does not apply, the party seeking the enforcement of this award must follow the procedures laid down in Articles 199-200 of the KCCP (Sarkouh 1986: 137-138). Article 199, which deals with the enforcement of foreign judgments, applies to foreign arbitral awards, subject to the requirement that the award must be in a matter which can be arbitrated under Kuwaiti law and the award for which the application of enforcement is made is enforceable and immediately executable in the issuing country.

Article 199 also requires the existence of reciprocity between Kuwait and the foreign country issuing the award. This requirement is a condition prior to the court's examination of the specific award and the satisfaction of the other requirements of Article 199. Reciprocity may be available due to the existence of a treaty (Kassim 1987).[1] The foreign judgment

[1] This principle of reciprocity is operative in the Egyptian law. According to the said principle, the foreign arbitration awards are given the same treatment as foreign judicial judgments or verdicts. The determinant of

(award) must not contain anything violating public policy or morals under Kuwaiti laws or conflict with any judgment or order previously issued by the Kuwaiti courts[1].

10.4.1.3 Enforcement of Foreign Arbitral Awards under the New York Convention

Kuwait is not a party to the Geneva Protocol of 1923 nor to the Geneva Convention of 26 September 1927, but is a party to the New York Convention of 10 June 1958 (Law No. 10/1978, dated 26 March 1978). Kuwait became a party to this agreement because many contracts concluded by the Kuwaiti Government, or by Kuwaiti companies or individuals with foreign parties, include a clause stating that disputes arising therefrom shall be settled by arbitration.

The arbitration may be local in the sense that the arbitral body may hold its meetings in Kuwait and the award that is issued will then be a Kuwaiti award to be enforced abroad - i.e. outside Kuwait. In any such case, if there are no agreements providing for enforcement of awards between Kuwait and the relevant foreign countries, then the enforcement will meet with many obstacles, and in the process Kuwaiti rights may be lost. In order to strengthen the position of the Kuwaiti side in any such situation, the Kuwaiti Government thought it necessary to become a party to the New York Agreement of 10 June 1958 concerning the Recognition and Enforcement of Foreign Arbitration Awards (Law No. 10 of 1978 dated 26 March 1978). However, Kuwait expressed reservations when it acceded to this agreemen (Al-Ahdab 1990: 284; Sarkouh 1986: 156),[2] stating that it would only recognise and enforce

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difference between the foreign arbitration award and the domestic arbitration award is the place in which the award is issued. It is foreign if it is issued in a foreign country (Shafiq 1973-1974: 262). The same criterion has been adopted by the Kuwaiti Legislature. Just as the Egyptian law demands that certain conditions should be fulfilled before any verdict for enforcement can be issued (Article 298, Procedures; Ibrahim 1980: 112) so the Kuwaiti legislator has adopted the same attitude towards this question (Article 199 of the Commercial and Civil Procedures Law).

[1] Moreover, the court can refuse the enforcement *ex officio* if the subject matter of the dispute is not capable of settlement by arbitration under the law of Kuwait, and if the recognition or enforcement of the award would be contrary to the public policy of Kuwait (Saad 198: 46).

[2] Article 1 (3) of the Convention allows states which adhere to the Convention to make two reservations. The first is the reservation as to reciprocity; the second is the commercial reservation, which featured in the 1923 Geneva Protocol (see Redfern and Hunter 1991: 458). The Convention provides in Article 1 (3) that "When signing, ratifying or acceding to this Convention, or notifying extension under Article X hereof, any state may, on the basis of reciprocity, declare that it will apply the Convention to the recognition and enforcement of awards *made only* in the territory of another contracting state."

awards made in the territory of another contracting State which was party to the agreement.[1] Provided that this reservation is satisfied, Kuwait will, pursuant to Article III of the Convention, recognise arbitral awards as binding and enforce them in according with the prevailing rules of procedure. Such recognition and enforcement are made under the condition that "there shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of the award to which this Convention applies than are imposed on the recognition and enforcement of domestic arbitral awards" (Article No. 3 of the New York Convention).

The enforcement of local arbitral awards depends, according to the provisions of the New York Agreement, upon the following condition: the country in which it is issued must be a party to the Agreement at the time when the award was issued. Thus it was on this basis that an arbitral award was issued in Kuwait on 18 September 1973 against the British consultancy firm, Sir Fredrick Snow and Partners, for which there was a court order for enforcement in Britain.[2] Under Kuwaiti law, the extent of judicial control differs according to whether enforcement is requested on the basis of Kuwaiti law or the New York Convention. Various writers have commented that in the latter case the control is less strict (Al Ahdab 1990: 384).

10.4.1.4. Enforcement of Arbitral Awards under Other Agreements and Conventions

On 20 May 1962 Kuwait became a party to the Arab League Convention on the Enforcement of Judgments and Awards of 14 September 1952. This Convention deals with arbitral awards

[1] See, on this kind of reservation, Albert Jan van den Berg, "New York Convention 1958, Commentary and Cases" reported in *Year Book*, vol. VIII, 1983, p. 337.

[2] See also in Dr Albert Jan van den Berg, "Does the New York Arbitration Convention of 1958 apply retrospectively, Decision of the House of Lords in *Government of Kuwait v. Sir Frederick Snow*" Arbitration International, Vol. 1, No. 1, April 1985, p.103.See also Prof. Clive Schmitthoff, *Yearbook of Commercial Arbitration,* Vol. VII, 1982, p.267.

issued in other member states (Kassim 1987). However, it is now being replaced by a new Convention, namely the Convention on Judicial Co-operation Between the States of the Arab League signed by Riyadh on 8 April 1983 (Al-Baharnah 1989: 332-333). Kuwait also ratified the Washington Convention (ICSID) in 1979, and authorised enforcement of awards made abroad under the same conditions as are required for foreign judgments (Al Ahdab 1990: 384) [1].

It should be noted that Articles 35 and 36 of the Model Law for International Commercial Arbitration, approved by the UN General Assembly in 1985, cover the question of the recognition and enforcement of international arbitral awards. Article 35 (1) states that "An arbitral award, irrespecive of the country in which it was made, shall be recognised as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of this Article and of Article 36." When a country adopts the Model Law[2] as national legislation regarding international commercial arbitration, it should simultaneously take cognisance of Article I which provides that "this law applies to international commercial arbitration subject to any agreement in force between this state and any other state or states". Therefore, a country that is applying the Model Law must nevertheless apply the international agreements which it may have ratified. Of these, the most important for Kuwait is the 1958 New York Agreement.

UNICITRAL has played a much more significant role in relation to international commercial arbitration than is generally recognised. Taken together, the New York Convention, the UNICITRAL Arbitration Rules and the Model Law represent a major contribution to the development of the international arbitration process, which is designed to

[1] It is noteworthy that the rule of enforcement of the arbitral award in the Model Law is wider than that of the New York Agreement. It states that the foreign arbitral award shall be effective and binding (unless there are reasons for rejection) irrespective of the country of origin. Thus the foreign arbitral award is binding in the country which has issued the Model Law, even if it is not a signatory member of the New York agreement. The said Law is looked upon from the standpoint of domestic legislation rather than international agreement. An important result thereof is thus entailed for the applicant for enforcement of the foreign arbitral award, in the same way that it shall be binding in the country which has issued the Model Law, on the basis of that law. This provides guarantee for the enforcement of foreign arbitral awards in countries which are not signatory members of the New York agreement. If the country which has issued the Model Law as national legislation for itself is a signatory member of the New York agreement, then this fact provides a second guarantee for the applicant for enforcement of the foreign arbitral award in that country (Hussein Al-Baharnah. 1992).

[2] United Nations Commission on International Trade Law adopting Model Law on International Commercial Arbitration on 21 June 1986. The text of the Model Law appears as Annex 1 to UN Doc. A/40/17.

produce a binding and enforceable method for the resolution of disputes in international trade (See Appendix XI for full text of United Nations Commission on International Trade Law (1976)). It is incontestable that such a system is required order to meet the demands of modern international trade in a global economy (Redfern and Hunter 1991: 527).

The above discussion of the main features of the enforcement of foreign arbitral awards under the Model Law and the New York Agreement has shown that these international agreements and conventions all aim to develop a truly international system of commercial arbitration. It would therefore be very encouraging if Kuwait were to incorporate the rules of the Model Law locally in addition to its accession to the New York Agreement.

10.5 CONCLUSION

The main argument advanced in this chapter is that Kuwaiti legislation should be developed to create a favourable climate for the settlement of foreign investment disputes. This is undoubtedly a key factor in the attraction of foreign investment. To keep in line with modern developments in arbitration and to facilitate commercial transaction, Kuwaiti legislation must be reviewed as a matter of urgency.

The author has suggested reforms such as the passing of a new independent law on arbitration which should be based substantially on the Model Law prepared by the UN Committee on International Trade and approved by the UN General Assembly in 1986. The proposed law may be called the Kuwaiti Model Law (KML). It must give a better account of the specificity of international commercial arbitration for providing a more favourable climate for foreign investment.

The KML must establish an International Centre for the Settlement in Kuwait of Disputes (the KICSD) arising between foreign investors and Government departments. This would be a better approach than that of compelling the foreign investor to resort to the ordinary courts in Kuwait. The KICSD would certainly boost foreign investor confidence in submitting to dispute settlement in Kuwait and would increase interest in doing business in and with Kuwait. The proposed Centre should, moreover, have both Kuwaiti and international arbitrators, as well as translation bureaux sponsored by the Kuwaiti Government

to provide translation services for a reasonable fee. The translation of documents from and into Arabic should be carried out by professional and reliable translators. Contracts and texts covering legal proceedings during arbitration inside the courts should be translated through this Centre.

The Centre should be provided with special chambers for arbitration. It should also have committees representative of the various establishments, corporations and Ministries which conclude agreements or contracts with foreign investors. This would help to solve differences gradually as they emerge, instead of leaving them to accumulate until the completion of the relevant project. Contacts should be established between the Centre and other regional and international centres in order to benefit from their experience and know-how.

Finally, the adoption of the model arbitration clauses will help to clarify and simplify matters in connection with the settlement procedures. The proposed Kuwaiti Centre for the settlement of Investment Disputes will provide quick, remedial processes for foreign investors who do not look with favour upon ordinary litigation in Kuwait.

CHAPTER ELEVEN

CONCLUSIONS

11.0 INTRODUCTION

This thesis has sought to examine how foreign direct investment (FDI) has affected the socio-economic development of Kuwait, with particular reference to the formation and development of a legal framework for the regulation of FDI activities. A consistent argument throughout the whole analysis has been that the existing legal framework for FDI in Kuwait is inadequate and, in some respects, ineffective. On the basis of a thorough and integral study of Kuwait's FDI laws and regulations, a number of conclusions have been reached, and these include specific recommendations for future change in Kuwait's FDI regime. The purpose of this chapter is to review the main points of argument in the thesis and to relate these to the various conclusions and recommendations. To begin with, it is necessary to present an overview of the general role of FDI in Kuwaiti development so that we can appreciate the main priorities which need to be stressed in using legal reform to support efforts to increase the future attractiveness of Kuwait for foreign investors.

11.1 THE ROLE OF FDI IN KUWAITI DEVELOPMENT

In order to identify and explore the potential and actual benefits of FDI to the recipient countries, a range of theories have been analysed. It is clear that opinions amongst scholars vary widely on matters of economic theory.[1] Fatouros (1995: 184) stresses that foreign investment was generally viewed in negative terms by less developed countries in the period between the end of World War II and the 1970s. This was in fact the period during which Kuwait became an independent State,[2] and the emergence of assertive nationalism manifested itself in an effort to wrest control of Kuwait's economy from the hands of foreign oil companies, thus bringing to an end what was commonly viewed within Kuwait as the

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[1] See Chapter One Section 2 for more details on theories on FDI.

[2] See Chapter Two.

continuation of 'imperialism'. This feeling was expressed in policies of expropriation of and hostility towards FDI, thus confirming Biersteker's (1978: 5) statement that "Independence did not resolve economic problems in that control was still in foreign hands." Following independence, Kuwaiti laws and regulations were designed to protect and promote indigenous participation and control of business. In particular, restrictions were imposed to protect local businesses from foreign competition. This approach meant that Kuwait subscribed to the arguments of dependency theory,[1] especially the claim that foreign investment does not meaningfully contribute to economic development (Sornarajah: 1994). For example, Ghai (1987-88: 771) claimed that foreign investors "exploited and plundered" the resources of developing countries in a manner very similar to colonialism.

The contribution of FDI to the Kuwaiti economy can best be evaluated with reference to Kuwait's oil industry. It cannot be denied that the production of crude oil has brought Kuwait to the first ranks of the world's oil producing and exporting countries. At the same time, Kuwait has suffered considerable disadvantages due to the activities of foreign oil companies. For example, for a long time natural gas - a valuable resource - was mostly flared off during oil production despite the fact that such a raw material had a potential contribution to make to industrialisation. KOC, to take a specific example, objected to all legislation which it saw as a threat to its rights so that in effect the company's approval was a precondition for the successful implementation of Kuwaiti laws.[2] However, it would be wrong to conclude from this that complete hostility towards FDI - perhaps in the form of a boycott - is the best policy for Kuwait or for any other developing country. Although it has to be accepted that Kuwait has suffered at the hands of MNCs, the great importance of FDI to the Kuwaiti economy must also be appreciated.

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[1] See Chapter One.

[2] This point has already been discussed in greater detail in Chapter Two Section 2.3.3. To take another example, KOC was criticised with respect to its policy and role in the employment of Kuwaitis and Arabs. In 1955 there were only about five Kuwaitis and Arabs who occupied high positions in KOC. In addition, BP and Gulf, by virtue of their ownership of the oil industry of Kuwait, had had the sole decision in determining the policy on oil production. For more about the disadvantages of foreign investment in Kuwait see Tamah Al Shammari, *Multinational Companies and Kuwait National Policy*, unpublished Ph.D. thesis 1980, pp. 134-167.

If the negative impacts of FDI can be avoided or modified in the host states, including Kuwait, by influencing or controlling TNCs,[1] then those states will undoubtedly gain from foreign investment. This point has been confirmed by studies carried out by the United Nations Commission on Transnational Corporations which show that TNCs can make a positive contribution to development if they are properly managed (Sornarajah 1994: 46-48). The weight of this argument is supported by a study conducted by the Research Department of the International Monetary Fund (IMF) which states that:

> In assessing the overall effects of direct investment, however, it is relevant that many of the principal benefits and costs can be substantially affected by the economic policies of the host country. In particular, the types of investment projects chosen will depend on relative prices in the host country; if these are inappropriate, the investment will also be inappropriate and of less benefit to the economy. The foreign investors themselves can also help to ensure that the direct investment process is mutually beneficial by co-operating with a host country's chosen development strategy and showing willingness, where necessary, to consider alternative arrangements, such as joint ventures and minority equity participation. (IMF, Occasional Paper No.33, January 1985.)

The classical theory of FDI holds that foreign investment can contribute to the development process of the recipient state in many ways: through the transfer or mobilisation of capital, through the generation of income, and through the transfer of technology which may result in industrialisation, thereby generating employment. These processes will enhance the quality and capacity of the human resources available in the state by developing the skills and expertise of the local labour force. The Vice-President of the World Bank, Mr Shihata, offered an example of the classical theory position when he stated that:

> FDI is an important vehicle for the transfer of technology. It usually brings in new knowledge on processing techniques, product design and packaging, communications technology as well as market development and strategy. These inputs are generally injected over the life of the investment, enabling the project to keep pace with technical innovations and developments in world markets. (Shihata 1991: 486.)

It has to be noted, however, that it is often difficult to evaluate these claims empirically, since both the direct and indirect effects of FDI must be analysed, and at the same time the implications of the *absence* of FDI have to be taken into account.

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[1] TNC (Trans National Corporations).

In this thesis support has been given to the structuralist theory which claims that, in less developed countries, FDI has played an extremely important role in contributing to industrialisation. Of course, FDI has also, in many cases, led to heavy dependence on private investment abroad, and in some circumstances this can be undesirable (Hirschmann 1971: 225-226). Therefore, a developing country such as Kuwait needs to encourage the inflow of foreign capital within the constraints of its development policies. By utilising FDI as a source of structural adjustment, socio-economic benefits for Kuwait can be enhanced, and this in turn will accelerate the process of development. This author shares the UN's (1974)[1] view that FDI is a vital component in the development of Kuwait but, unless Kuwait initiates proper legal steps to assign specific roles to foreign investment, the effects of FDI may be inadequate and even negative.

What has to be appreciated is that the Kuwaiti economy faces three particularly significant problems: (i) a shortage of human resources, especially skilled manpower; (ii) an absence of industrial capabilities; and (iii) obstacles to the transfer of technology. FDI can certainly help to overcome these problems, but only if the appropriate legal framework exists to support FDI. Most importantly, significant legal impediments to the inward flow of foreign investment must be removed.

11.2 IMPEDIMENTS TO FDI

Foreign investment in Kuwait is presently impeded by a number of factors, the most important of which were highlighted in Chapters Four and Five. They include the unnecessary proliferation of Departmental permits and regulations which leads to duplication, conflict and inefficiency. There is, generally, insufficient interdependence and co-operation between the issuing Departments. This has been supported by the Kuwaiti Chamber of Commerce and Industry, which declared that among the major problems facing the industrial sector is the fact that responsibility for industrial growth and development in Kuwait is concentrated in the hands of several distinct parts of the bureaucracy. This state of affairs leads to slowness in the

[1] See United Nations, *The impact of Multinational Corporations on Development and on International Relations*, 1974, pp. 28-29.

flow of information and repetition of the work done by Departments. At the same time, these Departments are not well equipped, lacking sufficient qualified and efficient staff (Kuwaiti Chamber of Commerce and Industry, October 1989: 51).

Foreign investment in Kuwait is also hindered by the multiplicity of laws, decisions and resolutions regulating foreign investment, all of which have a crippling effect upon the role of FDI in the development of the industrial sector.[1] In this regard, Dr Ali Taleb (no date: 9) has pointed out that "there are 65 laws and decrees all regulating industrial activity in Kuwait".

The lack of skilled labour and of administrative experience is another deterrent to foreign investment in Kuwait. The country's workforce represents only a marginal proportion of labour in the industrial sector which relies, for this reason, almost entirely on non-Kuwaiti labour. Al-Salman (1985: 471) observes that:"As regards the Kuwaiti labour force, their participation rate and their preferences for non-productive occupations restrict the number of Kuwaitis and their proportion in the labour market. Since it is difficult to change the structure of the Kuwaiti labour force in the foreseeable future, it depends upon whether foreign labour is likely to remain a basic obstacle to industrialisation."

Kuwait also lacks a well-defined strategy for the role of foreign investment in the industrial sector and in the Kuwaiti economy in general. Acceptance of foreign investment as a principal means of diversifying the productive sector in Kuwait is needed. The authorities, in devising such a strategy, should attempt to channel foreign investment into sectors which will accelerate economic growth in Kuwait. Without such a strategy, the relationship between the foreign investor's role and Kuwait's needs for modern technology and a trained workforce will remain blurred. It is often difficult to define the specific industries (for the purpose of Kuwait's developmental goals) which need to be targeted for FDI, but success in doing so could make an enormous contribution to the country's economic future. Kuwait presently has neither a clearly defined industrial policy nor a long-term industrial strategy because of continuing uncertainty about future development. It is thought that this may be because there is uncertainty as to what the authorities actually want. A progressive and developed industrial

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[1] See Chapter Four.

sector may not be desired because of the uncertain impact of imported labour or because of the financial burden which subsidies may impose on the country (Mahdi, Hamza, Al Salman 1985: 468-469).

In Kuwait, as in nearly all developing countries, lack of political stability[1] has always been a constraint on the inward transfer of capital.[2] Instability is often associated with change in government policy or ideology towards the economy, and this unquestionably has an adverse effect upon investment. The potential investor becomes extremely cautious and apprehensive about the future of his prospective investment. The absence of political stability and the concomitant change in the political climate, represented by new economic ideologies or philosophies dictated by political upheavals, are bound to minimise the inward flow of investment. In the context of our discussion on political stability, mention should be made of the fact that Kuwait was afflicted with the disaster of the Iraqi occupation on 2 August 1990. What looms large here is the political effect of this invasion upon investment in Kuwait. It is obvious that the invasion has greatly affected political stability and the consequent prospects of foreign investment. The development of Arab investment flows into Kuwait in the 1950s amounted to 105,000 thousand US dollars; in the 1960s it was 6,460 thousand US dollars; in the 1970s it reached 1,073,648 thousand US dollars; in the 1980s it was 29,488 thousand US dollars; in 1991 it was nil; in 1992 it amounted to 564 thousand US dollars (Investment Guarantee Bulletin No. 45 for 1989: 4). In addition to all this, there remains a common fear amongst potential foreign investors of nationalisation, confiscation or expropriation of an investment. In these circumstances, any incentives given by the host country to encourage FDI will have only a marginal effect because the basic requirements of a sound investment climate are absent (Sadiq 1985: 21).

Another important impediment to FDI which has been examined in this thesis is the limited size of the Kuwaiti market. This means that manufacturing companies may have a

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[1] For more about political stability in Kuwait see Abu-Hakima, Ahmed Mustafa (1984) The Modern History of Kuwait 1750-1965.

[2] The results of a questionnaire prepared by the Arab Organization for Investment Guarantees in 1993 show that the vast majority of those who stated that the investment climate in Kuwait had worsened were referring to the growing political and economic instability in Kuwait in the aftermath of the disaster caused by the Iraqi invasion of the country and to the wave of political tension thereby caused in the Gulf as a whole.

productive capacity which exceeds the absorption capacity of the local economy. The majority of the industrial processing (non-oil) firms established in Kuwait were intended to promote the replacement of imports. However, because these units were set up with a large productive capacity, they acted not simply as "import-substituting" industries but eventually became "export-promoting" ones. Their productive capacity could be utilised only through the improvement of their competitiveness and expansion into external markets (Kuwaiti Chamber of Commerce and Industry 1989: 50).

Last but not least, a major problem in the context of FDI is the lack of data or information bases to help Kuwaiti industry learn about, and apply, the most modern technological developments in the production of manufactures. Nor are there publications which summarise the key legal provisions and which could help guide the investor into suitable areas of investment. Most of the information available comes from the Ministry of Commerce and Industry in the form of statistical details, technical maps, studies and research relating to particular industries (Al Sherhan 1989: 3).

Kuwait can benefit from the experience of the newly industrialised countries (NICs) such as Singapore, Taiwan and Hong Kong by making use of the methods and policies which these countries adopted. It is evident that they have pursued strategies of industrialisation according to specific, selective criteria after careful investigation of long-term economic trends and prospects. These strategies initially involved the import and absorption of Western technology for purposes of industrial development. In Korea and Taiwan, for example, attempts were made to secure, imitate and develop Western technology in order to produce new technologies for the manufacture of products which were meant for exports. Accordingly, long-term planning was the key to success. Another key element of the East Asian "economic miracle" was the will to remove obstacles and provide incentives to foreign inward investment by companies and governments. It is noteworthy that these countries were not simply being magnanimous, but more often than not they directed their attention to certain spheres of activity rather than others, taking the factor of competitiveness into account. Also, we should remember that in investing in these countries, multinational companies were considering their own interests. The countries in question basically adopted policies which

would achieve their development goals in the long-run while at the same time giving foreign investors the proceeds or profits which they desired. (GOIC 1993: 269).

In the light of the foregoing analysis of the broad context of foreign investment, including technology, expertise and know-how, it is submitted that Kuwait should formulate a policy intended to secure the specific types of investment which can facilitate the transfer of Western technology in accordance with the country's established goals of development and its industrial strategy.

11.3 THE ROLE OF THE FDI REGIME IN KUWAIT'S DEVELOPMENT

The FDI regime can affect the development of Kuwait both directly and indirectly. This means that the legal system is a very significant factor in its own right which must be considered in discussions of the link between investment and development.

This thesis has argued that the official foreign investment policies of Kuwait, as well as the structure of the country's bureaucracy and government, have generally had a negative effect on attracting foreign investment. As discussed in some detail in Chapter Two, Kuwait's socio-economic fabric and its political system were shaped directly by the development process which stemmed from the discovery of oil by foreign oil investment companies.[1] The Kuwait oil industry has subsequently developed into one of the largest industries of its kind in the world because of the contribution of the multinational oil companies. As Al-Shammari (1980: 127) states: "In the 1930s and 1940s, Kuwait had nothing to offer except, of course, oil underneath the desert, to the multinational oil companies." These companies brought with them the capital, technology and know-how, plus the trained manpower, needed for oil exploration. Thus, it is easily seen that foreign direct investment has played an effective role in the social and economic development of the country. Al-Shammari (1985: 77) underlines the enormous contribution of the oil industry to Kuwait's development:

> The single most important resource in Kuwait is oil, which was first exploited commercially in 1946. Since then, oil revenues have been the main growth indicator and these have risen markedly, reaching $18.0 billion in 1980, compared to less than $1 million in 1946. Within this short time-span, oil has transformed the Kuwaiti

[1] See Chapter Two for more detail on the socio-economic development of Kuwait.

economy from a simple network of pearling, fishing and seafaring activities with very low per capita income into an economy whose per capita gross national product (GNP) is one of the highest in the world.

However, in Kuwait all sectors of the economy, apart from the oil sector, have continued to suffer from a lack of industrialisation. In general terms, the role of manufacturing in the economy is weak. Manufacturing growth during the 1980s was erratic but its share in GDP rose steadily, averaging 13.5 per cent between 1982 and 1986, and reaching 24 per cent in 1989. According to Al-Rashed (1976: 18-22): "Industry in Kuwait tends to fall into two types. First there are large-scale industries, either wholly or partly government-owned, for instance, oil and gas. The second type of industry is small scale, meeting primarily local needs such as in construction material, food processing and consumer-oriented products."

Once Kuwait gained independence, the Government introduced a series of foreign investment regulations [1] which sought to prtect and promote Kuwaiti participation and control of business. But considering the capital surplus available prior to the Iraqi invasion, it could be argued that the country was not keen to attract foreign investment outside the oil sector. According to Bazarian and Fauerbach (1980: 143), Kuwait did recognise that foreign investment was an important means of attracting technological and managerial skills and was a necessary conduit to international markets, but only if it was utilised under a regulated system of control. The key issue which this thesis has sought to address is whether the regulatory system which was developed was appropriate, adequate and effective.

Chapter Three sought to show that Kuwait has always needed foreign investment, but especially in the wake of the Iraqi invasion. This view is supported by Al-Hakim (1995), the legal advisor to the General Investment Authority, who stresses that Kuwait must not close its eyes to the development of technology, particularly in relationship to the oil, industrial and agricultural sectors.

The discussion in Chapters Three, Four and Five demonstrated the problems which have arisen from the fact that Kuwait has no single statute directed specifically at FDI.

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[1] See Chapter Three.

Existing laws generally regulate both Kuwaiti and foreign investments and commercial activities, but there are few laws which make explicit reference to foreigners. The laws that do relate to foreign investment contain many restrictions which inhibit both the types of business activity which are permitted and the vehicles available for conducting business.

In some respects the laws pertaining to foreign investment in Kuwait do apply the national treatment standard but, on balance, foreign investors are subject to less favourable treatment. An example of such inequality, as discussed in Chapters Four and Five, is the stipulation that a foreign investor may not hold more than 49 per cent of any business venture. This means that the investor must have a Kuwaiti partner who holds at least 51 per cent of any enterprise. Al-Melhem (1993) explains that the aim of this regulation is to protect local businesses against foreign competition, and to enable Kuwaitis to benefit from commercial ventures. Further restrictions placed on foreign investors include: the prohibition on owning land and (therefore) business premises, and the taxation of profits accruing to foreign investors (whereas those accruing to Kuwaitis are not taxed).[1] Naturally, foreign investors perceive these regulations as restricting their investment opportunities and preventing them from making a contribution towards the development of enterprises in Kuwait (Al-Deen , no date: 12).

It has been argued in this thesis that a foreign investor should be allowed the freedom of 100 per cent ownership of proposed projects in Kuwait without the restriction of having to take on board a Kuwaiti citizen as a partner. This view is emphatically supported by Mr Shaiq Hassan, the Legal Advisor of the Legislation and Fatwa Department (interview conducted by the author on 7 January 1995).

Chapter Four of this study demonstrated that Kuwait's screening regulations are restrictive because they require too many approvals from too many departments, and there is also a conspicuous lack of inter-departmental co-operation. The chapter also highlighted the cumbersome nature of the legal framework for granting approvals and licences, resulting in disincentives to FDI. It was suggested that the decentralised framework for screening foreign investment is costly and leads to much time being wasted in negotiation and a continuous

[1] See Chapter Eight.

uncertainty of outcome. As Weigel (1990) points out, potential investors, when faced with Kuwait's bureaucratic obstacles, frequently decide to invest in another country. Furthermore, the conflicting requirements of the various departments may force a foreign investor to redefine the form of an investment in such a way that it is no longer compatible with the broader national objectives. Mr Nafl Al-Dawsary, Director of the Licenses Department in the Industrial Registry, explained that:

> The reason why this law has not been applied is due to administrative problems, including. for example, the fact that no budget had been allocated for the licences department in the industrial register. Carrying out all the measures provided for by the law, and conducting the required research, all this would require a large number of staff, whereas what we have here is only one member of staff employed in that department. The reason why there are no full-time staff, and why there is no interest on the part of the state in this department, is that the main thrust of Kuwait's policy is commercial and industrial development. Interest in industrial development only started in the eighties. However, in view of the fact that Kuwait is a commercial state, not an industrial one, Kuwait did not provide the required structure necessary for the application of the patent law. (Interview conducted with the writer, 7 January 1995.)

The incorporation of a more flexible regulatory policy will require the development of an appropriate administrative structure and an improvement in interdepartmental co-operation on FDI. It is the author's opinion that Kuwait needs to adopt a centralised approach. An investment authority should be created which will have the power to apply a coherent and logical strategy.[1]

It is evident from the discussion in Chapter Five that the Commercial Companies Law (CCL) No. 15 of 1960, and the Regulations under it which govern all aspects of commercial companies in Kuwait, fall far short of being all-embracing and comprehensive. This Law has also not kept pace with recent developments. The procedures for incorporating and managing companies are based on complex articles which are not attractive to the foreign investor. For example, if a foreigner wishes to carry out a particular business project for a limited period of time, he must enter into a Joint Venture Contract with a Kuwaiti party under the auspices of the Kuwaiti party's trade licence (Article 16 of the CCL). No account is taken of the fact that the foreign investor may be contributing substantially in the form of capital or technology. In this situation, problems arise if the partners fall out with each other or if the Kuwaiti partner

[1] See the concrete proposals in this Chapter, Section 11.4.

dies, resulting in the business being adversely affected as a result of delays or difficulties encountered in the search for a new Kuwaiti partner with an appropriate licence. Kuwaiti law also forbids foreign companies from establishing wholly-owned branch offices. Hence, the CCL seems to serve the interests of local investors and is not a comprehensive law which treats foreign and local investors equally. Al-Hakim, the Legal Advisor to the General Investment Authority, when questioned by the author, stated that:

> The Companies Law is a fair law, but it is not a comprehensive law. Many things were ignored by the current law, nor did the law give adequate treatment to many matters. The result is that the management of companies has become a complex matter. This is a very important aspect of the law, and the Kuwaiti law, in this respect, has not kept pace with recent developments. It is for this reason that the Companies Law should be reconsidered so that it may keep abreast of modern developments (Ali Al-Hakim, in an interview conducted by the author on 5 January 1995.)

Mr Shafiq Hassan is also critical of the CCL: "The Companies Law had been originally enacted for the local investor. Now the time has come to amend this law because there are many areas or spheres of activity where Kuwait is in need of foreign experience. It would be meaningless, for example, to impose upon the foreign investor a precondition that he should have a Kuwaiti partner" (interview conducted by the author on 3 January 1995). The CCL personal company regulations lay down complicated procedures and adhere to many conditions of contract. Mr. Shafiq Hassan, the legal advisor in the Fatwa and Legislation Department (interview with the author, 3 January 1995), describes these conditions as follows:

> In order to properly understand these conditions and procedures, the foreign investor should make an adequate study of them before he conducts his investment. In this connection, these laws, which are complex and interrelated and therefore difficult for foreigners to understand, had been originally laid down for the Kuwaiti investors and not for foreigners. Also, if there are foreign investors willing to invest in Kuwait, then the Kuwaiti shareholding should be, according to these laws, dominant over the foreign shares.

In joint stock companies, foreign investors are allowed to participate only when the concerned authorities are convinced that the investment, know-how and expertise are actually needed in Kuwait. There are no definite guidelines covering these discretionary powers of the

authorities, and, as a result, foreign investors have no means of determining in advance whether their applications will be successful or not.

Foreign investors would almost certainly be less reluctant to invest in Kuwait if there were adequate mechanisms for the protection of their minority holdings. In some respects existing Kuwaiti law on minority protection is commendable, but its major shortcoming is that it can only offer protection against the Kuwaiti investor abusing his dominant position; it does not provide the foreign investor with equal ownership or give him control of the venture. If the law were to be amended, allowing parties to establish their own shareholdings both autonomously and co-operatively, this would go a long way towards meeting the reconstruction efforts in Kuwait (Gerald 1991: 322). An alternative would be to afford the partners the right to control the company as they see fit by providing for different classes of shares with different voting rights.

All the above mentioned restrictions imposed by the CCL are serious obstacles to Kuwait's economic development in so far as they discourage foreign investment. In the author's opinion, the law should be amended to take into account Kuwait's need to attract foreign investment and thus to promote the transfer of technology and expertise. In particular, Article 23 of the Commercial Law No. 86 of 1980 should be amended to make it more flexible towards the entry of foreign investors for business purposes. Another positive proposal is that the Commercial Companies Law, which is now thirty-five years old, should be reviewed in the light of changes which have occurred in the country's social and economic situation. Many other countries have adopted an open-door policy towards foreign investment. It is now time for Kuwait to do the same. Therefore, any future liberalisation scheme applying to foreign investments should replace state control with rational regulations within the context of a general reform strategy.

In Chapter Six attention was drawn to a range of incentives offered by Kuwait to attract foreign investment: preferential customs tariffs, favourable terms for the repatriation of funds, attractive bank loans. While these measures may be seen as steps in the right direction, their net effect cannot be considered as very successful, especially by comparison with the more favourable conditions for FDI to be found amongst Kuwait's Arab neighbours. The

specific terms of these incentives need to be reconsidered, and the specific proposal for a free export zone in Kuwait, which has been discussed for some time, should now be implemented. Much more important, however, is the question of Kuwait's tax regime as applied to foreign investment. Most foreign investors regard this as a major issue which has not yet been resolved with sufficient attention to their views and interests.

The background to the question of the transference effects of technology was explained in Chapter Seven. Shihata's (1991) analysis confirms that FDI is a principal vehicle for the transfer of technology. Although the import of technology is not governed by specific regulations, the Industrial Law Decree No. 6 of 1965 does contain some regulatory detail in that it requires the screening of technology licence agreements. The MCI will approve and grant licences for technology imports if that technology can be shown to be beneficial to Kuwait in terms of the country's economic and social needs. Yet again, it must be stressed that the present strict regulatory requirements - including the condition of a 51 per cent ownership by a Kuwaiti national - will neither attract foreign investment nor ensure the effective local development of technology.

The particular importance of patent regulations has also been stressed in this analysis. Anderfelt (1972: 1) commented that "developing countries extend patent protection to foreigners not in order to get reciprocal benefits abroad but to encourage inflow of foreign technology". Since it was issued in 1962, the Patent Law, subsequently amended by Regulation No. 15 of 1965, has not come into force, leading to the conclusion that the patent system is based upon the registration of patents, thus preserving the patentee's right of priority to registration.[1] What is now needed is a serious examination of how patent law might be properly applied and possibly reformed in order to gain the greatest possible benefits from technological innovation. This requires a greater level of protection for foreign investors' patents.

In the past, emphasis in Kuwait has certainly been placed on the country's technology-intensive industries. This uneven implementation of the development strategy urgently needs

[1] Shihata (1990: 131) rightly argues that the bureaucracy leads to an increase in the number of bureaucrats and intermediaries rather than of investors, thus creating a platform for widespread corruption. Often, only the worst sorts of investor survive in such an environment, while serious investors may abandon their plans entirely.

to be reconsidered. In particular, attention should also be given to the desirability of a mix of measures which will achieve efficiency gains. Kuwait's technology objectives require identification and clarification, and the fundamental principles behind the technology acquisition process must be made explicit so that its overall objectives can be better understood. It has become increasingly apparent that existing legislation fails to grasp the main purpose of technology transfer, which is to develop and enhance *local* capabilities. This lack of understanding is manifested in the procedures for technology acquisition. Therefore, the law, as it currently stands, cannot be used to encourage the adaptation of foreign technology.

It is therefore proposed that a law should be enacted which will have the specific purpose of regulating the process of technology transfer. In this way, steps can be taken to ensure that the most sought-after socio-economic development is achieved. Ensuring the protection of foreign investors' patents through guarantees and inducements would be an effective means of ensuring speedy development. Unfortunately, the current patent law does nothing to attract FDI and no specific law protects trade marks in Kuwait. Articles 68 to 92 of the CCL of 1961 contain the provisions and statutory rules governing trade marks and these 1961 regulations are still in force, with a few amendments having been introduced in 1980. It is therefore suggested that rules governing the protection of trade marks should be reviewed, developed and updated to conform to modern developments. Such a step would help to attract FDI, and thus encourage the transfer of appropriate modern technology to Kuwait. When modernising the trade mark law, the legal framework must ensure the protection of ownership rights during technology transfers. This will serve to encourage foreign investors to sell, license or transfer their know-how and skills into the country.[1] Currently, Kuwait's need for FDI and technology is greater than in any other period of the country's history. Therefore, Kuwait should become a party to various international agreements on trade marks, such as the Paris Agreement of 1886 and the Madrid Agreement of 1891.

[1] See Chapter Seven for more detail about technology transfer, patents, trademarks, the Offset Programme and manpower in Kuwait.

