

Kuwait's Strategic Response to its Developmental Challenges

Knowledge Sharing Program



Kuwait's Strategic Response to its Developmental Challenges : Recasting its Strategic Options and Implementation Strategy from a Korean Perspective

September 2008

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MINISTRY OF STRATEGY AND FINANCE

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Prepared for The Government of Kuwait

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Preface

In the 21st century, knowledge is the key factor in determining a country's level of socio-economic development. From this recognition, the Knowledge Sharing Program (KSP) was launched in 2004 by the Ministry of Strategy and Finance (MOSF) and the Korea Development Institute (KDI). KSP is designed to contribute to the socio-economic development of the targeted development partnership country by sharing Korea's development experiences. The most distinguishing characteristic of KSP is that it is demand-driven and participation-oriented. The program analyzes the problems from the partnership country's perspective and provides policy implications that are not far-reaching but can be practically implemented in the environment of the partnership country. For Kuwait, the KSP was first discussed at the Korea-Kuwait Joint Committee Meeting where both governments agreed to proceed with the program. Then at the Summit talks in March 2007, leaders of both countries reconfirmed the importance and the significance of the program.

Through an extensive survey of the Kuwaiti government and agencies, KDI and the Ministry of Planning (MOP), the counterpart organization, decided to tackle the issue on the formulation of a mid and long-term national development plan. After in-depth discussions, six sub-themes were selected: Confronting Kuwait's present reality; Critical Factors and SWOT analysis for crafting strategic response, Managing stakeholders and crafting the implementation strategy, Labor market reform, Updating education and human resources, Fiscal reform in Kuwait, Recommending policy initiatives for the five-year development plan of Kuwait.

I would like to take this opportunity to express my gratitude to the project manager Dr. Young Jae Lim and all the project consultants including Dr. Cheon



Sik Woo, Dr. Hun Joo Park, Dr. Chonghoon Rhee and Dr. Jin Kwon Hyun for all their hard work in successfully completing the KSP. I would also like to thank former Minister Jong Chan Choi who served as the Chairman of the KSP Steering Committee and other Committee members. My sincere thanks goes to all the Kuwaiti officials who actively supported the project, particularly H.H. Sheikh Sabah Al-Ahmed Al-Jaber Al-Sabah, The Amir of the State of Kuwait. Lastly, I would also like to thank the members of the Office for Development Cooperation (ODECO) of KDI for their dedication and contribution to the project.

Through this Knowledge Sharing Program, I hope the Kuwaiti government and relevant line ministry personals could benefit from the Korean experience. I also hope that our final report offers a broad strategic roadmap which answers the question of how to get today's Kuwaiti political economy moving and make progress in accordance with the nation's vision. The policy recommendations in this report, however, are based on the Korean experiences and are solely the opinions and recommendations of the authors.

Jung Taik Hyun
President
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Punchlines of This Report

The aim of this strategy report is three-fold. First, the report reassesses the present state of the Kuwaiti political economy and reevaluates its future challenges. Second, it suggests a long-term development strategy for Kuwait by drawing on the Korean development experiences. Third, the resultant strategy, which is designed to bridge the gap between the Kuwaiti economy as it is today and its vision of becoming a financial and trading hub by 2035, focuses on how to make and implement a series of five-year development plans in pursuit of the vision.

This report does not try to write a “comprehensive strategy” which may work out the details of the plans for the realization of the six pillars of the vision or set up quantitative targets for the Kuwaiti government to meet along the way towards the vision. Instead, this implementation strategy offers a broad strategic roadmap which answers the question of how to get today’s Kuwaiti political economy moving and make progress in accord with the nation’s vision.

This report’s point of departure is our analysis of why Kuwait’s past developmental efforts have failed: Among other causal factors, the major ones include lack of consensus on exactly “why and how to change”; inadequate attention to the political economy factors; absence of a practical and feasible strategy to cope and deal with political barriers; dearth of developmental focal groups both inside and outside of the government ministries.

The major arguments or policy suggestions of this report are as follows.

1. Although the Kuwaiti economy currently cruises in the midst of an oil boom, the present situation may not be sustainable over the long run. Crisis may well be in the offing in Kuwait’s primarily oil-driven political economy, and delaying a prompt, strategic and appropriate

response of the state to meet the challenges of the future may blow the crisis and the underlying problems out of proportions. Furthermore, against the increasing level of developmental competition in the region as a backdrop, Kuwait may not afford to keep increasing the opportunity costs of not moving forward or putting its otherwise respectable developmental potential to good use.

Under the circumstances, the Kuwaiti government's current effort to design and implement a successful five-year development plan is encouraging. Although the traditional-style, comprehensive five-year planning practice has been in decline across the globe, the importance of strategic and effective five-year plans remains valid. Particularly as in the case of Kuwait, where the private sector remains feeble, and the nation's developmental challenges fundamentally require a structural and societal transformation, a well-designed five-year plan has a very important symbolic and practical value as a vehicle for mobilizing the people of Kuwait for positive, long-term change and reform. We believe that strategic implementation of a series of five-year plans would prove indispensable in helping Kuwait move closer to its vision at least for the next 10 to 15 years.

2. Although Kuwait faces serious long-term development challenges, the drastic reform and change may not be feasible in the current conditions of the Kuwaiti political economy. Kuwait needs to take a phased, gradual, step-by-step approach to reform and change, strategizing not only the sequence but the pace of the process so that the citizens can absorb and embrace the proposed changes in their hearts and minds. The key lies in controlling the status quo, making a series of small successes with the programs, winning the hearts and minds of the Kuwaiti citizens for reform and change, and spreading the reform agenda and implementation schedule over a relatively long period of time, so that the reform issues become ripe enough in the eyes of the elite and citizens for a more full-scale mobilization of national energy.

3. Kuwait's present technological and manpower capacities may fall short of the level required to realize its vision, and thus the degree of success in crafting and implementing its long-term development strategy would depend on how effectively Kuwait makes use of international talents at least over the short and medium run. In other words, Kuwait may have to expect to face various industrial, technological, or manpower bottlenecks in making the way to its vision. Hence, in order to effectively deal with the bottlenecks it needs to actively attract international human and corporate resources to Kuwait and put them to use, while continuing to improve its internal capacities through gradual and yet determined economic, educational, and labor market reforms.

4. The key success to Kuwaiti developmental strategy would lie in the implementation of it, and for that purpose, Kuwait needs to establish developmental focus groups as its implementation agents both inside and outside of the government. In fact, Korea had virtually

no resources during the 1960s, and yet it was the presence of developmentally-dedicated officials in the pilot ministry like the Economic Planning Board (EPB) that pulled off a successful implementation of its early developmental plans. Likewise, Kuwait needs a strong pilot ministry like EPB for long-term development planning and implementation. Also setting up a national policy think tank like Korea's Korea Development Institute, as an effective interface between the governing leadership and the society in general, may greatly facilitate an effective implementation of Kuwait's development policies.

5. With respect to labor market reform, the core of Kuwait's task is to induce and empower its citizens to shift from low-productivity public sector jobs to high-productivity private sector jobs. The task is truly formidable, as it calls for nothing less than transformation of the current labor market structure and of the workers' attitudes and orientation. To start with, Kuwait needs to modify and strengthen such demand-side measures as "wage subsidies" and "employment quota" to encourage more Kuwaitis to seek jobs and gain work experience in the private sector. Such measures, however, need to be complemented by the supply-side policies to upgrade the quality of Kuwaiti workers, which would involve a heroic expansion and upgrading of vocational education and training programs. Otherwise, strengthened wage subsidies and employment quotas could end up aggravating the whole situation by making the distortions in the existing incentive structure actually worse. The basic objective is to help private firms willingly hire Kuwaiti workers even at high wages.

6. Going beyond the existing reports, the policy objectives and agendas of the Kuwaiti educational reform needs to be broadened to encompass all four issue areas: quantity, quality, efficiency, and equity. More attention has to be paid to such pivotal issues as those of the high school education sector as well as pre-school education and life-long-learning of adults. Reform strategy itself needs to be reset. At present in Kuwait, the higher and pre-school education sectors appear more prone to the market mechanism. Thus, Kuwait may want to start its educational reforms first with those sectors and more gradually spread the "small" successes to others, say, primary and secondary sectors. As for the higher education sector, we propose an active promotion of private universities so that they can make the backbone of Kuwait's higher education together with the Kuwait University. For secondary education, we suggest introduction of public "magnet schools" which, together with newly emergent quality private schools, can set off and lead quality competitions among the schools.

7. With regards to fiscal reform, based on the Korean experiences, we propose the following four measures or steps for the Kuwaiti government to adopt in a sequential manner: First, the government needs to increase the budget office's leadership and staff capacity to have a firm, top-down control over the budgetary process. Second, the government needs to combine its investment budget with operational budget which includes personnel expenses, monitoring them in a more integrated way. Third, gradually and over the longer run, the government may

experiment with adopting a MTEF (Medium Term Expenditure Framework) system and budgetary process on an at least three-year basis. Fourth, the government may develop a more sophisticated and technically harder reforms at a later stage and also more gradually over the medium or long term as the system gets settled down.

8. Lastly, the importance of such issue areas as privatization, FDI, and public-private partnership programs cannot be overemphasized. This is because the vibrant and dynamic private sectors are an indispensable part of the long-run sustainable and inclusive development of the Kuwaiti economy. Given that the current state of the private sectors in the Kuwaiti economy is too feeble and meager, we recommend a multi-staged approach to foster the private sectors.

First, public-private partnership programs should play a key role in the development of private sector-led economy and market discipline in the Kuwaiti economy. Based on policy experiences of Korea, we provide some key recommendations on the legislative and institutional requirements, priorities in choosing target facilities, and the diversification of the available PPP schemes. At the actual implementation stage, it would be wise to try and learn from the best practices of leading PPP program countries periodically and establish a sound monitoring mechanism of the performance to refine the PPP policy. Furthermore more attention should be given to the training of public officials as their quality may determine the level of success.

Second, we recommend a target-oriented FDI system for the Kuwaiti economy with a medium- or long-term perspective on the Kuwaiti industrial development. In this regard, the Irish example could serve as a benchmark. We provide a sketch of the Irish target-oriented FDI system.