The issue of employment rules and regulations must also be examined very carefully. Existing requirements stipulate that any national company wishing to employ an expatriate must prove that it cannot find a Kuwaiti with the necessary skills to fill the vacant position. It is also stipulated that not less than 25 per cent of an establishment's workforce must be Kuwaiti. An exception may be made by the Minister of Trade and Industry if it can be proved that there are insufficient Kuwaitis available to fulfil the 25 per cent requirement (Article 21, Law of Industry, 1965). Article 8 of the Law of Industry stipulates that the post of manager shall be filled by a Kuwaiti, but it does not specify how other key staff posts or executive managerial positions are to be distributed between expatriates and Kuwaitis. However, it is clear that these laws have not achieved their principal objective, which is to recruit more Kuwaitis into the workforce. Currently, the private sector workforce is made up of only 2 per cent Kuwaitis and 98 per cent expatriates. The author agrees with Al-Moussa's (1992: 148) statement that: "There is no law specifying the number of personnel who may be recruited from non-Kuwaiti sources by each company or corporation, depending on the nature of the work to be done. This lack of precision has led, in turn, to the recruitment of large numbers of people having nothing to do with the work required, and thus becoming what may be called a liability on society."

Discussion of the tax system provisions in Chapter Eight highlighted the need for their comprehensive amendment. The tax base should be widened so that enough wealth can be created to fund Kuwait's development plans. The present tax laws are discriminatory in that Kuwaiti profits are not taxed whereas foreign investors' profits are.

This cannot possibly encourage foreign investment, and is indeed likely to act as a deterrent. Dr Eid (1994: 282) suggests that the legal formulation of the Income Tax Decree should be clarified. He points out that problems were caused because the laws were originally written in English and then inaccurately translated into Arabic. If one considers the terminology used in the laws and compares this to terminology currently recognised in public finance, Eid's arguments seem to be convincing. Wael Al-Rashed (1991: 84) also expresses the view that

"Kuwait tax legislation cannot cope with modern development requirements, particularly in the area of tax incentives."

The question of whether Law No. 3 of 1955 should be amended or modified rather than completely reformulated has been answered by Hosny Al-Masri (1995). He is of the opinion that the wording of the Law should be made much clearer and more precise, and that the present text is not a strictly accurate translation from English into Arabic. The Director of the Income Tax Department has in fact issued many interpretations of the text in an effort to clarify relevant provisions of the law. This indicates that Kuwait now needs a clear and integrated law as a matter of urgency. (Hosny Al-Masry, in an interview with the author on 7 January 1995.)

In Kuwait, tax is levied according to the bands of a progressive tax system. However, a relic still in existence from a previous era is that the tax rate is determined in Indian rupees and not in the national currency. This is obviously an untenable and unhelpful situation (Al-Najjar 1982: 295). Furthermore, the principle of tax bands is unclear[1] and an explanatory memorandum is not attached. A set of up-to-date guidelines would be useful (Al Rashed 1992: 68-84). Kuwaiti tax law is not described in detail anywhere, and there is no clear statement as to how tax is levied. It is not surprising that many disputes have arisen concerning the application of the tax law.

It is true that some amendments and ministerial orders have been applied to the Act to eliminate obvious loopholes, but this has not stopped many individuals and organisations from commenting on the continuing inadequacy of the law (Al Rashed 1992: 84). It is clear that the tax law should be revised to accommodate modern international developments and to assist in attracting foreign investment (Ali Al-Hakim, in an interview conducted by the author on 7 January 1995).

As discussed in Chapter Eight, existing Kuwaiti tax legislation is incapable of meeting modern development requirements, and its poor incentives have also failed to contribute to the promotion of local industry. For example, the major incentive for an investor, with or

[1] The tax rate has been determined on the basis of bands in a progressive tax system. However, it must be stressed that the tax rate is determined in Indian rupees, a position which, although probably justifiable in 1955, is now untenable. The rate should be fixed in the national currency (El-Najjar 1982: 295).

without a foreign partner, to set up a manufacturing enterprise in Kuwait is the offer of a ten-year exemption from tax. This exemption, however, was not contained in the Income Tax Decree (ITD) and had to be granted under the provision of the Industry Act of 1965. The ITD is not well structured, has no logical order of subjects, and does not effectively encourage foreign investment.

Al Rashed (1992: 89) emphasises that the ITD should describe clearly all items which are taxable and indicate the criteria for the measurement of taxable income. It should stipulate the exemptions, and clarify the methods of tax collection and legal disputes. Al Muzaini (1984: 196-202) suggests that subsequent tax laws should take the form of amendments or appendices to the Decree rather than new Decrees, and that the time has come to replace the forty year-old ITD with a new, flawless tax law. This opinion was supported by Mr Shafiq Hassan: "The Kuwaiti tax law has been in force since 1955. Technically it is a very backward, undeveloped law. Far from being clear in its provisions, its application is also difficult" (interview with Mr.Shafiq Hassan conducted by the author on 6 January 1995).

The foreign investment income-tax regime should offer tax incentives to those industrial sectors targeted for growth, exports and development: that is, manufacturing, energy, transportation and agriculture. It should also ensure equality between Kuwaiti and foreign investors. As previously stated, no single law presently exists which regulates foreign investment in Kuwait. The set of laws containing provisions governing investment are inadequate, which is possibly why Kuwait concludes bilateral investment agreements to provide foreign investors with guarantees not incorporated in Kuwait's domestic laws.[1] The main needs have been summed up by Ali Al-Hakim, the Director of the Legal Department and also Legal Advisor to the General Investment Authority:

> There is no special law encouraging foreign investment. The rules regulating foreign investment are scattered here and there in the Kuwaiti laws. In order that the foreign investor may easily invest in Kuwait, there should be a single frame of reference for the companies instead of the many procedures which we have at present. Kuwait's entry as a partner in numerous bilateral and multi-lateral agreements gives, however, great reassurance to the investor. (Interview conducted on 6 January 1995)

[1] See Chapter Eight.

The bilateral and multilateral investment treaties discussed in Chapter Nine are followed - where applicable - in the absence of specific laws governing the treatment of foreign investment. Although the incentives contained in these treaties can help to promote foreign investment, they are not comprehensive. The Government's policy towards FDI needs to be revitalised to include a greater range of incentives, and Kuwait should enter into more detailed treaties.[1] The key test is whether the regulations which are adopted actually achieve the stated objectives.

An important consideration when creating an attractive environment for foreign investment is the procedure for settling disputes. In Kuwait, the settlement of disputes suffers from the shortcomings associated with arbitration.[2] As indicated in Chapter Ten, arbitration is regulated by sixteen clauses, Articles 173 to 188 (Chapter 12 of the Second Codex) of the Procedural Law. Since the Procedural Law contains a total of 304 Articles, it is obvious that the treatment of arbitration cannot be adequate. In general, the system of arbitration appears to work well in practice, but foreigners tend not to like it. The present regulations are not clear and straightforward, and their application is not easy. Therefore, the author proposes that a new, independent law should be passed to furnish easier and more effective procedures which take into account modern conditions. Ms Badriyya Al-Awady, a former Dean of the Faculty of Law of Kuwait University and an experienced arbitrator, supports this view:

> There should be an independent law of arbitration. This is all the more necessary as it was covered only by sixteen articles of the Kuwaiti Commercial and Civil Procedural law. These Articles, far from being an integrated arbitration law, are evidently incomplete and full of gaps. Therefore, there should be a separate and independent law of arbitration in the light of which procedures relating to arbitration should be organised. (Interview conducted by the author on 7 September 1995.)

Two major advantages would result from a reform of Kuwait's arbitration system: First, it would encourage investor confidence; and secondly, considering the Government's preference for local as opposed to international arbitration, it would benefit local reforms. The Council of Ministers' Resolution No. 11 of 22 March 1988 states that there should be no

[1] See Chapter Eight for more discussion on bilateral and multi-lateral treaties.
[2] This point has already been discussed in greater detail in Chapter Ten, Section 10.3.

stipulation of international arbitration in any contracts between Kuwaitis and foreign nationals, confirming the view that Kuwait has little confidence in international arbitration. However, it is precisely this type of negative attitude towards international arbitration which discourages foreign investment into Kuwait. An argument put forward by Abdl-Rida (1994: 4), the Director of the Fatwa and Legislation Department, is that the Civil Procedures Law No. 6 of 1960 did not accommodate international arbitration at all. The same applies to the new Law No. 38 of 1980. It provides for domestic arbitration only, leaving any foreign arbitration disputes to be dealt with under multilateral or bilateral agreements between Kuwait and foreign entities.

A question which requires an answer is whether the current Kuwaiti system of arbitration actually boosts foreign investor confidence and whether it is able to induce them to pursue domestic arbitration. In this thesis it has been found that both domestic and international arbitration procedures in Kuwait do provide sufficient guarantees to foreign investors. However, it is now time for Kuwaiti legislation on arbitration to be brought into line with modern conditions so that it can facilitate commercial transactions. Existing rules and procedures should therefore be amended to create a favourable climate for the settlement of disputes which, in turn, will have a positive effect on inward investment.

It can be seen, then, that FDI regulations play a crucial role in social, political and economic development, and, more specifically, law can help enormously to attract the right kinds of foreign investment into Kuwait. However, as we have seen, existing law fails to attract the necessary FDI because the Kuwaiti Government's policy of near-absolute control of FDI is not conducive to the right kind of positive investment climate. In Kuwait there is an excess of administrative procedures, policy statements and local rules which are not legally binding. This is indicative of a a failure of the law as an instrument for overcoming the erratic nature of policy-making. and its inability to ensure uniform treatment under Kuwait's foreign investment legal regime.

Kuwait's only viable option is to adopt an evolutionary process to accommodate structural changes, i.e. to be a source of structural adjustment and to have an impact on the process of development. Thus, any emerging reforms will have to be flexible enough to

allow further adjustment where necessary. This thesis has advanced some specific suggestions of what changes are needed in Kuwait's FDI regime, and how those changes can be implemented. These concrete proposals will be summarised in the next section.

11.4 CONCRETE PROPOSALS REGARDING THE REVISION OF KUWAIT'S INVESTMENT REGIME

Kuwait now has to move into a new phase of development for which the most important requirements are the training and improvement of manpower, technology transfer, and diversification of the economy leading to industrialisation. These goals can only be achieved by modifying the laws and procedures governing foreign direct investment (FDI) in the direction of greater liberalisation.

With this goal in mind, Kuwait needs an evolutionary strategy which will specify the role of FDI in the industrial sector, in manpower development, in the transfer of developed technology, and in the future general development of the country's economy. In other words, Kuwait should devise a strategy which successfuly incorporates FDI as an effective vehicle for the diversification of the country's productive infrastructure. The priority must be to make Kuwait a more attractive location for foreign investment.

Hitherto the Kuwaiti Government has failed to formulate a comprehensive strategy on FDI, and it is imperative that the key objectives are defined before legislation is drawn up. Al Shamlan (1985: 85-86) has commented on this lack of strategy:

> A widely held opinion of most Kuwaitis who are directly involved, both in the public and private sectors, is that there is no clearly defined industrial policy, and there is no consensus that one is needed. Indeed, Kuwait lacks a long-term industrial strategy, plans, policies and objectives of industrialisation. However, this does not mean that no formal or informal studies, researches or attempts to investigate the future of industrialisation in Kuwait have not been carried out. On the contrary, there are many of them, but none has been officially adopted.

This negative impression was confirmed when, in May and June 1992, the UN Industrial Development team visited Kuwait and subsequently stated that they had identified serious restrictions hampering industrialisation, in particular the absence of a well-defined industrial policy and the lack of overall economic planning and a sound strategy for the industrial sector

(Al-Mejrin 1993: 54-55). Such a strategy must be based on the need for competititon in the private sector amongst both local and foreign investors.

The laws which are of greatest concern to foreign investors are those governing investment entry, trade and industrial policy, taxation and foreign exchange, nationalisation and expropriation, and the settlement of disputes. The laws which govern FDI and the relevant policies must be simplified, clarified and made transparent in order to attract overseas investment. With this objective in mind, discrimination between local and foreign investors should also be eradicated.

The relevant new laws should be formulated in line with the recognised objectives of development, thus encouraging investment in those particular sectors which will strengthen the national economy. In order to do this, the new laws must be developed according to the policy of removing obstacles to development. However, as already stressed, existing regulations are not found in a single statute but are scattered in different legal sources. The present author, therefore, strongly recommends that Kuwait should have one single law regulating all aspects of foreign investment which could be entitled the Kuwaiti Foreign Investment Law (KFIL). This law should include provisions which regulate administration and registration procedures, incentives, intellectual property, the Offset Programme, contracts for the importation of technology, foreign exchange transactions, taxation, export processing zones, and guarantees. The key question here is that of how the KFIL should be adapted to suit Kuwait's development needs? The answers suggested in this thesis are that the law should be liberalised, with an open-door policy towards foreign investment, and directed towards making FDI fully beneficial to Kuwait.

No doubt, the law should attempt to combine the various means of attracting foreign investment but should simultaneously protect the national interest. To achieve this, foreign capital should be channelled into those specific areas which are most likely to enhance Kuwait's socio-economic development. Thus, the KFIL should segregate the investment sectors to make clear which sectors are open or closed to foreign investors. This would enable investors to know beforehand if their intended project is likely to be acceptable or not. It

would also help to demonstrate that Kuwait has a clear and well-defined policy regarding FDI, which in turn would be a positive and reassuring indication to potential investors.

The KFIL should regulate the process of technology transfer in such a way as to direct it into areas where it is most needed. Priority should be given to those foreign enterprises which will transfer the latest and most advanced technology. Included in this requirement should be assurances that the foreign investor will take steps to facilitate the acquisition of technology (and associated skills) by Kuwaitis. In the words of Al Ali (1986: 44), "appropriate types of technology are required to further the employment of local skills, as well as encourage the development of local capabilities".

By providing foreign investors with adequate guarantees and inducements to protect their patents, Kuwait's development can be accelerated. Therefore, the KFIL-governed patent system should include details of the standards required under the Trade Related Intellectual Property Rights (TRIPS). For example, developing countries are now obliged to grant product patents for pharmaceutical products as well as process (Article 17 of TRIPS). The patent system should endeavour to facilitate the transfer and adaptation of technology, and to encourage the development of technologies suited to the needs of the local areas in question. When designing provisions for the protection of trade marks, the KFIL should conform to current international trends, thereby constructing a framework which will attract those foreign investments which the country needs, together with a concomitant transfer of technology.

The Offset Programme should be regulated in such a way that reinvestment by foreign companies stimulates the participation of the private sector and ensures the diversification of income and development of industrial technology in Kuwait. Foreign companies within this programme should be given a list of projects in the general area of industrial investment in which they can participate. These projects should clearly allow for the transfer of technology and the development of manpower resources.

The KFIL should stipulate, as a legal requirement, that foreign investment projects must assist in the training of technical and managerial Kuwaiti staff and that Kuwaitis should be used in positions which will increase their skills and abilities.

To ensure the success of the Free Economic Zones (FEZs) in Kuwait, the FEZs should be designed so as to attract foreign investment into particular spheres to develop the country's industrial, administrative and financial infrastructure and expertise.

In the area of taxation, exemption from tax for a period of three years should be offered to corporations which satisfy the following conditions: (a) they import technology into Kuwait; (b) they employ Kuwaitis as 40 per cent or more of their workforce; and (c) they export at least 50 per cent of their production abroad. After three years, they may receive another three-year period of tax exemption if the number of Kuwaitis employed rises to 60 per cent of the total, or if the company's exports increase to 70 per cent of production. The initial tax holiday period may be extended if local component machinery and equipment constitutes at least 60 per cent of the total, and if the percentage of local staff participation and contribution to research and development exceeds 40 per cent. Tax incentives offered to foreign investors should be on the basis of modern technology imports, the training of labour and the export of industrial products. It is important to note that tax incentives and Kuwait's need for industrial development are closely linked.

The KFIL should guarantee that there will be minimum interference with private property, particularly through nationalisation or expropriation, except in those individual cases which have a special and demonstrable significance for relavant public purposes. In such cases, the expropriation must carry with it appropriate compensation and be undertaken in accordance with the law.

All incentives and support should be linked to the policy of employing the local workforce, who should have access to training programmes to improve their ability and increase their efficiency.

11.4.1 The Functions of a "One-stop" Agency

As well as adopting a new KFIL, as described above, Kuwait should also institute a central investment authority with powers to apply a coherent strategy to foreign investment: an independent "one-stop" agency operating with its own regulations. This agency should be well structured and run like a private market institution, thus enabling it to provide logical

and efficient solutions. It has been suggested in this thesis that the agency should incorporate four distinct units, each with its own clearly delineated role:

The first unit is the Approval Unit, which will deal with the granting of licences to industrial projects. This unit should serve as the sole agency with which the foreign investor deals regarding the procedures of the project, i.e. from its inception through to the post-operational stage.[1]

The second unit is the Information Unit, which will deal with the collection of industry-related information and data in order to provide prospective investors and Government agencies with all the necessary help. This unit will also handle the production of booklets and pamphlets giving details of investment prospects and regulations, and of the procedures for starting businesses and for promoting investments.

The role of the third unit, the Follow-Up Unit, will be restricted to rendering assistance towards the implementation and operation of the investor's business once a licence has been granted. Feedback obtained from projects will be useful to the agency, foreign investors, and the Kuwaiti Government who can refer to it when deciding future policies regarding foreign investment.

The final unit is the one-stop agency, the Industrial Sector Research Unit will be concerned with research on the industrial sector, and particularly with the identification of priority investment areas. The information gained from surveys conducted by this Unit will be invaluable.

It is also suggested that Kuwaiti embassies abroad should have an office of the one-stop agency attached to them so that a prospective foreign investor can obtain the information needed to ascertain the feasibility of a proposed project.

11.4.2 Kuwaiti International Centre for the Settlement of Disputes (KICSD)

The legislation covering the settlement of investment disputes should be carefully considered if a "foreign investor-friendly" environment is to be created. The present Kuwaiti legislation

[1] More details about this unit can be found in Chapter Eight.

regulating local arbitration is set out in the Commercial and Civil Procedures Law.[1] It is vital for Kuwait to reform its procedures to keep pace with modern progress in the field of arbitration. This thesis has argued the case for new independent legislation covering the question of arbitration. This law should be based on the Model Law prepared by the UN Committee on International Trade and approved by the UN General Assembly in 1986. The provisions of the resultant law, to be known as the "Kuwaiti Model Law" (KML), should be fully integrated. Adherence (as far as possible) to international commercial arbitration rules and procedures would go a long way towards providing a more favourable climate for foreign investment in Kuwait.

It is therefore proposed that a Kuwaiti International Centre for the Settlement of Disputes (KICSD) should be established at the same time as the Kuwaiti Model Law (KML). The Centre will provide foreign investors with a special formal process for settling disputes, rather than having to resort to ordinary courts, and this should encourage investors to have more confidence, less apprehension, and an appreciation of the Kuwaiti Government's good faith and integrity. These factors all help to attract potential investors to Kuwait.

Another useful service which should be provided by this Centre is a Government-sponsored translation bureau offering translation services for a reasonable fee, mainly for the translation of the required documents, including contracts and the texts of legal proceedings from and into Arabic.

Special Chambers for arbitration should be established within this Centre to create a congenial environment rather than the usual threatening and awe-inspiring one aassociated with judicial proceedings. The aim should always be to find amicable solutions which are acceptable to both parties to a dispute.

It is also proposed that the process of solving differences would be made easier if the Centre had committees representing those establishments, corporations and ministries which are empowered to reach agreements and conclude contracts with foreign investors. The basic purpose of these committees would be to solve differences as they arise rather than to tackle

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[1] See Chapter Nine.

an accumulation of problems. The Centre should continually consult other regional and international centres in order to benefit from their experience and expertise.

Finally, the adoption of model arbitration clauses will provide clarity and simplification in setting disputes. By providing quick, remedial services for foreign investors who do not favour ordinary litigation, the Centre will be able to offer powerful incentives for the efficient promotion of foreign investment.

11.5 RESEARCH OUTCOMES

The research undertaken for this thesis has led to an in-depth analysis of the weaknesses and inadequacies of existing Kuwaiti laws for foreign direct investment, and it has also resulted in the formulation of clear, specific proposals for future reform. The emphasis throughout has been on the need for a new Government policy based on well-defined goals which match the need successfully to attract foreign direct investment in Kuwait. The whole orientation of this research has been to link analysis to policy recommendations.

It has to be emphasised, in reviewing the final outcomes of the research, that Kuwaiti law by itself cannot succeed in attracting foreign investment unless an appropriate investment climate has also been created. It can be clearly demonstrated that the laws which have hitherto regulated foreign direct investment in Kuwait have failed to produce significant results. This thesis has clearly identified the main reasons for this failure. The general problem is that Kuwaiti laws are now out-dated, particularly the CCL and ITD laws, and have not kept pace with modern investment requirements in an age of increasing globalisation. The current foreign-investment climate in Kuwait is hardly an attractive one because there is no sound Government strategy designed for foreign investment as part of the country's programme of five-year plans. Thus the laws promulgated by the Kuwaiti legislature act as mere dummy instruments, whereas they really ought to be dynamic and effective tools for giving concrete expression to the national interests of the country.

The developmental problems confronting Kuwait since the country's independence have remained almost impossible to solve in the absence of growing and diverse foreign investment. This is why this thesis has advanced the strongest possible case for Kuwait to

change its investment laws and associated procedures and structures of administration. It is worth remembering that initially it was foreign investment in Kuwait which was responsible for the development of oil extraction and prospecting, for training manpower in this sector and for providing the kind of technology required for the oil industry. The significance of this lesson now needs to be applied to the growth of other major sectors of the Kuwaiti economy.

Since Kuwait's basic policy orientation has rejected the "open-door" model of foreign investment incentives, it seems clear that this orientation must now be reconsidered. This in turn means abandoning Kuwait's traditional acceptance of the theory of "dependency" which has looked upon foreign investment as detrimental to socio-economic development. This thesis has suggested that an alternative theoretical model - that of structural adjustment - should now be adopted and applied. It is argued that this will help greatly to establish a more positive foundation for the future growth and development of the economy.

Within the framework of structural adjustment applied to the Kuwaiti economy, technology inputs will involve the modernisation of the industrial sector, the improvement of import and export performance, and the training of skilled labour locally. This can be achieved only if the Government succeeds in overcoming the many serious impediments that are currently hampering foreign investment and which have been scrutinised in some detail in this thesis. In particular, this suggests an urgent need to improve the whole FDI climate and to change Government policy towards the essential goals of development. The emphasis of development policy in future must not just be on economic growth, but also on the quality of human and socio-economic relations all over the country. The primary findings or conclusions of this study can be extended to cover a large number of issues related to the role of foreign investment in the pursuit of Kuwaiti developmental goals.

The main recommendations outlined in this thesis cover both changes in the laws regulating foreign investment and in the structures and procedures for dealing with potential and actual foreign investors at all stages of the decision-making processes. At the present time there is clearly a need to give special attention to the needs of foreign investors, but eventually - when the desired level of development has been reached - there should in principle be no need, or at least a much reduced need, to discriminate in terms of laws and regulations

between foreign and Kuwaiti investors. In due course the State should adopt one integrated policy for both categories of investors, and should have one body of law to organise the investment process so that problems of entrepreneurship, competition, stability and so on can be settled effectively and efficiently in a healthy environment devoid of excessive regulations.

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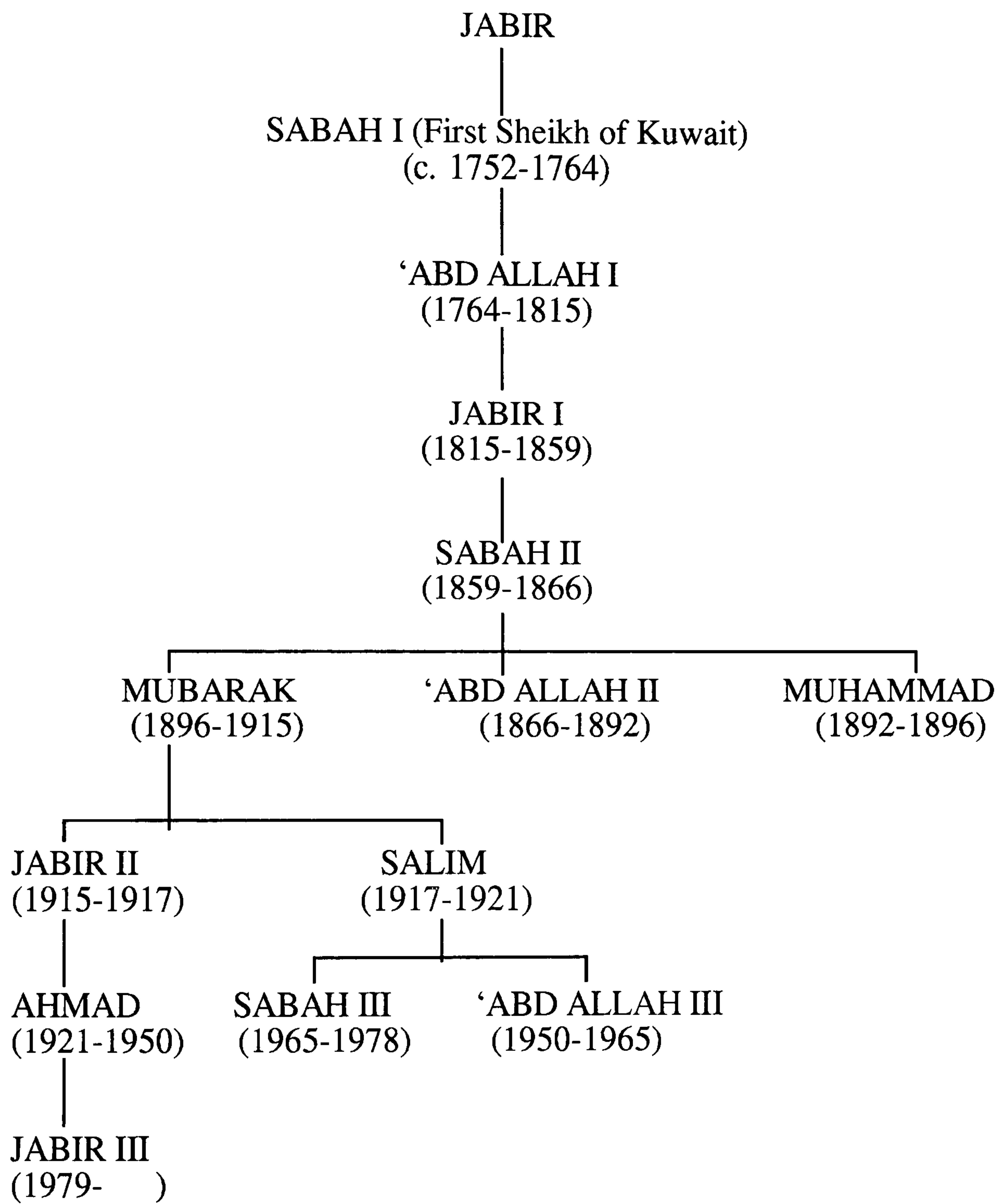
APPENDICES

APPENDICES

APPENDIX NO. I

AL-SABAH RULERS OF KUWAIT



APPENDIX NO. II

THE AGREEMENT DATED 23RD JANUARY 1899 BETWEEN THE SHEIKH OF KUWAIT (SHEIKH MUBARAK) AND THE BRITISH GOVERNMENT

(Translation)
Praise be to God alone (lit. in the name of God Almighty)
('Bissim Illah Ta'alah Shanuho')

The object of writing this lawful and honourable bond is, that it is hereby covenanted and agreed between Lieutenant-Colonel Malcolm John Meade, I.S.C., Her Britannic Majesty's Political Resident, on behalf of the British Government, on the one part, and Shaikh Mubarak-bin-Subah, of his own free will and desire, does hereby pledge and bind himself, his heirs and successors, not to receive the agent or representative of any Power of Government at Kuwait, or at any other place within the limits of his territory, without the previous sanction of the British Government; and he further binds himself, his heirs and successors, not to cede, sell, lease, mortgage, or give for occupation or for any other purpose, any portion of his territory to the Government or subjects of any other power without previous consent of Her Majesty's Government for these purposes. This engagement also to extend to any portion of the territory of the said Shaikh Mubarak which may now be in the possession of the subjects of any other Government.

In token of the conclusion of this lawful and honourable bond, Lieutenant-Colonel Malcolm John Meade, I.S.C., Her Britannic Majesty's Resident in the Persian Gulf, and Shaik Mubarak-bin-Shaikh Subah, the former on behalf of the British Government, and the latter on behalf of himself, his heirs and successors, do each, in the presence of witnesses, affix their signatures, on this the 10th day of Ramazan, 1316, corresponding with the 23rd day of January 1899.

(sd/-) M.J. Meade, Lieut-Col.
Political Resident in the Persian Gulf.
(L.S.) (sd/-) Mubarak-Al-Subah.

Witnesses:
sd/- E. Wickham Hore, Captain, I.M.S.
sd/- J. Calcott Gaskin.

(L.S. Muhammad Rahim-bin-Abdul Nebi Saffer.
(sd.) Curzon of Kedleston.
Viceroy and Governor-General of India.

Ratified by His Excellency the Viceroy and Governor-General of India at Fort William on the 16th day of February 1899.

(sd.) W.J. Cunningham,
Secretary to the Government of India
in the Foreign Department.

(SEAL)

APPENDIX NO. III

EXCHANGE OF NOTES:
GREAT BRITAIN AND KUWAIT

No. 5743
UNITED KINGDOM OF GREAT BRITAIN AND
NORTHERN IRELAND AND KUWAIT

EXCHANGE OF NOTES CONSTITUTING AN AGREEMENT[1]
REGARDING RELATIONS BETWEEN THE
UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND
AND THE STATE OF KUWAIT.
KUWAIT, 19 JUNE 1961

Official texts; English and Arabic,
Registered by the United Kingdom of Great Britain and Northern Ireland on 6 July 1961.

Kuwait, the 19th of June, 1961
Your Highness,

I have the honour to refer to the discussions which have recently taken place between Your Highness and my predecessor on behalf of Her Majesty's Government in the United Kingdom about the desirability of adapting the relationship of the United Kingdom of Great Britain and Northern Ireland and the State of Kuwait to take account of the fact that Your Highness' Government has the sole responsibility for the conduct of Kuwait's internal and external affairs.

The following conclusions were reached in the course of these discussions:

(a) The Agreement of the 23rd of January 1899, shall be terminated as being inconsistent with the sovereignty and independence of Kuwait.
(b) The relations between the two countries shall continue to be governed by a spirit of close friendship.
(c) When appropriate the two Governments shall consult together on matters which concern them both.
(d) Nothing in these conclusions shall affect the readiness of Her Majesty's Government to assist the Government of Kuwait if the latter request such assistance.

If the foregoing correctly represents the conclusions reached between Your Highness and Sir George Middleton I have the honour to suggest, on the instructions of Her Majesty's Principal Secretary of State for Foreign Affairs, that the present Note together with Your Highness' reply to that effect shall be regarded as constituting an Agreement between the United Kingdom and Kuwait in this matter which shall continue in force until either party gives the other at least three years' notice of their intention to terminate it, and that the Agreement of the 23rd of January, 1989, shall be regarded as terminated on this day's date.

I have the honour to be, with the highest consideration,
Your Highness' obedient servant,
(*Signed*) W.H. Luce
H.M. Political Resident

(Translation[2])

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[1] Came into force on 19 June 1961 by the exchange of the said notes.
[2] Translation by the Government of the United Kingdom.

KUWAIT
His Excellency Her Britannic Majesty's Political Resident in the Persian Gulf.

Greetings,
I have the honour to refer to Your Excellency's Note of today's date which reads as follows: [*See above*]

I confirm that Your Excellency's Note correctly represents the conclusions reached by myself and Sir George Middleton and I agree that Your Excellency's Note and my reply shall be regarded as constituting an Agreement between Kuwait and the United Kingdom in this matter.

With best regards,
(*Signed*) Abdullah as-Salim AS SABAH
The 19th of June, 1961

APPENDIX NO. IV

THE CONSTITUENT ASSEMBLY

THE CONSTITUTION OF
THE STATE OF KUWAIT

In the name of Allah, the Beneficent, the Merciful.
We, ABDULLAH al-SALIM al-SABAH
AMIR of the State of Kuwait,

Being desirous of consummating the means of democratic rule for our dear Country; and,
Having faith in the role of this Country in the furtherance of Arab nationalism and the promotion of world peace and human civilisation; and
Striving towards a better future in which the Country enjoys greater prosperity and higher international standing, and in which also the citizens are provided with more political freedom, equality and social justice; a future which upholds the traditions inherent in the Arab nature by enhancing the dignity of the individual, safeguarding public interest and applying consultative rule yet maintaining the unity and stability of the Country; and,
Having considered Law Number I of 1962 concerning the system of Government during the period of transition; and,
Upon the resolution of the Constituent Assembly;
Do hereby approve this Constitution and promulgate it.

PART I
THE STATE AND THE SYSTEM OF GOVERNMENT

Article 1

Kuwait is an Arab State, independent and fully sovereign. Neither its sovereignty nor any part of its territory may be relinquished.
The people of Kuwait are a part of the Arab Nation.

Article 2

The religion of the State is Islam, and the Islamic Sharia shall be a main source of legislation.

Article 3

The official language of the State is Arabic.

Article 4

Kuwait is a hereditary Amirate, the succession to which shall be in the descendants of the late Mubarak al-Sabah.
The Heir Apparent shall be designated within one year, at the latest, from the date of accession of the Amir.
His designation shall be effected by an Amiri Order upon the nomination of the Amir and the approval of the National Assembly which shall be signified by a majority vote of its members in a special sitting.
In case no designation is achieved in accordance with the foregoing procedure, the Amir shall nominate at least three of the descendants of the late Mubarak al-Sabah of whom the National Assembly shall pledge allegiance to one as Heir Apparent.
The Heir Apparent shall have attained his majority, be of sound mind and a legitimate son of Muslim parents.

A special law promulgated within one year from the date of coming into force of this Constitution shall lay down the other rules of succession in the Amirate. The said law shall be of a constitutional nature and therefore shall be capable of amendment only by the procedure prescribed for amendment of the Constitution.

Article 5

The flag, emblem, badges, decorations and National Anthem of the State shall be specified by law.

Article 6

The System of Government in Kuwait shall be democratic, under which sovereignty resides in the people, the source of all powers. Sovereignty shall be exercised in the manner specified in this Constitution.

PART II
FUNDAMENTAL CONSTITUENTS OF THE KUWAITI SOCIETY

Article 7

Justice, Liberty and Equality are the pillars of Society; co-operation and mutual help are the firmest bonds between citizens.

Article 8

The State safeguards the pillars of Society and ensures security, tranquillity and equal opportunities for citizens.

Article 9

The family is the corner-stone of Society. It is founded on religion, morality and patriotism. Law shall preserve the integrity of the family, strengthen its ties and protect under its auspices motherhood and childhood.

Article 10

The State cares for the young and protects them from exploitation and from moral, physical and spiritual neglect.

Article 11

The State ensures aid for citizens in old age, sickness or inability to work. It also provides them with services of social security, social aid and medical care.

Article 12

The State safeguards the heritage of Islam and of the Arabs and contributes to the furtherance of human civilisation.

Article 13

Education is a fundamental requisite for the progress of society, assured and promoted by the State.

Article 14

The State shall promote science, letters and the arts and encourage scientific research therein.

Article 15

The State cares for public health and for means of prevention and treatment of diseases and epidemics.

Article 16

Property, capital and work are fundamental constituents of the social structure of the State and of the national wealth. They are all individual rights with a social function as regulated by law.

Article 17

Public property is inviolable and its protection is the duty of every citizen .

Article 17

Private property is inviolable. No one shall be prevented from disposing of his property except within the limits of law. No property shall be expropriated except for the public benefit in the circumstances and manner specified by law, and on condition that just compensation is paid.

Inheritance is a right governed by the Islamic Sharia.

Article 19

General confiscation of the property of any person shall be prohibited. Confiscation of particular property as a penalty may not be inflicted except by a court judgment in the circumstances specified by law.

Article 20

The national economy shall be based on social justice. It is founded on fair co-operation between public and private activities. Its aim shall be economic development, increase of productivity, improvement of the standard of living and achievement of prosperity for citizens, all within the limits of law.

Article 21

Natural resources and all revenues therefrom are the property of the State. It shall ensure their preservation and proper exploitation due regard being given to the requirements of State security and the national economy.

Article 22

Relations between employers and employees and between landlords and tenants shall be regulated by law on economic principles, due regard being given to the rules of social justice.

Article 23

The State shall encourage both co-operative activities and savings, and supervise the system of credit.

Article 24

Social justice shall be the basis of taxes and public imposts.

Article 25

The State shall ensure the solidarity of society in shouldering burdens resulting from public disasters and calamities and provide compensation for war damages or injuries received by any person as a result of the discharge of his military duties.

Article 26

Public office is a national service entrusted to those who hold it. Public officials, in the exercise of their duties, shall aim at the public interest.

Aliens may not hold public offices except in the cases specified by law.

PART III
PUBLIC RIGHTS AND DUTIES

Article 27

Kuwaiti nationality shall be defined by law. No deprivation or withdrawal of nationality may be effected except within the limits prescribed by law.

Article 28

No Kuwaiti may be deported from Kuwait or prevented from returning thereto.

Article 29

All people are equal in human dignity, and in public rights and duties before the law, without distinction as to race, origin, language or religion.

Article 30

Personal liberty is guaranteed.

Article 31

No person shall be arrested, detained, searched or compelled to reside in a specified place, nor shall the residence of any person or his liberty to choose his place of residence or his liberty of movement be restricted, except in accordance with the provisions of law.

No person shall be subjected to torture or to degrading treatment.

Article 32

No crime and no penalty may be established except by virtue of law, and no penalty may be imposed except for offences committed after the relevant law has come into force.

Article 33

Penalty is personal.

Article 34

An accused person is presumed innocent until proved guilty in a legal trial at which the necessary guarantees for the exercise of the right of defence are secured.

The infliction of physical or moral injury on an accused person is prohibited;

Article 35

Freedom of belief is absolute. The State protects the freedom of practising religion in accordance with established customs, provided that it does not conflict with public policy or morals.

Article 36

Freedom of opinion and of scientific research shall be guaranteed. Every person shall have the right to express and propagate his opinion verbally, in writing or otherwise, in accordance with the conditions and procedures specified by law.

Article 37

Freedom of the press, printing and publishing shall be guaranteed in accordance with the conditions and manner specified by law.

Article 38

Places of residence shall be inviolable. They may not be entered without the permission of their occupants except in the circumstances and manner specified by law.