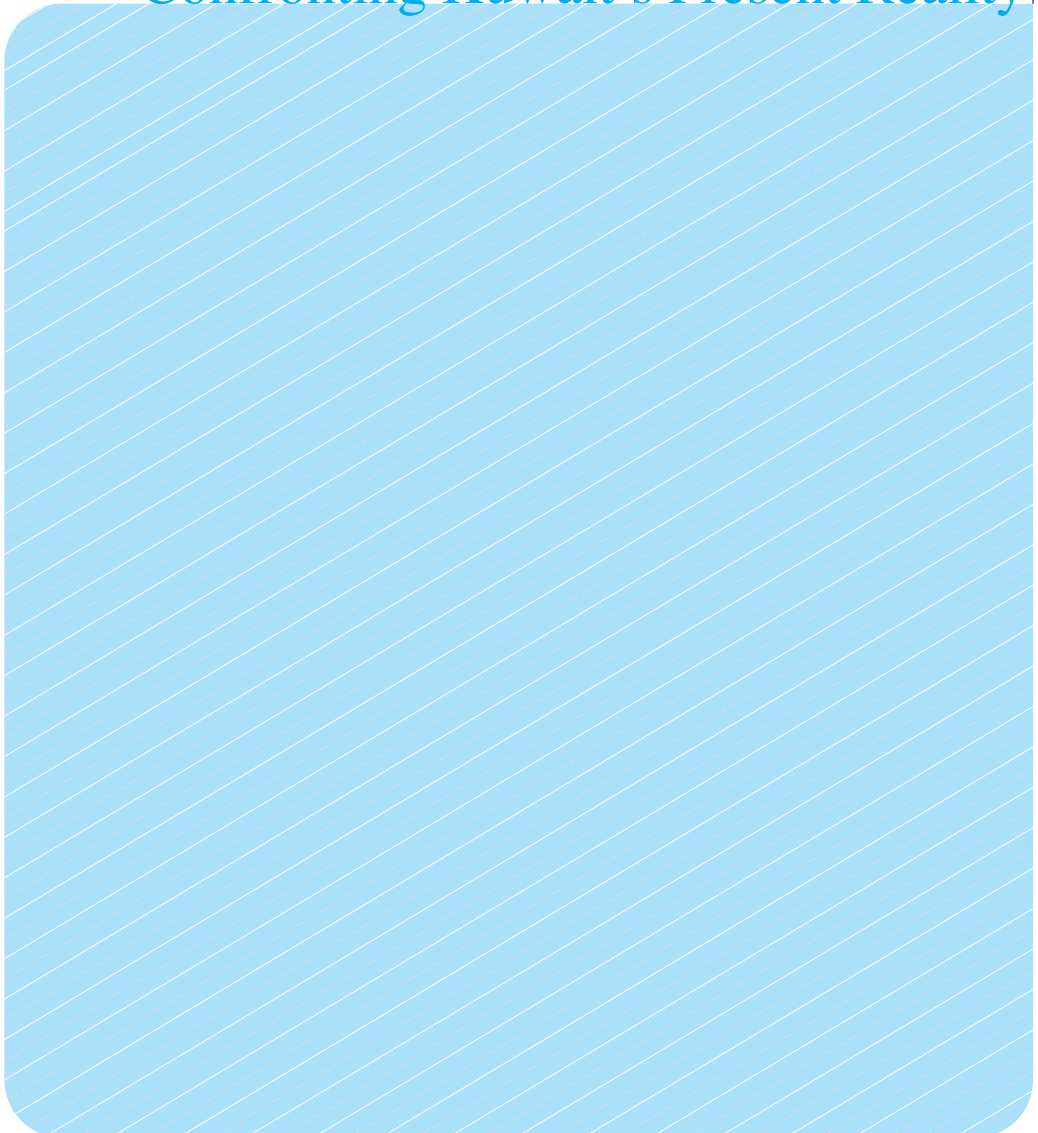
Third, we suggest some key recommendations with respect to privatization programs. Among other things, it is emphasized that the general privatization law (the general rules for privatization processes) should be first established and applied universally to all the to-be-privatized organizations. The general privatization law could include the establishment of “Privatization Fund” or “Kuwait Restructuring Fund” as a way of compensating the incumbent workers at the to-be-privatized organizations. We also suggest some guidelines about prioritizing the areas or targets of privatization.

Lastly, we suggest some key guiding principles for restructuring the electricity power and healthcare sectors. The restructuring of these sectors should have a high priority. These sectors have been doing poorly to serve the basic needs of the Kuwaiti people although they demand an increasingly large amount of resources. It reflects structural inefficiencies.

Kuwait's Strategic Response
to its Developmental Challenges

Chapter 01

Introduction: Confronting Kuwait's Present Reality



Introduction: Confronting Kuwait's Present Reality

Kuwait stands at a crossroads. There is no doubt that the Kuwaiti economy currently cruises in the midst of an oil boom. Its recent GDP growth rates have been impressive, and the country's economic outlook in the short and medium run looks positive. Among others, Kuwait possesses enormous reserves of oil, its current investments in oilfields are set to show dramatic increase in production, and it has set aside a huge sum of assets of some \$170 billion for future generations under the management of Kuwait Investment Authority.

However, the current Kuwaiti development or growth may not be sustainable over the long run, even if the present high price of oil could continue for the foreseeable future. A big if is in light of the record of past price volatility. In fact, the greater danger may lie in the fact that the current oil boom hides structural and institutional problems of the economy: the entangling consequences of the rentier state on the economy, the prospect of collapse of the public education system, the mal-functioning of the egregiously over-staffed government, and some ominous implications of the demographic trend-to be discussed in more detail below. Clearly, the current oil boom may turn even the bravest and the most visionary reformists rather reluctant to take progressive, future-oriented, or politically unpopular actions. Nevertheless, crisis may well be in the offing in Kuwait's primarily oil-driven political economy delaying a prompt, strategic and appropriate response of the state, to meet the challenges of the future, which may blow the crisis and the underlying problems out of proportions. Thus, now may be the best time for Kuwait to act and rise to the challenges. When it can, the government needs to judiciously exploit its current oil revenues to its full advantage, strategically leveraging them to enhance the productive capacities of the society in general and its non-oil, private sectors in particular. It would take true leadership for Kuwait to accomplish such a feat under the circumstances, but we believe that His Highness the Amir, has the successful qualities of true

leadership.

In fact, the Amir's 2005 promulgation of the vision to make Kuwait a regional financial and trading hub, represents such a leadership in action. Demonstrating the Amir's commitment to the nation's long-term development, some landmark reforms of the political economy have followed: most notably the 2006 suffrage law which guarantees the right of Kuwaiti women to vote and run for political office and the 2007 electoral district reform law which is expected to improve the representativeness of the National Assembly members. As part of such a series of new development initiatives, indeed, the Kuwaiti government is now in the process of preparing a five-year development plan which can help guide the Kuwaiti society to begin to realize its full potential in accord with the vision 2035.

Such a realization constitutes a tall task, however. It is so because, above all, to successfully and effectively implement a series of five-year development plans in accord with the vision requires a clearer understanding of the true size of the challenges which may confront Kuwait. While the nation's elite in general shares some sense of potency and urgency of reform and change, they have not as yet been able to translate it into concerted, decisive and strategically-guided policy actions. Such failure has stemmed at least in part from the lack of social understanding about the real magnitude of the nation's challenges or consensus on the question of "why and how to change." As was the case with the recently aborted five-year plan, the government plans did basically acknowledge a sense of the crisis, but proved not effective enough in articulating a compelling need for societal responses or persuasive enough in providing clear policy directions, means and tools, with which to solve the problems underlying the brooding crisis.

As mentioned earlier, there exist some critical structural and institutional challenges which call for rethinking about the nation's tasks and strategies about how to best deal with them. As a result of the distributive politics of the rentier state, a historical-institutional characteristic of the Kuwaiti political economy to be detailed below, the public sector is overburdened by an ever more serious problem of "disguised unemployment." Our interviews suggest that the level of personnel redundancy is already so serious that a significant percentage of public employees draws on the generous government salaries and benefits without even showing up at work. Still, given the current demographic trend, the government may have to keep creating additional public sector jobs to at least 20,000 young Kuwaitis every year as a Constitutional requirement-unless more attractive jobs are created for them in the private sector. Moreover, our field research also indicates that the level of social discipline has been precipitously falling, more so since the 1990 Iraqi invasion, and in its wake, the public primary and secondary education system in particular has been practically collapsing. The fact that there are no more than ten qualified and competent teachers who can teach physics in the Kuwaiti public schools speaks loudly about the nature of the crisis. With the education system for the Kuwaiti youth in

disarray, the nation's future may be in jeopardy.

Against the increasing level of developmental competition in the region as a backdrop, in short, Kuwait may not afford to keep increasing the opportunity costs of not moving forward or putting its otherwise respectable developmental potential to good use. Under such circumstances, the Kuwaiti government's current effort to make and implement a successful five-year development plan is sensible and encouraging. The traditional-style, comprehensive five-year planning practice has been in decline, but that does not deny the importance of strategic and effective five-year plans. Particularly in the case of Kuwait, where the private sector remains feeble, and the nation's developmental challenges fundamentally require a structural and societal transformation, a well-designed five-year plan has a symbolic and practical value as a vehicle for mobilizing the people of the Kuwait for positive, long-term change and reform. We believe that strategic implementation of a series of five-year plans would prove indispensable in helping Kuwait move closer to its vision at least for the next 10 to 15 years.

In an effort to craft strategic responses to Kuwait's long-term development challenges, therefore, the chapter that follows examines the underlying critical factors and offers a SWOT analysis.

Critical Factors and SWOT Analysis for Crafting Strategic Response

- 1_ Political Economy Factors
- 2_ SWOT Analysis
- 3_ Strategic Roadmap to Realize Kuwait's Potential

Critical Factors and SWOT Analysis for Crafting Strategic Response

1. Political Economy Factors

1.1. The Security Dimension

As one Kuwaiti historian has put it, Kuwait remains a small state living in a bad or unstable neighborhood. Security or potential lack of it could arguably be the single most critical impediment to Kuwaiti development. However, the security situation has more recently been essentially stable, and thus maintaining the status quo may be the best and reasonably feasible policy that can go hand in hand with Kuwait's long-term economic and social development planning.

Kuwait can continue to count on the United States security umbrella against any direct military threat under a ten-year defense agreement, which was renewed in September 2001. Given the drastically weakened power of Iraq, Iran may constitute the biggest source of potential security threat to Kuwait. In close consultation and cooperation with the United States, the unrivaled uni-polar hegemon which has kept its large-scale and low-profile military presence in Kuwait since 2003, the Kuwaiti government may pursue a status quo-driven containment policy, aiming to help stabilize the Iraqi situation, promote variegated diplomatic and peace-prone regional dialogues, and prevent Iran from going nuclear or from destabilizing the region by any aggressive or hostile moves.

Kuwait enjoys a strong Muslim tradition, and the religion of Islam provides the nation with a basic bond for social cohesion. While sectarian strife between Sunnis and Shiites in Iraq has

been rendering the nation to terrorism and religious cleansing, the religious practice in Kuwait has been for the most part moderate, reasonable and positive. About 25-30 percent of one million Kuwaiti Muslims consists of Shiites, but they partake of Kuwait's wealth and prosperity as legitimate Kuwaiti citizens. Although they may be underrepresented in the prime or top-notch positions of the government, they remain loyal to the Kuwaiti regime because they can also voice their concerns and thereby feel included as part of the national polity. A democratic government and its policies are indeed far more stable over time than authoritarian ones because democracy allows institutionalized channels for the expression of dissent and opposition within the system. Kuwait is proudly endowed with an exceptionally vibrant democratic tradition, robust National Assembly and largely free and lively public and private realms for socio-political discourse.

1.2. The Historical-Institutional Dimension

With respect to any thinking or rethinking about strategies of long-term national development, one seriously needs to take into consideration the historical and institutional features of a given political economy, and in the Kuwaiti national context, one of the most striking historical-institutional features lies in the fact that Kuwait fundamentally remains a rentier state, engaging in distributive politics based on economies of oil. As a way to maintain Kuwait's old ruling coalition between the ruling family and the merchant or trading families, for instance, starting in 1946 the Kuwaiti government or the Amir distributed the nation's oil wealth directly to the elite in the form of government purchases of land at highly inflated prices, resulting in a significant transfer of state revenues to the old merchant families as well as umpteen members of the ruling family. In return for giving huge economic wealth to the historically-powerful merchant families, the state gained increasing political autonomy and stability. Although the elite merchants retained some formal influence on state governance through the National Assembly, the rentier state has contained the extent of such an influence not only by nurturing other social groups such as religious and tribal within the legislative branch of the government over time, but also by practically guaranteeing and actually offering the masses of Kuwaiti citizens lucrative government jobs, making them new political allies or tacit supporters of the ruling regime. Additionally to maintain a firm grip on the subsequently expanded state structure, the Amir turned increasingly to the ruling family. As a result the ruling family councils became a powerful political forum for critical decision making. Somewhat ironically, therefore, the government's distributive policies as well as its independent oil wealth ended up not only strengthening the power of the state but also enlarging or over-blowing the size of the rentier state.

1.3. Two Core Challenges

As a consequence, two challenges stand out today on that score.

First, there is a serious lack of trust between the executive branch of the government and the National Assembly, and the National Assembly has become a focal point of political opposition, with the politicized Islamist movements appealing particularly strongly to those who have least benefited from the state's distributive policies. Although populist politics of Islamist movements, for instance, as played out in the National Assembly may not be entirely positive, the National Assembly serves some basic positive functions of the political economy by acting as a governmental watchdog as well as by giving voice to the weak and the marginalized citizens of the society. Corruption and favoritism appear prevalent in the government and society. Furthermore the hostility of the National Assembly is reflective at least in part of popular sense of relative deprivation and socio-economic resentment about such inequities, not to mention the deteriorating, real and perceived, quality of many public services. However, the politicization of various groups in the National Assembly has often resulted in the lack of stability in the cabinet and also continuity in the government's policies.

Second, the large and rapidly-growing public sectors spending in wages, salaries and various subsidies, is not only inefficient and crowding out the private sector, but also increasingly financially unsustainable. With respect to the problem of over-staffed public sector, it already employs over 95% of the Kuwaiti labor force (including the police and the military) and it simply cannot double its size just to absorb all young Kuwaiti citizens who are expected to join the nation's work force within the next 15 to 20 years.

Clearly, the development challenges that confront Kuwait represent more than technical ones in nature, as turning Kuwait into a financial and trading hub through a series of effective and consensus-building five-year development plans ultimately calls for change of its citizens' hearts and minds. That is why the role of wise and firm leadership is indispensable not only to provide a clear sense of direction and purpose, but also to convince the citizens that they are under a capable and caring leadership and that it is well worth to make a united national, if at times sacrificial, effort at creating a bright, prosperous and sustainable future for the posterity.

2. SWOT Analysis

Kuwait has good potential to realize its vision of transforming itself into a regional, globally competitive financial and trading hub. For a SWOT analysis as part of an effort to formulate an effective national implementation strategy for the vision, we have identified core component factors as follows, on the basis of both primary and secondary sources of information. The SWOT analysis, as summary presented in the table below, purports to identify the relative position of Kuwait and its strategic options primarily within the GCC or Arabic nations, although the global context is also considered to an extent. Most of the core factors identified in the SWOT analysis are largely self-explanatory. Since we have already emphasized some of the more critical causal, historical-institutional factors in detail earlier, we shall elaborate only on some of the key economic factors here.

Table 2-1 | SWOT Analysis

Strength	Weakness
<p>⟨Political Environments ⟩</p> <ul style="list-style-type: none"> • Democratic tradition & stable polity • Sound legal system <p>⟨Economy : Industry/Firms⟩</p> <ul style="list-style-type: none"> • Private sector potential • Established financial market • Reasonably developed SOC infrastructure <p>⟨Human Resources⟩</p> <ul style="list-style-type: none"> • Indigenous top talents • Established formal education sector <p>⟨Others⟩</p> <ul style="list-style-type: none"> • Strategic geopolitical position 	<p>⟨Political Environments⟩</p> <ul style="list-style-type: none"> • Tensions among stakeholders • Weak government leadership & mal-functioning bureaucracy <p>⟨Economy : Industry/Firms⟩</p> <ul style="list-style-type: none"> • Big and inefficient public sector • High oil dependency & shallow base for industrial competitiveness <p>⟨Human Resources⟩</p> <ul style="list-style-type: none"> • Lack of mid- to high-talents • Self-complacency & weak work discipline
<ul style="list-style-type: none"> • Reform-oriented top leadership • High oil revenue • Some successful cases of privatization • Essentially stable regional security • Thriving regional economy • International mobility of talents • Socio-economic disparity 	<ul style="list-style-type: none"> • Latent danger of brain drain • Regional and global market competition • Ill-prepared for ICT & knowledge-based economy
Opportunities	Threats

2.1. Human Resources and Labor Market

Human resources may constitute the single most important factor which can determine the ultimate success of Kuwait's new development initiatives. The prospects of success in this regard are mixed. First of all, Kuwait has some respectable number of top "indigenous talents" who can lead the people of Kuwait toward its vision in both the public and private sectors of the society¹. However, the top talents remain more or less dispersed across sectors and even within any given sector, and they have as yet to form a single coherent impact group to start off and sustain the nation's reform agenda. Also, the average Kuwaiti workers remain less than perfectly adequate to undertake more challenging jobs in terms of both work ethical and professional expertise. Because structural problems of the education sector, such as the low quality of teachers, low student motivation, and low accessibility to higher education, in a nutshell, many Kuwaitis enter the labor market without acquiring an adequate level of occupational skills. Most Kuwaitis prefer working in the public sector, which offers them higher wages and more relaxed working environments, but there the chances of their developing skills and learning remain limited. By all accounts, therefore, the problem of insufficient supply of talents both at the top and the middle may become more serious as Kuwait tries to upgrade and diversify its business activities. Against such a background, the latent risk of "brain drain" of top talents from Kuwait may require more policy attention.

Perhaps the biggest threat pertaining to Kuwait's human resources and labor market may stem from its young demographic structure. Kuwait's population is very young, and the birth rate remains very high². Abundant, young labor force can be a sound basis for long-term economic growth, but it can also become a grave threat if the present educational and labor market practices persist. It is so because the public sector, already seriously over-staffed with a mass of "disguised" employees, may have to keep creating inefficient public sector positions for the increasing number of young Kuwaiti labor market entrants.

2.2. High Oil Price

The recent oil boom provides an exceptional financial wherewithal for Kuwait to pursue even an ambitious socio-economic transformation program. Of course, high oil revenues could serve to further undermine the work ethics of Kuwaiti citizens, possibly aggravating the

1. Most of the high-ranking officials and professionals have been educated in the advanced academic institutions abroad, have postgraduate degrees and they have a good command of English. Academic and civil society groups have sound and sophisticated knowledge to advise, criticize, or consult government policies.

2. The portion of the population whose ages are less than 20 is 50%, and those who are less than 15 is 40%.

structural problems of the rentier state. If managed properly, however, it can serve as an invaluable asset which makes it possible for the government to build winning social coalitions and co-opt other stakeholders in its effort at reform and change. From the perspective of fiscal policy, low oil price used to cast a major constraint on government efforts at making viable development plans. The aborted third development plan of 2001/2-2004/5 was such a case in point. Fortunately, there seems a general consensus both inside and outside of Kuwait that the present state of high oil prices may continue for a foreseeable future. The situation prevailing now can be dubbed as one of “sustainable, soft budget constraint,” and thus the government can focus on “designing” of a development plan and its implementation, largely free from concern over any shortage of funds or fiscal soundness.

2.3. Industrial and Business Foundation

The business landscape of Kuwait is currently dominated by publicly-managed hydrocarbon sectors. The shares of the manufacturing and financial services sectors as well as that of the private sector in general remain relatively small. Thus, realizing Kuwait’s vision of building a financial and commercial hub is a formidable task, especially since it would necessarily involve some fundamental restructuring of business norms and practices in both the private and public sectors of the economy. However, Kuwait as a traditional leader in the region’s trade and financial businesses has long enjoyed the presence of highly competent entrepreneurs in the private sector, even though such a positive entrepreneurial spirit of the society may have been somewhat disrupted in the wake of the nationalization drive of the 1970s. Indeed, Kuwait still has one of the most advanced and resilient financial markets in the regions particularly with respect to the financial asset management businesses.

2.4. Regional Developmental Competition

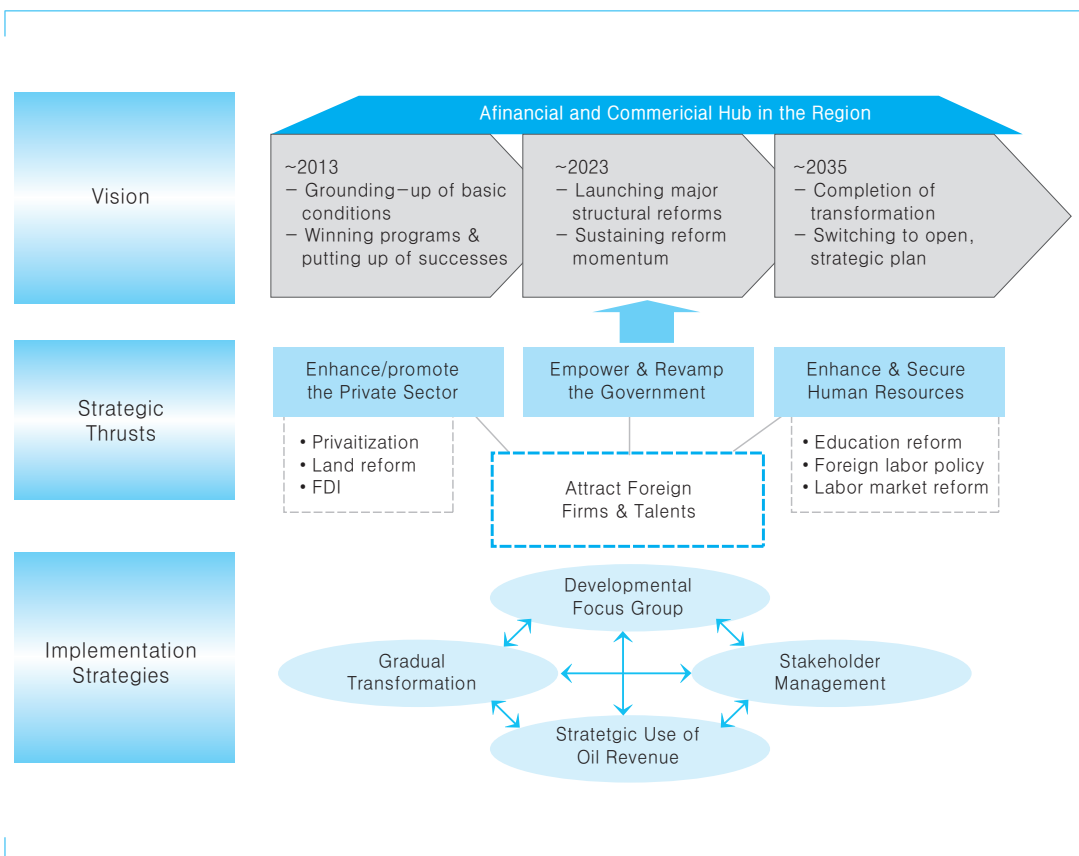
There are some solid grounds for optimism about Kuwait’s developmental potential and the capabilities of its people and especially the young generation, although it has largely failed to take advantage of them in comparison to its neighboring countries including Bahrain, Qatar, and Dubai. After the demise of Beirut as a regional financial center, for instance, Bahrain has made a good effort to turn itself into such a center by adopting an open banking policy and making its airports convenient to use and rents low-priced. Qatar has invested heavily in education especially by bringing in some top-flight schools from the developed countries, although it is still too early to tell how successful the education reform experiments will turn out to be in the end. Moreover its glittering successes so far, the durability of Dubai’s miracle has as yet to be tested. Overall, we believe that Kuwait has a better long-term development potential; among others, it has a well-established legal-institutional infrastructure which can far more adequately

protect private property rights. Its judicial system provides a channel for fair and transparent litigation processes both for domestic and international parties in case of business disputes. Particularly given the increasing regional market competitions, nonetheless, this is not to gainsay that Kuwait can and must do more to increase the openness and competitiveness of the Kuwaiti economy and society, attract top-quality international talents and foreign direct investments, and thereby help enhance the skill level of Kuwaiti workers and those of the technological capacities of Kuwaiti companies.

3. Strategic Roadmap to Realize Kuwait’s Potential

We visualize the strategic roadmap for realizing Kuwait’s vision in the diagram below.

Figure 2-1 | Synoptic Illustration of Kuwait’s Strategic Options



As mentioned in the Introductory Chapter, the traditional-style, comprehensive five-year planning practice has been in decline worldwide; however, it does not refute the value of strategic and effective five-year plans in Kuwait today. We believe that strategic implementation of a series of five-year plans would be indispensable in helping Kuwait move closer to its vision at least for the next 10 to 15 years. After the build-up of the private sector capacity and the commensurate maturation of market economy institutions, Kuwait may ofcourse switch to “open strategy planning.”

Realizing the vision requires three strategic thrusts, which are comparable to the six pillars in the official vision statement of the Kuwaiti government: (1) enhance and promote the private sector, (2) empower and revamp the government, and (3) enhance and secure human resources. In all of these areas, the strategic access to the foreign knowledge base (both human resources and technology) will be critical, since the indigenous knowledge base in Kuwait is reasonably good (compared to the other GCC countries) but not sufficient to support Kuwait’s realizing the vision. Kuwait must attract foreign top-notch firms and talents not for the financial capital which they could bring to Kuwait, but for their advanced knowledge capital. For instance, as in the case of existing offset programs, Kuwait could strategically utilize the advanced international knowledge capitals through such programs to build up the knowledge base of Kuwait.