Article 39

Freedom of communication by post, telegraph and telephone and the secrecy thereof shall be guaranteed; accordingly, censorship of communications and disclosure of their contents shall not be permitted except in the circumstances and manner specified by law.

Article 40

Education is a right for Kuwaitis, guaranteed by the State in accordance with law and within the limits of public policy and morals. Education in its preliminary stages shall be compulsory and free in accordance with law.

Law shall lay down the necessary plan to eliminate illiteracy.

The State shall devote particular care to the physical, moral and mental development of youth.

Article 41

Every Kuwaiti has the right to work and to choose the type of his work.

Work is a duty of every citizen necessitated by personal dignity and public good. The State shall endeavour to make it available to citizens and to make its terms equitable.

Article 42

There shall be no forced labour except in the cases specified by law for national emergency and with just remuneration.

Article 43

Freedom to form associations and unions on a national basis and by peaceful means shall be guaranteed in accordance with the conditions and manner specified by law. No one may be compelled to join any association or union.

Article 44

Individuals shall have the right of private assembly without permission or prior notification, and the police may not attend such private meetings.

Public meetings, processions and gatherings shall be permitted in accordance with the conditions and manner specified by law, provided that their purpose and means are peaceful and not contrary to morals

Article 45

Every individual shall have the right to address the public authorities in writing over his signature. Only duly constituted organisations and bodies corporate shall have the right to address the authorities collectively.

Article 46

Extradition of political refugees is prohibited.

Article 47

National defence is a sacred duty, and military service is an honour for citizens which shall be regulated by law.

Article 48

Payment of taxes and public imposts is a duty in accordance with law which shall regulate exemption of small incomes from taxes in such a way as to maintain the minimum standard of living.

Article 49

Observance of public order and respect for public morals are a duty incumbent upon all inhabitants of Kuwait.

PART IV
POWERS
Chapter I – General Provisions

Article 50

The system of Government is based on the principle of separation powers functioning in co-operation with each other in accordance with the provisions of the Constitution. None of these powers may relinquish all or part of its competence specified in this Constitution.

Article 51

Legislative power shall be vested in the Amir and the National Assembly in accordance with the Constitution.

Article 52

Executive power shall be vested in the Amir, the Cabinet and the Ministers, in the manner specified by the Constitution.

Article 53

Judicial power shall be vested in the Courts, which shall exercise it in the name of the Amir within the limits of the Constitution.

Chapter II – The Head of State

Article 54

The Amir is the head of the State. His person shall be immune and inviolable.

Article 55

The Amir shall exercise his powers through his Ministers.

Article 56

The Amir shall, after the traditional consultations, appoint the Prime Minister and relieve him of office. The Amir shall also appoint Ministers and relieve them of office upon the recommendation of the Prime Minister.

Ministers shall be appointed from amongst the members of the National Assembly and from others.

The number of Ministers in all shall not exceed one-third of the number of the members of the National Assembly.

Article 57

The Cabinet shall be re-constituted in the manner specified in the preceding Article at the beginning of every legislative term of the National Assembly.

Article 58

The Prime Minister and the Ministers shall be collectively responsible to the Amir for the general policy of the State. Every Minister shall also be individually responsible to the Amir for the affairs of his ministry.

Article 59

The Law referred to in Article 4 of this Constitution shall specify the conditions under which the Amir shall exercise his constitutional powers.

Article 60

Before assuming his powers the Amir shall take the following oath at a special sitting of the National Assembly:

> "I swear by Almighty God to respect the Constitution and the laws of the State, to defend the liberties, interests and properties of the people and to safeguard the independence and territorial integrity of the Country."

Article 61

In the event of his absence outside the Country and the inability of the Heir Apparent to act as Deputy for him, the Amir shall appoint, by an Amiri Order, a Deputy who shall exercise his powers during his absence. The said Amiri Order may include a specified arrangement for the exercise of the said powers on behalf of the Amir, or a limitation of their scope.

Article 62

The Amir's Deputy shall satisfy the qualifications laid down in Article 82 of this Constitution. If he is a Minister or a member of the National Assembly he shall not take part in the ministerial functions or in the work of the Assembly during the period he is acting as Deputy for the Amir.

Article 63

Before assuming his powers the Amir's Deputy shall, at a special sitting of the National Assembly. take the oath mentioned in Article 60 of this Constitution with the following phrase added thereto:

"and be loyal to the Amir".

In case the National Assembly in not in session, the Oath shall be taken before the Amir.

Article 64

The provisions of Article 131 of this Constitution shall apply to the Amir's Deputy.

Article 65

The Amir shall have the right to initiate, sanction and promulgate laws. Promulgation of laws shall take place within thirty days from the date of their submission by the National Assembly to the Amir. This period shall be reduced to seven days in case of urgency. Such urgency shall be decided upon by a majority vote of the members constituting the National Assembly.

Official holidays shall not be counted in computing the promulgation period.

If the period of promulgation expires without the Head of State demanding reconsideration, the bill shall be considered as having been sanctioned and shall be promulgated.

Article 66

Reference of a bill for reconsideration shall be by a decree stating the grounds therefore. If the National Assembly confirms the bill by a two-thirds majority vote of its members the Amir shall sanction and promulgate the bill within thirty days from its submission to him. If the bill does not receive the said majority, it shall not be reconsidered during the same session. If the National Assembly, in another session, confirms the same bill by a majority vote of its members, the Amir shall sanction and promulgate the bill as law within thirty days from its submission to him.

Article 67

The Amir is the Supreme Commander of the Armed Forces. He appoints and dismisses officers in accordance with law.

Article 68

The Amir shall declare defensive war by decree. Offensive war is prohibited.

Article 69

The Amir shall proclaim Martial Law in the cases of necessity determined by law and in accordance with the procedure specified therein. The proclamation of Martial Law shall be by decree. Such decree shall be referred to the National Assembly within the fifteen days following its issue, for a decision on the future of Martial Law. If the proclamation takes place during the period the National Assembly is dissolved it shall. be referred to the new Assembly at its first sitting.

Martial Law may not continue unless a decision to that effect is made by a majority vote of the members constituting the Assembly.

In all cases the matter shall be referred to the National Assembly in accordance with the foregoing procedure, every three months.

Article 70

The Amir shall conclude treaties by decree and shall transmit them immediately to the National Assembly with the appropriate statement. A treaty shall have the force of law after it is signed, ratified and published in the Official Gazette.

However, treaties of peace and alliance; treaties concerning the territory of the State, its natural resources or sovereign rights, or public or private rights of citizens; treaties of commerce, navigation and residence; and treaties which entail additional expenditure not provided for in the budget, or which involve amendment of the laws of Kuwait; shall come into force only when made by a law.

In no case may treaties include secret provisions contradicting those declared .

Article 71

Should necessity arise for urgent measures to be taken while the National Assembly is not in session or is dissolved, the Amir may issue decrees in respect thereof which shall have the form of law, provided that they shall not be contrary to the Constitution or to the appropriations included in the budget law.

Such decrees shall be referred to the National Assembly within the fifteen days following their issue if the Assembly is in being. If it is dissolved or its legislative term has expired such decrees shall be referred to the next Assembly at its first sitting. If they are not thus referred they shall retrospectively cease to have the force of law, without the necessity of any decision to that effect.. If they arc referred and the Assembly does not confirm them, they shall retrospectively cease to have the force of law, unless the Assembly approves their validity for the preceding period or settles in some other way the effects arising therefrom.

Article 77

The Amir shall, by decree, issue the regulations necessary for the execution of laws without amending or suspending such laws or making any exemption from their execution. A law may prescribe a less formal instrument than a decree for the issue of the regulations necessary for its execution.

Article 73

The Amir shall, by decree, issue regulations for public order and health. and regulations necessary for the organisation of public services and administration, not conflicting with any law.

Article 74

The Amir shall appoint and dismiss civil and military officials and diplomatic representatives to foreign countries in accordance with law. He shall also accept credentials of the representatives of foreign countries.

Article 75

The Amir may, by decree, grant a pardon or commute a sentence. However, general amnesty shall not be granted except by a law and then only in respect of offences committed prior to the proposal of the amnesty.

Article 76

The Amir shall confer Orders of Honour in accordance with law.

Article 77

Coins shall be minted in the name of the Amir in accordance with law.

Article 78

Upon the accession of the Head of State his annual emoluments shall be fixed by a law for the duration of his reign.

Chapter III - Legislative Power

Article 79

No law may be promulgated unless it has been passed by the National Assembly and sanctioned by the Amir.

Article 80

The National Assembly shall be composed of fifty members elected directly by universal suffrage and secret ballot in accordance with the provisions prescribed by the electoral law.

Ministers who are not elected members of the National Assembly shall be considered ex-officio members thereof.

Article 81

Electoral constituencies shall be determined by law.

Article 82

A member of the National Assembly shall:

(a) be a Kuwaiti by origin in accordance with law.
(b) be qualified as an elector in accordance with the electoral law.
(c) be not less than thirty calendar years of age on the day of election.
(d) be able to read and write Arabic well.

Article 83

The term of the National Assembly shall be four calendar years commencing with the day of its first sitting. Elections for the new Assembly shall take place within the sixty days preceding the expiry of the said term, due regard being given to the provisions of Article 107.

Members whose term of office expires may be re-elected.

The term of the Assembly may not be extended except for necessity in time of war and by a law.

Article 84

If, for any reason, a seat in the National Assembly becomes vacant before the end of the term, the vacancy shall be filled by election within two months from the date on which the Assembly declares the vacancy. The mandate of the new member shall last until the end of that of his predecessor.

If the vacancy occurs within six months prior to the expiry of the legislative term of the Assembly no successor shall be elected.

Article 85

The National Assembly shall have an annual session of not less than eight months. The said session may not be prorogued before the budget is approved.

Article 86

The Assembly shall start its ordinary session during the month of October of every year upon a convocation by the Amir. If the decree of convocation is not issued before the first of the said month, the time for the meeting shall be deemed to be 9 a.m. on the third Saturday of that month. If such day happens to be an official holiday, the Assembly shall meet on the morning of the first day thereafter.

Article 87

Notwithstanding the provisions of the preceding two Articles the Amir shall summon the National Assembly to hold its first meeting within two weeks of the end of the general election- if the decree of convocation is not issued within the said period, the Assembly shall be deemed to have been convoked for the morning of the day following these two weeks, due regard being given to the relevant provision of the preceding Article.

If the date of the meeting of the Assembly falls after the annual date mentioned in Article 86 of the Constitution, the term of the session specified in Article 85 shall be reduced by the difference between the said two dates.

Article 88

The National Assembly shall, by decree, be called to an extraordinary session if the Amir deems it necessary, or upon the demand of the majority of the members of the Assembly.

In an extraordinary session the Assembly may not consider matters other than those for which it has been convened except with the consent of the Cabinet.

Article 89

The Amir shall announce the prorogation of ordinary and extraordinary sessions.

Article 90

Every meeting held by the Assembly at a time or place other than that assigned for its meeting shall be invalid. and resolutions passed thereat shall, by virtue of law, be void.

Article 91

Before assuming his duties in the Assembly or in its committees, a member of the National Assembly shall take the following oath before the Assembly in a public sitting:

> "I swear by Almighty God to he faithful to the Country and to the Amir, to respect the Constitution and the laws of the State, to defend the liberties, interests and properties of the people and to discharge my duties honestly and truthfully."

Article 92

The National Assembly shall elect at its first sitting and for the duration of its term a President and a Deputy President from amongst its members. If either office becomes vacant the Assembly shall elect a successor for the remainder of its term.

In all cases election shall be by an absolute majority vote of the members present. If this majority vote is not attained in the first ballot, another election shall be held between the two candidates receiving the highest number of votes. If more than one candidate receives an equal number of votes in the second place, all such candidates shall participate in the second ballot. In this case the candidate who receives the greatest number of votes shall be elected. If there is a tie in this last ballot, the choice shall be by lot.

The oldest member shall preside of the first sitting until the President is elected.

Article 93

The Assembly shall form, within the first week of its annual session, the committees necessary for its functions. These committees may discharge their duties during the recess of the Assembly with a view to submitting their recommendations to it when it meets.

Article 94

Sittings of the National Assembly shall be public, though they may be held in secret upon the request of the Government, the President of the Assembly or ten of its members. The debate on such request shall be held in secret.

Article 95

The National Assembly shall decide upon the validity of the election of its members. No election may be declared invalid except by a majority vote of the members constituting the Assembly. This jurisdiction may, by law, be entrusted to a judicial body.

Article 96

The National Assembly shall be the competent authority to accept resignation of its members.

Article 97

For a meeting of the National Assembly to be valid more than half of its members must be present. Resolutions shall be passed by an absolute majority vote of the members present, except in cases where a special majority is required. When votes are equally divided, the motion shall be deemed to be rejected.

Article 98

Immediately upon its formation, every Cabinet shall present its programme to the National Assembly. The Assembly may make comments with regard to such a programme.

Article 99

Every member of the National Assembly may put to the Prime Minister and to Ministers questions with a view to clarifying matters falling within their competence. The questioner alone shall have the right to comment once upon the answer.

Article 100

Every member of the National Assembly may address to the Prime Minister and to Ministers interpellations with regard to matters falling within their competence.

The debate on such an interpellation shall not take place until at least eight days have elapsed after its presentation, except in case of urgency and with the consent of the Minister concerned.

Subject to the provisions of Articles 101 and 102 of the Constitution, an interpolation may lead to the question of no-confidence being put to the Assembly.

Article 101

Every Minister shall be responsible to the National Assembly for the affairs of his ministry. If the Assembly passes a vote of no-confidence against a Minister, he shall be considered to have resigned his office as from the date of the vote of no-confidence and shall immediately submit his formal resignation. The question of confidence in a Minister may not be raised except upon his request or upon a demand signed by ten members, following a debate on an interpellation addressed to him. The Assembly may not make its decision upon such a request before the lapse of seven days from the presentation thereof.

Withdrawal of confidence from a Minister shall be by a majority vote of the members constituting the Assembly excluding Ministers. Ministers shall not participate in the vote of confidence.

Article 102

The Prime Minister shall not hold any portfolio; nor shall the question of confidence in him be raised before the National Assembly.

Nevertheless, if the National Assembly decides, in the manner specified in the preceding Article, that it cannot co-operate with the Prime Minister, the matter shall be submitted to the Head of State. In such a case the Amir may either relieve the Prime Minister of office and appoint a new Cabinet or dissolve the National Assembly.

In the event of dissolution, if the new Assembly decides by the abovementioned majority vote that it cannot co-operate with the said Prime Minister, he shall be considered to have resigned as from the date of the decision of the Assembly in this respect, and a new Cabinet shall be formed.

Article 103

If, for any reason, the Prime Minister or a Minister vacates his office, he shall continue to discharge the urgent business thereof until his successor is appointed.

Article 104

The Amir shall open the annual session of the National Assembly whereupon he shall deliver an Amiri speech reviewing the situation of the country and the important public matters which happened during the preceding year, and outlining the projects and reforms the Government plans to undertake during the coming year.

The Amir may depute the Prime Minister to open the Assembly or to deliver the Amiri Speech.

Article 105

The National Assembly shall choose from amongst its members, a committee to draft the reply to the Amiri Speech which will embody the comments and wishes of the Assembly. After the said reply has been approved by the Assembly, it shall be submitted to the Amir.

Article 106

The Amir may, by a decree, adjourn the meeting of the National Assembly for a period not exceeding one month. Adjournment may be repeated during the same session with the consent of the Assembly and then once only. A period of adjournment shall not be counted in computing the duration of the session.

Article 107

The Amir may dissolve the National Assembly by a decree in which the reasons for dissolution shall be indicated. However, dissolution of the Assembly may not be repeated for the same reasons.

In the event of dissolution, elections for the new Assembly shall be held within a period not exceeding two months from the date of dissolution.

If the elections are not held within the said period the dissolved Assembly shall be restored to its full constitutional authority and shall meet immediately as if the dissolution had not taken place. The Assembly shall then continue functioning until the new Assembly is elected.

Article 108

A member of the Assembly represents the whole nation. He shall safeguard the public interest and shall not be subject to any authority in the discharge of his duties in the Assembly or in its committees.

Article 109

A member of the Assembly shall have the right to vitiate bills.

No bill vitiated by a member and rejected by the National Assembly may be reintroduced during the same session.

Article 110

A member of the National Assembly shall be free to express any views or opinions in the Assembly or in its committees. Under no circumstances shall he held liable in respect thereof.

Article 111

Except in cases of flagrante delicto, no measures of inquiry, search, arrest, detention or any other penal measure may be taken against a member while the Assembly is in session, except with the authorisation of the Assembly. The Assembly shall be notified of any penal measure that may be taken during its session in accordance with the foregoing provision. The Assembly shall always at its first meeting

be notified of any such measure taken against any of its members while it was not sitting. In all cases, if the Assembly does not give a decision regarding a request for authorisation within one month from the date of its receipt, permission shall be deemed to have been given.

Article 112

Upon a request signed by five members, any subject of general interest may be put to the National Assembly for discussion with a view to securing clarification of the Government's policy and to exchanging views thereon. All other members shall also have the right to participate in the discussion.

Article 113

The National Assembly may express to the Government wishes regarding public matters. If the Government cannot comply with these wishes, it shall state to the Assembly the reasons therefor. The Assembly may comment once on the Government's statement.

Article 114

The National Assembly shall at all times have the right to set up committees of inquiry or to delegate one or more of its members to investigate any matter within its competence. Ministers and all Government officials must produce testimonials, documents and statements requested from them.

Article 115

The Assembly shall set up, among its annual standing committees, a special committee to deal with petitions and complaints submitted to the Assembly by citizens. The committee shall seek explanation thereon from the competent authorities and shall inform the person concerned of the result.

A member of the National Assembly may not interfere with the work of either the Judicial or the Executive Power.

Article 116

The Prime Minister and Ministers shall be given the floor whenever they ask for it. They may call for assistance upon any senior officials or depute them to speak on their behalf. The Assembly may ask for a Minister to be present whenever a matter relating to his ministry is under discussion. The Cabinet shall be represented in the sittings of the Assembly by the Prime Minister or by some Ministers.

Article 117

The National Assembly shall lay down its standing orders which shall include the procedure of the Assembly and its committees, and the rules pertaining to discussion, voting, questions, interpellation and all other functions prescribed in the Constitution. The standing orders shall prescribe the sanctions to be imposed on any member who violates order or absents himself from the meetings of the Assembly or the committees without a legitimate excuse.

Article 118

The maintenance of order in the National Assembly shall be the responsibility of its President. The Assembly shall have a special guard under the authority of the President of the Assembly.

No armed forces may enter the Assembly or be stationed close to its gates unless so requested by the President.

Article 119

The remuneration of the President of the National Assembly, the Deputy President and the Members shall be fixed by law. In the event of a modification of the said remuneration, such modification shall not take effect until the next legislative term.

Article 120

Membership of the National Assembly shall be incompatible with public office except in the cases where compatibility is permitted in accordance with the Constitution. In such cases the right to the remuneration for membership and the right to the salary of the public office shall not be cumulated.

The law shall specify other cases of incompatibility.

Article 121

During his mandate a member of the National Assembly shall not be appointed on the board of directors of a company nor shall he participate in concessions granted by the Government or by public bodies.

Further, during the said mandate, he shall not buy or rent any property of the State, nor shall he let, sell or barter any of his property to the Government, except by public auction or tender, or in compliance with the system of compulsory acquisition.

Article 122

During their mandate, members of the National Assembly with the exception of those occupying a public office not incompatible with the membership of the National Assembly, may not be awarded decorations.

Chapter IV – The Executive Power
Section I – The Cabinet

Article 123

The Council of Ministers shall have control over the departments of the State. It shall formulate the general policy of the Government, pursue its execution and supervise the conduct of work in Government departments.

Article 124

A law shall determine the remuneration of the Prime Minister and the Ministers.

All other provisions regarding Ministers shall apply to the Prime Minister unless otherwise stated.

Article 125

A Minister shall satisfy the qualifications laid down in Article 82 of this Constitution.

Article 126

Before assuming office the Prime Minister and Ministers shall take before the Amir the Oath specified in Article 91 of this Constitution.

Article 127

The Prime Minister shall preside over the meetings of the Council of Ministers and supervise the co-ordination of work among the various ministries.

Article 128

Deliberations of the Council of Ministers shall be secret. Resolutions shall be passed only when the majority of its members are present and with the approval of the majority of those present. In case of an equal division of votes the side on which the Prime Minister has voted shall prevail.

Unless they resign. the minority shall abide by the opinion of the majority.

Resolutions of the Council of Ministers shall be submitted to the Amir for approval in cases where the issue of a decree is required.

Article 129

The resignation of the Prime Minister or his removal from office shall involve the resignation or removal of all other Ministers.

Article 130

Every Minister shall supervise the affairs of his ministry and shall execute therein the general policy of the Government. He shall also formulate directives for the ministry and supervise their execution.

Article 131

While in office, a Minister shall not hold any other public office or practice, even indirectly, any profession or undertake any industrial, commercial or financial business. Further, he shall not participate in any concession granted by the Government or by public bodies or cumulate the ministerial post with membership of the board of directors of any company.

Further, during the said period, a Minister shall not buy or take on hire any property of the State even by public auction, nor shall he let, sell or barter any of his property to the Government.

Article 132

A special law shall define the offences which may be committed by Ministers in the performance of their duties, and shall specify the procedure for their indictment and trial and the competent authority for the said trial, without affecting the application of other laws to their ordinary acts or offences and to the civil liability arising therefrom.

Article 133

Law shall regulate general and municipal self-governing bodies in such a way as to ensure their independence under the direction and supervision of the Government.

Section II – Financial Affairs

Article 134

No general tax may be established, amended or abolished except by a law. No one may be exempted, wholly or partially, from the payment of such taxes except in the cases specified by law. No one may be required to pay any other tax, fee or imposition except withal the limits of law.

Article 135

Law shall prescribe rules for the collection of public funds and the procedure for their expenditure.

Article 136

Public loans shall be concluded by a law. The Government may grant or guarantee a loan by a law, or within the limits of the funds appropriated for the said purpose in the budget.

Article 137

General and local self-governing bodies may grant or guarantee loans according to law.

Article 138

Law shall lay down rules for the protection of State properties, their administration, the conditions of their disposal, and the limits within which any of these properties may be relinquished.

Article 139

The financial year shall be fixed by law.

Article 140

The Government shall draw up the annual budget, comprising the revenue and expenditure of the State, and submit it to the National Assembly, for examination and approval, at least two months before the end of each current financial year.

Article 141

The budget shall be discussed in the National Assembly Part by Part. None of the public revenues may be allocated for a specific purpose except by law.

Article I42

Law may appropriate specific funds for more than one year if the nature of the expenditure so requires, provided that each budget shall include the funds allocated for that year. or alternatively, an extraordinary budget covering more than one financial year shall be drawn up.

Article 143

The budget law may not include any provisions establishing a new tax, increasing an existing tax, amending an existing law, or evading the issue of a special law on a matter in respect of which the Constitution provides that a law should be issued.

Article 144

The budget shall be issued by a law.

Article 145

If the budget law has not been promulgated before the beginning of the financial year, the preceding budget shall be applied until the new one is issued and revenues shall be collected and disbursements made in accordance with laws in force at the end of the preceding year.

However, if the National Assembly has approved one or more Parts of the new budget, they shall be put into effect.

Article 146

Any expenditure not included in the budget, or in excess of the budget appropriations as well as the transfer of any fund from one Part of the budget to another, shall be effected by law.

Article 147

In no case shall the maximum estimate of expenditure, included in the budget law or the laws amending it, be exceeded.

Article 148

Law shall specify the general budgets, both independent and annexed to which the provisions regarding the budget of the State Shall be applied.

Article 149

The final accounts of the financial administration of the State for the preceding year shall be submitted, within four months following the end of the said year, to the National Assembly for consideration and approval.

Article 150

The Government shall submit to the National Assembly, at least once during each ordinary session, a statement upon the financial position of the State.

Article 151

A financial control audit commission shall be established by a law which shall ensure its independence. The Commission shall be attached to the National Assembly and shall assist the Government and the National Assembly in controlling the collection of the State revenues and the disbursement of its expenditures within the limits of the budget. The commission shall submit to both the Government and the National Assembly an annual report on its activities and its observations.

Article 152

No concession for exploitation of either a natural resource or a public service may be granted except by a law and for a limited period. In this respect the preparatory measures shall facilitate the operations of prospecting and exploration and ensure publicity and competition.

Article 153

No monopoly shall be granted except by a law and for a limited period.

Article 154

Law shall regulate currency and banking and determine standards, weights and measures.

Article 155

Law shall regulate salaries, pensions, compensation, subsidies and gratuities which are a charge on the State treasury.

Article 156

Law shall lay down provisions relating to the budgets and the final accounts of local bodies and authorities which have a public legal personality.

Section 111 -- Military Affairs

Article 157

Peace is the aim of the State, and the safeguard of the integrity of the Country, which is part of the integrity of the Greater Arab World, is a trust devolving upon every citizen.

Article 158

Military service shall be regulated by law.

Article 159

The State alone shall establish armed forces and public security bodies, and that in accordance with law.

Article 160

Mobilisations, general or partial, shall be regulated by law.

Article 161

A Supreme Defence Council shall be set up to conduct affairs relating to defence, to the safeguard of the integrity of the Country and to the supervision of the armed forces, in accordance with law.

Chapter V
Judicial Power

Article 162

The honour of the Judiciary and the integrity and impartiality of judges are the bases of rule and a guarantee of rights and liberties.

Article 163

In administering justice judges shall not be subject to any authority. No interference whatsoever shall be allowed with the conduct of justice. Law shall guarantee the independence of the Judiciary and shall state the guarantees and provisions relating to judges and the conditions of their irremovability.

Article 164

Law shall regulate the Courts of various kinds and degrees and specify their functions and jurisdiction. Except when Martial Law is in force Military Courts shall have jurisdiction only over military offences committed by members of the armed and security forces within the limits specified by law.

Article 165

Sittings of the Courts shall be public save in the exceptional cases prescribed by law.

Article 166

The right of recourse to the Courts is guaranteed to all people. Law shall prescribe the procedure and manner necessary for the exercise of this right.

Article 167

The Public Prosecution Office shall conduct penal charges on behalf of society. It shall supervise the affairs of judicial police, the enforcement of penal laws, the pursuit of offenders and execution of judgments. Law shall regulate this body, lay down its duties, and define the conditions and guarantees for those who assume its functions.

As an exception, law may entrust to the public security authorities the conduct of prosecutions in misdemeanours in accordance with the manner prescribed by law.

Article 168

The Judiciary shall have a Supreme Council which shall be regulated, and its duties defined, by law.

Article 169

Law shall regulate the settlement of administrative suits by means of a special Chamber or Court, and shall prescribe its organisation and the manner of assuming administrative jurisdiction including the power of both nullifications and compensations in respect of administrative acts contrary to law.

Article 170

Law shall organise the body which shall render legal advice to ministries and public departments and shall draft bills and regulations. Law shall also regulate the representation of the State and other public bodies before the Courts.

Article 171

A Council of State may be established by a law to assume the functions of administrative jurisdiction, rendering legal advice, and drafting bills and regulations, mentioned in the preceding two Articles.

Article 172

Law shall prescribe the method of resolving conflicts of jurisdiction or of judgments between the various kinds of Courts.

Article 1 73

Law shall specify the judicial body competent to decide upon disputes relating to the constitutionality of laws and regulations and shall determine its jurisdiction and procedure.

Law shall ensure the right of both the Government and the interested parties to challenge the constitutionality of laws and regulations before the said body.

If the said body decides that a law or a regulation is unconstitutional it shall be considered null and void.

PART V
GENERAL AND TRANSITIONAL PROVISIONS

Article 174

Either the Amir or one-third of the members of the National Assembly shall have the right to propose the revision of this Constitution by amending or deleting one or more of its provisions or by adding new provisions.

If the Amir and the majority of the members constituting the National Assembly approve the principle of revision and its subject matter, the Assembly shall debate the bill article by article. Approval by a two-thirds majority vote of the members constituting the Assembly shall be required for the bill to be passed. The revision shall come into force on after being sanctioned and promulgated by the Amir regardless of the provisions of Articles 65 and 66 of this Constitution.

If the principle of revision or its subject matter is rejected, it shall not be presented again before the lapse of one year from the rejection.

No amendment to this Constitution may be proposed before the lapse of five years from its coming into force.

Article 175

The provisions relating to the Amiri System in Kuwait and the principles of liberty and equality, provided for in this Constitution, may not be proposed for revision except in relation to the title of the Amirate or to increase the guarantees of liberty and equality.

Article 176

The powers of the Amir, specified in this Constitution, may not be proposed for revision when a Deputy Amir is acting for him.

Article 177

The application of this Constitution shall not affect treaties and conventions previously concluded by Kuwait with other States and international organisations.

Article 178

Laws shall be published in the Official Gazette within two weeks of their promulgation and shall come into force one month after their publication. The latter period may be extended or reduced for any law by a special provision included in it.

Article 179

Laws shall apply to that which takes place after the date of their coming into force, and thus shall have no effect in respect of that which has taken place before such date. However, in other than penal matters, a law may, with the approval of a majority vote of the members constituting the National Assembly, prescribe otherwise.

Article 180

All provisions of laws, regulations, decrees, orders and decisions, in effect upon the coming of this Constitution into force, shall continue to be applicable unless amended or repealed in accordance with the procedure prescribed in this Constitution, provided that they are not contrary to any of its provisions.

Article 181

No provision of this Constitution may be suspended except when Martial Law is in force and within the limits specified by the law. Under no circumstances shall the meetings of the National Assembly be suspended, nor shall the immunities of its members be interfered with, during such period.

Article 182

This Constitution shall be published in the Official Gazette and shall come into force on the date of the meeting of the National Assembly which shall not be later than January 1963.

Article 183

Law Number I of 1962 concerning the system of Government during the period of transition shall continue to be in force, and the present members of the Constituent Assembly shall continue in the exercise of their duties specified in the said law, until the meeting of the National Assembly.

Abdullah al-Salim al-Sabah
AMIR OF THE STATE OF KUWAIT

Issued at the Siif Palace on the 14th of Jumada al - Thani, 1382, corresponding to the 11th of November, 1962.

Ref: F/16/3/1
date: 7/4/83

APPENDIX NO. V

CONCESSION AGREEMENT WITH KUWAIT OIL COMPANY LTD OF 23.12.1934

In the Name of God the Merciful.

THIS IS AN AGREEMENT made at Kuwait on the 23rd day of December in the year 1934 corresponding to 16th Ramadham 1353 between His Excellency Shaikh Sir Ahmed al-Jabir as-Subah, Knight Commander of the Most Eminent Order of the Indian Empire and Companion of the Most Exalted Order of the Star of India, the SHAIKH OF KUWAIT in the exercise of his powers as Ruler of Kuwait on his own behalf and in the name of and on behalf of his heirs and successors in whom is or shall be vested for the time being the responsibility for the control and government of the State of Kuwait (hereinafter called "the Shaikh") and the KUWAIT OIL COMPANY LIMITED, a Company registered in Great Britain under the Companies Act, 1929, its successors and assigns (hereinafter called "the Company").

ARTICLE 1

The Shaikh hereby grants to the Company the exclusive right to explore, search, drill for, produce and win natural gas, asphalt, ozokerite, crude petroleum and their products and cognate substances (hereinafter referred to as "petroleum") within the State of Kuwait including all islands and territorial waters appertaining to Kuwait as shown generally on the map annexed hereto, the exclusive ownership of all petroleum produced and won by the Company within the State of Kuwait, the right to refine, transport, sell and use within the State of Kuwait or for export and export or otherwise deal with or dispose of any and all such petroleum and the right to do all things necessary for the purposes of those operations. The Company undertakes however that it will not carry on any of its operations within areas occupied by or devoted to the purposes of mosques, sacred buildings or graveyards, or carry on any of its operations except the sale of petroleum, housing of staff and employees and administrative work within the present town wall of Kuwait.

The period of this Agreement shall be 75 years from the date of signature.

ARTICLE 2

A. Within nine months from the date of signature of this Agreement the Company shall commence geological exploration.

B. The Company shall drill for petroleum to the following total aggregate depths and within the following periods of time at such and so many places as the Company may decide:

(i) 4,000 feet prior to the 4th anniversary of the date of signature of this Agreement.

(ii) 12,000 feet prior to the 10th anniversary of the date of signature of this Agreement.

(iii) 30,000 prior to the 20th anniversary of the date of signature of this Agreement.

C. The Company shall conduct its operations in a workmanlike manner and by appropriate scientific methods and shall take all reasonable measures to prevent the ingress of water to any petroleum-bearing strata and shall duly close any unproductive holes drilled by it and subsequently abandoned. The Company shall keep the Shaikh

and his London Representative informed generally as to the progress and result of its drilling operations but such information shall be treated as confidential.

ARTICLE 3

In consideration of the rights granted by the Shaikh to the Company by this Agreement and of the assistance and protection which the Shaikh hereby undertakes to afford by all means in his power to the Company and its operations, employees and property, the Company shall pay to the Shaikh the following sums:

(a) Within thirty (30) days after signature of this Agreement Rupees Four hundred and seventy-five thousand (Rs. 475,000).

(b) On each anniversary of the date of signature until the Company declares that petroleum has been found in commercial quantities: EITHER Royalty of Rupees Three (Rs 3) for every English ton (2,240 lbs.) of Kuwait petroleum won and saved by the Company in Kuwait during the year ending three months prior to the anniversary of the date of signature, OR Rupees Ninety-five thousand (Es. 95,000) whichever shall be the greater sum.

(c) On each anniversary of the date of signature after the Company has declared that petroleum has been found in commercial quantities: Either Royalty as defined above, or Rupees Two hundred and fifty thousand (Rs. 250,000) whichever shall be the greater sum.

(d) For the purpose of this Agreement and to define the exact product to which the Royalty stated above refers, it is agreed that the Royalty is payable on each English ton of 2,240 lbs. of net crude petroleum won and saved by the Company from within the State of Kuwait - that is after deducting water, sand and other foreign substances and the oil required for the customary operations of the Company's installations in the Shaikh's territories.

ARTICLE 4

On each anniversary of the date of signature of this Agreement the Company shall deliver to the Shaikh a return of petroleum if any on which royalty is payable for the year ended three (3) months prior to such anniversary and a statement of the amount of royalty if any due to the Shaikh for such year, and a report of its operations under this Agreement during such year. The Shaikh or his Representative shall have the right to check such returns and statements which, a well as any reports, shall be treated as confidential by the Shaikh with the exception of such figures therein as he may be required by law to publish.

ARTICLE 5

A. For the purposes of its operations hereunder the Company shall have the right without hindrance to construct and to operate power stations, refineries, pipelines and storage tanks, facilities for water supply including boring for water, telegraph, telephone and wireless installations, roads, railways, tramways, buildings, ports, harbours, harbour works, wharves and jetties, oil and coaling stations with such lighting as may be requisite and any other facilities or works which the Company may consider necessary and for such purposes to use free of all payments to the Shaikh any stone, sand, gravel, gypsum, clay or water which may be available and may be required for its operations hereunder, provided always that the inhabitants of the State of Kuwait are not prevented from taking their usual requirements of these materials and that the water supply of the local inhabitants and nomad population who may be dependent on the same is not endangered. The Company at its discretion but in consultation with the Shaikh may select the position of any such works. The Company may likewise utilise without hindrance all such means of transportation by land, air and water communication or operation as may be necessary for the effective conduct of its operations hereunder.

But nothing in this Article 5A shall confer on the Company the right to dispose of stone, sand, gravel, gypsum, clay or water by sale, export or otherwise to any other company or person within or without the State of Kuwait.

B. The Company shall under normal conditions accept and transmit free of charge on its wireless and telegraph installations such of the Shaikh's messages as will not interfere with the Company's business, and in times of national emergency the Shaikh shall have the full use free of charge of the Company's wireless and telegraph installation and railways for governmental purposes.

C. The Shaikh's ships shall have the right to use harbours utilised or constructed by the Company provided that such use in no way hampers the Company or interferes in any with the safety of its operations of which the Company shall be the sole judge. Any wharves or appurtenances constructed by the Company shall be for its exclusive use. The Company may use for the purposes of its operations the harbours along the coast of Kuwait but the Company shall not impede or interfere with the subjects of the Shaikh or their right to continue the use of existing harbours, anchorages, wharves and docks along the coast of Kuwait at present utilised by them for their sailing craft and fishing boats.

ARTICLE 6

A. The Company shall maintain in the region of the Persian Gulf a Chief Local Representative to represent it in matters relating to this Agreement with the Shaikh. The Shaikh has the right to select on the first occasion the Chief Local Representative in consultation with His Majesty's Government.

B. The Shaikh shall have the right to appoint an Arab conversant with the English language to act a his Official Representative and who will represent him in Kuwait in matters relating to this Agreement with the Company and particularly whenever unskilled labour is recruited from among the subjects of the Shaikh this Representative shall be consulted and advise the Company regarding any such recruitment. The salary of the Representative shall not be less than Rupees Eight hundred (RS. 800) per month, and such salary shall be paid by the Company monthly to the Representative as from the date of his appointment by the Shaikh.

C. The Shaikh shall have the right to appoint - from the effective date of this Agreement - a Representative in London to represent the Shaikh in all matters relating to this Agreement with the Company in its London Office and such Representative shall have full access to the production records of the Company including the agenda of the Board meetings and shall be entitled to attend the Board's meetings at which the Shaikh's interests are discussed. The salary of such Representative shall not be less than Rupees Two thousand two hundred and fifty (Rs. 2,250) per month which shall be paid to the Representative by the Company and not by the Shaikh. The salary of such Representative shall be paid either in London or Bombay as requested by him. Travelling and general expenses of the Representative shall be defrayed from the above-mentioned sum of Rupees Two thousand two hundred and fifty (Rs. 2,250).

D. If at any time during the currency of this Agreement any dispute shall arise regarding the accuracy of the accounts of the Company in connection with the amount of the Royalty and/or other payments due to the Shaikh under this Agreement, the Shaikh shall have the right to appoint in consultation with His Majesty's Government a registered firm of Auditors to examine the books of the Company, on behalf of the Shaikh, at Kuwait and/or in London as he may consider necessary. All expenditure incurred in connection with such auditing shall be paid by the Shaikh.