The SWOT analysis points to the four essential ingredients in contemplating the implementation of development policies: stakeholder management, gradual transformation (initially starting with winning programs for quick and visible results), developmental focus groups, and strategic use of oil revenue. These four ingredients are also closely linked to the underlying reasons of why Kuwait’s past developmental efforts have failed: inadequate attention to the political economy factors; absence of a practical and feasible strategy to cope and deal with political barriers; dearth of developmental focal groups both outside and inside the government ministries.

Managing Stakeholders and Crafting the Implementation Strategy

- 1_ Stakeholder Management
- 2_ Starting with Winning Programs for Strategic Reform
- 3_ Establishing Developmental Focus Groups as Agents for
Effective Implementation of Kuwait's Strategic Responses
- 4_ Strategy for Successful Leadership
- Annex

Managing Stakeholders and Crafting the Implementation Strategy

1. Stakeholder Management

Changing the status quo surely engenders tension and brings hidden conflicts to the fore, as it challenges the existing way of doing things. Change can usually come when the elite or citizens find the existing situation intolerable or feel a crisis themselves, but such a sense of urgency for reform and change is currently found neither among the general public in Kuwait nor in the National Assembly-especially given the recent boom in oil prices and the economy. In order to enhance the chances of success of what may otherwise be necessarily as hard and difficult reform and change under such circumstances it may be critical for the Kuwaiti leadership to craft a differentiated set of tactical and strategic approaches to different segments of the society: reform opponents, allies, and those in the middle.

The opponents would include those with the most to lose in the process of reform and change: some of those may be the ruling elites, officials, National Assembly men and citizens who have vested interests in the current practices of the rentier state in Kuwait. The allies would be those who share the vision and future-oriented goals of the nation in common or those with the least to lose, including quite a few of those elite reform-minded officials and intellectuals in such places as Kuwait University, various research institutes, and varying NGOs such as Kuwait Chamber of Commerce and Industry and Kuwait Economic Society. Those in the middle would include the majority of citizens who may well end up deciding the long-term success of what the current leadership aims to accomplish; true success or full realization of any major reform may be attainable only if the great masses of people embody the spirit of reform and put it into practice in their everyday lives. Those in the middle by definition do not have

huge stakes in the existing way of doing business in the Kuwaiti political economy; nonetheless, they would resist any change too disruptive of their lives especially if it fails to entail positive, real or promised, societal progress or personal benefits in terms of better quality of life.

What further complicates the stakeholder matrix (Please see <Table 3-1> below) in Kuwait is the aforementioned, historically deeply-embedded lack of trust and cooperation between the executive and legislative branches of the government. The legacies of the rentier state and the distributive politics of its oil wealth are bound to entangle even the most forward-looking and future-oriented changes or reforms. Especially if such a government reform were to entail any transaction of public money or property, it would frequently provoke allergic, if not hysterical, reactions from members of the National Assembly, easily getting their hackles up.

In brief, given the current make-up of major stakeholders and their latent and expressed interests in Kuwait, any major effort at reform and change would clearly be more than an uphill battle. Thus, despite the current economic boom, the nation’s leadership should be on its guard against complacency about the state of the economy or nation, and start turning its vision and long-term development perspectives into concrete strategies and plans for implementation-in the hope of preparing for the possibility of lean years in the future or post-oil era.

2. Starting with Winning Programs for Strategic Reform

As far as the leadership requirement is concerned, fortunately, the present may offer one of the best opportunities for pursuit of long-term reform and change. For that matter, indeed,

Table 3-1 | Stakeholder Matrix

Issue		Amir	Ministries	National Assembly	Big Business	Opinion Leaders	Citizens/ Officials
Radical Reform	Power	H	M	H	M	L	L(if normal)
	Interest	-H	-H	-H	Mixed	H	-H
	Position	NS	NS	NS	Partial	S	NS
Gradual Reform	Power	H	M	H	M	L	L
	Interest	H	-M	-M	Mixed	M/H	-M
	Position	S	Partial	Partial	Partial	S	Partial

Notes: H=High, M=Medium, L=Low

-H=Negative High, -M=Negative Medium

S=Supportive, NS=Nonsupportive, Partial=Partially Supportive

Kuwait's current political economic circumstances may arguably provide an unprecedented window of opening for the leadership to begin implementing a viable and effective long-term national development plan.

In addition to the presence of the Amir who remains committed to the nation's long-term economic development, the government has ample financial resources as well as other policy tools to put to use in its efforts at buying, co-opting or mobilizing supporters for its development strategies and policies; and the societal elite including top-notch government personnel, other intellectuals and opinion leaders generally share the need for more adaptive or structural reforms or changes to bring about sustainable development, although the elite as a whole remains less than consensual or cohesive a force for socio-economic transformation.

Under the circumstances, the leadership may best start with easier and more technical reforms or winning programs and move slowly and flexibly towards harder, adaptive and structural ones. The criteria for the selection of winning programs include: 1) importance in terms of urgency and impact; 2) concreteness; 3) political feasibility. The criteria are critical for success because the winning programs need to produce quick results without much difficulty or complication to begin to win the hearts and minds of even the most myopic and complacent citizens and thereby build up the momentum for further change and reform. We identify and propose some of them in each of our sectoral reform chapters. The examples would include access reforms to improve the educational opportunities for Kuwaiti citizens, modification and strengthening of wage subsidies and employment quota, some successful privatization schemes, and perhaps a more disciplined budget for better alignment with strategic planning.

At any rate, starting the gradual and long-term reform efforts with such winning programs which are relatively small in terms of the size of the task and yet visibly successful and impactful in terms of policy results would clearly help in managing various stakeholder groups. Given the current complacency of the Kuwaiti general public about the state of political economy as is, demonstrating leadership through a series of small successful implementations of easier reform programs or measures may prove highly effective in mobilizing allies and supporters. Such small successes may also galvanize those Kuwaitis in the middle into little believers in the benefits of reform and change. Improvements, albeit incremental in government services, private sector dynamism, cost of living and consumer satisfaction may lower the resistance to reform, steadily instilling a "can-do-spirit" in the multitude of the Kuwaiti citizens is utmost important. Once the sound political will stays firm and resolute enough to cast a relatively long, stable, predictable and promising shadow of the future, the reform and long-term development in Kuwait may, in effect, become a matter of managing, steering and coordinating their timing, sequence, and pace.

3. Establishing Developmental Focus Groups as Agents for Effective Implementation of Kuwait's Strategic Responses

Even in terms of the nation's institutional arrangements and capabilities for reform and change, the current set-up may be highly propitious. If past attempts at making and implementing five-year development plans failed partly as a result of the lack of close linkage and coordination among concerned government ministries or institutions, the recent merger between the Supreme Council for Planning and Development (SCPD) and the Ministry of Planning as well as the closer institutional linkage between the SCPD and the Ministry of Finance, represents a step in the right direction. The SCPD's starting a dialogue to build consensus about the nation's vision, development goals and strategies among the top elite, key policy makers and other influential opinion makers of the society also constitutes a very encouraging and constructive move, which enhances the likelihood of success for the Kuwaiti government's current effort at hammering out an effective, socially desirable and politically feasible five-year development plan.

Thus, it may be crucial to ensure that the SCPD, the primary institution for driving the nation's long-term reform and development, has sufficient power, authority, human and budgetary resources to play a pivotal role in devising strategies, coordinating across ministries, following upon implementation and evaluating the resultant performances. In this regard, the head of the SCPD's direct reporting to the Prime Minister and the Amir on a frequent and regular basis would greatly facilitate overcoming any obstacles or hindrances to the reform and its process. Or for a more practical way of enhancing policy coordination across economic ministries, Kuwait may draw on the Korean experience and create the office of Deputy Prime Minister (DPM) for economic policymaking, which would help closely align the nation's budget with strategic long-term planning. If His Highness the Amir appoints the best equipped and developmentally-committed person as the new DPM and delegates full authority in economic policymaking and coordination to him, as well as the duty and privilege to directly report back to the Amir, in effect, this would tremendously facilitate the long-term reform and development works of the DPM and the SCPD in accord with the wishes of the Amir.

During Korea's rapid development decades, the DPM as head of the super ministry, the Economic Planning Board (EPB), conducted monthly meetings on the state of the Korean economy, and out of the total of 147 such meetings held at the EPB from January 1965 to the end of 1979, then President Park Chung-Hee, never missed attending them-except only once. The President's consistent attendance of the meetings had at least three-fold effects: First, it demonstrated the political leaderships' commitment to development, and the monthly follow-up

meetings had an evaluative and disciplining effect on bureaucratic officials, minimizing the possibility of their rent-seeking behavior. Second, the President's commitment to the meetings translated into delegation of power and authority to the DPM with respect to economic development planning and implementation, effectively stemming resistance or foot-dragging by other line ministers or ministries. Third, the implementation policies hammered out at the meetings had clear signaling effects on the private sector as well as the public sector about the government's policy priorities. As a consequence, the development policies became to be viewed as more predictable and credible, which enhanced trust and confidence in as well as the policy acceptance or response capacities of the society and private sector firms. Similarly, the Amir's attendance at the regular, if not necessarily monthly, SCPD-coordinated meetings on the state of Kuwaiti economy and reform may empower the process and powerfully mobilize both the public and private sectors for the cause of long-term development.

For the purpose of enhancing the effectiveness of inter-ministerial policy coordination and implementation, in short, the presence of three institutional features may be essential. The first is a strong pilot ministry like EPB for long-term development planning and implementation. The second is the political leaderships' empowering of the head of the EPB-like ministry, who as the first among all economic ministers would take charge in cross-ministry coordination. The third is to give the pilot ministry the power over budget allocation. In any medium-term or five-year planning, having concerned economic ministries actively participating in the preparation of sectoral projects or plans would be important to ensure effective implementation. In the end, however, the pilot ministry must have the authority to resolve any inter-ministerial conflicts over sectoral plans or their respective shares of the government budget with a high-level of policy consistency and in accord with long-term plans and strategic goals.

Box: The Process of Five-Year Development Plan: A Korean Experience

The process of making a five-year economic development plan in Korea typically took two years and three stages to complete: Preparatory stage (3-6 months); Preparation of Sectoral Plans (12 months); and Compilation and finalization of the plan (3-6 months).

During the preparatory stage, the EPB prepared plan guidelines in consideration of the external environment of the time, emerging policy issues, broad policy directions and major goals. During the process, the EPB in conjunction with the Korea Development Institute (KDI) organized umpteen public forums to induce the participation and contribution of many experts, opinion leaders, and other private sector representatives such as those from various industrial associations. No doubt did the EPB also closely consult and coordinate with other economic ministries by involving them even from this preparatory stage of the planning process.

During the second stage, at the request of the EPB, varying ad hoc work groups were formed. For each group, assistant ministers or sometimes director generals of concerned ministries assumed its

chairmanship, and a planning staff from the EPB served as the secretary for coordinating and organizing the group's work and meetings. Each group also held public forums to facilitate the process of drafting the sectoral plans and refine them.

During the compilation and finalization stages, the EPB integrated the sectoral plans through a Work Group for Policy Coordination. The EPB's assistant minister presided the work group, where heads of sectoral work groups from various concerned ministries participated as its members. The Work Group eliminates or resolves any conflicts or inconsistencies among the sectoral plans, checking for sectoral balance in accord with the long-term goals. At this stage, the EPB with the help of the KDI also updated macroeconomic plan targets by incorporating into the plan any latest changes from the domestic and international environment.

It should be noted here that the Korean government made sure that the EPB also took charge of coordinating annual planning of fiscal projects-linking budgetary spending with the five-year plans for effective yearly implementation of the plans.

At least in the medium run, in addition, the DPM or the SCPD may consider setting up a national policy think tank like Korea's KDI, which as an effective interface between the governing leadership and the society in general, may help prepare long-term development plans, analyze strategic and policy adjustment issues, monitor and evaluate the process of reform and its implementation, and develop and operate intellectually-grounded public awareness campaigns. Kuwait does have a comprehensive scientific research institute called KISR, but the composition of its constituent researchers remains too heterogeneous and their respective areas of specialty or expertise, too diverse for it to make a single integrated think tank that can clearly and strategically focus on the nation's long-term development policy issues.

In winning the hearts and minds of the citizens, if especially as a way of persuading the opposition forces of the National Assembly, the Kuwaiti leadership's creating a KDI-like research institute as its own national think tank would be of particularly good use. The newly-created national institution can become a chief supplier of credible expertise through painstaking research, objective policy analysis, and fresh alternative policy proposals. It could exert important and immediate influence on current and short-term policy debates. But far more importantly, through systematic and methodologically rigorous analysis, its policy experts can offer the government and the society independent, balanced, politically neutral, and thus social consensus-building policy ideas and proposals.

Especially since the political process in Kuwait in general and the Cabinet-National Assembly relations in particular remain frequently divisive and messy, the contributions that social scientists in the national think tank can make, in terms of providing rigorous, compelling, defensible, and yet politically detached diagnoses and prescriptions for solving important and pressing policy problems would be great. As top researchers at the policy think tank apply

rigorous research and analysis regarding public policy, they and their policy studies and recommendations command more credibility than those of interest groups or advocacy organizations.

Even in the case of the United States, where many of its think tanks have raised concerns about their credibility by becoming more politicized, ideologically-driven, and marketing-oriented policy advocacy organizations in the recent decades, have historically helped shape how the government institutions evolved and operated in term of their mission, purpose, role, size and function. For instance, it was the Brookings Institution that gave birth to the idea of creating the Budget Bureau in the government at the turn of the twentieth century.

Even when national think tank experts become mobilized by policy makers to justify and rationalize, instead of prescribing in a perfectly detached and neutral manner, the preferences of policy makers, the experts may prove more effective and influential than advocacy groups or individual scholars in universities because of their established political access, perceived and accumulated credibility, and timely and relevant research outputs made available to the policymaking process either in the form of research reports, strategically placed opinion pieces, or holding well-timed sets of meetings with major stakeholders, intellectuals or professionals of the society. The credibility that a national think tank can bestow on the government policy proposals may indeed constitute a critical dimension to any successful effort at government-led reform and change.

4. Strategy for Successful Leadership

While the nation's vision needs to aim high, a wise leadership takes a phased, gradual, step-by-step approach to reform and change, strategizing not only the sequence but the pace of the process so that the citizens can absorb and embrace the proposed changes in their hearts and minds. The key lies in transforming the attitudes of the Kuwaiti citizens, changing them from objects of reform into engaged and participatory subjects or enthusiastic supporters of change.

To achieve such a feat would require the leadership in Kuwait to control the status quo, make a series of small successes in the form of more innovative, productive, and strategic expansion of the private sector and oil-wealth distribution schemes (turning subsidies into performance-based dividend payments in the hope of reducing more pervasive price distortions) and spread the reform agenda and implementation schedule over a relatively long period of time so that the reform issues become ripe enough in the eyes of the elite and citizens for a full-scale mobilization of national energy.

In this context, Kuwait's strategic use of oil would be wise. The recent oil boom provides Kuwait with an exceptional situation of soft budget constraint, in which it can pursue even an ambitious socio-economic reform program, without worrying about fiscal soundness or shortage of funds for access reform measures. Thus, the Kuwaiti government needs to reset its policy priorities and use its oil wealth as well as current oil revenues a little more strategically and judiciously to its full advantage, in accord with its long-term development plans.

More specifically, for instance, one may start with the budget reform at least to keep the government's non-investment-driven spending from going out of control. The government may begin to implement this reform by enforcing slower pay raises for Kuwaiti public sector employees. Even in this kind of minimalist status quo-controlling strategy, nearly all of the Kuwaiti citizens who work in the public sector may find their wage raise at a rate lower than inflation objectionable. The popular resistance or stakeholder opposition may increase as the costs of reform rise. For instance, also as part of the strategy of accumulating quick and visible successes at the outset of the reform process, the Kuwaiti leadership may undertake a few relatively easy, small and simple privatization schemes with the aim of improving citizen satisfaction, more diversified economy and better job opportunities for Kuwaitis. However, such schemes would necessarily displace some Kuwaiti workers, who might turn themselves from dormant to demanding, if not dangerous, stakeholders. Therefore, it is essential for the leadership not only to strategically use its oil revenues, but also to stay connected with those who would lose in the process of reform and change, paying adequate attention and offering special care and help citizens like those displaced Kuwaiti workers.

To succeed in reform in general or stakeholder management in particular, calls for the governing leadership to proactively engage the elite and citizens in various forms of open and consensus-building dialogues. Especially as the reform efforts progress towards dealing with harder and more structural ones, the leadership needs to demonstrate its empathy with those who lose and acknowledge their losses, not to mention providing an adequate social safety net and taking other measures to help ameliorate the negative consequences, intended or unintended, of the reform and change. The citizens need to know that the leadership fully appreciates the difficulty, loss and pain the process of reform and change exacts from them. Additionally they need to acknowledge that the act of their giving up or yielding their individual interests or privileges would greatly contribute to building a better society and future for the nation and its posterity.

In order for the leadership to keep the confidence that the people have in it as well as to maintain the credibility of its reform programs and long-term development plans, it also needs to seek to govern by example. It may be very difficult to overemphasize the importance of political leadership and the government's institutional capacity in any major reform undertakings. But the society's or its private sector's capacity to respond to the government's

reform policies may be equally important for the successes of such reform efforts. Furthermore creating an ideal policy acceptance condition in the society requires a transparent, functional and accountable governance system and a fair and equitable distribution of income and wealth among the people. Absence of egregious economic power concentration would also help increase the autonomy of the government vis-à-vis the society in its pursuit of long-term development planning and implementation. For the people to patiently bear the more immediate and direct costs of reform and gladly bear with the political leadership for the realization of more distant and indirect benefits of reform, the leadership needs to offer them a vision of the nation, holding its hands together to press on towards constructing a good society, which enhances the well-being, human dignity, and a sense of community of the societal members.

1. The Establishment of A Pilot Ministry for Effective 5-Year Development Planning and Implementation

1.1. Target

In order for the Government of Kuwait to successfully meet the challenges of the nation's long-term development, it is crucial to establish and empower a pilot government ministry like Korea's Economic Planning Board (EPB) and ensure the ministry has sufficient power, authority, human and budgetary resources to play a pivotal role in devising long-term strategies and plans, coordinating across ministries, and following upon implementation and evaluating the resultant performances.

The EPB in Korea was created in July 1961 to handle the pressing economic development goals of the new military regime in Korea under Park Chung Hee. The EPB's original purpose was to translate the new Korean government's modernization strategy into a series of five-year development plans and coordinate their implementation. Prior to the Park Chung Hee administration, the previous governments of Korea had attempted to develop the country through multi-year economic development plans during the 1950s and early 1960s, but they failed to implement them. President Park just proved to be more determined to put similarly developed five-year economic development plans into practice, wasting no time in implementation. The creation of the EPB, indeed, not only clearly symbolized a strong commitment to economic development by the new Korean leadership, but also provided a key institutional agency to ensure sustained implementation of the government plans.

Thus, Kuwait may draw on the Korean experience and create the office of Deputy Prime Minister (DPM) to head the pilot ministry and thereby play the key role in enhancing policy coordination across economic ministries, closely aligning the nation's budget with strategic, long-term planning. If His Highness the Amir appoints the best equipped and developmentally-committed person as the new DPM and delegates full authority in economic policymaking and coordination to him as well as the duty and privilege to directly report back to the Amir, in effect, it would tremendously facilitate the long-term reform and development works of the DPM and the pilot ministry in accord with the wishes of the Amir.

1.2. Implementation Mechanism

As this executive program entails a change or reform of the state of public administration structure in Kuwait, the Prime Minister's office takes on the implementation as well as

necessary legislative tasks.

1.3. Institutional Requirement

The newly created pilot ministry needs to play some critical functions: In the case of Korea's EPB, it took over several such functions from other ministries: 1) the development planning function (The Economic Planning Bureau) from the Ministry of Construction, 2) the Budget Bureau from the Ministry Of Finance (MOF), and 3) the Statistics Bureau from the Ministry of Home Affairs.¹

It is important to note that in addition to the higher hierarchical order which Korea's EPB minister enjoyed over other economic ministers, the DPM also commanded a formal authority to coordinate the process of economic policymaking for effective execution of development plans. He did so, for instance, by chairing the Economic Ministers' Conference, where economic policy plans already agreed upon by the concerned ministries, were approved and recommended to the State Council, and the Economic Ministers' Consultation Meeting, a more informal, policy deliberating body to which more important or controversial policy proposals were submitted.²

To illustrate the importance of an effective institution, the following should also be taken into consideration of. The EPB conducted monthly meetings on the state of the Korean economy headed by the DPM. To these meetings, then President Park Chung-Hee demonstrated full attendance to the 147 meetings(during 1965 and 1979), apart from one meeting. Hence, his commitment to the meetings headed by the DPM, translates into the delegation of power and authority to the institution in charge of economic development planning and implementation. Moreover, such attendance scores also allowed the public and private sector to be aware of the importance of the institution, which was to be the key institution regarding economic development planning.

For the purpose of enhancing the effectiveness of inter-ministerial policy coordination and implementation of the five-year plans, in short, the presence of three institutional features may be essential. The first is a strong pilot ministry such as the EPB for long-term development planning and implementation. The second is the political leadership's empowering of the head

1. The EPB was composed of 3 offices (Planning and Management, Budget, and Fair Trade) and 5 bureaus (Economic Planning, Price Policy, Policy Coordination, Investment Projects Appraisal, and Statistics). It also oversaw the Agency for Government Supply.
2. The economic ministers during Korea's development decades included the heads of the EPB, MOF, Trade and Industry, Agriculture and Fisheries, Construction, Transportation, Communications, Labor, Health and Social Welfare, and Science and Technology Ministry.

of the pilot ministry like the EPB, who as the first among all economic ministers would take charge in cross-ministry coordination. The third is to give the pilot ministry the power over budget allocation. In any medium-term or five-year planning, having concerned economic ministries actively participate in the preparation of sectoral projects or plans would be important to ensure effective implementation. In the end, however, the pilot ministry must have the authority to resolve any inter-ministerial conflicts over sectoral plans or their respective shares of the government budget with a high-level of policy consistency and in accord with long-term plans and strategic goals.

In coordinating economic policies, the EPB could retain its core competence, reputation and credibility as the pilot ministry for the nation's long-term development not only because the political leadership in Korea gave the EPB such a broad mandate or mission, but also because unlike other government ministries or agencies, the EPB remained fundamentally autonomous from any particular societal groups. While being largely free from societal interest groups and without the constraint of parochial institutional interests, the EPB could pursue the nation's broader and long-term development goals. In fact, the persuasiveness of EPB's policies or arguments stemmed from its less biased and more rational analytical capacities: its ability to identify short- and long-term policy issues or problems as well as to offer more progressive and internally coherent policy alternatives to the pressing problems of the time.

1.4. Human Resource Requirement

For the pilot ministry to succeed, the importance of recruiting highly competent and dedicated officials to staff the ministry cannot be overemphasized. For that purpose, Kuwait may adopt a two-track recruitment system, where the elite cadre of officials who staff the pilot ministry or take on other key developmental functions of the government are recruited with a separate remuneration and promotion scheme. To be sure, the Korean leadership made sure that the EPB drafted the best and the brightest, including U.S.-educated economists whose ethos of economic rationality greatly influenced the up starting ministry. EPB officials were thus viewed as the most "rational" among all bureaucrats from inside and outside government circles.

1.5. Budgetary Requirement

Remuneration for the elite cadre of officials in the two-track recruitment system.

2. The Establishment of A National Policy Think Tank to Support Development Planning and Implementation

2.1. Target

As an effective interface between the government of Kuwait and the society in general, setting up a national policy think tank is highly desirable and necessary to help the government prepare long-term development plans, analyze strategic and policy adjustment issues, monitor and evaluate the process of reform and its implementation, and develop and operate intellectually-grounded public awareness campaigns. Kuwait does have a comprehensive scientific research institute called KISR, but the composition of its constituent researchers remains too heterogeneous and their respective areas of specialty or expertise too diverse for it to make a single integrated think tank that can clearly and strategically focus on the nation's long-term development policy issues.