The Company shall provide the registered firm of Auditors appointed by the Shaikh the necessary facilities to enable them to check the books and registers of the

Company and to render every assistance to enable the Auditors to thoroughly examine such accounts and in every way to assist them safeguard the interests of the Shaikh. The Shaikh shall regard as confidential all information supplied in connection with all such auditing with the exception of such items as ma have an actual bearing on the dispute or are connected with it.

ARTICLE 7

A. The Company shall have the right to import water, petroleum, fuel, machinery, motor-cars and lorries, equipment, plant, timber, utensils, iron work, building materials, food, supplies, medicines, medical supplies, office equipment and household furniture, and all other materials equipment and goods of whatsoever nature required by the Company and its employees for the purposes of its operations hereunder but not for resale to others, and to export its petroleum and articles previously imported by the Company free of customs or import or export duty and taxes or other charges, but it shall pay on all personal goods, clothing and general merchandise imported by the Company for the personal use of its employees or for resale to them the ordinary duty in force for the time being in the State of Kuwait. Saving as in Article 3 and this Article provided, the Company, its operations income, profits and property including petroleum shall be exempt and free during the period of this Agreement from all present or future harbour duties, import duties, export duties, taxes, imposts and charges of any kind whether State or local, tolls, and land surface rent of whatever nature; and in consideration thereof the Company shall in addition to the payments provided for in Article 3 pay to the Shaikh on each anniversary of the date of signature of this Agreement four annas (annas 4) per ton (2,240 lbs.) of petroleum on which royalty is payable.

B. The importation by the Company of firearms and other weapons is prohibited except with the written permission of the Shaikh.

C. If the Company should sell in Kuwait any material or goods previously imported into Kuwait for the purposes of it operations hereunder and no longer required by the Company, the Company shall pay to the Shaikh in respect of such material or goods sold the equivalent of import duty thereon at the rate in force at the time of sale. The duty shall be computed on the price received on sale.

D. Necessary customs officials at harbours constructed by the Company or additional customs officials required at any other ports utilised by the Company shall be appointed by the Shaikh in consultation with the Company and their salaries which shall not exceed the usual salaries of such officials shall be paid by the Company which shall also provide at its own expense suitable buildings for the accommodation of customs officials at harbours which it has constructed.

ARTICLE 8

A. The Company shall have the right to purchase at current market rates fuel, water, food, building and constructional materials and other supplies of every kind in connection with its operations hereunder.

B. The Company shall employ subjects of the Shaikh as far as possible for all work for which they are suited under the supervision of the Company's skilled employees, but if the local supply of labour should in the judgment of the Company be inadequate or unsuitable the Company shall have the right with the approval of the Shaikh which shall not be unreasonably withheld to import labour preference being given to labourers from the neighbouring Arab countries who will obey the local laws.

The Company shall also have the right to import skilled and technical employees. Any employee imported by the Company who shall by misconduct cause a breach of peace or public disturbance shall at the request of the Shaikh be dismissed and shall if it is within the power of the Company to do so be sent out of Kuwait. The Company shall pay to the workmen it employs a fair wage, such wage to be decided and stated by the Company at the time the workmen are engaged.

C. The Company shall provide free of charge medical service for its employees and the Shaikh and his family shall have the right to such medical service and necessary medical supplies free of charge.

ARTICLE 9

The Shaikh grants to the Company free of cost the unrestricted use and occupation of and surface rights over all uncultivated land belonging to the Shaikh which the Company may need for the purposes of its operations and in particular the Company shall have the right to select in consultation with the Shaikh an area or areas of land chosen by the Company outside the present town wall of Kuwait with exclusive surface rights upon which to erect oil refineries, storage, terminal and shipping facilities and any other works required for the Company's operations; and the Company may with the cognisance of the Shaikh buy or lease for such purpose any lands, houses or buildings with the consent of and on conditions to be arranged with the proprietors thereof but the terms of such purchase or lease shall not be in excess of those ordinarily current in their respective localities.

A. The Company shall acquire only such land, houses and buildings as are necessary for its operations under this Agreement. The Company shall inform the Shaikh from time to time of the land, houses and buildings which it requires to occupy for its operations; and land, houses and buildings previously acquired by the Company from the Shaikh but found no longer necessary for its operations shall be returned by the Company to the Shaikh free of charge.

B. The Shaikh shall retain for himself the right to grant - in consultation with the Company - to another Company or Companies operation petroleum areas within territories adjoining the Kuwait borders the right to lay down pipelines and to permit such Company or Companies to construct and erect within the Kuwait territory and across same, the necessary buildings and machinery required for the transport in transit or passage over Kuwait territory of crude oil to a suitable site within the State of Kuwait considered convenient for the loading of the said crude oil

ARTICLE 10

The Shaikh shall give to the Company and its employees and property all the protection in his power from theft, highway robbery, assault, wilful damage and destruction, and the Company may appoint in consultation with the Shaikh and itself pay trustworthy guards who shall at all times be Kuwait subjects unless the Shaikh permits otherwise to assist in protecting the property of the Company and its employees. The Company shall erect at its own expense suitable buildings for the accommodation of such guards at such places as the Company may decide.

ARTICLE 11

A. Before the expiration of the period specified in Article 1 hereof this Agreement shall come to an end either by surrender as provided in paragraph (B) of this Article or in Article 12 or in one of the three following cases:

(a) If the Company shall fail to fulfil its obligations under Article 2 hereof in respect of geological exploration or drilling.

(b) If the Company shall fail within six (6) months after any anniversary of the date of signature of this Agreement to make to the Shaikh any payments agreed to be due under Article 3.

(c) If the Company shall be in default under the arbitration provisions of Article 18.

In any of the above-mentioned cases the Shaikh shall be entitled to terminate this Agreement and all the property of the Company within the State of Kuwait shall become the property of the Shaikh.

B. In the event of the Company failing to make the declaration provided in Article 3 within 12 years of the date of signature of this Agreement the Company shall at its option either pay to the Shaikh the minimum annual payment provided in Article 3 (c) or surrender all rights under this Agreement.

ARTICLE 12

A. The Company have the right at any time after it has drilled the 4,000 feet provided in Article 2 (b) (i) or after the expiry of two years from the date of signature of this Agreement - whichever shall be the later date - to give the Shaikh one year's notice in advance to terminate this Agreement and the Company shall on expiry of such notice have no further liabilities except to make payment of all monies which may be due to the Shaikh up to the date of termination.

B. Should this Agreement be terminated by the Company under this Article 12, then:

(a) If such termination occurs within 35 years from the date of signature of this Agreement all lands granted by the Shaikh and any lands or buildings which the Company may have bought and any houses or buildings constructed by and other movable property of the Company within the State of Kuwait shall be handed over to the Shaikh free of cost. Producing wells or borings at the time of such terminated shall be handed over in reasonably good order and repair,

but

(b) If such termination occurs after 35 years from the date of signature of this Agreement all the movable and immovable property of the Company in the State of Kuwait shall be handed over to the Shaikh free of cost. Producing wells or borings at the time of such termination shall be handed over in reasonably good order and repair.

ARTICLE 13

On the expiry of this Agreement at the end of the period of 75 years provided in Article 1 or of any extension or renewal of that period all the movable and immovable property of the Company in the State of Kuwait shall be handed over to the Shaikh free of cost. Producing wells or borings at the time of such expiry shall be handed over in reasonably good order and repair.

ARTICLE 14

The Shaikh hereby agrees that the Company may transfer the obligations and benefits of this Agreement to any Company registered within the British Empire.

ARTICLE 15

A. Nothing in this Agreement shall be read as restricting in any way the right of the Shaikh to grant to other parties concessions or permits for substances other than petroleum provided that the operations and rights of the Company hereunder are not thereby injuriously affected.

If the Shaikh should at any date subsequent to the date of signature of this Agreement grant to any other parties concessions or permits for substances other than petroleum, the Shaikh undertakes that such concessions shall contain provisions

requiring the holders thereof to abstain from damaging, impeding or interfering with the property, operations and interests of the Company.

Deposits of mineral substances other than petroleum such as gold, silver, copper, lead, potash, sulphur and salt or the like which may be discovered by the Company shall be reported to the Shaikh and shall not be worked by the Company except under a special concession or permit from the Shaikh.

B. The Company shall use the Shaikh's flag within the State of Kuwait.

ARTICLE 16

Failure on the part of the Company to fulfil any of the conditions of this Agreement shall not give the Shaikh any claim against the Company or be deemed a breach of this Agreement in so far as such failure arises from *force majeure*, and if through *force majeure* the fulfilment by the Company of any of the conditions of this Agreement be delayed the period of such delay shall be added to the periods fixed by this Agreement. *Force majeure* as used in this Agreement includes the act of God, war, insurrection, riot, civil commotion, tide, storm, tidal wave, flood, lightning, explosion, fire, earthquake, and any other happening which the Company could not reasonably prevent or control.

ARTICLE 17

The Shaikh shall not be general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 11. No alteration shall be made in terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to this Agreement.

ARTICLE 18

A. At any time during the currency of this Agreement any difference or dispute shall arise between the parties hereto concerning the interpretation or execution hereof or anything herein contained or in connection herewith, or the rights or liability of either party hereunder, the same shall, failing any agreement to settle it in any other way, or after consultation with the British Political Agent in Kuwait or the British Political Resident in the Persian Gulf, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee, who shall be chosen by the arbitrators before proceeding to arbitration.

B. Each party shall nominate its own arbitrator within 60 days after the delivery of a request so to do by the other party failing which its arbitrator may at the request of the other party be designated by the British Political Resident in the Persian Gulf. In the event of the arbitrators failing to agree upon the referee within 60 days after being chosen or designated, the British Political Resident in the Persian Gulf may appoint a referee at the request of the arbitrators or either of them.

C. The decision of the arbitrators, or in case of a difference of opinion between them the decision of the referee, shall be final and binding upon both parties.

D. In giving a decision the arbitrators or the referee shall specify an adequate period of delay during which the party against whom the decision is given shall conform to the decision and that party shall be in default only if that party has failed to conform to the decision prior to the expiry of that period and not otherwise.

E. The place of arbitration shall be such as may be agreed by the parties and in default of agreement shall be London.

ARTICLE 19

The Company shall make all payments that become due to the Shaikh under this Agreement into the Shaikh's account at the Ottoman Bank in Basrah and the Bank's receipt shall be a full discharge for the Company in respect to the payment of the sum stated in the Bank's receipt. The Shaikh may from time to time designate in writing another Bank or Banks for the purpose of this article.

ARTICLE 20

For the purpose of royalty payments the Company shall measure by a method customarily used in good technical practice all petroleum on which royalty is payable and the Shaikh by his representative duly authorised by him shall have the right to observe such measuring and to examine and test whatever appliances may be used for such measuring. Such representative shall comply with all necessary and usual safeguards for the prevention of fire or other accident; and shall make all examinations and tests at such times and in such manner as will cause the minimum of interference with the Company's operations. If upon such examination or testing any such appliance shall be found to be out of order the Company will cause the same to be put in order at its own expense within a reasonable time, and if upon any such examination as aforesaid any error shall be discovered in any such appliance, such error shall if the Shaikh so decides after hearing the Company's explanation be considered to have existed for three (3) calendar months previous to the discovery thereof or from the last occasion of examining the same in case such occasion shall be within such period of three (3) calendar months and the royalty shall be adjusted accordingly. If the Company should find it necessary to alter, repair or replace any measuring appliance it shall give reasonable notice to the Shaikh or his representative to enable a representative of the Shaikh to be present during such alteration, repair or replacement.

The Company shall keep full and correct records of all measurements as aforesaid the said representative of the Shaikh shall have access at all reasonable times to such records and shall be at liberty to make extracts from them. Such records shall be treated as confidential by the Shaikh and his representatives with the exception of such figures therein as the Shaikh may be required by law to publish.

ARTICLE 21

This Agreement is written in English and translated into Arabic. If there should at any time be disagreement as to the meaning or interpretation of any clause in this Agreement the English text shall prevail.

IN WITNESS whereof the parties to this Agreement have set their hands the day and year first above written.

On behalf of the Kuwait Oil Company Limited
(Signed)
Frank Holmes
A. Chisholm

In the presence of H.R.P. Dickson, Lt.-Col.,
23rd December 1934

Shaikh of Kuwait
(Signed)
(Signature of Shaikh of Kuwait)

In the presence of H.R.P. Dickson, Lt.-Col.,
23rd December 1934

APPENDIX NO. VI

CONCESSION AGREEMENT
WITH THE AMERICAN INDEPENDENT OIL COMPANY (AMINOIL)
OF 28.6.1948

In the Name of God the Merciful

This is an AGREEMENT made at Kuwait on the 18th day of June in the year 1948 corresponding to the 23rd day of Sha'aban in the year 1367, between His Highness Shaikh Sir Ahmad Al-Jabir as-Subah, K.C.S.I., K.C.I.E., THE SHAIKH OF KUWAIT in the exercise of His powers a Ruler of Kuwait on His own behalf and in the name of and on behalf of His heirs and successors in whom is or shall be vested for the time being the responsibility for the control and government of the State of Kuwait (hereinafter called "the Shaikh") and the American Independent Oil Company, a Company incorporated in the State of Delaware in the United States of America, whose principal office is situated in the City of Wilmington in the State of Delaware its subsidiaries, successors and assigns (hereinafter called "the Company").

ARTICLE 1

The Shaikh hereby grants to the Company to the extent of His right, title and interest the exclusive right to explore, search, drill for, produce and win natural gas, asphalt, ozokerite, crude petroleum and their products and cognate substances (hereinafter referred to as "petroleum") within the Kuwait-Saudi Arab Neutral Zone otherwise known as "Saudi Arab-Kuwait Neutral Zone" including all islands and territorial waters appertaining to the Kuwait-Saudi Arab Neutral Zone otherwise known as the Saudi Arab-Kuwait Neutral Zone (hereinafter called "Neutral Zone"), the exclusive ownership of all petroleum produced and won by the Company within said Neutral Zone, the right to refine, transport, sell for use within said Neutral Zone or for export, or otherwise deal with or dispose of any and all such petroleum and the right to do all things necessary for the purposes of these operations. The Company undertakes, however, that it will not carry on any of its operations within areas occupied by or devoted to the purposes of mosques, sacred buildings or graveyards, or carry on any of its operations except the sale of petroleum, housing of staff and employees and administrative work within the present town wall of Kuwait.

The period of this Agreement shall be sixty (60) years from the date of signature.

ARTICLE 2

A. Within nine months from the date of signature of this Agreement the Company shall commence geological and geophysical exploration.

B. The Company shall drill for petroleum to the following total aggregate depths and within the following periods of time at such and so many places as the Company may decide:

(i) 4,000 feet prior to the 4th anniversary of the date of signature of this Agreement.

(ii) 16,000 feet prior to the 10th anniversary of the date of signature of this Agreement.

(iii) 40,000 prior to the 20th anniversary of the date of signature of this Agreement.

C. The Company shall conduct its operations in a workmanlike manner and by appropriate scientific methods and shall take all reasonable measures to prevent the ingress of water to any petroleum-bearing strata and shall duly close any unproductive holes drilled by it and subsequently abandoned. The Company shall keep the Shaikh and His Foreign Representative informed generally as to the progress and result of its drilling operations but such information shall be treated as confidential.

ARTICLE 3

In consideration of the rights granted by the Shaikh to the Company by this Agreement and of the assistance and protection which the Shaikh hereby undertakes to afford by all means in His power to the Company and its operations, employees and property, the Company shall pay to the Shaikh the following sums and considerations:

(a) On date of signature of this Agreement Six Hundred and Twenty-Five Thousand United States Dollars ($625,000) which sum is payment in advance of the first Minimum annual payment to be paid as described in paragraph (c) of this Article.

(b) Within thirty (30) days after signature of this Agreement Seven Million, Two Hundred and Fifty Thousand United States Dollars ($7.250,000). If the Company does not pay the sum of Seven Million, Two Hundred and Fifty Thousand United States Dollars ($7.250,000) within thirty (30) days of the date of signature of this Agreement then this Agreement shall terminate without damages or penalty of any kind being imposed against the Company and the Company shall be relieved of any and all responsibilities under this Agreement.

(c) On each anniversary of the date of signature of this Agreement: Either, Royalty of Two and One-Half United State Dollars ($2.50) for Every English ton (2,240 pounds) of said Neutral Zone petroleum won and saved by the Company in said Neutral Zone during the year ending three (3) months prior to the anniversary of the date of signature, Or, Six Hundred and Twenty-Five Thousand United States Dollars ($625,000) whichever shall be the greater sum.

(d) For the purpose of this Agreement and to define the exact product to which the Royalty stated above refers, it is agreed that the Royalty is payable on each English ton (2,240 pounds) of net crude petroleum won and saved by the Company from within the said Neutral Zone; that is after deducting water, sand and other foreign substances and the oil required for the customary operations of the Company's installations in the Shaikh's territories.

(e) One Eighth (1/8th) of the gross proceeds received by the Company from the sale of any natural gas or natural gas products produced, manufactured and sold from said Neutral Zone by the Company, less the cost of handling and transportation of such natural gas or natural gas products from the place of production to final destination or point of consumption.

(f) Fifteen (15) Percent of the shares of a subsidiary company to be organised by the American Independent Oil Company, which subsidiary company will be formed for the purpose of exploring and exploiting said Neutral Zone under terms of this Agreement. The shares owned by the Shaikh shall be non-assessable and will represent a net interest of fifteen (15) percent in the above-mentioned subsidiary company, and shall involve no financial contributions on the part of the Shaikh.

(g) If and when there is reached a daily production of Fifteen (15) Thousand English tons of 2,240 pounds, the Company pledges itself to construct a modern and suitable oil refinery having a capacity of not less than Ten (10) Percent of the Fifteen (15) Thousand tons daily productions. The site of the refinery will be the subject of mutual agreement between the Shaikh and the Company.

The above-mentioned refinery shall be owned by a company to be formed as a subsidiary of the American Independent Oil Company. Of the total shares of the said subsidiary refining company, the Shaikh shall receive Fifteen (15) Percent and said shares belonging to the Shaikh shall be non-assessable and will represent a net interest of fifteen (15) Percent in the above-mentioned refining company, and shall involve no financial contributions on the part of the Shaikh.

(h) Any obligation hereunder to pay a specified sum in United States Dollars shall be discharged by the payment of a sum in United States Dollars equal to the official United States Government purchase price in force at the date of payment for such quantity of gold, of the standard and fineness prevailing at the date of signature hereof, as such specified sum would have been sufficient to purchase at the date of signature of this Agreement at the official United States Government price then in force. The principle underlying this paragraph is that the present value of the United States Dollar shall be maintained throughout the term of this Agreement.

ARTICLE 4

On each anniversary of the date of signature of this Agreement the Company shall deliver to the Shaikh a return of petroleum if any on which royalty is payable for the year ended three (3) months prior to such anniversary and a statement of the amount of royalty if any due to the Shaikh for such year, and a report of its operations under this Agreement during such year. The Shaikh or His Representative shall have the right to check such returns and statements which, a well as any reports, shall be treated as confidential by the Shaikh with the exception of such figures therein as he may be required by law to publish.

ARTICLE 5

A. For the purposes of its operations hereunder the Company shall have the right without hindrance in the Neutral Zone and subject to the approval of Shaikh and to existing prior rights particularly such rights granted by the Shaikh to the Kuwait Oil Company Limited and/or the Eastern Gulf Oil Company Limited in the State of Kuwait, to construct and to operate power stations, refineries, pipelines and storage tanks, facilities for water supply including boring for water, telegraph, telephone and wireless installations, roads, railways, tramways, buildings, ports, harbours, harbour works, wharves and jetties, oil and coaling stations with such lighting as may be requisite and any other facilities or works which the Company may consider necessary and for such purposes to use free of all payments to the Shaikh any stone, sand, gravel, gypsum, clay or water which may be available and may be required for its operations hereunder, provided always that the inhabitants of said Neutral Zone and/or the State of Kuwait are not prevented from taking their usual requirements of these materials and that the water supply of the local inhabitants and nomad population who may be dependent on the same is not endangered. The Company at its discretion but in consultation with the Shaikh may select the position of any such works. The Company may likewise utilise without hindrance all such means of transportation by land, air and water communication or operation as may be necessary for the effective conduct of its operations hereunder. But nothing in this Article (5A) shall confer on the Company the right to dispose of stone, sand, gravel, gypsum, clay or water by sale, export or otherwise to any other company or person within or without the State of Kuwait or said Neutral Zone.

B. The Company shall under normal conditions accept and transmit free of charge on its wireless and telegraph installations such of the Shaikh's messages as will not interfere with the Company's business, and in times of national emergency the Shaikh shall have the full use free of charge of the Company's wireless and telegraph installation and railways for governmental purposes.

C. The Shaikh's ships shall have the right to use harbours utilised or constructed by the Company provided that such use in no way hampers the Company or interferes in any with the safety of its operations of which the Company shall be the sole judge. Any wharves or appurtenances constructed by the Company shall be for its exclusive use. The Company may use for the purposes of its operations the harbours along the coast of said Neutral Zone and subject to the approval of the Shaikh and to existing

prior rights, particularly such rights granted by the Shaikh to the Kuwait Oil Company Limited and/or the Eastern Gulf Oil Company Limited the harbours along the coast of Kuwait, but the Company shall not impede or interfere with the subjects of the Shaikh or their right to continue the use of existing harbours, anchorages, wharves and docks along the coast of Kuwait and said Neutral Zone at present utilised by them for their sailing craft and fishing boats.

In its use of Kuwait harbour and the harbours in Kuwait and said Neutral Zone, the Company shall use the services of local concerns such as the Kuwait Landing Company and similar contracting concerns to such extent as is possible considering the scope of work to be done and the facilities and services offered by such contracting concerns.

ARTICLE 6

A. The Shaikh shall have the right to appoint from the date of signature of this Agreement an Arab conversant with the English language to act a his Official Representative and who will represent him in Kuwait and said Neutral Zone in matters relating to this Agreement with the Company and particularly whenever unskilled labour is recruited from among the subjects of the Shaikh this Representative shall be consulted and advise the Company regarding any such recruitment. The salary of the Representative shall not be less than Nine Hundred United States Dollars ($900) per month, and such salary shall be paid to him by the Company every month together with all reasonable expenses incurred by him in the performance of his duties hereunder.

The first Representative under this clause shall be Mr. Abdulla Mulla Saleh, M.B.E. of Kuwait.

B. The Shaikh shall have the right to appoint - from the effective date of this Agreement - a Foreign Representative in London to represent the Shaikh in all matters relating to this Agreement and such Representative shall have full access to the production records of the Company including the agenda of the Board[3] meetings and shall be entitled to attend the Board's meetings at which the Shaikh's interests are discussed. The salary of such Representative shall not be less than Fourteen Hundred United States Dollars ($1,400) per month, which shall be paid to the Foreign Representative by the Company and not by the Shaikh. The Company shall also pay all travelling and other reasonable expenses incurred by the Foreign Representative in the performance of his duties hereunder.

The first Foreign Representative under this clause shall be Mr. Herbert Thomas Kemp of the White House, Pages Lane, London, N.10.

C. The salaries of the above Representatives shall be paid to them in United States Dollars, Sterling or Rupees as they elect at such places as they elect.

D. If at any time during the currency of this Agreement any dispute shall arise regarding the accuracy of the accounts of the Company in connection with the amount of the Royalty and/or other payments due to the Shaikh under this Agreement, the Shaikh shall have the right to appoint a registered firm of Auditors of His own selection to examine the books of the Company on behalf of the Shaikh, all expenditures incurred in connection with such auditing shall be paid by the Shaikh.

The Company shall provide the registered firm of Auditors appointed by the Shaikh the necessary facilities to enable them to check the books and registers of the Company and to render every assistance to enable the Auditors to thoroughly examine such accounts and in every way to assist them safeguard the interests of the Shaikh.

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[3] *Note:* Although not defined it seems obvious that "Board" means the "Board of Directors of the Company and it is so interpreted.

The Shaikh shall regard as confidential all information supplied in connection with all such auditing with the exception of such items as may have an actual bearing on the dispute or are connected with it.

ARTICLE 7

A. The Company shall have the right to import water, petroleum, fuel, machinery, motor-cars and lorries, equipment, plant, timber, utensils, iron work, building materials, food, supplies, medicines, medical supplies, office equipment and household furniture, and all other materials equipment and goods of whatsoever nature required by the Company and its employees for the purposes of its operations hereunder but not for resale to others, and to export its petroleum and articles previously imported by the Company free of customs or import or export duty and taxes or other charges, but it shall pay on all personal goods, clothing and general merchandise imported by the Company for the personal use of its employees or for resale to them the ordinary duty in force for the time being in the State of Kuwait or said Neutral Zone. Saving as in Article 3 and this Article provided, the Company, its operations income, profits and property including petroleum shall be exempt and free during the period of this Agreement from all present or future harbour duties, import duties, export duties, taxes, imposts and charges of any kind whether State or local, tolls, and land surface rent of whatever nature; and in consideration thereof the Company shall in addition to the payments provided for in Article 3 pay to the Shaikh on each anniversary of the Date of signature of this Agreement Seven and One-Half United States Cents (7_ cents) per ton (2,240 lbs.) of petroleum on which royalty is payable.

B. The importation by the Company of firearms and other weapons is prohibited except with the written permission of the Shaikh.

C. If the Company should sell in Kuwait or said Neutral Zone any material or goods previously imported into Kuwait or said Neutral Zone for the purposes of its operations hereunder and no longer required by the Company, the Company shall pay to the Shaikh in respect of such material or goods sold the equivalent of import duty thereon at the rate in force at the time of sale. The duty shall be computed on the price received on sale.

D. Necessary customs officials at harbours constructed by the Company or additional customs officials required at any other ports utilised by the Company shall be appointed by the Shaikh in consultation with the Company and their salaries which shall not exceed the usual salaries of such officials shall be paid by the Company which shall also provide at its own expense suitable buildings for the accommodation of customs officials at harbours which it has constructed.

ARTICLE 8

A. The Company shall have the right to purchase at current market rates fuel, water, food, building and constructional materials and other supplies of every kind in connection with its operations hereunder.

B. The Company shall employ subjects of the Shaikh as far as possible for all work for which they are suited under the supervision of the Company's skilled employees, but if the local supply of labour should in the judgment of the Company be inadequate or unsuitable the Company shall have the right with the approval of the Shaikh which shall not be unreasonably withheld to import labour preference being given to labourers from the neighbouring Arab countries who will obey the local laws. The Company shall also have the right to import skilled and technical employees. Any employee imported by the Company who shall by misconduct cause a breach of peace or public disturbance shall at the request of the Shaikh be dismissed and shall if it is within the power of the Company to do so be sent out of Kuwait and/or said Neutral

Zone. The Company shall pay to the workmen it employs a fair wage, such wage to be decided and stated by the Company at the time the workmen are engaged.

C. The Company shall provide free of charge for its employees in said Neutral Zone all necessary medical services.

The Shaikh and His family shall have the right to such medical services and necessary medical supplies free of charge. Such necessary medical service provided by the Company shall consist of erecting in said Neutral Zone a modern dispensary of adequate size to care for all employees who may need medical treatment as a result of working under the Company's directions. Such dispensary shall be staffed with capable doctors, nurses and assistants a may be needed to operate the dispensary in an efficient and satisfactory manner. The Company shall within four (4) years after the date of discovery of petroleum, begin the construction of a modern dispensary and hospital containing thirty (30) beds which shall be devoted primarily to the treatment of tuberculosis and similar diseases. Such hospital shall be located in or near the City of Kuwait at a site to be designated by the Shaikh.

After the date described above, the Company shall also begin a program of education whereby financial assistance will be given certain Kuwait Nationals by the Company to attend such schools and institutions of learning as they choose under the direction of the Shaikh and the Company.

ARTICLE 9

The Shaikh grants to the Company free of cost the unrestricted use and occupation of and surface rights over all uncultivated land belonging to the Shaikh which the Company may need for the purposes of its operations and in particular the Company shall have the right to select in consultation with the Shaikh an area or areas of land chosen by the Company within the Neutral Zone and/or subject to existing prior rights, in Kuwait with exclusive surface rights upon which to erect oil refineries, storage, terminal and shipping facilities and any other works required for the Company's operations; and the Company may with the cognisance of the Shaikh buy or lease for such purpose any lands, houses or buildings with the consent of and on conditions to be arranged with the proprietors thereof but the terms of such purchase or lease shall not be in excess of those ordinarily current in their respective localities.

A. The Company shall acquire only such land, houses and buildings as are necessary for its operations under this Agreement. The Company shall inform the Shaikh from time to time of the land, houses and buildings which it requires to occupy for its operations; and land, houses and buildings previously acquired by the Company from the Shaikh but found no longer necessary for its operations shall be returned by the Company to the Shaikh free of charge.

B. The Shaikh shall retain for himself the right to grant in consultation with the Company - to another Company or Companies operation petroleum areas within territories adjoining the Neutral Zone borders the right to lay down pipelines and to permit such Company or Companies to construct and erect within the Neutral Zone territory and across same, the necessary buildings and machinery required for the transport in transit or passage over Neutral Zone territory of crude oil to a suitable site within the State of Kuwait or said Neutral Zone considered convenient for the loading of the said crude oil.

ARTICLE 10

The Shaikh shall give to the Company and its employees and property all the protection in His power from theft, highway robbery, assault, wilful damage and destruction, and the Company may appoint in consultation with the Shaikh and itself pay trustworthy guards who shall at all times be Kuwait subjects unless the Shaikh permits otherwise to assist in protecting the property of the Company and its employees. The Company

shall erect at its own expense suitable buildings for the accommodation of such guards at such places as the Company may decide.

ARTICLE 11

Before the expiration of the period specified in Article 1 hereof this Agreement shall come to an end as provided in Article 3 (b) or by surrender as provided in Article 12 or in one of the three following cases:
(a) If the Company shall fail to fulfil its obligations under Article 2 hereof in respect of geological and geophysical exploration or drilling.
(b) If the Company shall fail within six (6) months after any anniversary of the date of signature of this Agreement to make to the Shaikh any payments agreed to be due under Article 3.
(c) If the Company shall be in default under the arbitration provisions of Article 18.
In any of the above-mentioned cases the Shaikh shall be entitled to terminate this Agreement and all the property of the Company within the State of Kuwait and said Neutral Zone shall become the property of the Shaikh.

ARTICLE 12

A. The Company have the right at any time after it has drilled the 4,000 feet provided in Article 2 B (i) or after the expiry of 2 years from the date of signature of this Agreement - whichever shall be the later date - to give the Shaikh one year's notice in advance to terminate this Agreement and the Company shall on expiry of such notice have no further liabilities except to make payment of all monies which may be due to the Shaikh up to the date of termination.

B. Should this Agreement be terminated by the Company under this Article 12, then:

(a) If such termination occurs within 35 years from the date of signature of this Agreement all lands granted by the Shaikh and any lands or buildings which the Company may have bought and any houses or buildings constructed by it and other movable property of the Company within the State of Kuwait and said Neutral Zone shall be handed over to the Shaikh free of cost. Producing wells or borings at the time of such terminated shall be handed over in reasonably good order and repair,

but

(b) If such termination occurs after 35 years from the date of signature of this Agreement all the movable and immovable property of the Company in the State of Kuwait and said Neutral Zone shall be handed over to the Shaikh free of cost. Producing wells or borings at the time of such termination shall be handed over in reasonably good order and repair.

ARTICLE 13

On the expiry of this Agreement at the end of the period of 60 years provided in Article 1 or of any extension or renewal of that period all the movable and immovable property of the Company in the State of Kuwait and said Neutral Zone shall be handed over to the Shaikh free of cost. Producing wells or borings at the time of such expiry shall be handed over in reasonably good order and repair.

ARTICLE 14

In the event the Company desires to sell or convey any or all of its rights, powers or interest under this Agreement it shall first obtain the written permission of the Shaikh. It is understood between the Shaikh and the Company that such a transfer or transfers shall be made only to purchasers registered in the United States of America or within the British Empire.

It is further agreed between the Shaikh and the Company that the Shaikh shall have the option to acquire, at the same price and terms specified in any proposed transfer or sale, the rights and interest being offered by the Company.

ARTICLE 15

A. Nothing in this Agreement shall be read as restricting in any way the right of the Shaikh to grant to other parties concessions or permits for substances other than petroleum provided that the operations and rights of the Company hereunder are not thereby injuriously affected.

If the Shaikh should at any date subsequent to the date of signature of this Agreement grant to any other parties concessions or permits for substances other than petroleum, the Shaikh undertakes that such concessions shall contain provisions requiring the holders thereof to abstain from damaging, impeding or interfering with the property, operations and interests of the Company. Deposits of mineral substances other than petroleum such as gold, silver, copper, lead, potash, sulphur and salt or the like which may be discovered by the Company shall be reported to the Shaikh and shall not be worked by the Company except under a special concession or permit from the Shaikh.

B. The Company shall use the Shaikh's flag within the State of Kuwait and said Neutral Zone.

ARTICLE 16

Failure on the part of the Company to fulfil any of the conditions of this Agreement shall not give the Shaikh any claim against the Company or be deemed a breach of this Agreement in so far as such failure arises from force majeure, and if through force majeure the fulfilment by the Company of any of the conditions of this Agreement be delayed the period of such delay shall be added to the periods fixed by this Agreement. Force majeure as used in this Agreement includes the act of God, war, insurrection, riot, civil commotion, tide, storm, tidal wave, flood, lightning, explosion, fire, earthquake, and any other happening which the Company could not reasonably prevent or control.

ARTICLE 17

The Shaikh shall not be general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 11.

No alteration shall be made in terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to this Agreement.

ARTICLE 18

A. At any time during the currency of this Agreement any difference or dispute shall arise between the parties hereto concerning the interpretation or execution hereof or anything herein contained or in connection herewith, or the rights or liability of either party hereunder, the same shall, failing any agreement to settle it in any other way, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee, who shall be chosen by the arbitrators before proceeding to arbitration.

B. Each party shall nominate its own arbitrator within 60 days after the delivery of a request so to do by the other party failing which its arbitrator may at the request of the other party be designated by the British Political Resident in the Persian Gulf. In the event of the arbitrators failing to agree upon the referee within 60 days after being chosen or designated, the British Political Resident in the Persian Gulf may appoint a referee at the request of the arbitrators or either of them.

C. The decision of the arbitrators, or in case of a difference of opinion between them the decision of the referee, shall be final and binding upon both parties.

D. In giving a decision the arbitrators or the referee shall specify an adequate period of delay during which the party against whom the decision is given shall conform to the decision and that party shall be in default only if that party has failed to conform to the decision prior to the expiry of that period and not otherwise.

E. The place of arbitration shall be such as may be agreed by the parties and in default of agreement shall be London.

ARTICLE 19

The Company shall make all payments that become due to the Shaikh under this Agreement into the Shaikh's account at such bank or banks as the Shaikh may designate in writing and the Bank's receipt shall be a full discharge for the Company in respect to the payment of the sum stated in the Bank's receipt. The Shaikh shall nominate no bank which does not have a correspondent in the United States of America or England.

ARTICLE 20

For the purpose of royalty payments the Company shall measure by a method customarily used in good technical practice all petroleum on which royalty is payable and the Shaikh by his representative duly authorised by him shall have the right to observe such measuring and to examine and test whatever appliances may be used for such measuring. Such Representative shall comply with all necessary and usual safeguards for the prevention of fire or other accident; and shall make all examinations and tests at such times and in such manner as will cause the minimum of interference with the Company's operations. If upon such examination or testing any such appliance shall be found to be out of order the Company will cause the same to be put in order at its own expense within a reasonable time, and if upon any such examination as aforesaid any error shall be discovered in any such appliance, such error shall if the Shaikh so decides after hearing the Company's explanation be considered to have existed for three (3) calendar months previous to the discovery thereof or from the last occasion of examining the same in case such occasion shall be within such period of three (3) calendar months and the Royalty shall be adjusted accordingly. If the Company should find it necessary to alter, repair or replace any measuring appliance it shall give reasonable notice to the Shaikh or his Representative to enable a Representative of the Shaikh to be present during such alteration, repair or replacement. The Company shall keep full and correct records of all measurements as aforesaid the said representative of the Shaikh shall have access at all reasonable times to such records and shall be at liberty to make extracts from them. Such records shall be treated as confidential by the Shaikh and his representatives with the exception of such figures therein as the Shaikh may be required by law to publish.

ARTICLE 21

The rights conferred by this Agreement so far as they apply to the State of Kuwait shall be so exercised as not to damage, impede or interfere with the property, operations and interests of the Kuwait Oil Company Limited and/or the Eastern Gulf Oil Company Limited under their respective agreements with the Shaikh.

ARTICLE 22

This Agreement is written in English and translated into Arabic. If there should at any time be disagreement as to the meaning or interpretation of any clause in this Agreement, the English text shall prevail.

IN WITNESS whereof the parties to this Agreement have set their hands the day and year first above written.

On behalf of the American Independent Oil Company
S. MacPherson
Vice President

In the presence of
H.B.M.'s Political Agent

His Highness
Shaikh Sir Ahmed al Jabir as-Subah
K.C.S.I., K.C.I.E.
Ruler of Kuwait

In the presence of
H.B.M.'s Political Agent

APPENDIX NO. VII

THE AGREEMENT OF THE NEW OIL CONCESSION OVER THE NEUTRAL ZONE OFFSHORE AREA

THIS AGREEMENT entered into at Kuwait on the eighteenth day of the month of Dhul Hijjah in the year One thousand three hundred and seventy-seven corresponding to the Fifth day of July One thousand nine hundred and fifty-eight BETWEEN HIS HIGHNESS SHAIKH SIR ABDULLA AL-SALIM AL-SUBAH K.C.M.G., C.I.E. The Shaikh of Kuwait in the exercise of His powers as Ruler of Kuwait on His own behalf and in the name and on behalf of His heirs and successors in whom is or shall be vested for the time being the responsibility for the control and government of the State of Kuwait (hereinafter called "the Shaikh") of the one part and THE ARABIAN OIL COMPANY LTD., of Chiyodadenden Building 1, No. 6, Ootemachi, Chiodaku, Tokyo Japan, of the other part.
WITNESSETH that:
WHEREAS:

I. . The Shaikh among other things has sovereignty over an undivided one half interest in and to the neutral territory (herein called "the Neutral Zone") lying between Kuwait and the Kingdom of Saudi Arabia in accordance with that certain agreement concluded between His Majesty Abdul Aziz Bin Abdul Rahman Al-Faisal Al-Saud the King of Saudi Arabia and His Highness Ahmad Al-Jabir As-Subah the Shaikh of Kuwait dated 13 Rabie II 1341, corresponding to December 1, 1922; and
II.