As a way of helping to win the hearts and minds of the citizens as well as persuade the opposition forces of the National Assembly, the Kuwaiti leadership's creation of its own national think tank would be of particularly good use, modeling it after the Korea Development Institute (KDI) in Korea. KDI was established in 1971 as a national think tank directly under the EPB, with the generous endowment funds coming from the USAID and the Korean government. Just as was the case with the KDI, the newly-created national institution in Kuwait can become a chief supplier of credible expertise through painstaking research, objective policy analysis, and fresh alternative policy proposals. It could exert important and immediate influence on current and short-term policy debates. But far more importantly, through systematic and methodologically rigorous analysis, its policy experts can offer the government and the society independent, balanced, politically neutral, and thus social consensus-building policy ideas and proposals.

A national policy think tank would indeed serve as an appropriate mechanism for the politically sensitive environment of Kuwait. Top social scientist, who are trusted by the Kuwaiti people, can provide rigorous, compelling, defensible and yet politically detached research results and policy directions. Accordingly, the establishment and long-term credibility of national think tanks can be seen in numerous countries, such as KDI in Korea and also The Brookings Institute in the United States.

Even when national think tank experts become mobilized by policy makers to justify and rationalize, instead of prescribing in a perfectly detached and neutral manner, the preferences of policy makers, the experts may prove more effective and influential than advocacy groups or individual scholars in universities because of their established political access, perceived and accumulated credibility, and timely and relevant research outputs made available to the

policymaking process either in the form of research reports, strategically placed opinion pieces, or holding well-timed sets of meetings with major stakeholders, intellectuals or professionals of the society. The credibility that a national think tank can bestow on the government policy proposals may indeed constitute a critical dimension to any successful effort at government-led reform and change.

2.2. Implementation Mechanism

As the foundation of a national think tank requires not only relevant legislations but also annual government budgetary contributions, if not sufficient endowment funds at the outset, the SCPD or the pilot ministry itself may take the initiative to implement this executive program.

2.3. Institutional Requirement

Key institutional requirements for a successful national think tank include the following: 1) strong support for and blessing on it as a policy research center of excellence by the top political leadership; 2) close but autonomous working relationship with the government in general and the pilot ministry in particular; 3) generous funding and good research facilities.

In the case of Korea, the EPB oversaw KDI, appointing its president and approving its budget. However, the relationship between the two was not necessarily lop-sided. This was partly because the EPB itself was a broad, liberal-minded and analytically-oriented ministry, and also partly because President Park Chung Hee himself took a personal interest in the management of KDI, which enhanced the think tank's institutional pride and autonomy.

2.4. Human Resource Requirement

Just as was the case with the KDI in Korea, it is the quality of policy research outputs produced by the national think tanks that ultimately decides and solidifies its position as a center of excellence. In this regard, the importance of attracting top-quality researchers to staff the think tank cannot be overemphasized. On that score, the Kuwaiti leadership may emulate the key ingredients of the KDI model of governance, incentive structure and organizational culture.

First, KDI's governance system, as discussed above, maintained research autonomy, balance between practical policy research and academic rigor, and minimum hierarchy. Second, to attract and keep top-notch researchers, who were mostly U.S.-educated economists, KDI paid its research fellows above-the-market salaries as well as various perks such as chauffeur-driven cars, secretaries, personal and competent research support staff, and decent housing. Third, KDI's open, liberal, and horizontal organizational culture was instrumental in sustaining the

quality of its research products by way of strict internal review and referee process for research papers and policy proposals. Thus, KDI and its research fellows have developed a strong commitment to excellence as well as robust institutional pride and autonomy.

2.5. Budgetary Requirement

Competitive and attractive remuneration for the top-notch scholars and field experts.

Labor Market Reform

- 1_ The Stylized Facts of Kuwaiti Labor Market
 - 2_ Basic Strategies of Labor Market Reform
 - 3_ Policy Suggestion I: Promoting Job Creation in the Private Sector
 - 4_ Policy Suggestion II: Upgrading the Quality of Workers
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Strategy for Successful Leadership

1. The Stylized Facts of Kuwaiti Labor Market

1.1. Population and Labor Force

First, Kuwait has a very high dependency on foreign nationals (foreigners) in their population composition. Out of 3 million residing in Kuwait, only over 1 million (33%) are Kuwaiti nationals whilst the rest are foreigners.

Second, the average age of the Kuwaitis is relatively young. Out of 1 million Kuwaitis, only 57% are in the working age (age of 15 to 64), and 50% are less than 20 years old (40% is less than 15 or younger). This is due to a high population growth rate of over 3%. In 10 years, it is anticipated that a big number of the Kuwaiti labor force will enter into the labor market. Currently, approximately 87% of foreigners are in the working age of 15 to 54.

Third, the dependency on foreigners in the labor force is much higher. The imbalance in the population between the Kuwaitis and foreigners is less so in the labor force. Out of 1.87 million in the Kuwaiti labor force, Kuwaitis are only 0.34 million and the rest are foreigners. 61% of the total population is in the labor force (i.e. economically active population), but only 33% of the Kuwaitis are in the labor force while 75% of the foreigners are in labor market. This may be mostly due to the fact that 40% of the Kuwaitis are of age 15 and under.

Fourth, Kuwaiti labor market is segmented to dual markets being Kuwaiti-oriented (based) public and foreigner-oriented (based) private sectors. Most of the Kuwaitis in the labor force

(approx. 85%) work in the public (governmental) sector and approx. 15% work in the private sector. On the other hand only 6% of the foreigners work in the public sector. Additionally, 75% of the workers in the public sector are the Kuwaitis while only 4% of the workers in the private sector are Kuwaitis.

Amongst occupational categories 40% of the Kuwaitis work as clerks, policemen, and fire fighters while 20% are teachers and office managers. On the other hand 60% of the foreigners work as manual labors.

1.2. Dual Structure Labor Market and Moral Hazard Behavior of Kuwaitis

While the Kuwaitis are concentrated in the public sector and the foreigners are in the private sector, there is a big difference in the level of compensation and in working conditions. On average, wage, work intensity, job security, and related conditions in the public sector are relatively better than in the private sector. The differences are even greater especially in the low-skilled job categories. However, the recent policy of guaranteeing private sector workers same social allowances as government workers (i.e., the Kuwaitis hired in the private sector receive 70KD for each spouse and 50KD for each child up to 7) may reduce the compensation gap between public and private sector.

In some industries such as the financial sector, wages are considerably higher than in the public sector, however, tougher work intensity and lower job security should be expected. Therefore, Kuwaitis are often left to choose whether to look for challenging opportunities in the private sector or to be content with easy-going jobs in the public sector.

The reasons why the Kuwaitis are concentrated in the public sector are:

- (1) There is a clause in the Kuwaiti constitution stating that the government shall endeavor to make it available for Kuwaiti citizens to have jobs.
- (2) Most of the Kuwaitis prefer to work in the public sector where the work intensity is relatively low and the working conditions are relatively better than the private sector.
- (3) In order to fulfill the demands, Kuwaiti government creates superfluous jobs (positions) with abundant budget from the oil sales. (There is a governmental body called Civil Service Commission, specially created to provide jobs for the Kuwaitis.)

Obviously, such conditions created the dual structure in the Kuwaiti labor market and also made a fat government. Consequently, surplus and redundant workers in the government often break work discipline and it creates a vicious cycle of the Kuwaitis preferring jobs in the public

sector over private sector.

The dual structure is detrimental to the efficient distribution of resources and will not be sustained due to the following reasons:

- (1) If the Kuwaiti government faces financial difficulties, it will not be able to continue absorbing new workers.
- (2) There will be a big number of new Kuwaiti workers entering into the labor market in the coming years (approx. 20,000 persons per year) and realistically it will be difficult for the Kuwaiti government to absorb the growing number of new work force. If the efforts continue, the government will eventually face financial difficulties and will become oversized and malformed.

Kuwaitis already face long waiting periods for job placements and there is an increase of youth unemployment. During the waiting period, Kuwaiti government pays unemployment allowances. However, to those young and new work forces, the amount of the allowance and the long waiting period do not discourage waiting for jobs in the public sector, because most of the Kuwaiti households are well off enough and can receive support from other members of the family. That is, their reservation wages do not decrease. Due to inherent family wealth, most of Kuwaitis choose to be placed in a less competitive and less work intense positions in the public sector rather than facing challenging and work intense environment in the private sector. Even the government employees often have side businesses of their own, and working as a government worker is often considered as one of his/her property right.

Therefore most of the general public do not feel the need of a reform and they are not ready to face such reform. Although the top leaders (officials) in the government seriously feel the need of a reform, the representatives in the Parliament, being populists, are passive. Most of the general public are content with lives as rent-seekers over the oil-money.

1.3. Employment Quotas for Kuwaiti in Private Sector

There is a regulation in Kuwait, called ‘Kuwaitization Policy’, which enforces private businesses to employ certain number of Kuwaitis. The rate of quota varies depending on the type of business, however, a small amount of levy needs to be paid (100KD per year per person) if the quota is not met. Also, the government often provides incentives such as the use of state owned lands, loans, and on government purchases, or prizes to the private which highly exceeds the set quota. However, the Kuwaiti government does not offer employment subsidy for the excess employment over quotas.

However, a fundamental question to this regulation (employment quota and levy) is “Whether the private businesses are reluctant to hire the Kuwaitis or not?” or “Whether the Kuwaitis want to work in the private sector or not?” First, as long as the Kuwaiti government guarantees job placements in the public sector, Kuwaitis will choose to wait for placements in the public sector in spite of long waiting periods and the private firms cannot fulfill the employment quota even if they want to hire Kuwaiti workers. Therefore a reform of the public sector is required in order for the regulation (Kuwaitization Policy) to find its initial intentions and meanings.

Second, even if the public sector is reformed, the government will not be able to force the private businesses to hire Kuwaitis with relatively high wages. However, if the Kuwaitis are asked to accept the relatively low paying employment in the private sector, it will create a lot of resistance and eventually the reform would be opposed. In the end it is advised for the government to subsidize to narrow the gaps (with public sector) in wages and compensation for the Kuwaitis who are willing to work in the private sector.

1.4. Dominance of Females among New Civil Labor Force

A large portion of young Kuwaiti males volunteer for military service. This is because the Kuwaiti government is in pursuit of reinforcing national defense by Kuwaiti nationals after the Gulf War in 1990. Many young males go on to a special military/police academy after finishing high school, because they are paid about 30% more and have better chances of inter promotion than the government employees. Detailed statistics are not known due to the fact that information, such as the number of military enrollment and its budget, are regarded as national secrets.

Due to such reasons 75% of recent graduates of ‘Kuwait University’ are females. If we suppose that the desire for those female graduates to look for jobs in the private sector, such as in the financial industry is less than those of males, it is hard to conclude that Kuwait is having adequate supply of high-quality human resources to enhance the private economy such as financial industries. According to the recent statistics, a large number of female college graduates find jobs as teachers although a small number become lawyers and accountants.

1.5. The Need for Educating Financial Experts

Historically, Kuwait has a long history, culture and talent in finance. The Kuwaiti economy was traditionally led by big merchants. Although Kuwait’s core industries are now led and controlled by the public sector, the financial industries have been led by the private sector. Up

to now, private banks of Kuwait provided advices and suggestions to the financial institutions in Dubai and Kuwait Investment Agency. Currently the level of the human resources (including the Kuwaiti-nationals) working in the Kuwaiti financial industries is regarded as relatively superior within the GCC. The individuals who have chosen to work in the private sector instead of easy-going public jobs should have challenging minds and strong desires to succeed in the financial sector (i.e. sample-selection).

However, in order for Kuwait to realize its vision of becoming a finance and trade hub, it must educate (train) more and better-qualified experts in those fields. Kuwait University is at least as good a university as those of GCC countries. Most faculty members are well-qualified. Most of them have received their academic degrees at the top universities in advanced countries. Additionally private universities in Kuwait are also evaluated as to have good educational environments.

Nonetheless, college graduates from Kuwaiti universities, even in economics and business majors, are not thought to be well prepared to work in the finance sector. This can be viewed as a kind of problem of low academic atmospheres at schools. This is mostly because the students' low incentive to study and learn. Being guaranteed to work at the government and being in a family of wealth, the Kuwaiti students are little expected to have strong incentives to study hard and to achieve social success. Therefore, even though the faculty and academic curriculum in colleges are of decent quality, college graduates are not fully armed to work in financial firms and they need to be educated for being financial specialists.

Foreign financial specialists should be complimentary. Rational HRM(human resource management) policies for the division of work between nationals and foreigners are important. For example, it would be better that the jobs requiring direct contact with the customers are assigned to Kuwaiti employees who have no language and culture gap to them, and the jobs with the specialty of high degree, where they can hardly find the right nationals, are assigned to foreign specialists. Whether the foreigners are willing to educate the nationals also depends on the HRM. Financial firms needs to introduce HRM practices for inducing knowledge transfer from foreign specialists to Kuwaiti employees.

2. Basic Strategies of Labor Market Reform

2.1. Opportunities or Threats

Opportunities can turn into threats. For example, Kuwait's young population can be an asset for economic development, but it can also be a big burden especially if the government has difficulty in creating a sufficient number of good jobs for them. Similarly, while oil wealth can be used to facilitate various access reforms, it can also discourage the people from working hard or supporting structural reforms necessary for the nation's long-term development. How well Kuwait turns the threat factors into opportunities depends in part on the quality of the government leadership, and for that matter, labor market reform may well prove to be a litmus test not only for the leadership quality but also for the ultimate success of the national vision.

2.2. Basic Strategy: Creation of Private Sector Employment

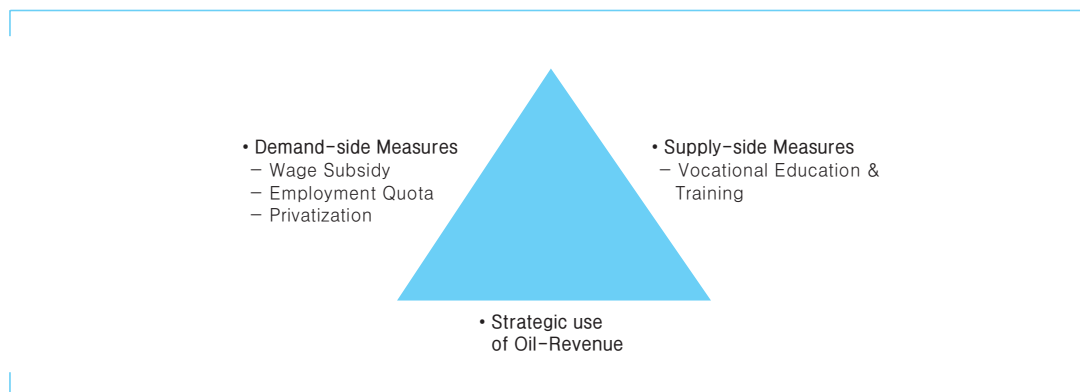
The bottom line of our implementation strategy is that our proposed labor market reform does not jeopardize the present state of welfare for Kuwaiti citizens. Yet at the same time, the reform should aim to change not only the concept of welfare as Kuwaitis know it, but also the current approach to welfare. For instance, the government providing every Kuwaiti citizen with a decent job represents a good thing; yet, not all such jobs need to be in the public sector. Even if politically desirable, in fact, it may not be economically feasible, given, for instance, the increasing size of young generation entering the labor market. In the future, a greater number of Kuwaitis would have to find jobs in the private sector and the government would need to help them equip themselves with the necessary skills to make the most of their lives under the market incentive structure.

The ultimate goal of the labor market reform lies in shifting the main source of employment from the low-productivity public sector to high-productivity private sectors. The basic directions and strategies may be summarized as follows:

- First, on the demand side, Kuwait needs to create more jobs for Kuwaitis in the private sector. To do so requires a series of well-designed, well-prioritized privatization schemes or projects, and its success would depend as much on the quality of the regulatory regime as on that of the projects. As such an effort would take a relatively long time to bring about desired outcome, it needs to be supplemented by more immediate policy measures such as strengthening of “wage subsidies” and “employment quotas” so that Kuwaiti workers can find working in the private sector attractive enough as an option.

- The pulling effect of the private sector needs to be complemented by the government’s push factor. Otherwise, strengthened wage subsidies and employment quotas could end up aggravating the whole situation by making the distortions in the existing incentive structure actually worse. To avoid such problem, supplementary measures must be taken on the supply side to upgrade the quality of Kuwaiti workers, which would include a substantial expansion and upgrading of vocational education and training programs. The basic objective is to help private firms willingly hire Kuwaiti workers even at high wages.
- In pursuit of both demand and supply side reforms, the government needs to use its abundant oil wealth as strategically as possible, a valuable resource which can help make even a massive labor market reform politically and economically feasible. If the current practice of spending the oil revenue to provide public sector jobs for almost all Kuwaitis continues, the Kuwaitis may never have either the incentive or the skills to work in the private sector. Thus, the government needs to reset its policy priorities and use its oil wealth a little more wisely in accord with its long-term development plans: both for increasing the private sector demand for Kuwaiti workers by way of strengthened wage subsidies and employment quotas and for reinforcing the foundation for the supply of more adequately trained Kuwaiti workers by way of vocational education and training programs. The government can also judiciously use the extra financial resources to take care of those Kuwaiti workers who may be displaced by the privatization schemes.

Figure 4-1 | Strategies to Boost Private-Sector Employment



2.3. Best Use of Females and Foreigners

Also, to optimize the desired effect of our proposed reform, the government needs to put greater strategic emphasis on female and foreign workers.

- As is the case in many advanced industrialized countries, female students can be a main source of productive work force in many high valued-added industries or businesses. Female college graduates have already started to play more important roles in the Kuwaiti labor market. Hence not to waste any of the Kuwait citizens' minds, designing a pragmatic, well-balanced and future-oriented education and training programs for the Kuwaiti women as well as men cannot be overemphasized.
- More active and strategic use of non-Kuwaiti labor force is also called for in order to complement the Kuwaiti labor force at least for the first five to ten years after the onset of the reform program. Kuwait is endowed with a blessed pool of top-quality intellectuals, but it seriously lacks mid-level experts and skilled practitioners both in the public and private sectors. In the medium and long run, Kuwait should be able to fill in the gap with better-qualified and motivated people of its own. But at least in the meantime, the role of foreign expert groups would be very useful and positive. To recruit and retain the foreign talents Kuwait needs for its reform, their working and living conditions need to be improved. The view that foreign talents crowd out Kuwaiti workers is a myopic and ill-grounded. From a dynamic and long-term perspective, the contributions well-motivated foreign talents can make to the Kuwaiti economy, would greatly outweigh the short-term costs they may incur.

3. Policy Suggestion I: Promoting Job Creation in the Private Sector

3.1. Switch to a New Model of Employment Protection and Social Service Jobs

In principle, there are three roles the government plays for employment protection: 1) direct provision of jobs in the public sector, 2) helping to find jobs in the private sector, 3) providing vocational education and training. In the future, the Kuwaiti government should restrain from the first role and focus more on the other two. In switching to the new model of employment protection, for the political feasibility, the government may start applying the new approach first to new labor market entrants, gradually extending it to the existing workers.

With respect to the direct provision of public sector jobs, the government needs to aim at limiting the creation of new jobs to the minimum necessary level (for instance, new offering only for the vacant posts). Such policy, however, may cause socio-political resistance to the change at least until the private sector can create enough attractive jobs to absorb the excess supply of the new labor market entrants. Under the circumstances, the government may

consider creating new kinds of jobs in the public sector for which there is a “real” demand from the market. One good policy option for such a purpose is to expand “social service jobs,” jobs geared to provide more and better public services in the fields of health, education, childcare, job placement, and etc.-especially for the needy. Some may argue that Kuwait already has too much of social services with a vast number of workers deployed in the inefficient public sector. Nonetheless, the government should be able to identify some areas where the quality and even quantity of services lag behind and fix them by supplying new and preferably more devoted workers into the system. Those areas may constitute a healthier source of new public jobs, which not only help lessen the political pressure of “the public sector downsizing,” but also serve to improve the welfare of the Kuwaiti society for the future (see the box below for Korea’s recent policy drive to promote social services jobs) .

The public sector is often heavily criticized for failing to train its employees or improving their skills. A remedial measure may include a new personnel system which preferentially treats those who take authorized vocational trainings outside of their work. For the purpose of implementation, once again, the government may apply the new system to new entrants first and then gradually extend it to all other workers, making the career-long learning and training as an integral part of any public sector job.

The implications of the Korean experiences are:

- The government needs to make clear definition of social service jobs and to design the government policies for promoting social service jobs including the legal enactment for financial support to social service jobs.
- The government needs to consider the way of promoting social enterprises, (while providing financial support to them) whilst making them create social service jobs.

Box: Social Services Jobs, the Experience of Korea

In general, social service jobs denote jobs provided by the government to promote the welfare of society or to help lower-income class people. Typical characteristics of social services are: non-marketability, collective consumption decision-making, and generality of financial commitment. In case of Korea, social services includes (1) social work services such as child care and the protection of the disabled or the elderly, (2) education services and health/medical services such as patient caring and nursing, and (3) cultural and public administrative services such as after-school activities, special education, etc.

Expansion of social service jobs can be pursued either as an employment (job creation) policy or as a welfare policy. As an employment policy, it aims to combat the unemployment problem of the socially vulnerable group of people like low-income and low-skilled. As a welfare policy, it tackles

the insufficient provision of social services for lower income class people who need such services but cannot afford it.

In March 2003, the Korean government officially announced the expansion of social service jobs as a new model of job creation as a national priority project. The underlying presumption was that social services jobs can be ‘market-creating’ and ‘self-reliant’, but this would require close cooperation between companies and NGOs. In July 2007, the Promotion of Social Enterprises Act took effect. Since then the government has introduced various supportive measures such as a certification system, corporate tax cuts, preferential purchase, and etc., which were meant to help participating organizations in the project develop into specialized social enterprises.

3.2. Strengthen the Wage Subsidy for the Kuwaiti Workers Choosing Private Sector Jobs

Despite wage subsidies provided for the Kuwaitis working in the private sector, most Kuwaitis prefer and do end up working in the public sector. This indicates that the level of subsidy is not high enough to affect the prevailing job choices of the most Kuwaitis. This situation can be rectified to some degree by raising wage subsidies. The important thing is that the wage subsidy should be raised to such a level that the total pecuniary compensation of the private sector - wage paid by the firm plus the wage subsidy - is high enough to more than make up for the more demanding working conditions of the private sector.

One exemplary case in accord with this subsidy scheme is to set the wage subsidy at a level equal to the total compensation of the public sector worker. Under such a setting, the total compensation of the private sector employee exceeds that of the government employee by the wage paid by the private firm (See <Annex> for mathematical and graphical illustrations). This kind of payment scheme may appear to come into conflict with the Kuwaiti Constitution, which basically entitles all Kuwaitis to jobs of their choice. But it actually does not. The seemingly preferential treatment of private sector workers is justifiable as a kind of “equivalent compensation” for their undertaking more demanding jobs. Both in principle and in practice, there needs to be an equilibrating level of wage subsidies in consideration of differences in characteristics of workplaces and workers, which would increase fairness between the public and private sector jobs.

Of course, in the short-to medium-run, this kind of wage subsidy scheme may incur as much costs as the current system of Kuwait, if the government absorbs almost all the willing Kuwaiti worker even by opening unnecessary job positions. However, over the long run, more Kuwaiti workers are led to work on “real” jobs in the private sector, gain skills over time through on-the-job-learning, and thus produce greater value-added to the economy.

Box: The wage subsidy System in Korea

In Korea, there is a wage subsidy program, called “employment promotion subsidy for vulnerable groups.” Under the program, subsidy is given for the hiring of marginal workers whose productivities are lower than their reservation wages and thus are not capable of getting a job without subsidy. For long, several subsidy programs have been in effect, each designed to serve certain cohort of such vulnerable people as the aged, female workers, female household heads, and the long-term unemployed etc. In October 2006, all these programs were integrated into one program, with the scope of eligible subsidy recipients extended also to the disabled and the unemployed young people.