III. . There appertains to the Neutral Zone the seabed and the subsoil lying beneath the high seas of the Arabian Gulf continuous to the territorial waters of the Neutral Zone, and extending seawards to boundaries to be decided with greater precision when an opportunity offers, and on equitable principles, after discussions between Kuwait, and Saudi Arabia and the neighbouring States, AND this seabed and subsoil are subject to the Shaikh's jurisdiction and control to the same extent as the right, title and interest of the Shaikh in the Neutral Zone and the Shaikh is accordingly the owner of the oil and gas rights with respect to an undivided one half interest in the said seabed and subsoil; and
IV.

V. . The said Company is desirous of obtaining from the Shaikh and the Shaikh is desirous of granting unto the Company, the concession and rights hereinafter set forth and described of His undivided one-half interest in and to the Concession Area as herein defined upon the terms and conditions hereafter set forth;

NOW THEREFORE, in consideration of the premises and the mutual agreements and undertakings hereinafter contained, the Shaikh and the said Company represented by Mr. Taro Yamashita, President of the Company, hereby agree as follows.

ARTICLE 1

In this Agreement unless inconsistent with the subject or context:

"Concession Area" means and includes the aforementioned seabed and subsoil with the exception of the seabed and subsoil beneath the Concessionary Waters as hereinafter defined. When the precise boundaries of this area shall have been

determined an agreed definition thereof shall be attached to this Agreement and shall be a part thereof.

"*Concessionary Waters*" means (a) the waters contiguous to and extending from the mainland of the Neutral Zone up to a distance of six nautical miles from the low water base line or base points used on the 28th day of June 1948 corresponding to the 23rd day of Sha'aban in the year of 1367 for delimiting the territorial waters of the Neutral Zone and (b) the waters contiguous to and extending from the islands of Qaru and Umm al Maradim up to a distance of three nautical mile from the low water base line or base points used on the 22nd day of September 1949 corresponding to the 30th day of Xoulka'ada 1368 for delimiting the territorial waters of those islands.

"*Company*" means and includes the party of the second part hereto and any company to which this Agreement shall be assigned pursuant hereto and if the Company shall have appointed or established an Operating Company shall include that Operating Company to the extent of its functions and the Company agrees that each of the terms and conditions hereof shall inure to and be binding upon itself its successors and assigns and lawful representatives and shall remain binding upon them notwithstanding the appointment and establishment of an Operating Company.

"*Operating Company*" means any company which the Company may appoint and establish for the purpose of the conduct of its operations under this Agreement or any part thereof.

"*Petroleum*" means crude petroleum, gas asphalt ozokerite and their products and cognate substances.

"*Crude Petroleum*" means crude petroleum produced by the Company in the concession Area freed of water sand and other foreign substances.

"*Barrel*" when used in connection with Petroleum or Liquid Petroleum products, means that quantity thereof equivalent in volume to the total of forty-two (42) United States gallons adjusted to sixty degrees (60) Fahrenheit.

"*Anniversary Date*" means in each Year the anniversary of the date of signature of this Agreement.

Oil shall have been discovered "*in commercial quantities*" when a well or wells have been completed and tested and found capable of producing hereunder at least One thousand five hundred (1,500) barrels of Crude Petroleum a day for Thirty (30) consecutive days.

"*Posted Price*" means the price for Crude Petroleum from the Concession Area established from time to time by the Company or its Affiliate and announced by it or its Affiliate in accordance with the usual commercial practice at which crude petroleum of equivalent quality and gravity is offered for sale by it or its Affiliate f.o.b. tankship at the Company's seaboard terminal in cargo lots to buyers generally.

A company shall be deemed to be an "*Affiliate*" of the Company either

(i) if share capital conferring a majority of votes at general meetings of such company is beneficially owned directly or indirectly by the Company or

(ii) if it is the beneficial owner directly or indirectly of share capital conferring a majority of votes at general meetings of the Company or

(iii) if share capital conferring a majority of votes at general meetings of such company aforesaid and share capital conferring a majority of votes at general meetings of the Company are beneficially owned directly or indirectly by the same company or corporation.

"*Adjusted Posted Price*" means the Posted Price or if there is an Agreed Discount, then the Posted Price after deduction of that Agreed Discount.

"*Agreed Discount*" means and includes any selling charge or any volume or other discount agreed in accordance with the provisions of Article 8 paragraph 2 hereof.

"*Initial Period*" means the period if any between the date of commencement of Regular Exports of Petroleum and the next following 31st December.

"*Kuwait Income Tax*" means in relation to any Year the total amounts receivable by the Shaikh under Kuwait Income Tax Decree No. 3 of 1955 as applied by Queen's Regulation No. 2 of 1955 dated 10th October 1955 in respect of that Year by way of income tax based on the profits or gains of that Year arising out of operations and

transactions hereunder whether such income tax is payable by the Company or by any other person or body.

"*Kuwait Income Tax Decree*" means the aforesaid Kuwait Income Tax Decree No. 3 of 1955 as so applied.

"*Exported Oil*" means Crude Petroleum delivered for refining in Kuwait and/or the Neutral Zone the Concession Area or the Concessionary Waters.

"*Exported Products*" means petroleum products derived from Refinery Oil and exported.

"*Year*" means a Christian calendar year.

"*Regular Exports of Petroleum*" means export for commercial and industrial purposes and does not include occasional exports made for purposes of testing and oil reservoir or production equipment or exports made for purposes of analysing testing or sampling. Petroleum or Crude Petroleum "*produced by the Company for its own account*" means eighty percent of the quantity of Petroleum or Crude Petroleum produced by the Company under this Agreement in any Year of each and every type and quality.

"*Oil Operations*" means the operations carried out by the Company under this Agreement for the purpose of producing Refinery Oil Exported Oil, oil delivered to the Shaikh pursuant to Article 6 (A) (d) and Crude Petroleum sold to the Shaikh pursuant to Article 11 natural asphalt and Gas and delivering the same for refining or export or (as the case may be) to the Shaikh pursuant to the said Articles.

"*Marketing Operations*" means all operations of the Company under this Agreement other than (a) Oil Operations and (b) the sale of Crude Petroleum.

"*Oil Profit*" means the profits of the Company in the Initial Period and in any Year thereafter from Oil Operations ascertained in accordance with the provisions of Article 8, 3 hereof.

"*Marketing Profit*" means the profits of the Company in any Year from Marketing Operations ascertained in accordance with the provisions of Article 9 hereof.

"*Neutral Zone*" means the neutral territory lying between Kuwait and Saudi Arabia hereinafter referred to.

"*Effective Date*" means the date of signature of this Agreement.

"*Gas*" means all gaseous substances regardless of gravity including casinghead gas, produced from the Concession Area in a vaporous or gaseous form, regardless of whether said gaseous substances existed in a liquid or gaseous form in the reservoir or in solution with crude petroleum.

ARTICLE 2

A. The Shaikh hereby grants to the Company to the extent of His undivided one half interest in the Concession Area for a period of forty-four and one half (44.5) years from the Effective Date:

(i) the exclusive right to explore, search for, drill for, produce and win Petroleum within the Concession Area; and

(ii) subject as hereinafter provided the exclusive ownership of all Petroleum produced and won by the Company pursuant to this Agreement within the Concession Area; and

(iii) the right within Kuwait the Concession Area the Neutral Zone and the Concessionary Waters, but subject as hereinafter provided to refine transport sell for use within such areas aforesaid or for export and to export or otherwise to deal with or dispose of any and all such Petroleum; and

(iv) the right subject as hereinafter provided to do all things necessary for the purposes of the above operations.

B. The Company shall exercise the rights hereby granted subject to existing prior rights and in particular rights granted by concession agreements relating to (i) the mainland of Kuwait and the islands of Warbah, Bibiyan, Failaka, Ashjan and Auha (ii) the Neutral Zone and (iii) the islands of Kubr Qaru and Umm al Maradim, and the

Company shall not damage impede or interfere with the property operations and interests or owners of such concessions.

C. The Company's operations shall be conducted with due regard to the character of the sea overlying the Concession Area and the Concessionary Waters and in particular the Company undertakes that in the exercise of its rights and in the fulfilment of its obligations under this Agreement it will interfere to the minimum extent possible with and will take adequate precautions for the protection of navigation fishing and pearling and that it will comply with all reasonable requirements of the competent authorities affecting the navigation of ships and aircraft.
D. The Company undertakes that it will not within the State of Kuwait or the Neutral Zone or any islands within the jurisdiction of the Shaikh carry on any operations within areas occupied or devoted to the purposes of mosques, sacred buildings or graveyards, nor carry on any operations except the sale of Petroleum housing of staff and employees and administrative work within the area zoned for building development on the Master Plan for the town of Kuwait dated 8th May, 1952.

E. Any Gas from the Shaikh's undivided one half interest not utilised by the Company for its own operations hereunder or treated by the Company or sold by it shall remain the property of the Shaikh and shall if required by Him be delivered to Him free of charge at a gathering centre or other technically suitable place, but the company shall not be bound to store Gas for the Shaikh.

F. The rights of the Company hereunder shall be exercised in a lawful manner subject to the laws applicable to Kuwait, and existing agreements to which the Shaikh is a party and the rights, if any of third parties to suitable indemnity; and due respect in the exercise thereof shall be accorded to the religion and customs of the people.

The Company shall be responsible in the manner prescribed by law for any loss or damage to third parties wrongfully caused by it, without any responsibility on the part on the Shaikh.

ARTICLE 3

A. Within six months of the date of signature of this Agreement the Company shall commence geological and/or geophysical exploration.

B. Within two years from the date of signature of this Agreement the Company shall commence the drilling of a test well.

C. The Company shall thereafter proceed diligently (a) with the drilling of a test well or wells to an aggregate depth of not less than 20,000 feet unless oil is discovered in commercial quantities before reaching that aggregate depth and (b) in the conduct of its operations for the purpose of discovering and producing Petroleum in the Concession Area and exporting it.
D. The Company shall conduct its operations in a workmanlike manner and by appropriate scientific methods and shall take all reasonable measures to prevent the ingress of water to any Petroleum-bearing strata and to prevent the pollution of the sea and shall duly close any unproductive holes drilled by it and subsequently abandoned. The Company shall where necessary consult with the Shaikh on measures which are desirable to maintain reservoir pressure and secure the maximum recovery of Petroleum from every reservoir. The Company shall keep the Shaikh and His duly appointed Representatives informed generally as to the progress and result of all of its operations but such information shall be treated as confidential save in so far s it is required for the purpose of settling a dispute between the parties hereto by arbitration.

E. As soon as possible after the discovery of oil in commercial quantities the Company shall establish and shall at all times thereafter maintain not less than two rotary drilling rigs in continuous operation in the Concession Area.

F. If the quality or gravity of crude Petroleum differs from one field to another or from one level to another the Company shall if required by the Shaikh handle it in separate gathering and storage systems.

ARTICLE 4

One half of all Petroleum produced within the Concession Area shall be deemed to have been produced from the Shaikh's undivided one half share in the Petroleum resources in the said Are and one half shall be deemed to have been produced from the undivided one half share therein belonging to the Government of the Kingdom of Saudi Arabia.

ARTICLE 5

The Company shall in addition to the operations specified in Article 2 (A) hereof when the level of product permits and when requested by the Shaikh carry out all phases of the oil industry including the refining processing transporting storing and marketing of Petroleum. If and when Crude Petroleum produced by the Company from the Shaikh's undivided one half interest in the Concession Area shall have reached a daily production of 30,000 Barrels for a period of ninety days the Company pledges itself to discuss with the Shaikh the construction in Kuwait or the Neutral Zone of a suitable oil refinery. Among the factors to be taken into account in reaching a decision will be (a) the desirability of increasing the Shaikh's share in the profit from the Company's operations and (b) the economics of refinery in Kuwait or the Neutral Zone to the Company. At any time after Crude Petroleum produced by the Company from the Shaikh's undivided one half interest in the Concession Area shall have averaged seventy-five thousand (75,000) Barrels per day for a period of ninety days, the Company shall if required by the Shaikh commence and prosecute to completion as rapidly as reasonably practicable and in no more than two yeas, the construction in the State of Kuwait or the Neutral Zone of a refinery or refineries having a minimum daily throughput capacity of not less than thirty percent (30%) of the Company's production from the Concession Area. The said refinery or refineries shall manufacture all possible high priced yields including engine oils, lubricating oils a well as asphalt. The Company shall also from time to time discuss with the Shaikh the establishment of a plant or plants in the State of Kuwait or the Neutral Zone for the utilisation of the Gas produced by the Company.

The site of the refinery and such plant or plants aforesaid will be the subject of mutual agreement between the Shaikh and the Company.

The Company may, subject to the consent of the Government of the Kingdom of Saudi Arabia, erect a refinery in the Concession Area or the Neutral Zone of sufficient capacity to satisfy the obligation of the Company under this Agreement and under the aforesaid Agreement dated 10th December 1957 and such refinery shall be deemed to satisfy the obligation of the Company under this Agreement.

ARTICLE 6

A. In consideration of the rights granted by the Shaikh to the Company by subparagraph (A) (i) and (ii) of Article 2 of this Agreement and of the assistance and protection which the Shaikh hereby undertakes to afford by all means in His power to the Company and its operations employees and property, the Company shall pay to the Shaikh the following sums and considerations.

(a) On or within fourteen days after the Effective Date in respect of the year 1958 and on the First day of January in each Year thereafter in respect of such Year until and including the Year in which oil is discovered in commercial quantities a rental at the rate of $1,500,00 per year in currency of the United States of America the first

such payment to be sum apportioned on a daily basis from the Effective Date until the 31st December, 1958.

(b) Upon and subject to the discovery of oil in commercial quantities a sum apportioned on a daily basis from the Effective Date until the date of such discovery at the rate of $1,000,000 per year in currency of the United States of America. Such sum shall be paid to the Shaikh within two months of the date of such discovery.

(c) From the date of discovery of oil in commercial quantities a minimum payment at the rate of $2,500,000 per year in currency of the United States of America. A sum at the aforesaid rate apportioned on a daily basis from such date until the 31st day of December next following shall be paid within two months of such date and sums in respect of each subsequent Year shall be paid in advance on the first day of January in each Year. The proportion of the payment made pursuant to sub-paragraph (a) of this paragraph in respect of the Year in which oil is discovered in commercial quantities calculated on a daily basis fro the date of discovery until the 31st December in that Year shall be a credit against the sum payable pursuant to this sub-paragraph (c) in respect of that Year and the sums payable pursuant to this sub-paragraph (c) shall be credited against sums payable pursuant to the next succeeding sub-paragraph (d).

(d) Within thirty days after the 31st March, 30th June, 30th September and 31st December in each Year Royalties of:

(aa) Twenty per cent of the Posted Price of every barrel of Crude Petroleum won and saved by the Company hereunder from the Shaikh's undivided one half interest; and

(bb) Twenty per cent on the natural asphalt extracted by the Company hereunder from the Shaikh's undivided one half interest; and

(cc) Twenty per cent on the Gas won and saved by the Company hereunder from the Shaikh's undivided one half interest other than Gas delivered to the Shaikh under the provisions of Article 2 (E) and Gas derived from refining during the three months ending on those dates respectively.

For the purpose of calculating the Royalty payable hereunder:

(i) It is agreed that Petroleum returned to the Reservoir and Petroleum required for the customary operations of the Company's installations within the Concession Area the State of Kuwait the Neutral Zone and the Concessionary Waters shall be deducted;

(ii) Royalty on natural asphalt and Gas shall be calculated on the value thereof as determined from time to time by agreement between the Shaikh and the Company.

The Shaikh may be notice given to the Company not less than three months prior to the commencement of any Year elect to receive any part or the whole of the Royalty payable to Him in respect of that Year in kind. The quantity to be received in kind shall be valued fifteen days prior to the commencement of such Year and the minimum payment payable under paragraph (A) (c) of this Article in respect of that Year shall be reduced by a like amount with an adjustment at the end of that year in the event of any variation in quantities or values at the dates of delivery.

Any oil which the Shaikh elects to take in kind under this Article shall be delivered f.o.b. at the Company's seaboard terminal or to such place in the State of Kuwait or the Neutral Zone as the Shaikh and the Company may agree. Any asphalt which the Shaikh elects to take in kind under this Article shall be delivered in drums or by some other arrangement with the Shaikh at any sea port or other place in Kuwait or the Neutral Zone the Shaikh indicates. Any Gas which the Shaikh so elects to take shall be delivered at a gathering centre or other technically suitable place, but the Company shall not be compelled to store Royalty gas for the Shaikh.

(e) When the Company shall for the first time produce from the Shaikh's undivided one half interest in the Concession Area 50,000 barrels of Crude Petroleum in one day the sum of five million dollars ($5,000,000) in Currency of the United States of America.

(f) All matters required for the implementation of this Article and not hereinbefore specifically provided for shall be determined in such manner as the Shaikh and the Company may agree.

B. No money paid by the Company to the Shaikh shall, except in the case of an error in accounting, be returnable in any circumstances whatever.

ARTICLE 7

1. The Company undertakes that in the Initial Period and in every Year thereafter the Shaikh shall receive in the manner provided in this Article not less than the greater of:

A. The amount payable under Article 6 (A) (c) in respect of that Period or Year; or

B. Fifty-seven (57) percent of the Oil Profit to be ascertained as provided in Article 8; or

C. An amount equal to the aggregate of:

(a) Royalties payable under Article 6 (A) (d) for the Period or Year (no deduction being made for the purposes of this sub-paragraph (C) (a) for any amount payable under Article 6 (A) (c); and

(b) Forty (40) percent of the amount (if any) by which the Oil Profit (to be ascertained as provided in Article 8) for that Period or Year exceeds the amounts refereed to in sub-paragraph (a) of this paragraph (C) for that Period or Year.

2. The undertaking under paragraph 1 of this Article shall in respect of any Year be satisfied by the receipt by the Shaikh of:

(a) Kuwait Income Tax on the Company's Oil Operations in respect of that Year; and

(b) The payment under Article 6(A)(c) in respect of that Year (and in the case of the Year in which the Company commences Regular Exports the proportion of such payment from the date of such commencement until the next succeeding 31st day of December); and

(c) Royalties payable under Article 6(A)(d) hereof (in so far as they exceed the amount payable under Article 6(A)(c) hereof) in respect of that Year; and

(d) Any further sum which may be requisite (herein called "the Make-up Payment). The Royalties, Kuwait Income Tax and the Make-up payment shall be paid in Dollars of the United States of America in accordance with the procedure mentioned in Article 10.

3. The Company undertakes that the Shaikh shall receive fifty-seven (57) percent of the Marketing Profit to be ascertained as provided in Article 9 hereof. This undertaking shall in respect of any Year be satisfied by the receipt by the Shaikh of an amount (hereinafter called "the Marketing Make-up Payment") which when added to Kuwait Income Tax payable on the Company's Marketing Operations in respect of that Year would give an aggregate total equal to fifty-seven (57) percent of the Marketing Profit.

4. (a) For the purpose of ascertaining the Oil Profit and the Marketing Profit:

(i) all principal books and accounts shall be kept in U.S. dollars;

(ii) all expenditure and receipts and Posted Prices shall be expressed in U.S. dollars;

(iii) any expenditure and receipts in a currency other than U.S. dollars shall be converted into U.S. dollars according to the normal commercial practice;

(iv) Posted Prices quoted in a currency other than U.S. dollars shall be converted into U.S. dollars on the basis of the par value for the time being established under the Articles of Agreement of the International Monetary Fund. Failing par values so established or if either of the parties shall consider that such par

values do not provide a fair and reasonable basis for conversion the parties shall seek to agree upon an alternative basis and failing such agreement the Posted Price shall be converted on such a basis as shall be specified by the First National City Bank of New York to be fair and reasonable.

(b) The Company shall keep its principal books and accounts in the Neutral Zone or shall keep duplicate books and accounts in Kuwait.

ARTICLE 8

I. The Company shall establish and announce or shall procure that an Affiliate shall establish and announce its Posted Price in accordance with practice in the Arabian Gulf and at Arabian Gulf levels and the Shaikh shall be entitled at any time to call upon the Company to establish that its Posted Price or that of its Affiliate applies to Crude petroleum from the Concession Area offered (as provided in the definition of Posted Price in Article 1) to buyers generally.

II.

III. . Prior to the commencement of Regular Exports of Crude Petroleum and at agreed intervals thereafter the Shaikh and the Company shall consider and decide whether any selling charge and/or any volume or other discount shall be applied to the Posted Price for the purpose of calculating the Oil Profit and the amount of any such selling charge and/or volume or other discount and the tonnage of Crude Petroleum to which it shall apply. In arriving at any such decision consideration shall be given to any similar selling charge and/or volume or other discounts applied for the purpose of calculating the revenue accruing to the respective Governments from Petroleum, to the Posted Prices of other Petroleum exported from Kuwait and of Petroleum exported from neighbouring countries.

IV.

3. The Oil Profit shall be ascertained in the following manner:

A. The quantity and quality of Exported Oil, Refinery Oil, oil delivered to the Shaikh pursuant to Article 6(A)(d) and Crude Petroleum sold to the Shaikh pursuant to Article 11 shall be ascertained in respect of each day.

B. The Posted Prices shall be ascertained for each day and the appropriate Adjusted Posted Price shall be applied to each barrel of Crude Petroleum delivered from the Company's tanks for export or refining on that day or to the Shaikh pursuant to Articles 6(A)(d) or 11.

C. The cost of Exported Oil and Refinery Oil and oil delivered to the Shaikh as aforesaid shall be ascertained by sound and consistent accounting methods as follows:

(a) There shall be determined the total of all costs and expenses of the Company (but excluding any sum in respect of payments under Articles 6 and 7 the cost of services supplied pursuant to Article 28 Kuwait Income Tax and any taxation on income or profits levied outside Kuwait) for the Initial Period and for each Year thereafter which are fairly and properly attributable to the operations of the Company in the Crude Concession Area, in the State of Kuwait, the Neutral Zone and in the area of the Concessionary Waters for the purpose of producing Crude Petroleum and delivering it for export or refining or to the Shaikh as aforesaid. Such costs and expenses including provision for the exhaustion, depreciation and obsolescence of properties used in carrying on such operations shall (save as in this Article provided) be ascertained in accordance with the provisions of the Kuwait Income Tax Decree.

No provision for exhaustion, depreciation and obsolescence shall be made in respect of any property if the provision when added to the provisions in respect of the same property for previous years exceeds the capital costs of such property.

All expenditure including survey exploration and development costs incurred before the date of commencement of Regular Exports shall be incurred before the date of commencement of Regular Exports shall be treated in the books of the Company as

capital expenditure and shall not be included in the total costs and expenses of the Company or amortised for the purposes of this Article or for the purposes of Kuwait Income Tax save that property acquired prior to the date of commencement of Regular Exports and still in use at such date may be amortised at the rates specified in Article 3(c) of the Kuwait Income Tax Decree from the date of such commencement until the residue of cost of such property has been written off.

The "residue of cost" means the original cost of the property reduced by the amounts which would have been written off if Article 3(c) of the Kuwait Income Tax Decree had applied in the period prior to the commencement of Regular Exports.

The following costs and expenses shall be treated in the books of the Company as capital expenditure and shall not be included in the total costs and expense for the purpose of this Article save that an amount not exceeding 10% of such costs and expenses incurred on or after the date of commencement of the Regular Exports may be so included until the same are fully written off:

(i) Survey and exploration costs,

(ii) A reasonable portion of the indirect expenses incurred by the Company in field and development operations.

For the purposes of Kuwait Income Tax such last mentioned costs and expenses shall be similarly treated and the rate of 10% shall be deemed to be reasonable for the purposes of Article 3(c) of the aforesaid Decree.

(b) The Auditors for the time being of the Company and of the Shaikh shall within three (3) months after the end of the Initial Period and of each Year thereafter agree in writing the total of all costs and expenses of the Company for such period or Year as the case may be calculated under sub-paragraph (a) above.

(c) In the event of disagreement between the Auditors of the Company and of the Shaikh under sub-paragraph (b) above a difference or dispute shall be deemed to have arisen under Article 33 hereof and shall if no agreement can be arrived at for settling it by any other method be referred to arbitration in accordance with the provisions of that Article.

D. The Oil Profit shall be the aggregate for the Initial Period or the Year in question of the amounts calculated in accordance with sub-paragraphs 8. 3(A) and (B) hereof less the costs and expenses ascertained under sub-paragraph 8. 3(c) hereof.

4. The Oil Profit in relation to the production of natural asphalt and Gas shall be ascertained in like manner as is provided in paragraph 3 of this Article in relation to Exported Oil and Refinery Oil and oil delivered to the Shaikh as therein specified but if no prices are posted for natural asphalt or Gas there shall be taken such sums as may be agreed between the Shaikh and the Company being the best prices that Company might reasonably expect to receive from the sale of such natural asphalt or Gas upon a sale between a willing seller and a willing buyer.

5. The cost of providing services pursuant to Article 28 shall not be deductible as an expense or amortised for the purpose of computing the Oil Profit or the Marketing Profit.

6. If the calculation for the purposes of paragraphs 3 and 4 of this Article shall result in a loss the amount of such loss may be carried forward and, so far as may be, deducted or set off against the amount of the Oil Profit in respect of the following periods. Any such deduction or set-off under this paragraph shall be made as far as possible in the first subsequent Year and so far as it cannot be so made then in the next year and so on.

ARTICLE 9

A. The Marketing Profit shall be ascertained by sound and consistent accounting methods and in particular

(a) All quantities of (i) crude petroleum and (ii) natural asphalt and Gas taken into Marketing Operations shall be taken respectively at the Adjusted Posted Price ascertained and applied thereto for the purposes of Article 8. 3(B) or the Price ascertained and applied thereto for the purposes of Article 8. 3(B) or the sums ascertained under Article 8. 4 hereof. Stocks shall be valued on the basis of first in first out.

(b) All costs and expenses including provision for exhaustion depreciation and obsolescence of properties used in carrying on such operations shall be ascertained in like manner as costs and expenses (including provision as aforesaid) are ascertainable under paragraph 3(C) of Article 8 hereof.

(c) Foreign Taxes upon the Company's profits paid in respect of Marketing Operations carried on wholly outside Kuwait, the Neutral Zone, the Concessionary Waters and the Concession Area may be treated as expenses for the purpose of determining such profit. Profits derived by the Company from the operation of tankers from or to the Company's seaboard terminals in the Arabian Peninsula shall not be deemed to be profits from an operation carried on wholly outside such areas aforesaid. Foreign taxes paid by the Company shall as between one of the Company's operations and another be apportioned in a fair and equitable manner to be agreed from time to time between the Shaikh and the Company. Such foreign taxes as may be payable in respect of any period other than a Year shall be apportioned on a daily basis and the proportion of each payment attributable to any part of the any year shall be deemed to have been paid in such year.

B. The Company undertakes that it shall conduct its Marketing Operations to the best advantage and shall sell products at the best prices it can obtain in a free competitive market and in any event at prices no less than those from time to time agreed between the Company and the Shaikh. The procedure for dealing with products refined in Kuwait and/or the Neutral Zone and sold for consumption in Kuwait and/or the Neutral Zone and not for export and the prices at which such products shall be sold shall be determined in a manner to be agreed at a later date by the Shaikh and the Company.

ARTICLE 10

As from the date of commencement of Regular Exports of Crude Petroleum

1. (a) The Company shall within thirty (30) days after the end of each quarter ending on the 31st day of March, the 30th day of June, the 30th day of September and the 31st day of December in each year, submit to the Shaikh a provisional tonnage statement showing the quantity and quality of Exported Oil Refinery Oil natural asphalt and Gas produced from the Shaikh's undivided one half interest during such quarter or (in the case of the first provisional tonnage statement) during the period which has elapsed since the date of commencement of Regular Exports of Crude Petroleum and containing all such other information as may be reasonably required to enable the Shaikh to calculate the amount of the Royalty due in respect of such quarter or period and to assess the Oil Profit in such quarter or period for which purpose the cost of Exported Oil and Refinery Oil shall be the Company's estimate thereof.

(b) The Company shall within three (3) months after the end of each Year submit to the Shaikh a final tonnage statement containing in respect of that Year or (in the case of the first final tonnage statement) of the Initial Period the information required to be stated in a provisional tonnage statement except that if the cost of the Exported Oil Refinery Oil natural asphalt and Gas to which it relates has been agreed pursuant to Article 8 hereof, such agreed cost shall be used for the purposes of such final tonnage statement. The final tonnage statement either as submitted or as subsequently varied by agreement shall become conclusive not later than the Fifteenth day of April in the Year in which it is submitted except to the extent that such tonnage statement is inconclusive by reason of the occurrence of two following events or either of them:

(i) that either the Company or the Shaikh has prior to that date by notice in writing to the Shaikh or the Company, as the case may be, requested that any

dispute concerning any matter contained in such final tonnage statement be referred to arbitration for decision;

(ii) that a difference or dispute in relation to cost shall have been deemed to have arisen in accordance with Article 8. 3. (C)(c) hereof.

2. Royalty shown to be due in a provisional tonnage statement shall be paid and satisfied by the Company at the time such provisional tonnage statement is submitted. If a final tonnage statement shows any further sum to be due to the Shaikh in respect of Royalty to which it relates the Company shall forthwith pay the same, and if a final tonnage statement shows the amount paid by the Company in respect of Royalty to be in excess of the amount which ought to have been paid, such excess shall be treated as an advance by the Company against future Royalty.

3. Any Make-up Payment in respect of any Year shall be paid by four approximately equal and (if necessary) provisional quarterly payment on the dates on which instalments of Kuwait Income Tax are payable in respect of that Year, but if, when the total amount which the Shaikh is entitled to receive under Article 7 paragraph 1 hereof in respect of that Year is finally determined, provisional payments as aforesaid are found to be less in the aggregate than the Make-up Payment, the Company shall forthwith make good the deficiency. If such provisional payments as aforesaid are found in the aggregate to have exceeded the Make-up payment, such excess shall be treated as an advance against future Royalty.

4. The Company shall also within three months after the end of each Year submit to the Shaikh a statement containing all such information as may be reasonably required to enable the Shaikh to calculate the amount due to Him in respect of that Year pursuant to Article 7.3. hereof.

ARTICLE 11

(a) In addition to His rights to receive Crude Petroleum natural asphalt and Gas in kind pursuant to Article 6 the Shaikh shall have the right to purchase from the Company at the prices hereinafter specified less a discount of 5% for His own use and for use within Kuwait and the Neutral Zone but not for resale others abroad or for export an amount not in excess of 10% in value of all Petroleum produced by the Company for its own account.

(b) The Shaikh shall also have the right to purchase from the Company for resale to friendly Arab countries at the prices hereinafter specified an amount not in excess of 10% in value of all Petroleum produced by the Company for its own account.

(c) For the purposes of this Article (i) Petroleum may be purchased by the Shaikh the form of Crude Petroleum natural asphalt or Gas or in the form of any refined or treated product or derivative thereof produced by the Company in Kuwait the Neutral Zone or the Concession Area (ii) Petroleum shall be valued for the purpose of determining the amount to be purchased by the Shaikh, in the case of Crude Petroleum at posted prices and in the case of other forms of Petroleum in such manner as the parties shall from time to time agree (iii) the term "the prices hereinafter specified" means in the case of Crude Petroleum the Adjusted Posted Price and in the case of other forms of Petroleum such price as the Shaikh and the Company shall hereafter determine having regard to the prices received by the Company and by other producers in Kuwait and in neighbouring countries upon contracts for sale of Petroleum of the same or similar type and quantity.

ARTICLE 12

The Company undertakes that

A. After the discovery of oil in commercial quantities the Company will either procure that the Shareholders will offer to sell to the Shaikh at par 10 percent of the share capital of the Company then issued or offer to Him for subscription for cash at par such number of shares as will provide for Him if He subscribes for them all 10 percent of the share capital of the Company after such subscription. Such offers shall be in writing and the Shaikh shall have the right at any time before the expiration of 60 days after the receipt of the offer to purchase or as the case may be subscribe for all or any of the shares so offered. The purchase or subscription terms shall in all other respects be the same as those upon which the shares then in issue shall have been issued including the currency of subscription.

B. Whenever the Company decides to issue new shares thereafter the Company shall offer to the Shaikh for subscription for cash at par 10 per cent of the shares to be issued and the Shaikh shall have the right at any time within 60 days of the receipt of the offer to subscribe for all or any of the shares offered. The subscription terms for the shares shall in all respects be the same as those upon which the other shares are issued to others including the currency of subscription.

ARTICLE 13

The Company shall at the third anniversary of the discovery of oil in commercial quantities and at the expiration of every five years thereafter relinquish to the Shaikh and to the Government of the Kingdom of Saudi Arabia an area equal to twenty per cent (20%) of the area unexploited at the date of relinquishment. The portions so relinquished shall be of sufficient size and convenient shape to enable oil operations to be carried out thereon. Such portions shall thereupon be released from the terms and conditions of this Agreement, excepting only that during the life of this Agreement the Company shall continue to enjoy the right to use the portions so relinquished for transportation and communication facilities, which, however, shall interfere as little as practicable with any other use to which the relinquished portions may be put.

ARTICLE 14

A. For the purpose of its operations hereunder the Company shall have the right without hindrance in the Concession Area in the State of Kuwait the Neutral Zone and in the area of the Concessionary Waters but subject to the provisions of Article 2 and to existing prior rights mentioned in that Article to construct and operate power stations, refineries, pipelines and storage tanks, facilities for water supply including boring for water, telegraph, telephone and wireless installations, roads, railways, tramways, buildings, ports, harbours, harbour works, piers and jetties, sea and submarine loading lines including lines to and from the mainland of Kuwait and all necessary pumps and pumping stations, gathering and distribution systems, oil and coaling stations, with such lighting as may be requisite and any other facilities or works which the Company may consider necessary and for such purposes to use free of all payments to the Shaikh any stone, sand, gravel, gypsum, clay or water which may be available and may be required for its operations hereunder provided always that the inhabitants are not prevented from taking their usual requirements of the materials and that the water supply of the local inhabitants and nomad population who may be dependent on the same is not endangered. The position of any such works shall be approved by the Shaikh. The Company may likewise utilise without hindrance all such means of transportation by land, air, pipeline and water communication or operation as may be necessary for the effective conduct of its operations hereunder.

But nothing in this Article 14 shall confer on the Company the right to dispose of stone, sand, gravel, gypsum, clay or water by sale, export or otherwise to any other company or person within or without the areas specified above.

B. The Company shall under normal conditions accept and transmit free of charge on its wireless and telegraph installations such of the Shaikh's messages as will not interfere with the Company's business, and in times of national emergency the Shaikh shall have the full use free of charge of the Company's wireless and telegraph installation and railways for governmental purposes.

C. The Shaikh shall have the right to use free of charge pipelines harbours and other transportation facilities established by the Company including transportation facilities for the Shaikh's officials in the performance of their duties in Kuwait the Neutral Zone the Concessionary Waters and the Concession Area provided that such use in no way hampers the Company or interferes in any way with the safety of its operations of which the Company shall be the sole judge. Any piers or appurtenances construction by the Company shall be for its exclusive use.

The Company may use for the purposes of its operations the harbours along the coast of the State of Kuwait upon payment of the appropriate harbour dues and in accordance with Port Regulations subject to existing prior rights, particularly such rights mentioned in Article 2 but the Company shall not impede or interfere with the subjects of the Shaikh or their right to continue the use of existing harbours, anchorages, wharves and docks along the coast of Kuwait at present utilised by them for their sailing craft and fishing boats.

In its use of Kuwait harbour and other harbours on the mainland of Kuwait, the Company shall use the services of local concerns to such extent as is possible considering the scope of work to be done and the facilities and services offered by such concerns, and observe all regulations and bye-laws of the Port of Kuwait.

D. The Company shall give favourable consideration to the employment so far as is practicable for ocean transport of its Crude Petroleum and/or Exported Products of suitable tank vessels owned by Kuwaiti nationals, such employment to be at current market rates.

ARTICLE 15

A. The Shaikh shall be entitled to nominate one sixth of the Boar of Directors (with a minimum of two) of the Company or any company to which this Concession is assigned and thereupon the said Company shall arrange to have the said nominees elected to the Board and to any other body that may perform the duties of the Board of Directors or any of them.

This one sixth of the Board of Directors shall enjoy the rights and privileges and received emoluments not less than those received by other persons in the like position. They and the Shaikh's auditors shall have the same rights to inspect all accounts and records of such Company's operations hereunder.

B. The Shaikh shall have the right to appoint an Arab conversant with the English language to act a his Official Representative and who will represent him in the State of Kuwait and in the Concession Area in matters relating to this Agreement with the Company and particularly whenever unskilled labour is recruited from among the subjects of the Shaikh this Representative shall be consulted and advise the Company regarding any such recruitment. The salary of the Representative shall be agreed, and such salary shall be paid by the Company together with all reasonable expenses incurred by him in the performance of his duties hereunder.

The first Representative under this clause shall be Mr. Abdulla Mulla of Kuwait.

C. The Shaikh shall have the right to appoint a London Representative to represent the Shaikh in all matters relating to this Agreement and such Representative shall have full access to the production records of the Company including the agenda of the Board meetings and shall be entitled to attend the Board's meetings at which the Shaikh's interests are discussed.

All information acquired by the Shaikh's London Representative in the course of his duties shall be regarded as strictly confidential save in so far as it is required for a settlement of a dispute between the parties hereto by arbitration. The salary of such Representative shall be agreed, and shall be paid to the London Representative by the Company and not by the Shaikh. The Company shall also pay all travelling and other reasonable expenses incurred by the London Representative in the performance of his duties hereunder.

The First London Representative under this clause shall be Mr. Herbert Thomas Kemp of the White House, Pages Lane, London, N.10.

D. The salaries of the above Representatives shall be paid to them in United States Dollars, Sterling or Rupees as they elect at such places as they elect. On the commencement of Regular Exports of Petroleum the Company will favourably consider increasing the amounts of the above salaries.

E. The Shaikh shall have the right to appoint a registered firm of auditors who shall be an internationally recognised firm of accountants of His own selection to examine the books of the Company on behalf of the Shaikh. All expenditures incurred in connection with such auditing shall be paid by the Shaikh.

The Company shall provide such firm of auditors with the necessary facilities to enable them to check the books and registers of the Company and shall render every assistance to enable the Auditors to thoroughly examine the same and shall assist them in every way to safeguard the interests of the Shaikh.

The Shaikh and His auditors shall regard as confidential all information supplied in connection with such audit, except in so far as such information is required for settlement of a dispute between the parties hereto by arbitration.

F. A representative of the Company (not being a director appointed by the Shaikh hereunder) shall reside at the Town of Kuwait. Such representative shall be vested with sufficient powers to enable him to consider and decide matters relating to the day to day activities of the Company relating to drilling and production together with such other powers as may be vested in him by the Board of Directors. Matters which such representative is not empowered to decide shall be dealt with by the Board of Directors as quickly as possible. Such representative shall whenever appropriate act in consultation with the representative appointed by the Company to reside at the seat of Government in the Kingdom of Saudi Arabia.

ARTICLE 16

A. The Company undertakes to furnish the Shaikh with all data in order to enable Him to have a complete knowledge of the operations of the Company and also ample geological and geophysical information concerning the regions studied and the wells drilled, and all reports and results of research made inside or outside the Concession Area and the Neutral Zone as finally presented to the top Company officials together with the conclusions based on the basic data and upon which the Company's engineering decisions and operations are based; all of which is to be furnished within a reasonable period, which shall not exceed six months after the respective operations have been carried out or the information or reports have become available. The above mentioned data and information shall be considered as strictly confidential save in so far as they are required for the settlement of a dispute between the parties hereto by arbitration. The Company shall also keep the Shaikh posted at all times on such research and engineering problems as are under study. Duly authorised representatives of the Shaikh shall have direct access at all reasonable times to all technical records of the Company, all of which shall be kept in the Neutral Zone or duplicates thereof in Kuwait.

B. The Company shall also furnish the Shaikh with copies of complete reports of its economic studies concerning all the aspects of the Company's oil operations and the world markets, especially the markets that have direct effect on its operation. The Shaikh shall regard all such reports as strictly confidential save in so far a they are required for the settlement of a dispute between the parties hereto by arbitration.

C. The Company shall notify the Shaikh as soon as practicable of any damage of whatever nature to the oil fields or the installations and shall take all necessary measures to stop and rectify such damage.

D. The Company shall present to the Shaikh within three months of the end of each Year a report relative to its operations in such Year with plans, photographs and statistics, such report shall contain:

(a) A statement on drilling operations carried out during the Year.

(b) A statement on refining transport and other Marketing Operations carried out during the same period.

(c) The total amount of taxes that the Company paid during the Year, stating why they were caused, and the total amount owing by it.

(d) The number of employees and labour, indicating their nationality, salary and wage, with a report on the medical aid and educational assistance given such employees, their living conditions and the nature of their work.

E. The Company and every Operating Company shall supply the Shaikh His Official Representative in Kuwait and His London Representative with copies of all notices accounts reports and other documents which Shareholders of the Company and such Operating Companies receive or are entitled to receive. Such copies of notices accounts reports and other documents shall be so supplied not later than the same are served upon or supplied to the Shareholders and shall be accompanied in each case by three copies of the same translated in the case of copies forwarded to the Shaikh and His Official Representative in Kuwait into Arabic and English and in the case of copies forwarded to His London Representative into English.

F. The Company shall consult with the Shaikh as to the number of barrels to be produced from each well or field. Subject thereto the Company shall take all necessary measures after the discovery of Petroleum in any well to put such well into operation without undue delay and all wells shall be produced at their maximum efficient rate, provided that a satisfactory market exists for the Petroleum. The Company shall not start production from any field or well before testing and making sure to the satisfaction of the Shaikh's representatives that the well has been properly completed in accordance with first-class oilfield practice.

G. The Shaikh through duly authorised representatives shall have the right to inspect the works and activities of the Company related to exploration, exploitation, production, manufacture, refining, transportation and marketing.

ARTICLE 17

A. Within the Concession Area, subject to the approval of the Shaikh, and in the State of Kuwait and the Neutral Zone subject to the approval of the Shaikh and subject to existing prior rights, particularly such rights mentioned in Article 2 the Company shall have free of cost the unrestricted use and occupation of and surface rights over such uncultivated land belonging to the Shaikh as the Company may need for the purposes of its operations and in particular the Company shall have the right to select, subject as aforesaid, an area or areas of land chosen by the Company with exclusive surface rights upon which to erect oil refineries, storage, terminal and shipping facilities and any other works required for the Company's operations; and the Company may, subject as aforesaid, buy or lease for such purpose any lands, houses or buildings with the consent of and on conditions to be arranged with the proprietors thereof but the

terms of such purchase or lease shall not be in excess of those ordinarily current in their respective localities.

B. The Company shall acquire only such land, houses and buildings as are necessary for its operations under this Agreement. The Company shall inform the Shaikh from time to time of the land, houses and buildings which it requires to occupy for its operations; and land, houses and buildings previously acquired by the Company from the Shaikh (including lands and islands reclaimed or created by the Company) but found no longer necessary for its operations shall be returned to the Shaikh free of charge by the Company.

C. The Shaikh shall retain for himself the right to grant - in consultation with the Company - to another Company or Companies operating petroleum areas within territories adjoining the Concession Area the right to lay down pipelines and to permit such company or companies to construct and erect within the Concession Area and across same, anything required for the transport in transit or passage over the Concession Area of crude oil to a suitable site considered convenient for the loading of the said crude oil, provided that the operations of the Company are not thereby impeded.

D. The Company shall not be entitled to construct airfields within the State of Kuwait or the Neutral Zone without the written consent of the Shaikh.

ARTICLE 18

A. The Company shall have the right to import water, petroleum, fuel, machinery, motor-cars and lorries, equipment, plant, timber, utensils, iron work, building materials, food, supplies, medicines, medical supplies, office equipment and household furniture, and all other materials equipment and goods of whatsoever nature required by the Company and its employees for the purposes of its operations hereunder but not for resale to others, and to export its Petroleum and articles previously imported by the Company free of customs or import or export duty and taxes or other charges, but it shall pay on all personal goods, clothing and general merchandise imported by the Company for the personal use of its employees or for resale to them the ordinary customs duty, taxes and other charges in force for the time being in the State of Kuwait. Except as provided in Article 6 and in this Article, the Company, its operations income, profits and property including Petroleum shall be exempt and free during the period of this Agreement from all present or future import duties, export duties, taxes (other than Kuwait Income Tax as defined in Article 1) imposts and charges of any kind, whether state or local, tolls, and land surface rent of whatever nature.

B. The importation by the Company of firearms and other weapons is prohibited except with the written permission of the Shaikh.

C. If the Company should sell any material or goods previously imported for the purposes of its operations hereunder, the Company shall pay to the Shaikh in respect of such material or goods sold the equivalent of customs or import duty thereon at the rate in force at the time of sale. The duty shall be computed on the price received on sale.

D. Necessary Customs and quarantine Officials at harbours and airfields constructed by the Company or additional Customs or quarantine Officials required at any other harbours or airfields utilised by the Company shall be appointed by the Shaikh in consultation with the Company and their salaries which shall not exceed the usual salaries of such officials shall be paid by the Company which shall also provide at its own expense suitable buildings for offices and living accommodation of Customs and quarantine Officials at harbours and airfields which it has constructed.

Reasonable and suitable quarantine provisions shall be enforced at the Company's expense at harbours and airports constructed by the Company, and the

Company shall take all reasonable precautions in its operations hereunder to prevent the spread of disease.

ARTICLE 19

A. A Committee composed of equal numbers of the Shaikh's and the Company's representatives shall be formed to supervise and examine all the expenses and purchases of the Company and ensure that they are reasonable and that the prices and quality of the goods and materials purchased by the Company are also reasonable. The Company may purchase in the State of Kuwait at current market rates, fuel, water, food, building and constructional materials, and other supplies of every kind in connection with its operations hereunder.

B. The Company shall give preference to goods and materials that are available in Kuwait and friendly Arab Countries of suitable type and reasonably comparable quality and price. The Company shall not purchase goods or materials from any foreign country hostile or unfriendly to the Shaikh.

ARTICLE 20

A. The Company shall not knowingly sell, directly or indirectly, any Petroleum produced by it from the Concession Area to any foreign power hostile or unfriendly to the Shaikh or to any subject or citizen of such power.

B. All other things being equal, the Company shall afford priority with respect to the sale of the product and by-products of any refinery or refineries built by it within Kuwait or the Neutral Zone to domestic purchasers or to purchasers within friendly Arab nations upon the same terms upon which such products and by-products are offered for sale generally.

ARTICLE 21

A. The Company shall employ Kuwait personnel in the management and operation of its activities hereunder. The following proportions shall be observed:

(a) Inside Kuwait the Neutral Zone the Concessionary Waters and the Concession Area a minimum of 70% of its employees and labour shall be subjects of the Shaikh.

(b) Outside Kuwait the Neutral Zone the Concessionary Waters and the Concession Area a minimum of 30% shall be subjects of the Shaikh, if and when they are available. If the local supply of employees should in the judgment of the Company be inadequate or unsuitable the Company shall have the right with the approval of the Shaikh which shall not be unreasonably withheld, to import employees, preference being given to (a) citizens of other Arab states, failing which (b) citizens of other friendly states.

The Company shall also have the right to import skilled and technical employees. Any employee imported by the Company who shall by misconduct cause a breach of peace or public disturbance or shall otherwise render himself undesirable shall at the request of the Shaikh be dismissed and shall if it is within the power of the Company to do so be sent out of the State of Kuwait and the Neutral Zone.

The Company shall pay to the employees it employs a fair salary or wage, such salary or wage to be decided and stated by the Company at the time the employees are engaged.

The Company undertakes not to employ any person or company in Kuwait the Neutral Zone or the Concession Area that is undesirable to the Shaikh for political or security reasons.

B. The Company shall also prepare, in consultation with the Shaikh and carry out a specialised training programme for Kuwaiti employees of the Company relating to all aspects of the oil industry including supervisory and directorial training at all levels.

C. The Company shall provide free of charge for its employees and for the Shaikh's officials working in the Concession Area all necessary medical services including dispensary clinical and hospital facilities. The Shaikh and His family shall have the right to such medical services and facilities free of charge.

ARTICLE 22

The Shaikh shall give to the Company and its employees and property all the protection in His power from theft, highway robbery, assault, wilful damage and destruction, and the Company may appoint in consultation with the Shaikh and itself pay trustworthy guards to assist in protecting the property of the Company and its employees. Such guards shall at all times be Kuwait subjects unless the Shaikh permits otherwise and shall remain under the direction and control of the Shaikh. The Company shall erect at its own expense suitable buildings for the accommodation of such guards and/or of the Shaikh's police at such places as the Company shall select with the approval of the Shaikh.

ARTICLE 23

A. If the Company shall fail within four (4) calendar months after any payment due to make to the Shaikh any payment due under Article 6 or 7 and the amount of such payment is not in dispute the Shaikh shall be entitled to prohibit the export of Petroleum until the amount in question be paid. If payment be not made within a further three calendar months after the expiration of such four months aforesaid (whether or not the Shaikh shall have prohibited the export of Petroleum as aforesaid) the Shaikh shall be entitled to terminate this Agreement forthwith.

B. The Shaikh shall be entitled to terminate this Agreement before the expiration of the period specified in Article 2 hereof:

(i) as provided in paragraph (A) of this Article 23; or
(ii) by surrender as provided in Article 24; or
(iii) as provided in Article 30; or
(iv) if the Company shall fail to fulfil its obligations under paragraphs (A) or (B) of Article 3 or the drilling obligation under paragraph (C) of that Article 3; or
(v) if the Company shall be in default under the arbitration provisions of paragraph (D) of Article 33.

In the event of termination upon the expiration of the period specified in Article 2 or in any of the cases mentioned under sub-paragraphs (i), (iii), (iv) or (v) of this paragraph the Company undertakes at that time to transfer to the Shaikh all its movable and immovable property within the State of Kuwait, the Neutral Zone, the Concession Area and the area of the Concessionary Waters to the extent that such property is directly employed in operations hereunder and the Company also undertakes to transfer to the Shaikh all such rights as it may have to the use of property so employed, to whomsoever belonging, which are at that time enjoyed by it.

C. If oil shall not be discovered in commercial quantities within a period of 4_ years after the Effective Date or such later date as the Shaikh may agree this Agreement shall thereupon be terminable by the Shaikh. The Company shall within two months of such termination and upon the performance of all of its obligations hereunder to the satisfaction of the Shaikh be entitled to the repayment by the Shaikh of a sum in currency of the United States of America which bears the same proportion to the annual

payment under Article 6(A)(a) for the Year in which this Agreement is so terminated as the number of days remaining in that Year after the date of termination bears to 365.

ARTICLE 24

A. The Company shall have the right at any time after two years from the Effective Date and prior to the discovery of oil in commercial quantities to terminate this Agreement by 60 days notice given in writing to the Shaikh.

B. The Company shall also have the right at any time after such discovery to terminate this agreement:

(i) by 180 days notice given in writing to the Shaikh; or

(ii) upon payment to the Shaikh of a sum equal to one half of all sums paid or payable to Him hereunder in respect of the previous Year.

C. Should this Agreement be terminated by the Company under this Article 24, then,

(a) If such termination occurs not more than ten years from the Effective Date all lands granted by the Shaikh and any lands or buildings which the Company may have bought and any houses or buildings constructed by and other immovable property of the Company within the State of Kuwait and the islands mentioned in Article 2(B)(iii) and the Concessionary Waters thereof shall be handed over to the Shaikh free of cost. All such properties situated within the Concession Area the Neutral Zone or its Concessionary Waters shall become the joint property of the Shaikh and of the Kingdom of Saudi Arabia. Producing wells or borings at the time of such termination shall be handed over in reasonably good order and repair but

(b) If such termination occurs more than ten (10) years from the Effective Date all movable and immovable property of the Company in the State of Kuwait and the islands mentioned in Article 2(B)(iii) and the Concessionary Waters thereof shall be handed over to the Shaikh free of cost and all property of the Company within the Concession Area the Neutral Zone and its Concessionary Waters shall become the joint property of the Shaikh and of the Kingdom of Saudi Arabia. Producing wells or borings at the time of such termination shall be handed over in reasonably good order and repair.

ARTICLE 25

Upon termination of this Agreement for any cause or in any manner whatever except under Article 23(C).

A. The Company shall in addition to any amounts payable to the Shaikh pursuant to paragraph (B)(ii) of Article 24 pay to the Shaikh all other sums payable to Him pursuant to this Agreement.

B. All property of the Company outside Kuwait, Saudi Arabia, the Concession Area, the Concessionary Waters and the Neutral Zone shall become the joint property of the Shaikh and of the Government of the Kingdom of Saudi Arabia save that the Shaikh and the aforesaid Government shall at their option

(i) pay to the Company, at the time of surrender of the property in respect of wholly amortized property 43% of the market value thereof and in respect of partly amortized property 43% of the amount (if any) by which the market value thereof exceeds its book value; or

(ii) permit such property to remain in the ownership of the Company subject to payment to the Shaikh and the aforesaid Government at the time of the surrender of its rights therein in respect of wholly amortized property of 57% of the market value and in the case of partly amortized property 57% of the market value and in the case of partly amortized property 57% of the amount (if any) by which the market value thereof exceeds its book value.

The book value of such properties shall be the cost of purchase less amounts written off at the rates specified in the Kuwait Income Tax Decree.

C. Any impediments to navigation erected by the Company shall, if the Shaikh so requires, be removed by the Company.

ARTICLE 26

A. The Company may not, without the written consent of the Shaikh assign its rights and obligations under this Agreement to any other person or corporation and shall not so assign this Agreement to any corporation which shall have shareholders undesirable to the Shaikh.

B. Without prejudice to His right to withhold His consent to any such assignment or to His right to require that such consent shall only be given subject to such terms and conditions as He shall think fit the Shaikh shall have the right to require that any assignee of this Agreement shall take such steps as the Shaikh shall think fit to procure that the Shaikh and His subjects (if He so requires) shall within six months after such assignment be entitled to acquire 10% of the issue share capital of such assignee at par or at the issue price thereof whichever shall be the less.

C. It is further agreed between the Shaikh and the Company that the Shaikh shall have the option to acquire, at the same price and terms specified in any proposed assignment hereof the rights and interests offered by the Company.

D. The Company shall have the right to appoint an Operating Company or Companies for the purposes of carrying out its rights and obligations hereunder. Any such Operating Company shall be subject to the terms and conditions hereof and in the event of shares or stock of such Operating Company shall offer ten percent of such shares or stock to the Shaikh upon the same terms and conditions as the same are offered to the general public. The Articles of Association and the Bye-laws of any Operating Company shall be filed with the Shaikh and any provision therein inconsistent with this Agreement shall be without effect.

E. The Company shall at all times retain such measure of control over the affairs of such Operating Company as the Shaikh shall think fit; and the Shaikh shall have the right to appoint one person to the Board of Directors or any management committee of such Operating Company. This person shall enjoy the rights and privileges and receive emoluments not less than those received by other Directors of such company. He and the Shaikh's auditors shall have the same right to receive reports and other information and to inspect all accounts and records of the operations hereunder of the said Operating Company as they have in respect of the Company pursuant hereto.

ARTICLE 27

The Company will erect or provide at every permanent installation maintained by it:
(a) An office and living quarters for inspectors and representatives appointed by the Shaikh to the Company;
(b) Suitable buildings and living accommodation for use by the police;
(c) A building or building for use by the post office, public health department, Government telephone exchange and Government telegraph facilities, which building shall contain decent living quarters for Government workers in such services;
(d) Decent living quarters, in buildings, for Kuwaiti personnel employed by the Company in connection with such permanent installations;
(e) A mosque;
(f) Common waterpipes and baths, if practicable;
(g) Telephone, light and water facilities for police; customs, post office, public health, telegraph and telephone buildings;

(h) Market facilities, where practicable;
(i) Streets and public improvements.

ARTICLE 28

A. As soon as possible after the discovery of oil in commercial quantities, the Company undertakes to contribute to the cause of the welfare of the people of Kuwait by providing such educational, medical, hygienic and other services as may be agreed upon with the Shaikh.

B. When the Company's production of Crude Petroleum in any one day from the Shaikh's undivided one half interest in the Concession Area shall exceed 30,000 barrels the Company shall forthwith establish and maintain a Research Institute in Kuwait with staff and facilities for the study and survey of the natural resources, improvements of water supply, insect control, plant life, wind erosion, climatic conditions, etc. in Kuwait. The types of research to be undertaken by such institute shall be agreed from time to time between the Shaikh and the Company and the findings of such Institute shall be made available to the Shaikh.

C. The Company hereby acknowledges that the costs of the services supplied by it pursuant to this Article are not deductible under Article 3 of the Kuwait Income Tax Decree.

ARTICLE 29

A. Nothing in this Agreement shall be read as restricting in any way the right of the Shaikh to grant to other parties concessions or permits relating to the Concession Area for substances other than Petroleum provided that the operations and rights of the Company hereunder are not thereby injuriously affected.

If the Shaikh should at any date subsequent to the date of signature of this Agreement grant to any other parties concessions or permits relating to the Concession Area for substances other than Petroleum the Shaikh undertakes that such concessions shall contain provisions requiring the holders thereof to abstain from damaging, impeding or interfering with the property, operations and interests of the Company.

Deposits of mineral substances other than Petroleum, such as gold, silver, copper, lead, potash, sulphur and salt or the like which may be discovered by the Company within the Concession Area shall be reported to the Shaikh and shall not be worked by the Company except under a special concession or permit from the Shaikh.

B. The Company shall use the Shaikh's flag within the State of Kuwait, the Neutral Zone and the Concession Area.

ARTICLE 30

Failure on the part of the Company to fulfil any of the conditions of this Agreement shall not give the Shaikh any claim against the Company or be deemed a breach of this Agreement in so far as such failure arises from force majeure (other than any act by the Japanese Government or failure on its part whereby the Company is prevented from making any payment to the Shaikh hereunder) and if through force majeure (other than such act or failure aforesaid) the fulfilment by the Company of any of the conditions of this Agreement be delayed the period of such delay shall be added to the periods fixed by this Agreement.

In the event of the Company failing to make any royalty or other payment to the Shaikh hereunder, such failure having arisen from force majeure the Company shall, if so required by the Shaikh, discontinue its operations hereunder until the cause of such failure shall have been removed. If the cause shall not have been removed for a period of twelve months after the Company's failure aforesaid the Shaikh shall have the right to terminate this Agreement.

Force majeure as used in this Agreement means any happening which the Company could not reasonably prevent or control, including, but without limiting the generality of the foregoing, act of God, war, flood, lightning, explosion, fire and earthquake.

ARTICLE 31

A. Neither the Company nor any of the employees in its service may interfere with the administrative, political or religious affairs of the Shaikh or His subjects.
B. The Company renounces any right of diplomatic recourse regarding any matters relating to this Agreement and the rights thereunder.
C. No right under this Agreement is or shall be in any manner acquired, either directly or indirectly by a foreign government or state or foreign governments or states, or by a corporation or any other entity dependent on them, nor may said governments, entities or corporations be admitted or accepted as partners or shareholders.
D. The Company shall not do or cause to be done any act which constitutes an infringement of or is derogatory to the rights or privileges or sovereignty of the Shaikh and if it be proved that any one of the Company's employees has committed any such offence then the Shaikh shall have the right to banish him from Kuwait and the Neutral Zone beside any other punishment according to law.
E. The employees of the Company shall be subject in all their acts to the laws of Kuwait.

ARTICLE 32

The Shaikh shall not by general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 23. No alteration shall be made in terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to this Agreement.

ARTICLE 33

A. At any time during the currency of this Agreement any difference or dispute shall arise between the parties hereto concerning the interpretation or execution hereof, or anything herein contained or in connection herewith, or the rights or liability of either party hereunder, the same shall, failing any agreement to settle it in any other way, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee, who shall be chosen by the arbitrators before proceeding to arbitration.
B. Each party shall nominate its own arbitrator within sixty (60) days after the delivery of a request so to do by the other party, failing which its arbitrator may at the request of the other party be designated by the President of The International Court of Justice. In the event of the arbitrators failing to agree upon the referee within sixty (60) days after being chosen or designated, the President of the International Court of Justice may appoint a referee at the request of the arbitrators or of either of them.
C. The decision of the arbitrators, or in case of a difference of opinion between them, the decision of the referee, shall be final and binding upon both parties.
D. In giving a decision the arbitrators or the referee shall specify an adequate period of delay during which the party against whom the decision is given shall conform to the decision and that party shall be in default if that party has failed to conform to the decision prior to the expiry of that period and not otherwise.
E. The place of arbitration shall be such as may be agreed by the parties and in default of agreement shall be Kuwait.

F. In the event of a dispute to which the Company is a party arising in connection with the Kuwait Income Tax Decree the dispute shall, should the Company so request, be determined by submission to arbitration.

ARTICLE 34

All payments that become due to the Shaikh hereunder (including payments of Kuwait Income Tax) shall be paid in United States Dollars into His account at such bank or banks as the Shaikh may designate in writing. The bank's receipt shall be a full discharge for the Company in respect of the payment of the sum stated therein.

ARTICLE 35

For the purpose of payments to the Shaikh the Company shall measure by a method customarily used in good technical practice all Petroleum produced hereunder and the Shaikh by his representative duly authorised by Him shall have the right to observe such measuring and to examine and test whatever appliances may be used for such measuring. Such representative shall comply with all necessary and usual safeguards for the prevention of fire and/or other accident; and shall make all examinations and tests at such times and in such manner as will cause the minimum of interference with the Company's operations. If upon such examination or testing any such appliance shall be found to be out of order the Company will cause the same to be put in order at its own expense within a reasonable time, and if upon any such examination as aforesaid any error be discovered in any such appliance, such error shall, if the Shaikh so decides after hearing the Company's explanation be considered to have existed for three (3) calendar months previous to the discovery thereof or from the last occasion of examining the same in case such occasion shall be within such period of three (3) calendar months and the payments shall be adjusted accordingly. If the Company should find it necessary to alter, repair or replace any measuring appliance it shall give reasonable notice to the Shaikh or his Representative to enable a Representative of the Shaikh to be present during such alteration, repair or replacement.

The Company shall keep full and correct records of all measurements as aforesaid and the said Representative of the Shaikh shall have access at all reasonable times to such records and shall be at liberty to make extracts from them. Such records shall be treated as confidential by the Shaikh and his representatives with the exception of such figures therein as the Shaikh may be required by law to publish.

ARTICLE 36

Any notice or other communication to be given to the Shaikh shall be addressed to whomever the Shaikh may designate.

Any notice or other communication required to be given by the Company hereunder shall be written in both Arabic and English, shall be signed and shall be given in such reasonable number of copies as shall be requested by the Shaikh.

ARTICLE 37

If the Shaikh deems it appropriate in the national interest to grant a Petroleum Concession over His undivided one half interest in the Concession Area for any period of time after the termination of this Agreement, the Company shall unless it shall be in default hereunder have a preferential right over other applicants, not being the subjects of the Shaikh, upon equal terms.

ARTICLE 38

If in the future arrangements are made between the Governments of other Middle Eastern countries or any agents of such Governments and any other party in regard to the development of oil fields and the production and marketing of oil which results in any such Government or its agents receiving a higher proportion of the profits of such development production and marketing than that specified in this Agreement, the Company will be willing to review and discuss the situation with the Shaikh in the light of the new terms and all other relevant facts and circumstances.

ARTICLE 39

The parties base their relations with regard to this Agreement on the principle of goodwill and good faith. Taking account of their different nationalities this Agreement shall be given effect and must be interpreted and applied in conformity with the principles of law common to Kuwait and Japan and, in the absence of such common principles, then in conformity with the principles of law normally recognised by civilised states in general, including those which have been applied by international tribunals.

ARTICLE 40

This Agreement is written in English and translated into Arabic. If there should at any time be disagreement as to the meaning or interpretation of any clause in this Agreement, the English text shall prevail.

IN WITNESS whereof the parties to this Agreement have set their hands the day and year first above written.
On behalf of the Arabian Oil Company Limited
Tara Yamashita
President

APPENDIX NO. VIII

AGREEMENT WITH

KUWAIT SHELL PETROLEUM DEVELOPMENT COMPANY LTD.

OF 15.1.1961

THIS AGREEMENT made at Kuwait on the fifteenth day of January in the year On Thousand Nine Hundred and Sixty One corresponding to the twenty-eighth day of Rajab in the year One thousand three hundred and eighty between HIS HIGHNESS SHEIKH SIR ABDULLA AL-SALIM AL-SUBAH G.C.M.G., C.I.E., in the exercise of His powers as Ruler of Kuwait on His own behalf and in the name and on behalf of His heirs and successors in whom is or shall be vested for the time being the responsibility for the control and government of the State of Kuwait (hereinafter called "the Emir") of the one part and THE KUWAIT SHELL PETROLEUM DEVELOPMENT COMPANY LIMITED, a company incorporated in England whose registered office is situated at St. Helen's Court, Great St. Helen's, London E.C.3 (hereinafter called "the Company" as hereinafter defined) of the other part WITNESSETH THAT:

WHEREAS:

I. . There appertains to the State of Kuwait the seabed and the subsoil lying beneath the high seas of the Arabian Gulf continuous to the territorial waters of Kuwait, and extending seawards to boundaries to be decided with greater precision when an opportunity offers, and on equitable principles after discussions between Kuwait and the neighbouring States, and this seabed and subsoil are subject to the Emir's jurisdiction and control and the Emir is accordingly the owner of the oil and gas rights in the said seabed and subsoil; and

II.

III. . The Company is desirous of obtaining from the Emir and the Emir is desirous of granting unto the Company, the concessions and rights hereinafter set forth and described in and to the Concession Area as herein defined upon the terms and conditions hereinafter set forth;

NOW THEREFORE in consideration of the premises and the mutual agreements and undertakings hereinafter contained, the Emir and the Company hereby agree as follows:

ARTICLE 1

In this Agreement unless inconsistent with the subject or context:

"Concession Area" means and includes:

(i) all the seabed and subsoil underlying the waters of the Arabian Gulf, the subject of the Proclamation made by the then Ruler of Kuwait on 12th June, 1949, but excluding Concessionary Waters (as hereinafter defined).

(ii) Any and all islands, islets, shoals and bars, which fall within the jurisdiction of the Emir and lie within the boundaries of the area defined (i) above but excluding the islands of Warbah, Bubiyan, Failaka, Mashjan, Auha, and Kubr and their Concessionary Waters. (The islands of Qaru and Umm al Maradim fall within the jurisdiction of the Emir but lie beyond the boundaries of the Concession Area and, together with their Concessionary Waters, are excluded therefrom).

The approximate boundaries of the seabed to which Kuwait is entitled are straight lines joining the following points:

(i) The seaward end of the boundary between Kuwait and Iraq in the Khor Abdullah;
(ii) A point 29° 43' 12" N. and 48° 31' 30" E;
(iii) A point 29° 35' 00" N. and 48° 37' 00" E;
(iv) A point 29° 32' 24" N. and 48° 47' 24" E;
(v) A point 29° 21' 54" N. and 49° 13' 18" E;
(vi) A point 28° 58' 36" N. and 49° 29' 48" E;
(vii) A point 29° 01' 36" N. and 48° 52' 12" E;
(viii) A point 28° 49' 42" N. and 48° 22' 30" E;
(ix) A point 28° 50' 42" N. and 48° 19' 06" E;
(x) The seaward end of the boundary between Kuwait and the Kuwait/Saudi-Arabian Neutral Zone.

"Concessionary Waters"
Means (a) the waters contiguous to and extending from the mainland and the named islands of Kuwait:
(i) Up to a distance of six nautical miles from the low water base line or base points used on the 11th day of October, 1955, corresponding to the 24th day of Safar 1375, for delimiting the territorial waters of the Kuwait including the base line or base points along the shores of the islands of Warbah, Bubiyan, Failaka, Mashjan and Auha; provided that where the said base line crosses Kuwait Bay it shall for this purpose be drawn across the entrance of Kuwait Bay, that is, it shall be drawn from low water mark at Ras al Ardh to the point at low water mark on the opposite coast at latitude 29° 27' 10" North longitude 48° 14' 00" East and
(ii) up to a distance of three nautical miles from the low water base line or base points used on the 22nd day of September 1949, corresponding to the 30th day of Zoulka'ada, 1368, for delimiting the territorial waters contiguous to the shores of the island of Kubr.

"Unexploited Area"
Means that part of the Concession Area which does not comprise productive structures. For the purposes of this definition "Productive structures" shall include the surface projection of any oil accumulation or accumulations from which petroleum can be produced by an existing well or existing wells.

"*The Company*"
Means and includes the party of the second part to this Agreement and its successors and assigns. If the Company shall appoint one or more operating companies pursuant to the power in that behalf contained in Article 28 (2) hereof the expression "the Company" shall include such operating company or companies in so far as the Company shall delegate to it or to them some or all of its functions under this Agreement.

"*Operating Company*"
Means any company which the Company may from time to time appoint for the purpose of the conduct of its operations under this Agreement.

"Affiliate"
A company shall be deemed to be an affiliate of the Company:
(i) If a majority of its issued voting share capital is beneficially owned directly or indirectly by the Company; or
(ii) If it is the beneficial owner directly or indirectly of a majority of the issued voting share capital of the Company; or
(iii) If a majority of its issued voting share capital and a majority of the issued voting share capital of the Company are owned directly or indirectly by the same company or companies.
For the purposes of this definition a company shall be deemed to be in the direct ownership of another company (hereinafter called "the parent company") when a series

of companies can be specified, commencing with the parent company and ending with the particular company, so related that each company of the series, except the parent company, is owned as to the majority of its issued voting share capital by one or more companies earlier in the series.

"Petroleum"
Means crude petroleum, natural gas, asphalt, ozokerite, and their products and cognate substances.

"Crude Petroleum"
Means crude petroleum produced by the Company in the Concession Area freed of water, sand and other foreign substances.
"Natural Gas"
Means all gaseous substances regardless of gravity produced by the Company in the Concession Area, in a vaporous or gaseous form, regardless of whether the said gaseous substances existed in a liquid or gaseous form in the reservoir or in solution with Crude Petroleum, but excluding condensate which by normal field methods of petroleum gas processing i separated and not sold separately from Crude Petroleum.

"Commercial Qualities"
Crude Petroleum shall have been discovered "in commercial quantities" when two or more wells have been completed and between them found capable of producing on test in accordance with good oilfield practice at least fifteen thousand (15,000) barrels of Crude Petroleum a day. The Company shall after completion of such tests as aforesaid by notice to the Emir declare that Crude Petroleum has been discovered in commercial quantities and such notice shall be accompanied by complete technical data relating to the said tests and to all geological and geophysical tests carried out in the Concession Area. All such data produced to the Emir shall be regarded as confidential by Him and by any experts to whom He may submit such data for the purpose of obtaining advice thereon. In the event of the Emir raising any dispute within 30 days after receipt of such notice regarding the conclusion to be drawn from such tests then the discovery of Crude Petroleum in commercial quantities shall be established by the Company production such wells at the foregoing rate for 30 days which shall either be consecutive or if interrupted by circumstances beyond the Company's control will be such as will properly establish the capacity of the wells under test.

"Discovery Date"
Means the date upon which the notice referred to in the last preceding definition is given to the Emir relating to a discovery of Crude Petroleum in commercial quantities.

"Net Production of the Company"
Means the quantity of Crude Petroleum won and saved by the Company, less petroleum returned to the reservoir and petroleum required for the Company's operations hereunder within the Concession Area, in the State of Kuwait and in the area of the Concessionary Waters.

"Posted Price"
Means the published price for each particular export quality and gravity of Crude Petroleum from time to time established by the Company or its affiliates in accordance with commercial principles at which crude petroleum of that quality or gravity is offered for sale by it or its affiliates to buyers generally in cargo lots f.o.b. tankship at the Company's export terminal in Kuwait or in the Concession Area.

"Barrel"
Means a quantity thereof equivalent in volume to a total of 42 United States gallons adjusted to 60° F.

"Ton"

Means English ton of two thousand two hundred and forty pounds.

"Regular Exports of Petroleum"
Means regular exports of Crude Petroleum for commercial and industrial purposes and does not include occasional exports made for purposes of testing and oil reservoir or production equipment or exports made for purposes of analysing testing or sampling Crude Petroleum.

"Chargeable Oil"
In relation to any period means Crude Petroleum exported by the Company from Kuwait and the Concession Area during that period and Crude Petroleum (other than Crude Petroleum exported as aforesaid) disposed of by the Company to any other person or body corporate during that period including oil delivered to the Emir pursuant to Article 9(2)(c).

"Anniversary Date"
Means in each year of the currency of this Agreement the anniversary of the Effective Date.

"Year"
Means a Gregorian calendar year and for the purposes of this Agreement shall also include the period, if any between the date of commencement of Regular Exports of Crude Petroleum and the 31st December of the yea in which that date occurs.
"Kuwait Income Tax Decree"
Means the Kuwait Decree No. 3 of 1955 relating to Income Tax in the precise terms in force at the date of this Agreement..

"Kuwait Income Tax"
Means in relation to any Year the total amounts receivable by the Emir under Kuwait Income Tax Decree No. 3 of 1955 in respect of income tax for that year based on the profits or gains of that year arising out of operations and transactions in respect of Petroleum produced by the Company in the Concession Area or in respect of rights thereto whether such income tax is payable by the Company or by any other person or body corporate.

"Effective Date"
Means the date of signature of this Agreement

"The Venture"
Means the rights and liabilities of the Company pursuant to this Agreement and where the context permits includes the undertaking of the Company established pursuant hereto.

"The Kuwaiti Participant"
Means either the Emir if he shall exercise the right of election contained in Article 23 hereof on his own behalf or the Kuwaiti Company in which the Emir has a controlling interest which the Emir may nominate to take an interest in the Venture pursuant to the said Article.

ARTICLE 2

1. The Emir hereby grants to the Company for a period of forty-five years from the date of signature hereof:
   (i) the exclusive right to explore, search for, drill for, produce and win Petroleum within the Concession Area;
   (ii) The exclusive ownership of all Petroleum produced and won within the Concession Area;

(iii) The right within the Concession Area, the State of Kuwait, and the Concessionary Waters, but subject as hereinafter provided to refine, transport, sell for use within the State of Kuwait or for export and to export freely or otherwise to deal with or dispose of any such Petroleum; and

(iv) The right subject as hereinafter provided to do all things necessary for the purposes of the above operations.

2. The Company shall exercise the rights hereby granted subject to existing prior rights and in particular prior rights granted by concession agreements relating to

(i) the mainland of Kuwait and the islands of Warbah, Bibiyan, Failaka, Ashjan and Auha

(ii) the Kuwaiti-Saudi Arabian Neutral Zone and its Continental Shelf, and

(iii) the islands of Kubr, Qaru and Umm al Maradim

3. The Company's operations shall be conducted with due regard to the character of the sea overlying the Concession Area and the Concessionary Waters and in particular the Company undertakes that, in the exercise of its rights and in the fulfilment of its obligations under this Agreement, it will interfere to the minimum extent possible with and will take adequate precautions for the protection of navigation, fishing and pearling; and that it will comply with all reasonable requirements of the competent authorities affecting the navigation of ships and aircraft.

4. The Company undertakes that it will not within the State of Kuwait or the Concession Area or the Concessionary Waters carry on any operations within areas occupied by or devoted to the purposes of mosques, sacred buildings or graveyards, nor except with the permission of the Emir carry on any operations except the sale of petroleum housing of staff and employees and administrative work within the area zoned for building development for the town of Kuwait.

5. The rights of the Company hereunder shall be exercised in a lawful manner according to the laws of Kuwait and the prior rights, if any, of third parties and due respect in the exercise thereof shall be accorded to the religion and customs of the people of Kuwait.

6. The Company will accept responsibility for any loss or damage done to third parties by its wrongful or negligent acts or omission in the conduct of its operations and will at all times indemnify the Emir against all claims and liabilities in respect thereof.

ARTICLE 3

1. Within nine (9) months from the Effective Date the Company shall commence geological or geophysical exploration.

2. Within thirty (30) months from the Effective Date the Company shall spud in a test well.

3. The Company shall thereafter proceed diligently in accordance with good oilfield practice (a) with the drilling of a test well or wells to an aggregate depth of not less than 20,000 feet unless oil is discovered in commercial quantities before reaching that aggregate depth; and (b) in the conduct of its operations for the purpose of discovering and producing Petroleum in the Concession Area and exporting it.

4. The Company shall conduct its operations in a workmanlike manner and by appropriate scientific methods and shall take all reasonable measures to prevent fire, to prevent the ingress of water to any petroleum-bearing strata and to prevent the pollution of the sea and shall duly close any unproductive holes drilled by it and subsequently abandoned. The Company shall keep the Emir and His London Representative fully informed as to the progress and result of all its operations but such information shall be

treated as confidential save in so far as it is required for the purpose of settling a dispute between the parties hereto by arbitration.

ARTICLE 4

After a substantial daily rate of production of Crude Petroleum has been reached and adequate reserves have been discovered to maintain this rate of production for a substantial period, the Company undertakes to discuss and decide with the Emir whether or not a suitable oil refinery or other plant for treatment of petroleum shall be constructed by the Company in Kuwait. Among the factors to be taken into account in reaching a decisions shall be (a) the desirability of increasing by the erection of such refinery or plant in the State of Kuwait the profit in which the Emir is to share from the Company's operations and (b) the economics of refining or treating petroleum in Kuwait to the Company. The site of any refinery or plant will be the subject of mutual agreement between the Emir and the Company.

ARTICLE 5

In consideration of the rights granted by the Emir to the Company by this Agreement and of the assistance and protection which the Emir hereby undertakes to afford by all means in His power to the Company and its operations, employees and property, the Company shall pay to the Emir the following sums and considerations:

(a) A signature bonus, payable on the signing of this Agreement of £7,000,000 (seven million pounds).

(b) A rental payable:

(i) At the rate of £1,000,000 (one million pounds) per annum until the date of discovery of Crude Petroleum in commercial quantities or until the second Anniversary Date, whichever shall be the earlier, and thereafter.

(ii) At the rate of £2,000,000 (two million pounds) per annum until the date of commencement of Regular Exports of Crude Petroleum.

Such rental shall be payable on the Anniversary Date in each year in respect of the previous twelve months or in the event of termination of this Agreement by the Company pursuant to Article 21 hereof on the date of such termination in respect of the period from the preceding Anniversary Date or, in the case of a final payment under sub-paragraph (ii) of this paragraph (b), on the date of commencement of Regular Exports of Crude Petroleum in respect of the period from the preceding Anniversary Date.

(c) (i) A deferred bonus, payable on the fourth Anniversary Date or on the date upon which the Net Production of the Company first reaches and maintains an average daily rate of 100,000 barrels over 30 consecutive days, whichever is the earlier, of £7,000,000 (seven million pounds).

(ii) Further deferred bonuses as follows, payable on the dates upon which the Net Production of the Company first reaches and maintains an average daily rate over 30 consecutive days of:

(a) 200,000 barrels, a bonus of £4,000,000 (four million pounds); and

(b) 300,000 barrels, a bonus of £4,000,000 (four million pounds); and

(c) 400,000 barrels, a bonus of £4,000,000 (four million pounds); and

(d) 500,000 barrels, a bonus of £4,000,000 (four million pounds).

(d) (i) In respect of every ton of the Net Production of the Company in every year or part thereof prior to the date of commencement of Regular Exports of Crude Petroleum a Royalty of five shillings payable in the manner provided in Article 9(2) hereof.

(ii) In respect of every year after the date of commencement of Regular Exports of Crude Petroleum a Royalty, payable in the manner provided in Article 9(2) hereof, equal to 12_ per cent of the Posted Price on the day of production for every barrel of the Net Production of the Company during such year.

ARTICLE 6

1. The Company undertakes that in respect of every year after the date of commencement of Regular Exports of Crude Petroleum the Emir shall receive in the manner provided in this Article fifty (50) per cent of the Oil Profit to be ascertained as provided in Article 8 hereof.

2. The Company further undertakes that if, in respect of any such year, the Emir's receipts under the provisions of paragraph (1) of this Article are at a rate less than the rate of

(a) £2,000,000 (two million pounds) per annum; plus

(b) The amount of Royalty paid or due in respect of the twelve months' period preceding the date of commencement of Regular Exports of Crude Petroleum the Company shall pay to the Emir on the dates and in accordance with the procedure mentioned in Article 9(2) a sum equal to the balance.

3. The undertaking under paragraph (i) of this Article shall in respect of any year be satisfied by the receipt by the Emir of an amount (hereinafter called "the Make-up Payment") which when added to the sum of

(a) Kuwait Income Tax in respect of that year; and

(b) The value of Royalty payable otherwise than under Article 5 (d) (i) hereof in respect of that year, would give an aggregate total equal to fifty (50) per cent of the Oil Profit. The Make-up Payment shall be paid in accordance with the procedure mentioned in Article 9(2).

ARTICLE 7

The Company shall both establish and announce, or shall procure that an affiliate shall establish and announce, its Posted Price (in accordance with the definition of Posted Price in Article 1 and practice in the Arabian Gulf) and the Emir shall be entitled at any time to call upon the Company to show that its Posted Price, or that of its affiliate, is that of Crude petroleum offered to buyers generally.

ARTICLE 8

1. In this Article 8 unless inconsistent with the subject or context and having regard to any agreement between the Emir and the Company pursuant to paragraph (4) of this Article:

"The Daily Value of Chargeable Oil"

Means the aggregate value of Chargeable Oil for any day calculated by applying to each barrel thereof exported or disposed of on that day the Posted Price appropriate thereto as defined in Article 1 hereof.

"The Aggregate Income"

Means in relation to any year the aggregate of the Daily Values of Chargeable Oil for that year.

2. The Oil Profit in respect of any year shall be the difference between the Aggregate Income of that year and the Cost of Operations for that year [ascertained in the manner provided in paragraph (3) of this Article]: Provided that if for any year the Cost of Operations shall exceed the Aggregate Income then the amount of such excess shall be carried forward for recovery in the subsequent year or years by being added to and becoming part of the Cost of Operations for the year next following that in which such excess arises.

3. (a) Subject to the provisions of this paragraph the Cost of Operations for any year shall be the total of the costs and expenses, as ascertained by sound and consistent accounting principles, incurred by the Company in that year and fairly and

properly attributable to the operations of the Company in the exercise and performance of the Company's rights and obligations under this Agreement within the Concession Area, in the State of Kuwait and in the area of the Concessionary Waters, together with the amount of any excess of Cost of Operations over Aggregate Income in respect of the immediately preceding year which pursuant to paragraph (2) of this Article is to be added to and become part of the Cost of Operations in the year in question.

Provided that there shall be excluded from the Cost of Operations all sums in respect of payments made under Article 5 or Article 6 of this Agreement, of payments under the Kuwait Income Tax Decree, of any taxation on income or profits levied outside Kuwait or of interest on borrowed moneys.

(b) The costs and expenses comprised in the Cost of Operations shall include provision for the exhaustion, depreciation and obsolescence of properties used by the Company for its operations aforesaid and subject to the provisions of this paragraph (3) shall be ascertained in accordance with the provisions of the Kuwait Income Tax Decree provided that:

(i) No provision for exhaustion, depreciation and obsolescence and no provision for any amount treated as survey, exploration or development costs shall be made in respect of any property if and to the extent that such provision when added to the provisions in respect of the same property for previous years exceeds the capital cost of such property or such survey, exploration and development costs.

(ii) Any amount by which the value of property acquired prior to the Company's first taxable period under the Kuwait Income Tax Decree has to be adjusted for exhaustion, depreciation and obsolescence, in accordance with Article 4 of the aforesaid Decree together with any amount for exhaustion, depreciation and obsolescence, at the rates specified in Article 3(c) of the said Decree, for the period commencing on the first day of such first taxable period and terminating on the day prior to the date of commencement of Regular Exports of Crude Petroleum of property acquired prior to such last mentioned date, shall be considered as survey, exploration and development costs incurred before the date of commencement of Regular Exports of Crude Petroleum and shall be treated in the same manner a such costs.

(iii) Survey, exploration and development costs incurred before the date of commencement of Regular Exports of Crude Petroleum shall be treated in the books of the Company as capital expenditure and shall not be included in the Cost of Operations sae that an amount not exceeding 10 per cent per annum of the aggregate of such survey, exploration and development costs shall, from the date of the commencement of Regular Exports of Crude Petroleum, be so included until they are fully written off: for the purposes of the Kuwait Income Tax Decree such costs shall be similarly treated and the rate of 10 per cent per annum shall be deemed to be reasonable for the purposes of Article 3 (c) of the said Decree.

4. Prior to the installation by the Company of facilities in the State of Kuwait:

(a) To win and save Natural Gas for use for industrial or commercial purposes (other than natural gas returned to the reservoir or required for the Company's operations within the Concession Area, the State of Kuwait and the area of the Concessionary Waters); or for sale of export; or for manufacturing products from such Natural Gas for sale or export; or

(b) To produce petroleum products for sale or for export by refining or otherwise treating Crude Petroleum; the Emir and the Company shall negotiate an agreement providing for:

(i) The payment by the Company to the Emir of a Royalty not exceeding 12 per cent upon Natural Gas sold as such and on the value of Natural Gas used to manufacture products as mentioned in sub-paragraph (a) of this paragraph;

(ii) The income derived by the Company from such operations to be added to and included in the Aggregate Income for the purposes of calculating the Oil Profit pursuant to paragraph (2) of this Article.

To the intent that the Emir shall from the commencement of any such operations receive in the manner provided by Article 6 hereof 50 per cent of the aggregate profit derived by the Company from such operations and from the production of Chargeable

Oil. Such income shall be computed, in manner provided by such agreement, by reference to an appropriate measure of the market value in Kuwait of the petroleum products produced and sold or exported, or of the Natural Gas or derivatives therefrom sold or exported, pursuant to such operations; and providing further for such additions as may be necessary, consequential upon such agreement, to the matters required to be included in the Statements to be rendered by the Company to the Emir pursuant to Article 9 hereof, and for the dates and manner of payments to be made to the Emir pursuant to such agreement.

5. For the purpose of ascertaining the Oil Profit:

(a) All principal books and accounts shall be kept in sterling.

(b) All expenditure and receipts and Posted Prices shall be expressed in sterling.

(c) Any expenditures and receipts in a currency other than sterling shall be converted into sterling according to normal commercial practice.

(d) Posted Prices quoted in a currency other than sterling shall be converted into sterling on the basis of the par value for the time being established under the Articles of Agreement of the International Monetary Fund. Failing par values so established or if either of the parties shall consider that such par values do not provide a fair and reasonable basis for conversion, the parties shall seek to agree upon an alternative basis and, failing such agreement, the Posted Prices shall be converted on such a basis as shall be specified as fair and reasonable by internationally recognised bankers in New York, U.S.A., agreed between the Emir and the Company.

ARTICLE 9

1. Until the date of commencement of Regular Exports of Crude Petroleum the Company shall submit to the Emir a statement in respect of each year commencing prior to such date of the Net Production of the Company for that year showing the Royalty due in respect thereof; every such statement shall be submitted not later than the 31st day of March next following the year to which it relates.

2. As from the date of commencement of Regular Exports of Crude Petroleum:

(a) (i) The Company shall within thirty (30) days after the end of each quarter ending on the 31st day of March, the 30th day of June, the 30th day of September and the 31st day of December in each year, submit to the Emir a provisional tonnage statement showing the Net Production of the Company and the quantity and quality of Chargeable Oil produced during such quarter or (in the case of the first provisional tonnage statement) during the period which has elapsed since the date of commencement of Regular Exports of Crude Petroleum and containing all such other information a may be reasonably required to enable the Emir to calculate the amount of the Royalty due in respect of such quarter or period and to assess the Oil Profit in such quarter or period for which purpose the Cost of Operations shall be the Company's estimate thereof.

(ii) The Company shall within three (3) months after the end of each year submit to the Emir a final tonnage statement containing in respect of that year the information required to be stated in a provisional tonnage statement as defined in Clause (i) of this sub-paragraph (2) (a) except that the actual Cost of Operations for the year to which it relates as computed pursuant to Article 8 hereof shall be used for the purposes of such final tonnage statement and that the computation of the Oil Profit for that year shall be shown thereon. The final tonnage statement and computation of Oil Profit shall be accompanied by Reports thereon signed by the Auditors for the time being of the Emir and of the Company. In the absence of any difference or dispute the final tonnage statement and computation of Oil Profit shall by notice in writing be accepted by the Emir or by His representative appointed for the purpose as conclusive not later than the 30th day of June in the year in which it is submitted. In the event of such notice in

writing not having been given or in the event of disagreement between the Company and the Emir or between their respective Auditors as to any of the items shown in the final tonnage statement or computation of Oil Profit for any, a difference or dispute shall be deemed to have arisen under Article 19 hereof and shall if no agreement can be arrived at for settling it by any other method be referred to arbitration in accordance with the provisions of that Article.

(b) Royalty shown to be due in a statement rendered pursuant to paragraph (1) of this Article or in a provisional tonnage statement shall be paid and satisfied by the Company at the time such statements are submitted. If a final tonnage statement shows any further sum to be due to the Emir in respect of Royalty the Company shall forthwith pay the same. If a final tonnage statement shows the amount paid by the Company in respect of Royalty to be in excess of the amount which ought to have been paid, such excess shall be treated as an advance by the Company against future Royalty.

(c) (i) Notwithstanding the provisions of sub-paragraph (b) hereof the Emir may by such notice as shall be agreed to be adequate having regard to the quantity involved given to the Company beginning of any year after the date of commencement of Regular Exports of Crude Petroleum elect to take in kind the whole or any part of the Royalty payable to him in respect of that year; the value of any Royalty oil taken in kind in respect of any year shall be determined by applying to such Royalty oil the appropriate Posted Price. Any Crude Petroleum which the Emir elects to take in kind under this paragraph shall be delivered f.o.b. at the Company's export terminal or to such place within the Concession Area as the Emir and the Company may agree.

(ii) The Emir undertakes that He will take regular delivery at reasonable intervals of the Crude Petroleum which He has elected to take in kind, and the Company shall not in any event be required to store such Crude Petroleum for more than thirty (30) days or a quantity thereof in excess of a tanker load at any one time.

(d) Any Make-up Payment in respect of any year shall be paid by four approximately equal and (if necessary) provisional quarterly payments on the dates on which instalments of Kuwait Income Tax are payable in respect of that year, but if, when the total amount which the Emir is entitled to receive under Article 6, paragraph (1) hereof as aforesaid are found to be less in the aggregate than the Make-up Payment, the Company shall forthwith make good the deficiency. If such provisional payments as aforesaid are found in the aggregate to have exceeded the Make-up Payment, such excess shall be treated as an advance against future Royalty.

3. No money paid by the Company to the Emir under this Agreement shall, except in the case of an error in accounting, be returnable in any circumstances whatever.

ARTICLE 10

The Company shall at the third anniversary of the discovery of oil in commercial quantities and at the expiration of every five years thereafter relinquish to the Emir an area or areas to be selected by it equal in aggregate to 20 percent of the Unexploited Area at the date of relinquishment. The portions so relinquished shall so far a reasonably possible be of sufficient size and convenient shape taking into account continuous areas already relinquished and not the subject of a further concession to enable oil operations to be carried out thereon, and upon relinquishment shall be released from the terms and conditions of this Agreement and cease to be part of the Concession Area, excepting only that during the life of this Agreement the Company shall continue to enjoy the right to use the portions so relinquished for transportation and communication facilities, which, however, shall interfere as little a practicable with any use to which the relinquished portions may be put.

ARTICLE 11

1. For the purposes of its operations hereunder the Company shall have the right without hindrance in the Concession Area, in the State of Kuwait, and in the area of the Concessionary Waters but subject hereto and subject in particular to the provisions of Article 2 and to existing prior rights mentioned in that Article to construct and to operate power stations, refineries, pipelines and storage tanks, facilities for water supply including boring for water, telegraph, telephone and wireless installations, roads, railways, tramways, buildings, dwelling houses and other staff facilities, ports, harbours, harbour works, piers, jetties, sea and submarine loading lines including lines to or from the mainland of Kuwait and all necessary pumps and pumping stations, gathering and distributing systems, oil and coaling stations, with such lighting as may be requisite and any other facilities or works which the Company may consider necessary and for such purposes to use free of all payments to the Emir any stone, sand, gravel, gypsum, clay or water which may be available and may be required for its operations hereunder, provided always that the inhabitants are not prevented from taking their usual requirements of the materials and that the water supply of the local inhabitants and nomad population who may be dependent on the same is not endangered. The position of any such works shall be approved by the Emir. The Company may likewise utilise without hindrance all such means of transportation by land, air, pipeline and water communication or operation as may be necessary for the effective conduct of its operations hereunder.

But nothing in this Article 11 (1) shall confer on the Company the right to dispose of stone, sand, gravel, gypsum, clay or water by sale, export or otherwise to any other company or person within or without the State of Kuwait.

2. The Company shall under normal conditions accept and transmit free of charge on its wireless and telegraph installations such of the Emir's messages as will not interfere with the Company's business, and in times of national emergency the Emir shall have the full use free of charge of the Company's wireless and telegraph installation and railways for governmental purposes.

3. The Emir in his governmental capacity shall have the non-assignable right to use free of charge pipelines (in respect of Royalty oil derived from the Concession Area), harbours and other transportation facilities established by the Company including transportation facilities for the Emir's officials in the performance of their duties in Kuwait, the Concessionary Waters and the Concession Area, provided that such use in no way hampers the Company or interferes in any with the safety of its operations of which the Company shall be the sole judge. Any piers or appurtenances constructed by the Company shall be for its exclusive use.

The Company may use for the purposes of its operations the Port of Kuwait and other harbours along the coast of the State of Kuwait upon payment of the appropriate and generally applicable port and harbour dues in accordance with Port Regulations subject to existing prior rights, particularly such rights mentioned in Article 2 but the Company shall not impede or interfere with the subjects of the Emir or their rights to continue the use of existing harbours, anchorages, wharves and docks at present utilised by them.

In its use of the Port of Kuwait and other harbours on the Mainland of Kuwait, the Company shall use the services of local concerns to such extent as is possible considering the scope of work to be done and the facilities and services offered by such concerns, and observe all regulations and bye-laws of the Port of Kuwait and other harbours.

4. The Company will when in the market to charter tankers charter at least one tanker wearing the Kuwaiti flag and beneficially owned as to a majority by Kuwaiti nationals if suitable for the Company's requirements and if available at the market rates and conditions prevailing at the time of charter and will give favourable consideration to the employment at such rates and conditions of further tankers of such Kuwaiti ownership.

ARTICLE 12

1. The Emir shall have the right to appoint from the Effective Date an Official Representative and who will represent him in the State of Kuwait and the Concession Area in all matters relating to this Agreement with the Company.

The first Representative under this Article shall be His Excellency Emir Jabir Al-Ahmed Al-Subah in his capacity as President of the Department of Finance and Economy.

2. The Emir shall have the right to appoint from the Effective Date a London Representative to represent the Emir in all matters relating to this Agreement and such Representative shall have full access to the production records in respect of the Concession Area of the Company (including any Operating Company), including the agenda of the Board Meetings and shall be entitled to attend Board Meetings at which the Emir's interests are discussed.

The first London Representative under this Article shall be Mr. Herbert Thomas Kemp of the White House, Pages Lane, London, N.10.

3. The Emir shall have the right to appoint a firm of Auditors who shall be an internationally recognised firm of accountants of His own selection to examine the books of the Company on behalf of the Emir. The Company shall provide such firm of Auditors with the necessary facilities to enable them to check the books, registers and statements of the Company and to render every assistance to enable the Auditors to thoroughly examine the same and in shall assist them in every way to safeguard the interests of the Emir. The Emir shall regard as confidential all information supplied in connection with all such audit, except in so far as such information is required for the settlement of a dispute between the parties hereto by arbitration.

4. The Company undertakes that it shall maintain an office in Kuwait in the charge of an Authorised Representative who shall be resident in Kuwait and shall be vested with sufficient powers to enable him to consider and decide matters relating to the day to day activities of the Company relating to drilling and production. Matters which such Representative is not empowered to decide shall be dealt with by the Board of Directors of the Company as quickly as possible.

ARTICLE 13

1. The Company undertakes to furnish the Emir with all data in order to enable him to have a complete knowledge of the operations of the Company and also ample geological and geophysical information concerning the regions studied and the wells drilled, and all reports and results of research made in respect of the Concession Area as finally presented to the Company's highest officials in hat capacity together with the conclusions based on the basic data upon which the Company's engineering decisions and operations are based; all of which shall be furnished within a reasonable period but not exceeding three months after the respective operations have been carried out or six weeks after the information or reports have become available. The above mentioned data shall be considered as strictly confidential save in so far as they are required for the settlement of a dispute between the parties hereto by arbitration. The Company shall also keep the Emir informed at all times of such material research and engineering problems as are under study. Duly authorised representatives of the Emir shall have access at all reasonable times to the technical records of the Company, duplicates of which shall be kept in Kuwait.

2. The Company shall also furnish the Emir with copies of complete reports of its economic studies concerning all the aspects of the Company's oil operations and the market that have direct effect on its operations. The Emir shall regard all such reports as strictly confidential save in so far as they are required for the settlement of a dispute between the parties hereto by arbitration.

3. The Company shall notify the Emir as soon as practicable of any damage of whatever nature to the oil fields or the installations and shall take all necessary measures to stop and rectify such damage.

4. The Company shall present to the Emir within three months of the end of each year a report relative to its operations within the Concession Area, in the State of Kuwait and in the area of the Concessionary Waters in such year with plans, photographs and statistics. Such report shall contain:

(a) A statement on drilling operations carried out during the year.

(b) A statement on refining and marketing operations if any.

(c) The total amount of taxes that the Company paid in Kuwait during the year, their nature and the total amount which the Company estimates to be payable by it in respect of that year.

(d) The number of employees and labour, indicating their nationality, the total amount of salaries and wages, with a report of the medical aid and educational assistance given to such employees, their working and living conditions.

5. The Company and every Operating Company shall supply the Emir and his official representatives in Kuwait and London with copies of all notices, accounts, reports and other documents which shareholders of the Company and such operating companies are entitled to receive. Such documents shall be so supplied not later than the same are supplied to the shareholders, and if requested the Company shall supply three copies translated into Arabic of any document sent to the Emir and his representative in Kuwait.

6. The Company will keep the Emir informed from time to time as to the number of barrels to be produced from each well or field. The Company shall take all necessary measures after the discovery of petroleum in any well to put such well into operation without undue delay. The Company will not start production from any field or well before testing and making sure that the well has been properly completed in accordance with good oilfield practice. The Company shall inform the Emir sufficiently in advance to enable him to send a representative to be present at such tests.

7. The Emir, through His duly authorised representative, shall have the right to inspect the works and activities of the Company at all reasonable times.

ARTICLE 14

I. . The Company shall have the right to import machinery, motor cars and lorries, oilfield supplies and equipment, plant, timber, utensils, iron and steel work, medicines and medical supplies, office equipment and household furniture, and all other materials equipment and goods required by the Company and its employees for the purposes of its operations hereunder but not for resale to others, and to export its Petroleum and articles previously imported by the Company free of customs or import or export duty and taxes or other charges, but it shall pay on all personal goods, clothing and general merchandise imported by the Company for the personal use of its employees or for resale to them the ordinary customs duty, taxes and other charges in force for the time being in the State of Kuwait. Except as provided in Articles 5 and 6, the Company and its shareholders shall, in respect of all income derived from the operations of the Company under this Agreement and of all payments whether by way or dividend or otherwise made out of such income be free and exempt during the period of this Agreement, from all present or future taxation, imposts, and charges whatsoever (other than tax payable under the Kuwait Income Tax Decree) and further the Company its capital, operations and property, including Petroleum used in or derived from its operations hereunder, shall, except as aforesaid, be exempt and free for the like period from all present

and future harbour and port duties, import duties, export duties, imposts and charges of any kind, whether State or local, tolls and land surface rents of whatever nature.
II.

III. . The importation by the Company of firearms and other weapons is prohibited except with the written permission of the Emir.
IV.

V. . If the Company shall sell in the State of Kuwait or in the Kuwaiti/Saudi Arabian Neutral Zone other than to a company or companies enjoying the like exemptions as in paragraph (1) of this Article and other than for export any material or goods previously imported for the purposes of its operations hereunder and no longer required by the Company, the Company shall pay to the Emir in respect of such material or goods sold the equivalent of customs or import duty thereon at the rate in force at the time of sale. The duty shall be computed on the price received on sale.
4. Necessary Customs and quarantine Officials at harbours and airfields constructed by the Company or additional Customs or quarantine Officials required at any other harbours or airfields utilised by the Company shall be appointed by the Emir in consultation with the Company and their salaries, which shall not exceed the usual salaries of such officials, shall be paid by the Company which shall also provide suitable office and living accommodation of Customs and quarantine Officials at harbours and airfields which the Company has constructed.

Reasonable and suitable quarantine provisions shall be enforced at the Company's expense at harbours and airports constructed by the Company, and the Company shall take all reasonable precautions in its operations hereunder to prevent the spread of disease.

ARTICLE 15

1. A Committee shall be formed by the Company to supervise and examine all the expenses and purchases of the Company and ensure that they are reasonable and that the price and quality of the goods and materials purchased by the Company are also reasonable and the Emir shall be invited to nominate a representative to attend its meetings.

2. The Company may purchase in the State of Kuwait at current market rates such supplies of fuel, water, food, building and constructional materials and other supplies of every kind as may be required in connection with its operations hereunder and it shall give preference to such supplies as are available from Kuwait or from other friendly Arab countries provided that such supplies are available in Kuwait at reasonably competitive prices and are of the necessary quality. The Company shall not purchase goods or materials from any country which the Emir has declared to be hostile or unfriendly to Him.

3. The Company shall train and employ subjects of the Emir as far as practicable for all works in the management and operations of its activities hereunder for which they are suited, and as far as practicable inside Kuwait, the Concession Area and the Concessionary Waters 70 per cent of its labour and employees shall be subjects of the Emir. If the local supply of labour should in the judgment of the Company, be inadequate or unsuitable the Company shall have the right with the approval of the Emir, which shall not be unreasonably withheld, to import labour, preference being given to labourers from the neighbouring Arab countries, and the Company undertakes that 90 per cent of the personnel employed in its unskilled labour departments shall be subjects of the Emir or subjects of neighbouring Arab countries. The Company shall also have the right to import skilled and technical employees. Any employee imported by the Company who shall by misconduct cause a breach of peace or public disturbance or shall otherwise render himself undesirable, shall at the request of the Emir be

dismissed and shall, if it is within the power of the Company to do so, be sent out of the State of Kuwait. The Company shall pay to the workmen it employs a fair wage, such wage to be decided and stated by the Company at the time the workmen are engaged.

The Company undertakes not to employ any person or company in Kuwait or the Concession Area who is undesirable to the Emir for political or security reasons.

4. The Company shall provide free of charge for its employees and for the Emir's Officials working in the Concession Area all necessary medical services including hospitalisation and dispensary and clinical facilities.

5. The Company shall give preference to the employment of Kuwaiti contractors where the works to be carried out by them are within their abilities and their terms are reasonably competitive.

ARTICLE 16

1. With effect from the discovery date the Company shall, in consultation with the Emir, prepare a special programme for higher education in university, technical college or equivalent institutions in Kuwait or abroad. From the commencement of regular exports the Company will give effect to the programme as agreed with the Emir. From year to year, thereafter appropriate revisions of this programme shall be submitted to the Emir and if agreed carried out.

2. These programmes will be prepared for the benefit of Kuwaiti subjects, preference being given to employees of the Company or their children. Should there not be an adequate number of eligible Kuwaitis to meet the requirements of paragraph (3) of this Article, the remainder of this requirement may, if He so desires, be selected by the Emir in consultation with the Company from non-Kuwaiti Arabs in the employment of the Government or of the Company or in Kuwaiti secondary and industrial schools.

3. In any one year the number of trainees in such universities or institutions in accordance with this Article shall not be less than 15% of the total number of the non-Arab staff in the employment of the Company in the previous year otherwise than in junior clerical, domestic and labour grades.

4. Such trainees as satisfactorily complete their training in accordance with this Article shall be offered employment by the Company on their return to Kuwait, but they shall be free (subject to any contractual obligations) to opt to be employed by either the Emir or others if they so desire.

5. Without restricting the scope of other studies than those mentioned hereunder, such trainees as are selected in accordance with this Article may specialise in any of the following subjects:

(i) Industrial chemistry, petrochemical and related research work, petroleum, mechanical, electrical and civil engineering, surveying, physics (geophysics, applied physics together with gravity and seismology), geology, petrology, palacontology, drilling and related subjects, radio and telecommunication, production engineering and marine engineering.

(ii) Industrial relations, industrial management, economics and finance; or

(iii) Such other subjects as may be contained in the programme agreed with the Emir from time to time.

6. The Company will establish in Kuwait for its own purposes and for the purposes of this Article all such laboratory and other research facilities as shall be appropriate to the Company's operations and obligations under this Agreement.

ARTICLE 17

1. Within the Concession Area and in the State of Kuwait, subject to the approval of the Emir and subject to existing prior rights, particularly such rights mentioned in Article 2, the Company shall have, free of cost, the unrestricted use and occupation of and surface rights over such uncultivated land belonging to the Emir as the Company may need for the purposes of its operations and in particular the Company shall have the right to select, subject as aforesaid, an area or areas of land chosen by the Company with exclusive surface rights upon which to erect oil refineries, storage, terminal and shipping facilities and any other works required for the Company's operations; and the Company may, subject as aforesaid, buy or lease for such purpose any lands, houses or buildings with the consent of and on conditions to be arranged with the proprietors thereof but the terms of such purchase or lease shall not be in excess of those ordinarily current in their respective localities.

2. The Company shall acquire only such land, houses and buildings as are necessary for its operations under this Agreement. The Company shall inform the Emir from time to time of the land, houses and buildings which it requires to occupy for its operations; and land, houses and buildings previously acquired by the Company from the Emir (including lands and islands reclaimed or created by the Company) but found no longer necessary for its operations shall be returned to the Emir free of charge by the Company.

3. The Emir shall retain for himself the right to grant, in consultation with the Company, to another company or companies operating within areas adjoining the Concession Area the right to lay down pipelines and to permit such company or companies to construct and erect within the Concession Area and across it anything required for the transit over the Concession Area of crude oil, provided that the operations of the Company are not thereby impeded.

4. The Company shall not be entitled to construct airfields within the State of Kuwait without the written consent of the Emir.

ARTICLE 18

The Company will make available to the Emir free of charge at the point of production or in close proximity thereto any natural gas which the Company does not itself wish to use in connection with its operations or to market or put to some other economic use. If the Emir establishes His own use for supplies of such gas the Company will not, except in so far as may be required for its own operations in accordance with good oilfield practice, thereafter increase the use of gas for its own purposes to an extent which would reduce such supplies.

ARTICLE 19

The Emir shall give the Company and its employees and property all the protection in His power from theft, highway robbery, assault, wilful damage and destruction The Company shall pay all charges in connection with the police required in protecting the property of the Company and its employees. The Company shall erect suitable buildings for the accommodation of such police at such places as the Company shall select with the approval of the Emir.

ARTICLE 20

1. If the Company shall fail within four calendar months after any payment date to make to the Emir any payment due under Articles 5 or 6 and the amount of such payment is not in dispute the Emir shall be entitled upon giving one month's notice in writing to prohibit the export of petroleum until the amount in question be paid. If payment be not made within a further three calendar months after the expiration of such

four months aforesaid (whether or not the Emir shall have prohibited the export of petroleum as aforesaid) the Emir shall be entitled to terminate this Agreement forthwith.

2. Save as aforesaid this Agreement shall not be terminated before the expiration of the period specified in Article 2 hereof except by surrender as provided in Article 21 or in one of the two following cases:

(a) if the Company shall fail to fulfil its obligations under paragraphs (1) or (2) of Article 3 hereof in respect of geological or geophysical exploration or the drilling obligation under paragraph (3) of that Article 3.

(b) If the Company shall be in default under the arbitration provisions of paragraph (4) of Article 29.

In any of the abovementioned cases the Emir shall be entitled to terminate this Agreement without prejudice to any antecedent rights hereunder and the Company undertakes at that time to transfer to the Emir all its movable and immovable property within the State of Kuwait, the Concession Area and the area of Concessionary Waters to the extent that such property is directly employed in operations hereunder and the Company also undertakes to transfer to the Emir all such rights as it may have to the use of property so employed, so far as these rights are transferable, to whomsoever belonging, which are at that time enjoyed by it provided that the Emir assumes from the date of transfer all the obligations devolving upon the Company in respect of its enjoyment of the said rights.

ARTICLE 21

1. The Company shall have the right at any time after the third Anniversary Date to give the Emir 60 days' notice in advance to terminate this Agreement and the Company shall on expiry of such notice have no further liabilities except to make payment of all moneys which may be due to the Emir up to the date of termination.

2. Should this Agreement be terminated by the Company under this Article 21, then:

(a) If such termination occurs within twenty-five (25) years from the date of signature of this Agreement all lands granted by the Emir and any lands or buildings which the Company may have bought and any houses or buildings constructed by and other immovable property of the Company within the State of Kuwait, the Concession Area and the area of the Concessionary Waters shall be handed over to the Emir free of cost. Producing wells or borings at the time of such termination shall be handed over in reasonably good order and repair, but

(b) If such termination occurs after twenty-five (25) years from the date of signature of this Agreement all the movable and immovable property of the Company in the State of Kuwait, the Concession Area and the area of the Concessionary Waters shall be handed over to the Emir free of cost. Producing wells or borings at the time of such termination shall be handed over in reasonably good order and repair.

(c) Any impediments to navigation erected by the Company shall, if the Emir requires, be removed.

ARTICLE 22

On the expiry of this Agreement at the end of the period of forty-five years provided in Article 2, or of any extension or renewal of that period, all the movable and immovable property of the Company in the State of Kuwait, the Concession Area and the area of the Concessionary Waters shall be handed over to the Emir free of cost. Producing wells or borings at the time of such termination shall be handed over in reasonably good order and repair. Any impediments to navigation erected by the Company shall, if the Emir requires, be removed.

ARTICLE 23

1. Within a period of 90 days from the date upon which it is established that Crude Petroleum has been discovered in commercial quantities, the Emir may by notice in writing to the Company and upon payment of the sum referred to in paragraph (3) below elect either by Himself or by a Kuwaiti company nominated by Him and in which He has a controlling interest to take an interest of twenty per cent (or such lesser proportion as the Emir shall then determine) in the Venture.

2. The Company, in conjunction with its shareholders, and the Kuwaiti Participant shall thereupon consult together and agree upon the appropriate corporate structure necessary to promote their interests in the Venture.

3. The Kuwaiti Participant shall pay for such interest a sum in sterling equal to twenty per cent (or such lesser proportion as aforesaid) of the total expenditure (including cash in hand and at bank less undischarged liabilities other than those whether in the form of share capital or loans representing the interest in the Venture of the shareholders of the Company or any affiliate of the Company and excluding any bonus or rental payments accrued or due pursuant to Article 5 hereof) incurred by the Company up to the discovery date in respect of its operations under this Agreement, and the Kuwaiti Participant shall share in the assets and liabilities of the Venture in accordance with its interest therein with effect from that date.

4. Whether or not the Emir shall have exercised the election pursuant to sub-paragraph (1) of this Article, He shall be entitled to nominate and appoint one Director to the Board of the Company.

5. The Kuwaiti Participant shall upon the payment of the sum referred to in sub-paragraph (3) of this Article be entitled to appoint and maintain in office on the Board of the Company or any joint company incorporated pursuant to sub-paragraph (2) of this Article or any operating or similar committee [as may be appropriate to the corporate structure determined in accordance with sub-paragraph (2) of this Article] one or such greater number of Directors or representatives a is in proportion to its interest in the Venture. Such persons shall enjoy the rights and privileges and receive emoluments not less than those received by the other members of the aforesaid boards or committees as such and the Articles of Association or bye-laws of any such company shall provide accordingly. The rights given to the Kuwaiti Participant under this paragraph shall be in addition to the rights of the Emir under the preceding paragraph (4).

6. The Company will co-operate with the Kuwaiti Participant in a real spirit of partnership maintaining close consultation and endeavouring to promote their joint and respective interests . The Company and its Affiliates will consider in a friendly spirit any possibilities of further co-operation which may develop in the course of time.

ARTICLE 24

The Company shall use the Kuwaiti flag within the State of Kuwait and the Concession Area,

ARTICLE 25

Nothing in this Agreement shall be read as restricting in any way the right of the Emir to grant to other parties concessions or permits relating to the Concession Area for substances other than Petroleum provided that the operations and rights of the Company hereunder are not thereby injuriously affected.

If the Emir should at any ate subsequent to the date of signature of this Agreement grant to any other parties concessions or permits relating to the Concession Area for substances other than Petroleum, the Emir undertakes that such concessions

shall contain provisions requiring the holders thereof to abstain from damaging, impeding or interfering with the property, operations and interests of the Company.

Deposits of mineral substances other than Petroleum, such as gold, silver, copper, lead, potash, sulphur and salt or the like which may be discovered by the Company within the Concession Area shall be reported to the Emir and shall not be worked by the Company except under a special concession or permit from the Emir.

ARTICLE 26

Failure on the part of the Company to fulfil any of the conditions of this Agreement shall not give the Emir any claim against the Company or be deemed a breach of this Agreement in so far as such failure arises from force majeure and if through force majeure the fulfilment by the Company of any of the conditions of this Agreement be delayed the period of such delay shall be added to the periods fixed by this Agreement.

Force majeure, as used in this Agreement, includes the act of God, war, insurrection, riot, civil commotion, tide, storm, tidal wave, flood, lightning, explosion, fire, earthquake and any other happening which the Company could to reasonably prevent or control.

In the event of the Company failing for six months to make any royalty or other payment to the Emir hereunder, such failure having arisen from force majeure the Company shall, if so required by the Emir, discontinue the export of Petroleum obtained hereunder until such failure shall have been remedied.

ARTICLE 27

1. The Emir shall not by general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 20. No alteration shall be made in terms of this Agreement by either the Emir or the Company except in the event of the Emir and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to this Agreement.

2. If, as a result of changes in the terms of concessions in existence on the Effective Date or as a result of the terms of concessions granted thereafter an increase in benefits to Governments in the Middle East should come generally to be received by them the Company will consult with the Emir whether in the light of all relevant circumstances including the conditions in which operations are carried out and taking into account all payments made, any alteration to the terms of this Agreement would be equitable to the parties.

ARTICLE 28

1. In the event that the Company desires to sell or convey any or all of its rights, powers or interests under this Agreement it shall first obtain the written permission of the Emir save that no such permission shall be required if such sale or conveyance is to a company the entirety of whose share capital is owned directly or indirectly by N.V. Koninklijke Nederlandsche Petroleum Maatshappij (Royal Dutch Petroleum Company) and The "Shell" Transport and Trading Company, Limited, or either of them.

2. The Company shall have the right to appoint an operating company or companies for the purpose of carrying out its rights and obligations hereunder and the Company will ensure that any such operating company or companies will perform and observe all the duties and obligations accepted by or imposed upon the Company by this Agreement. Such appointment shall operate so as to release the Company from its liability to the Emir for due performance of the terms and conditions of this Agreement.

ARTICLE 29

1. If at any time any difference or dispute shall arise between the parties hereto concerning the interpretation or execution of this Agreement, or anything herein contained or in connection herewith, or the rights or liability of either party hereunder, the same shall, failing any agreement to settle it in any other way, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee, who shall be chosen by the arbitrators before proceeding to arbitration.

2. Each party shall nominate its own arbitrator within sixty (60) days after the delivery of a request so to do by the other party, failing which its arbitrator may at the request of the other party be designated by the President of The International Court of Justice. In the event of the arbitrators failing to agree upon the referee within sixty (60) days after being chosen or designated, the President of the International Court of Justice may appoint a referee at the request of the arbitrators or of either of them.

3. The decision of the arbitrators, or in case of a difference of opinion between them, the decision of the referee, shall be final and binding upon both parties.

4. In giving a decision the arbitrators or the referee shall specify an adequate period of delay during which the party against whom the decision is given shall conform to the decision and that party shall be in default if that party has failed to conform to the decision prior to the expiry of that period and not otherwise.

5. The place of arbitration shall be such as may be agreed by the parties and in default of agreement shall be Kuwait.

6. In the event of a dispute to which the Company is a party arising in connection with the Kuwait Income Tax Decree the dispute shall, should the Company so request, be determined by submission to arbitration.

ARTICLE 31

For all measurements of Petroleum required for the purposes of this Agreement the Company shall employ methods customarily used in good technical practice and the Emir by His representative duly authorised by Him shall have the right to observe such measuring and to examine and test whatever appliances may be used. Such representative shall comply with all necessary and usual safeguards for the prevention of fire and/or other accident and shall make all examinations and tests at such times and in such manner as will cause the minimum of interference with the Company's operations. If upon such examination or testing any such appliance shall be found to be out of order the Company will cause the same to be put in order at its own expense within a reasonable time, and if upon any such examination as aforesaid any error be discovered in any such appliance, such error shall, if the Emir so decides after hearing the Company's explanation be considered to have existed for three (3) calendar months previous to the discovery thereof or from the last occasion of examining the same in case such occasion shall be within such period of three (3) calendar months and all consequential adjustments shall be made to any payments thereby affected. If the Company should find it necessary to alter, repair or replace any measuring appliance it shall give reasonable notice to the Emir to enable a representative of the Emir to be present during such alteration, repair or replacement.

The Company shall keep full and correct records of all measurements as aforesaid and the said representative of the Emir shall have access at all reasonable times to such records and shall be at liberty to make extracts from them. Such records shall be treated as confidential by the Emir and his representatives with the exception of such figures therein as the Emir may be required by law to publish.

ARTICLE 31

If the Company erects on land within the State of Kuwait any permanent installations or offices and living quarters for its employees otherwise than within a reasonable distance

from the Town of Kuwait, it agrees to provide suitable office accommodation and, if need be, living accommodation required for such of the following as may be appropriate under this Agreement:

(a) The Emir's inspectors and representatives.

(b) Police, Public Health and Customs Officials.

The Company shall then also provide a mosque and such other amenities and services as are reasonably necessary.

ARTICLE 32

All payments that become due to the Emir under this Agreement shall be made by the Company to the Emir or to His order in sterling or in such other currencies as may be agreed. The receipt of any bank or person designated by the Emir to receive such payment shall be a full discharge for the Company in respect of the payment of such sum stated in such receipt.

ARTICLE 33

The rights conferred by this Agreement so far as they apply to the State of Kuwait shall be so exercised as not to damage, impede or interfere with the property, operations and interests of the owners of the existing petroleum concessions under their respective agreements with the Emir.

ARTICLE 34

Any notice or other communication to be given to the Emir shall be addressed to whomever the Emir may designate.

Any notice or other communication required to be given by the Company hereunder shall be written in both Arabic and English, shall be signed and shall be given in such reasonable number of copies as shall be requested by the Emir.

ARTICLE 35

1. The parties base their relations with regard to this Agreement on the principle of goodwill and good faith. Taking account of their different nationalities this Agreement shall be given effect and must be interpreted and applied in conformity with the principles of law common to Kuwait and England and, in the absence of such common principles, then in conformity with the principles of law normally recognised by civilised states in general, including those which have been applied by international tribunals.
2. The Company renounces any right of diplomatic recourse regarding any matters relating to this Agreement or the rights thereunder.

ARTICLE 36

This Agreement is written in English and translated into Arabic. If there should at any time be disagreement as to the meaning or interpretation of any clause in this Agreement, the English text shall prevail.

IN WITNESS whereof the parties hereto have subscribed this Agreement on the day and year first above written.

APPENDIX NO. IX

THE UNIFIED ECONOMIC AGREEMENT AMONG THE COUNTRIES OF THE GULF COOPERATION COUNCIL

With the help of the God Almighty;
The Governments of the Member States of the Gulf Cooperation Council;

In accordance with the Charter thereof, which calls for closer reapproachment and stronger links; and,

Desiring to promote, expand and enhance their economic ties on solid foundations, in the best interest of their peoples; and,

Intending to coordinate and unify their economic, financial and monetary policies, as well as their commercial and industrial legislation, and customs regulations.

Have Agreed as follows:

CHAPTER ONE

TRADE EXCHANGE

ARTICLE 1

a. The Member States shall permit the importation and exportation of agricultural, animal, industrial and natural resource products that are of national origin. Also, they shall permit exportation thereof to other member states.
b. All agricultural, animal, industrial and natural resource products that are of national original shall receive the same treatment as national products.

ARTICLE 2

. All agricultural, animal, industrial and natural resource products that are of national original shall be exempted from customs duties and other charges having equivalent effect.
. Fees charges for specific services such as demurrage, storage, transportation, haulage or unloading, shall not be considered as customs duties when they are levied on domestic products.
I.

ARTICLE 3

. For products of national origin to qualify as national products, the value added ensuing from their production in members states shall not be less than 40% of their final value. In addition, the share of the member states citizens in the ownership of the producing plant shall not be less than 51%.
. Every item to be exempted hereby shall be accompanied by a certificate of origin duly authenticated by the government agency concerned.

ARTICLE 4

I. . Member states shall establish a uniform minimum customs tariff applicable to the products of the third countries.

II. . One of the objectives of the uniform customs tariff shall be the protection of national products from foreign competition.
III. . The uniform customs tariff shall be applied gradually within five years from the date of entry into force of this agreement. Arrangements for the gradual application shall be agreed upon within one year from the said date.
IV.

ARTICLE 5

Member states shall grant all facilities for the transit of any member state's goods to other member states, exempting them from any duties and taxes, whatsoever, without prejudice to the provisions of Paragraph 2 of Article 2.

ARTICLE 6

Transit shall be denied to any goods that are barred from entry into the territory of a member state by its local regulations. Lists of such goods shall be exchanged between the customs authorities of the member states.

ARTICLE 7

Member states shall coordinate their commercial policies and relations with other states and regional economic groupings and blocs with a view towards creating balanced trade relations and favourable circumstances and terms of trade therewith.

To achieve this goal, the member states shall make the following arrangements:

I. . Coordinate import/export policies and regulations.
II. . Coordinate policies for building up strategic food stocks.
III. . Conclude economic agreements collectively, when and if the common benefit of the member states is realised.
IV. . Work for the creation of a collective negotiating force to strengthen their negotiating position vis-à-vis foreign parties in the field of importation of basic needs and exportation of major products.

CHAPTER TWO

MOVEMENT OF CAPITAL, CITIZENS AND EXERCISE OF ECONOMIC ACTIVITIES

ARTICLE 8

The member states shall agree on the executive rules which would insure that each member state shall grant the citizens of all other member states the same treatment granted to its own citizens without any discrimination or differentiation in the following fields:

I. . Freedom of movement, work and residence.
II. . Right of ownership, inheritance and bequest.
III. . Freedom of exercising economic activity.
IV. . Free movement of capital.

ARTICLE 9

The member states shall encourage their respective private sectors to establish joint ventures in order to link their citizens' economic interest in the various spheres.

CHAPTER THREE

COORDINATION OF DEVELOPMENT

ARTICLE 10

The member states shall endeavour to achieve coordination and harmony among their respective development plans with a view to achieving economic integration between them.

ARTICLE 11

I. . The member states shall endeavour to coordinate their policies with regard to all aspects of the oil industry including extraction, refining, marketing, processing, pricing, exploitation of natural gas, and development of energy sources.

II. . The member states shall endeavour to formulate unified oil policies and adopt common positions vis-à-vis the outside world, and in the international and specialised organisations.

ARTICLE 12

To achieve the objectives specified in this Agreement, the member states shall perform the following:

I. . Coordinate industrial activities, formulate policies and mechanisms aiming at the industrial development and the diversification of their productive bases on an integrated basis.

II. . Standardise their industrial legislation and regulations and guide their local production units to meet their needs.

III. . Allocate industries between member states according to relative advantages and economic feasibility, and encourage the establishment of basic a well as ancillary industries.

ARTICLE 13

Within the framework of their coordinating activities, the member states shall pay special attention to the establishment of joint ventures in the fields of industry, agriculture and services, and shall support them with public, private or mixed capital in order to achieve economic integration, productive interface, and common development on sound economic basis.

CHAPTER FOUR

TECHNICAL COOPERATION

ARTICLE 14

The member states shall collaborate in finding spheres for common technical cooperation aimed at building a genuine local base founded on encouragement and

support of research and applied sciences and technology a well a adapting imported technology to meet the region's progress and development objectives.

ARTICLE 15

Member states shall set rules, make arrangements and lay down terms for the transfer of technology, selecting the most suitable or introducing such changes thereto a would serve their various needs. Member states shall also, whenever feasible, conclude uniform agreements with foreign governments and scientific or commercial firms to achieve these objectives.

ARTICLE 16

The member states shall formulate policies and implement coordinated programs for technical, vocational and professional training and rehabilitation at all levels and stages. They shall also upgrade educational curricula at all levels to link education and technology with the development needs of the member states.

ARTICLE 17

The member states shall coordinate their manpower policies and shall formulate uniform and standardised criteria and classifications for the various categories of occupations and crafts in different sectors in order to avoid harmful competition among themselves and to optimise the utilisation of available human resources.

CHAPTER FIVE

TRANSPORT AND COMMUNICATION

ARTICLE 18

The member states shall accord means for passenger and cargo transportation belonging to citizens of the other member states, when transiting or entering its territory, the same treatment they accord to the means of passenger and cargo transportation belonging to their own citizens, including exemption from all duties and taxes, whatsoever. However, local transportations are excluded.

ARTICLE 19

I. . The member states shall cooperate in the fields of land and sea transportation, and communications. They shall also coordinate and establish infrastructure projects such as seaports, airports, water and power stations, roads, with a view to realising common economic development and linking their economic activities with each other.

II. . The contracting states shall coordinate aviation and air transport policies among them and promote all spheres of joint activities at various levels.

ARTICLE 20

The member states shall allow steamers, ships and boats and their cargoes, belonging to any member state to freely use the various ports facilities and grant them the same treatment and privileges granted to heir own in docking or calling at the ports as concerns fees, pilotage, and docking services, haulage, loading and unloading, maintenance, repair, storage of goods and other similar services.

CHAPTER SIX

FINANCIAL AND MONETARY COOPERATION

ARTICLE 21

The member states shall seek to unify investment in order to achieve a common investment policy aimed at directing their internal and external investments towards serving their interest, and realising their people's aspirations in development and progress.

ARTICLE 22

The member states shall seek to coordinate their financial, monetary and banking policies and enhance cooperation between monetary agencies and central banks, including an endeavour to establish a common currency in order to further their desired economic integration.

ARTICLE 23

Member states shall seek to coordinate their external policies in the sphere of international and regional development aid.

CHAPTER SEVEN

CLOSING PROVISIONS

ARTICLE 24

In the execution of the Agreement and determination of the procedures resulting therefrom, consideration shall be given to differences in the levels of development between the member states and the local development priorities of each. Any member state may be temporarily exempted from applying such provisions of this Agreement as may be necessitated by temporary local situations in that state or specific circumstances faced by it. Such exemption shall be for a specified period and shall be decided by the Supreme Council of the Gulf Arab States Cooperation Council.

ARTICLE 25

No member state shall give to any non member state any preferential privilege exceeding that given herein.

ARTICLE 26

a. This Agreement shall enter into force four months after its approval by the Supreme Council.
b. This Agreement may be amended by consent from the Supreme Council.

ARTICLE 27

In case of conflict with local laws and regulations of member states, execution of the provisions of this Agreement shall prevail.

ARTICLE 28

Provisions herein shall supersede any similar provisions contained in bilateral agreements.

Drawn up at Riyadh on 6 Sha'ban 1401 Corresponding to 8 June 1981.

APPENDIX NO. X

UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

ARBITRATION RULES

(Resolution 31/98 adopted by the General Assembly on December 15, 1976)

SECTION I. INTRODUCTORY RULES

Scope of Application

Article 1

1. Where the parties to a contract have agreed in writing[2] that disputes in relation to that

1. *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17* (A/31/17), chap. V, sect. C.

contract shall be referred to arbitration under the UNCITRAL Arbitration Rules, then such disputes shall be settled in accordance with these Rules subject to such modification as the parties may agree in writing.

2. These Rules shall govern the arbitration except that where any of these Rules is in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail.

Notice, Calculation of Periods of Time

Article 2

1. For the purposes of these Rules, any notice, including a notification, communication or proposal, is deemed to have been received if it is physically delivered to the addressee or if it is delivered at his habitual residence, place of business or mailing address, or, if none of these can be found after making reasonable inquiry, then at the addressee's last-known residence or place of business. Notice shall be deemed to have been received on the day it is so delivered.
2. For the purposes of calculating a period of time under these Rules, such period shall begin to run on the day following the day when a notice, notification, communication or

2. MODEL ARBITRATION CLAUSE: Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force.

Note–Parties may wish to consider adding:

(a) The appointing authority shall be ... (name of institution or person);
(b) The number of arbitrators shall be . . . (one or three)
(c) The place of arbitration shall be . . . (town or country);
(d) The language(s) to be used in the arbitral proceedings shall be . . .

proposal is received. If the last day of such period is an official holiday or a non-business day at the residence or place of business of the addressee, the period is extended until the first business day which follows. Official holidays or non-business days occurring during the running of the period of time are included in calculating the period.

Notice of Arbitration

Article 3

1. The party initiating recourse to arbitration (hereinafter called the "claimant") shall give to the other party (hereinafter called the "respondent") a notice of arbitration.
2. Arbitral proceedings shall be deemed to commence on the date on which the notice of arbitration is received by the respondent.
3. The notice of arbitration shall include the following:
   (a) A demand that the dispute be referred to arbitration;
   (b) The names and addresses of the parties;
   (c) A reference to the arbitration clause or the separate arbitration agreement that is invoked;
   (d) A reference to the contract out of or in relation to which the dispute arises;
   (e) The general nature of the claim and an indication of the amount involved, if any;
   (f) The relief or remedy sought;
   (g) A proposal as to the number of arbitrators (i.e. one or three), if the parties have not previously agreed thereon.
4. The notice of arbitration may also include:
   (a) The proposals for the appointments of a sole arbitrator and an appointing authority referred to in article 6, paragraph 1;
   (b) The notification of the appointment of an arbitrator referred to in article 7;
   (c) The statement of claim referred to in article 18.

Representation and Assistance

Article 4

The parties may be represented or assisted by persons of their choice. The names and addresses of such persons must be communicated in writing to the other party; such communication must specify whether the appointment is being made for purposes of representation or assistance.

SECTION II. COMPOSITION OF THE ARBITRAL TRIBUNAL

Number of Arbitrators

Article 5

If the parties have not previously agreed on the number of arbitrators (i.e. one or three), and if within fifteen days after the receipt by the respondent of the notice of arbitration the parties have not agreed that there shall be only one arbitrator, three arbitrators shall be appointed.

Appointment of Arbitrators (Articles 6-8)

Article 6

1. If a sole arbitrator is to be appointed, either party may propose to the other:
   (a) The names of one or more persons, one of whom would serve as the sole arbitrator; and
   (b) If no appointing authority has been agreed upon by the parties, the name or names of one or more institutions or persons, one of whom would serve as appointing authority.

2. If within thirty days after receipt by a party of a proposal made in accordance with paragraph 1 the parties have not reached agreement on the choice of a sole arbitrator, the sole arbitrator shall be appointed by the appointing authority agreed upon by the parties. If no appointing authority has been agreed upon by the parties, or if the

appointing authority agreed upon refuses to act or fails to appoint the arbitrator within sixty days of the receipt of a party's request therefor, either party may request the Secretary-General of the Permanent Court of Arbitration at The Hague to designate an appointing authority.

3. The appointing authority shall, at the request of one of the parties, appoint the sole arbitrator as promptly as possible. In making the appointment the appointing authority shall use the following list-procedure, unless both parties agree that the list procedure should not be used or unless the appointing authority determines in its discretion that the use of the list-procedure is not appropriate for the case:

(a) At the request of one of the parties the appointing authority shall communicate to both parties an identical list containing at least three names;

(b) Within fifteen days after the receipt of this list, each party may return the list to the appointing authority after having deleted the name or names to which he objects and numbered the remaining names on the list in the order of his preference;

(c) After the expiration of the above period of time the appointing authority shall appoint the sole arbitrator from among the names approved on the lists returned to it and in accordance with the order of preference indicated by the parties;

(d) If for any reason the appointment cannot be made according to this procedure, the appointing authority may exercise its discretion in appointing the sole arbitrator.

4. In making the appointment, the appointing authority shall have regard to such considerations as are likely to secure the appointment of an independent and impartial arbitrator and shall take into account as well the advisability of appointing an arbitrator of a nationality other than the nationalities of the parties.

Article 7

1. If three arbitrators are to be appointed, each party shall appoint one arbitrator. The two arbitrators thus appointed shall choose the third arbitrator who will act as the presiding arbitrator of the tribunal.

2. If within thirty days after the receipt of a party's notification of the appointment of an arbitrator the other party has not notified the first party of the arbitrator he has appointed:

(a) The first party may request the appointing authority previously designated by the parties to appoint the second arbitrator; or

(b) If no such authority has been previously designated by the parties, or if the appointing authority previously designated refuses to act or fails to appoint the arbitrator within thirty days after receipt of a party's request therefor, the first party may request the Secretary-General of the Permanent Court of Arbitration at The Hague to designate the appointing authority. The first party may then request the appointing authority so designated to appoint the second arbitrator. In either case, the appointing authority may exercise its discretion in appointing the arbitrator.

3. If within thirty days after the appointment of the second arbitrator the two arbitrators have not agreed on the choice of the presiding arbitrator, the presiding arbitrator shall be appointed by an appointing authority in the same way as a sole arbitrator would be appointed under article 6.

Article 8

1. When an appointing authority is requested to appoint an arbitrator pursuant to article 6 or article 7, the party which makes the request shall send to the appointing authority a copy of the notice of arbitration, a copy of the contract out of or in relation to which the dispute has arisen and a copy of the arbitration agreement if it is not contained in the contract. The appointing authority may require from either party such information as it deems necessary to fulfil its functions.

2. Where the names of one or more persons are proposed for appointment as arbitrators, their full names, addresses and nationalities shall be indicated, together with a description of their qualifications.

Challenge of Arbitrators (Articles 9-12)

Article 9

A prospective arbitrator shall disclose to those who approach him in connection with his possible appointment any circumstances likely to give rise to justifiable doubts as to his impartiality or independence. An arbitrator, once appointed or chosen, shall disclose such circumstances to the parties unless they have already been informed by him of these circumstances.

Article 10

1. Any arbitrator may be challenged if circumstances exist that give rise to justifiable doubts as to the arbitrator's impartiality or independence.
2 A party may challenge the arbitrator appointed by him only for reasons of which he becomes aware after the appointment has been made.

Article 11

1. A party who intends to challenge an arbitrator shall send notice of his challenge within fifteen days after the appointment of the challenged arbitrator has been notified to the challenging party or within fifteen days after the circumstances mentioned in articles 9 and 10 became known to that party.
2. The challenge shall be notified to the other party, to the arbitrator who is challenged and to the other members of the arbitral tribunal. The notification shall be in writing and shall state the reasons for the challenge.
3. When an arbitrator has been challenged by one party, the other party may agree to the challenge. The arbitrator may also, after the challenge, withdraw from his office. In neither case does this imply acceptance of the validity of the grounds for the challenge. In both cases the procedure provided in article 6 or 7 shall be used in full for the appointment of the substitute arbitrator, even if during the process of appointing the challenged arbitrator a party had failed to exercise his right to appoint or to participate in the appointment.

Article 12

1. If the other party does not agree to the challenge and the challenged arbitrator does not withdraw, the decision on the challenge will be made:

(a) When the initial appointment was made by an appointing authority, by that authority;

(b) When the initial appointment was not made by an appointing authority, but an appointing authority has been previously designated, by that authority;

(c) In all other cases, by the appointing authority to be designated in accordance with the procedure for designating an appointing authority as provided for in article 6.

2. If the appointing authority sustains the challenge, a substitute arbitrator shall be appointed or chosen pursuant to the procedure applicable to the appointment or choice of an arbitrator as provided in articles 6-9 except that, when this procedure would call for the designation of an appointing authority, the appointment of the arbitrator shall be made by the appointing authority which decided on the challenge.

Replacement of an Arbitrator

Article 13

1. In the event of the death or resignation of an arbitrator during the course of the arbitral proceedings, a substitute arbitrator shall be appointed or chosen pursuant to the

procedure provided for in articles 99 that was applicable to the appointment or choice of the arbitrator being replaced.
2. In the event that an arbitrator fails to act or in the event of the de jure or de facto impossibility of his performing his functions the procedure in respect of the challenge and replacement of an arbitrator as provided in the preceding articles shall apply.

Repetition of Gearings in the Event of the Replacement of an Arbitrator

Article 14

If under articles 11-13 the sole or presiding arbitrator is replaced, any hearings held previously shall be repeated; if any other arbitrator is replaced, such prior hearings may be repeated at the discretion of the arbitral tribunal.

SECTION III. ARBITRAL PROCEEDINGS

General Provisions

Article 15

1. Subject to these Rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at any stage of the proceedings each party is given a full opportunity of presenting his case.
2. If either party so requests at any stage of the proceedings, the arbitral tribunal shall hold hearings for the presentation of evidence by witnesses, including expert witnesses or for oral argument. In the absence of such a request, the arbitral tribunal shall decide whether to hold such hearings or whether the proceedings shall be conducted on the basis of documents and other materials.
3. All documents or information supplied to the arbitral tribunal by one party shall at the same time be communicated by that party to the other party.

Place of Arbitration

Article 16

1. Unless the parties have agreed upon the place where the arbitration is to be held, such place shall be determined by the arbitral tribunal, having regard to the circumstances of the arbitration.
2. The arbitral tribunal may determine the locale of the arbitration within the country agreed upon by the parties. It may hear witnesses and hold meetings for consultation among its members at any place it deems appropriate, having regard to the circumstances of the arbitration.
3. The arbitral tribunal may meet at any place it deems appropriate for the inspection of goods, other property or documents. The parties shall be given sufficient notice to enable them to be present at such inspection.
4. The award shall be made at the place of arbitration.

Language

Article 17

1. Subject to an agreement by the parties, the arbitral tribunal shall, promptly after its appointment, determine the language or languages to be used in the proceedings. This determination shall apply to the statement of claim, the statement of defence, and any further written statements and, if oral hearings take place, to the language of languages to be used in such hearings.
2. The arbitral tribunal may order that any documents annexed to the statement of claim or statement of defence, and any supplementary documents or exhibits submitted in the course of the proceedings, delivered in their original language, shall be accompanied by a translation into the language or languages agreed upon by the parties or determined by the arbitral tribunal.

Statement of Claim

Article 18

1. Unless the statement of claim was contained in the notice of arbitration, within a period of time to be determined by the arbitral tribunal, the claimant shall communicate his statement of claim in writing to the respondent and to each of the arbitrators. A copy of the contract, and of the arbitration agreement if not contained in the contract, shall he annexed thereto.

2. The statement of claim shall include the following particulars:
   - (a) The names and addresses of the parties;
   - (b) A statement of the facts supporting the claim;
   - (c) The points at issuę;
   - (d) The relief or remedy sought.

The claimant may annex to his statement of claim all documents he deems relevant or may add a reference to the documents or other evidence he will submit.

Statement of Defence

Article 19

1. Within a period of time to be determined by the arbitral tribunal, the respondent shall communicate his statement of defence in writing to the claimant and to each of the arbitrators.
2. The statement of defence shall reply to the particulars (b), (c) and (d) of the statement of claim (article 1S, para. 2). The respondent may annex to his statement the documents on which he relies for his defence or may add a reference to the documents or other evidence he will submit.
3. In his statement of defence, or at a later stage in the arbitral proceedings if the arbitral tribunal decides that the delay was justified under the circumstances, the respondent may make a counter-claim arising out of the same contract or rely on a claim arising out of the same contract for the purpose of a set-off.
4. The provisions of article 18, paragraph 3, shall apply to a counter-claim and a claim relied on for the purpose of a set-off.

Amendments to the Claim or Defence

Article 20

During the course of the arbitral proceedings either party may amend or supplement his claim or defence unless the arbitral tribunal considers it inappropriate to allow such amendment having regard to the delay in making it or prejudice to the other party or any other circumstances. However, a claim may not be amended in such a manner that the amended claim falls outside the scope of the arbitrator clause or separate arbitration agreement.

Pleas as to the Jurisdiction of the Arbitral Tribunal

Article 21

1. The arbitral tribunal shall have the power to rule on objections that it has no jurisdiction, including any objections with respect to the existence or validity of the arbitration clause or of the separate arbitration agreement.
2. The arbitral tribunal shall have the power to determine the existence or the validity of the contract of which an arbitration clause forms a part. For the purposes of article 21, an arbitration clause which forms part of a contract and which provides for arbitration under these Rules shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.
3. A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence or, with respect to a counter-claim, in the reply to the counter-claim.

4. In general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question. However, the arbitral tribunal may proceed with the arbitration and rule on such a plea in their final award.

Further Written Statements

Article 32

The arbitral tribunal shall decide which further written statements, in addition to the statement of claim and the statement of defence, shall be required from the parties or may be presented by them and shall fix the periods of time for communicating such statements.

Periods of Time

Article 23

The periods of time fixed by the arbitral tribunal for the communication of written statements (including the statement of claim and statement of defence) should not exceed forty-five days. However, the arbitral tribunal may extend the time-limits if it concludes that an extension is justified.

Evidence and Hearings (Articles 24 and 25)

Article 24

1. Each party shall have the burden of proving the facts relied on to support his claim or defence.
2. The arbitral tribunal may, if it considers it appropriate, require a party to deliver to the tribunal and to the other party, within such a period of time as the arbitral tribunal shall decide, a summary of the documents and other evidence which that party intends to present in support of the facts in issue set out in his statement of claim or statement of defence.
3. At any time during the arbitral proceedings the arbitral tribunal may require the parties to produce documents, exhibits or other evidence within such a period of time as the tribunal shall determine.

Article 25

1. In the event of an oral hearing, the arbitral tribunal shall give the parties adequate advance notice of the date, time and place thereof.
2. If witnesses are to be heard, at least fifteen days before the hearing each party shall communicate to the arbitral tribunal and to the other party the names and addresses of the witnesses he intends to present, the subject upon and the languages in which such witnesses will give their testimony.
3. The arbitral tribunal shall make arrangements for the translation of oral statements made at a hearing and for a record of the hearing if either is deemed necessary by the tribunal under the circumstances of the case, or if the parties have agreed thereto and have communicated such agreement to the tribunal at least fifteen days before the hearing.
4 Hearings shall be held in camera unless the parties agree otherwise. The arbitral tribunal may require the retirement of any witness or witnesses during the testimony of other witnesses. The arbitral tribunal is free to determine the manner in which witnesses are examined.
5. Evidence of witnesses may also be presented in the form of written statements signed by them.
6. The arbitral tribunal shall determine the admissibility, relevance, materiality and weight of the evidence offered.

Interim Measures of Protection

Article 26

1. At the request of either party, the arbitral tribunal may take any interim measures it deems necessary in respect of the subject-matter of the dispute, including measures for the conservation of the goods forming the subject-matter in dispute, such as ordering their deposit with a third person or the sale of perishable goods.

2. Such interim measures may be established in the form of an interim award. The arbitral tribunal shall be entitled to require security for the costs of such measures.
3. A request for interim measures addressed by any party to a judicial authority shall not be deemed incompatible with the agreement to arbitrate, or as a waiver of that agreement.

Experts

Article 27

1. The arbitral tribunal may appoint one or more experts to report to it, in writing, on specific issues to be determined by the tribunal. A copy of the expert's terms of reference, established by the arbitral tribunal, shall be communicated to the parties.
2. The parties shall give the expert any relevant information or produce for his inspection any relevant documents or goods that he may require of them. Any dispute between a party and such expert as to the relevance of the required information or production shall be referred to the arbitral tribunal for decision.
3. Upon receipt of the expert's report, the arbitral tribunal shall communicate a copy of the report to the parties who shall be given the opportunity to express, in writing, their opinion on the report. A party shall be entitled to examine any document on which the expert has relied in his report.
4. At the request of either party the expert, after delivery of the report, may be heard at a hearing where the parties shall have the opportunity to be present and to interrogate the expert. At this hearing either party may present expert witnesses in order to testify on the points at issue. The provisions of article 25 shall be applicable to such proceedings.

Default

Article 28

1. If, within the period of time fixed by the arbitral tribunal, the claimant has failed to communicate his claim without showing sufficient cause for such failure, the arbitral tribunal shall issue an order for the termination of the arbitral proceedings. If, within the period of time fixed by the arbitral tribunal, the respondent has failed to communicate his statement of defence without showing sufficient cause for such failure, the arbitral tribunal shall order that the proceedings continue.
2. If one of the parties, duly notified under these Rules, fails to appear at a hearing, without showing sufficient cause for such failure, the arbitral tribunal may proceed with the arbitration.
3. If one of the parties, duly invited to produce documentary evidence, fails to do so within the established period of time, without showing sufficient cause for such failure, the arbitral tribunal may make the award on the evidence before it.

Closure of Hearings

Article 29

1. The arbitral tribunal may inquire of the parties if they have any further proof to offer or witnesses to be heard or submissions to make and, if there are none, it may declare the hearings closed.
2. The arbitral tribunal may, if it considers it necessary owing to exceptional circumstances, decide, on its own motion or upon application of a party, to reopen the hearings at any time before the award is made.

Waiver of Rules

Article 30

A party who knows that any provision of, or requirement under, these Rules has not been complied with and yet proceeds with the arbitration without promptly stating his objection to such non-compliance, shall be deemed to have waived his right to object.

SECTION IV. THE AWARD

Decisions

Article 31

1. When there are three arbitrators, any award or other decision of the arbitral tribunal shall be made by a majority of the arbitrators.

2. In the case of questions of procedure, when there is no majority or when the arbitral tribunal so authorises, the presiding arbitrator may decide on his own, subject to revision, if any, by the arbitral tribunal.

Form and Effect of the Award

Article 32

1. In addition to making a final award, the arbitral tribunal shall be entitled to make interim, interlocutory, or partial awards.

2. The award shall be made in writing and shall be final and binding on the parties. The parties undertake to carry out the award without delay.

3. The arbitral tribunal shall state the reasons upon which the award is based, unless the parties have agreed that no reasons are to be given.

4. An award shall be signed by the arbitrators and it shall contain the date on which and the place where the award was made. Where there are three arbitrators and one of them fails to sign, the award shall state the reason for the absence of the signature.

5. The award may be made public only with the consent of both parties.

6. Copies of the award signed by the arbitrators shall be communicated to the parties by the arbitral tribunal.

7. If the arbitration law of the country where the award is made requires that the award be filed or registered by the arbitral tribunal, the tribunal shall comply with this requirement within the period of time required by law.

Applicable Law, Amiable Compositeur

Article 33

1. The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

2. The arbitral tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorised the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration.

3. In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

Settlement or Other Grounds for Termination

Article 34

1. If, before the award is made, the parties agree on a settlement of the dispute, the arbitral tribunal shall either issue an order for the termination of the arbitral proceedings or, if requested by both parties and accepted by the tribunal, record the settlement in the form of an arbitral award on agreed terms. The arbitral tribunal is not obliged to give reasons for such an award.

2. If, before the award is made, the continuation of the arbitral proceedings becomes unnecessary or impossible for any reason not mentioned in paragraph 1, the arbitral tribunal shall inform the parties of its intention to issue an order for the termination of the proceedings. The arbitral tribunal shall have the power to issue such an order unless a party raises justifiable grounds for objection.

3. Copies of the order for termination of the arbitral proceedings or of the arbitral award on agreed terms, signed by the arbitrators, shall be communicated by the arbitral

tribunal to the parties. Where an arbitral award on agreed terms is made, the provisions of article 32, paragraphs 2 and F7, shall apply.

Interpretation of the A ward

Article 35

1. Within thirty days after the receipt of the award, either party, with notice to the other party, may request that the arbitral tribunal give an interpretation of the award.
2. The interpretation shall be given in writing within forty-five days after the receipt of the request. The interpretation shall form part of the award and the provisions of article 32, paragraphs 2-7, shall apply.

Correction of the Award

Article 36

1. Within thirty days after the receipt of the award, either party, with notice to the other party, may request the arbitral tribunal to correct in the award any errors in computation any clerical or typographical errors, or any errors of similar nature. The arbitral tribunal may within thirty days after the communication of the award make such corrections on is own initiative.
2. Such corrections shall be in writing, and the provisions of article 32, paragraphs 2-7, shall apply.

Additional Award

Article 37

1. Within thirty days after the receipt of the award, either party, with notice to the other party, may request the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the award.
2. If the arbitral tribunal considers the request for an additional award to be justified and considers that the omission can be rectified without any further hearings or evidence, it shall complete its award within sixty days after the receipt of the request.
3. When an additional award is made, the provisions of article 32, paragraphs 2-7, shall apply.

Costs (Articles 38-40)

Article 38

The arbitral tribunal shall fix the costs of arbitration in its award. The term "costs" includes only:

(a) The fees of the arbitral tribunal to be stated separately as to each arbitrator and to be fixed by the tribunal itself in accordance with article 39;
(b) The travel and other expenses incurred by the arbitrators;
(c) The costs of expert advice and of other assistance required by the arbitral tribunal;
(d) The travel and other expenses of witnesses to the extent such expenses are approved by the arbitral tribunal;
(e) The costs for legal representation and assistance of the successful party if such costs were claimed during the arbitral proceedings, and only to the extent that the arbitral tribunal determines that the amount of such costs is reasonable
(f) Any fees and expenses of the appointing authority as well as the expenses of the Secretary-General of the Permanent Court of Arbitration at The Hague.

Article 39

1. The fees of the arbitral tribunal shall be reasonable in amount, taking into account the amount in dispute, the complexity of the subject-matter, the time spent by the arbitrators and any other relevant circumstances of the case.

2. If an appointing authority has been agreed upon by the parties or designated by the Secretary-General of the Permanent Court of Arbitration at The Hague, and if that

authority has issued a schedule of fees for arbitrators in international cases which it administers, the arbitral tribunal in fixing its fees shall take that schedule of fees into account to the extent that it considers appropriate in the circumstances of the case.

3. If such appointing authority has not issued a schedule of fees for arbitrators in international cases, any party may at any time request the appointing authority to furnish a statement setting forth the basis for establishing fees which is customarily followed in international cases in which the authority appoints arbitrators. If the appointing authority consents to provide such a statement, the arbitral tribunal in fixing its fees shall take such information into account to the extent that it considers appropriate in the circumstances of the case.

4. In cases referred to in paragraphs 2 and 3, when a party so requests and the appointing authority consents to perform the function, the arbitral tribunal shall fix its fees only after consultation with the appointing authority which may make any comment it deems appropriate to the arbitral tribunal concerning the fees.

Article 40

1. Except as provided in paragraph 2, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable taking into account the circumstances of the case.

2. With respect to the costs of legal representation and assistance referred to in article 38, paragraph (e), the arbitral tribunal, taking into account the circumstances of the case, shall be free to determine which party shall bear such costs or may apportion such costs between the parties if it determines that apportionment is reasonable.

3. When the arbitral tribunal issues an order for the termination of the arbitral proceedings or makes an award on agreed terms, it shall fix the costs of arbitration referred to in article 38 and article 39, paragraph 1, in the text of that order or award.

4. No additional fees may be charged by an arbitral tribunal for interpretation or correction or completion of its award under articles 35-37.

Deposit of Costs

Article 41

1. The arbitral tribunal, on its establishment, may request each party to deposit an equal amount as an advance for the costs referred to in article 38, paragraphs (a), (b) and (c).

2. During the course of the arbitral proceedings the arbitral tribunal may request supplementary deposits from the parties.

3. If an appointing authority has been agreed upon by the parties or designated by the Secretary-General of the Permanent Court of Arbitration at The Hague, and when a party so requests and the appointing authority consents to perform the function, the arbitral tribunal shall fix the amounts of any deposits or supplementary deposits only after consultation with the appointing authority which may make any comments to the arbitral tribunal which it deems appropriate concerning the amount of such deposits and supplementary deposits.

4. If the required deposits are not paid in full within thirty days after the receipt of the request, the arbitral tribunal shall so inform the parties in order that one or another of them may make the required payment. If such payment is not made, the arbitral tribunal may order the suspension or termination of the arbitral proceedings.

5. After the award has been made, the arbitral tribunal shall render an accounting to the parties of the deposits received and return any unexpended balance to the parties.