3.3. Reinforce the Kuwaitization Policy (Employment Quota with Levy)

In addition to wage subsidies, the government may further reinforce and improve on the existing system of employment quota as well as non-compliance penalty (levy) to promote Kuwaitization. First, the level of penalty must be raised. Currently, the levy is so cheap (100 KD per person per year) so that many firms would opt to pay the penalty rather than meet the quota. In order to make quota fully binding, the penalty must be set high enough to exceed the difference between the wage paid by the firms and the marginal productivity of the Kuwaiti workers hired to “just meet” the quota. (See <Technical Annex> for mathematical and graphical expositions).

Secondly, the levy should be collected into a separate fund (say, “Kuwaitization Fund,” which is managed independently of the general budget) and used to subsidize those firms which hire more Kuwaiti workers than required by the quota (over-achievers). The subsidy to the over-achieving firms - employment subsidy - will then work as a kind of selectively-disbursed “wage subsidy” so as to lead those firms to hire more Kuwaiti workers beyond quota.

In a well-designed scheme, where higher level of penalty is imposed in association with higher level of quota, we can expect that the higher the penalty is, the more Kuwaitis will be employed in the private sector. One important caveat here is that there is an upper limit to the level of penalty the government can set. If the penalty is set too high, then some private firms may find it beneficial to ‘get around the system’, for instance by hiring some workers (thus avoiding penalty) but not putting them to actual work - the case of “paper workers” as documented in other countries which implement an ‘employment quota cum levy’ system. (see <Technical Annex>)

Box: Employment quota and levy system in Korea (the case for the disabled workers)

In Korea, any firm with more than 100 full-time employees is required to hire disabled workers amounting to at least 2% of total employees. If an employer does not satisfy its quota, it should pay the levy proportionately to the difference between the requirement (quota) and actual hiring. The levy is 500US\$ per person and per month, which amounts to more or less than 80% of legal minimum wage. Also, there is also 50% (=250US\$) additional charge (levy) applied when the actual hiring of the disabled falls short of 1% of the total employment. The levy is collected as 'The Fund of Employment Promotion for Disabled Workers' and with the Fund, the government gives employment subsidies to the employers who hire more disabled workers than required by the quota. The range of employment subsidy is from 300US\$ to 600US\$, varying by gender and by the degree of disability (e.g. greater subsidy to female and major disabled workers.)

3.4. Promote Job Creation in the Private Sector by Supporting Privatization

In promoting job creation in the private sector, privatization is necessarily a high priority strategy. Privatization could be effective in creating the private sector job in the long run, not only by creating more jobs within the same privatized firm (through a managerial innovation effect for instance), but also by allowing a group of other private firms in the same or related businesses to prosper in a competitive market environment.

To undertake privatization, however, we need to successfully handle the resistance of the incumbent workers at the to-be-privatized organization. Basically, a privatization drive, as quite massive as what would be expected of Kuwait, can not proceed successfully without detailed schemes of the labor protection for the workers who will be affected. Some of the most important guidelines and points of cautions that need to be taken into account of in designing such protection scheme are as follows:

- First, the job security of all employees needs to be ensured at least for some years. For example, the new privatized firm needs to commit itself to keeping all employees from the existing firm. If we assume the increase of managerial efficiency in privatized firms, their sales(output) and employment would increase (i.e. scale effect of labor demand) and we would not worry about downsizing.
- Second, after the privatization, all employees will be guaranteed their jobs for a certain period of time (e.g., 5 years). If downsizing is unavoidable, some workers may be temporarily laid-off. But they will be laid-off for a finite period of time (e.g. up to 5 years) and guaranteed a substantially high unemployment benefit (say, 80~90% of the last

salary) during the lay-off period.

- Third, if a permanent downsizing is inevitable after a certain period, then the firm may recourse (from job security plan) to income security plan. One plausible compensation scheme is “early-retirement bonus’. The amount of bonus may vary depending on the employee’s salary level and length of service. The retiree may have an option to choose between “lump-sum bonus” and “retirement-pension for a certain period.” Stock-options may be an additional useful form of exit compensation. It has quite an ‘economic fairness’ aspect in the sense that the early-retirees (who should burden the cost of restructuring) can share the benefit of restructuring (downsizing), while the cost of stock-option is burdened by the shareholders who would get the benefit of restructuring.
- Fourth, the government needs to set up special funds to finance all of the above types of labor protection measures. Specifically, it will be very helpful to construct a public fund, entitled for instance, “Kuwait Restructuring Fund” (KRF) or “Privatization Fund” (PF). Unemployment benefits for the laid-off and the bonus for the early retiree may be borne by both PF and “privatized firms,” in order to prevent the moral hazard of “casual downsizing” by privatized firms. In order to institutionalize the burden by privatized firms, the government may better obligate the privatized firm to establish a “Private Unemployment Benefit Fund” (PUBF)’, the cost of which will be shared by employer and employees. The PUBF will then function as a kind of ‘Private Unemployment Insurance’, designed to protect the employees from the prospective risk of being laid-off or leaving early.
- Fifth, the above protection scheme needs to be set as a general rule and applied universally to all affected firms within Kuwait. Should the protection schemes (i.e. the compensation rules) be individualized or different across privatized firms, labor unions (or employees) would resist or hold up as much as possible so as to secure the most favorable compensation out of their respective negotiation process. The employees at an already-privatized firm may also step out again asking for re-negotiation. This could cause long delays in the entire privatization process, possibly making it increasingly politically non-viable to continue in the worst case scenario.
- Sixth, “Manpower and Government Restructuring Program”, recently established but not having a clear mission and role, can take charge of implementing the above scheme, cooperating with “Civil Service Commission” whose role is managing government employees.

4. Policy Suggestion II: Upgrading the Quality of Workers

4.1. Construct Effective Public Vocational Training System

The Kuwaiti government needs to greatly strengthen the public vocational training system. The target groups are broad, including: (1) the low-skilled and the unemployed (those who fail to get a job in either in the public or the private sector), (2) college students, and (3) general adults.

The public vocational system consists of various vocational training programs sponsored by the government. In general, it can take the following forms: (a) programs directly provided by government, (b) voucher system, (c) project financing, and (d) programs provided by firms. For Kuwait, the first two do not make feasible options at least in the short-run. The government may not have much capacity to design and provide vocational training programs directly on its own. Voucher system is not feasible either, because there are not enough private training institutes competing with one another in the market. Thus, the remaining two options (c) and (d) are the feasible ones.

4.1.1. Provide Training for Low-Skilled Workers

The government needs to introduce “target-oriented, customized training programs” provided by the best specialty institutes chosen by open competition. The first step is to define the target group. An example of target group is “a certain segment of unskilled workers who can be employed only when they finish a certain vocational training program.” The second step is to design and provide the right training programs. Some general guidelines are as follows:

- Design right programs by considering both the trainees’ human capital characteristics (i.e. job abilities) and industrial demands.
- Choose the best training institute (including foreign institutes) by open competition. In selecting the provider, the specialty and training ability should be the top criterion, not the cost factor.
- Support the full training costs and pay trainee allowances as large as the government wage, in order to make full incentives for joining the training program. If a worker refuses to sign in for a training program, the trainee allowances should not be paid.
- Establish, for institutional foundation, for example a “Public Vocational Training Promotion Act”, where the State’s duty will be defined; including providing public training, monitoring the institutes which provide the public training, project financing for selecting the training institutes, determining the training costs.

- Need to consult with the government staffs of other countries (e.g. Germany or Korea) who have the experiences of construction sound public training programs, and to design the education program for training teachers. Note that the Kuwaiti government has little experience of public vocational training and there are few training teachers in Kuwait.

4.1.2. Provide Vocational Training by Industry (Firms)

For employability, on-site training (or internship) at individual firm (or association of firms) is often a very effective form of vocational training. In this sense, Kuwait needs to expand internships for college students greatly. More specifically, it is desirable to require all college freshmen to enroll in, for example “Professional Career Center” (PCC). The center first provides the participating students with job career counseling service. After counseling, the center provides the student with the internship program which best matches his/her interest and ability. During internships, the students are paid a salary, the cost of which is to be shared by the government and the sponsoring firm. It is important for the sponsoring firm to bear some cost. If not, then interns become free goods, and the firm is likely to abuse the system by assigning various odd jobs which have nothing to do with interns’ skill improvements.

Also, the government can make FDI (Foreign Direct Investment) firms have the role of education institutes for advanced technologies. For good education, the ability to educate, i.e. the knowledge and technology of the education supplier, is a necessary condition. If there are not sufficient experts of advanced technologies, Kuwait should find another source of good teachers. For example, the government may set the new criteria for screening foreign construction firms which have applied the big projects financed by the government. It may screen them by their educational abilities or/and quality of their educational programs for domestic technicians, as well as the construction cost.

4.1.3. Support the Vocational Education in College

It will be helpful to establish “Professional Academies” in colleges, specialized in teaching job skills which are demanded by industries. While colleges are expected to produce high quality manpower needed by industries, it is difficult for colleges to meet the industrial skills demand by the regular academic curriculum only. Basically, the academic institutions are hard to be restructured and thus often lag behind the changes in industry demands. The more suitable and realistic approach then will be providing supplementary specialized programs for professional (vocational) education. The modalities of the operation of ‘Professional Academies’ can be summarized as follows:

- Set the priorities by urgency and the size of excess labor demand. Also given that the female students outnumber male students, the colleges had better to start with some

program designed mainly to the needs of female students.

- The Academy should be operated by means of academic-industry cooperation. The teachers should consist of both academic faculty and industrial experts.
- The establishment and operation costs need to be borne by the government.
- If possible, the education programs need to be linked to the certificates of qualification. Design right programs by considering both the trainees' human capital characteristics (i.e. job abilities) and industrial demands.

Box: Further Education in the US - Community Colleges

Originally started as the institute for adult education, community colleges in the US have become a vital center for technical training in general. They provide improvement training (i.e. for skill upgrading and updating) for current employees in local areas, as well as reemployment training for the unemployed. Also, community colleges have become efficient institutions to provide vocational education for non-college-bound students, who generally finish their high schools without any specific vocational skills. Community colleges have a list of advantages over universities such as affordable costs, easy accessibility in location, flexible curriculum, and field experience (through enterprise's participation).

Box: Professional Academy in Korea - Social Education Academy (SEA)

SEA is quite similar to community colleges of US. It provides further education for adults as well as the vocational education for those who failed to advance to college (including high school drop-outs). However, SEA in Korea is operated by the universities, while community colleges of the US are independent institutes. The programs are mainly for the jobs in service industries, such as animation, acting & musical/vocal performance, social security counseling, nursery teacher, body guard, martial arts, dance sports, yoga & aerobics, alternative medicine, real estate brokerage, etc. A certificate for achievement and a private certificate for qualification are usually issued by the president of the university to which the SEA belongs.

4.1.4. Educate “Finance and Trade Experts”

In promoting vocational education in colleges, the government should give the highest priority to the fields of finance and trade. This is a logically natural emphasis, given Kuwait's vision as a financial and commercial center. The government should estimate the demand for the manpower needed and set up a detailed plan for vocational education. The association of financial or trade firms and an education institute (or a consortium of education institutes) may jointly open a professional education program for financial or trade specialists. Then, the

government may support the training costs in the form of matching fund with financial (trade) firms. Also, the education program needs to be linked with certificates of qualification which is globally approvable.

4.2. Construct National Infrastructure of HRD

The public vocational education and training (VET) system as discussed above is one important element of the national HRD infra, and other elements include (i) national technical qualification system, (ii) research for job catalogue (i.e. occupation information) and labor market information, (iii) manpower planning, and (iv) labor market information networks, etc.

Kuwait has a central institute in charge of national HRD, namely “Manpower and Government Restructuring Program (MGRP).” However, MGRP does not seem to be fully established yet, with its mission and main activities limited in scope and the organization as a whole less than fully empowered. The role of MGRP needs to be expanded and reconfigured as follows:

- First, it needs to conduct research on job information and labor market conditions, as what kind of jobs are available in Kuwait, and what kind of skills required for them needs to be defined more clearly.
- Second, it needs to shape up labor market information networks, putting together job applicants and job postings. Then, it needs to analyze and identify the industry demands for workers, the skill-demands of jobs, and the vocational training demand of the job applicants.
- Third, it needs to design the vocational training programs needed, and, in some occasions, it may assume a leading role in establishing a special institute for public vocational training.
- Fourth, with the job information (eg. Job catalogue), it needs to design “National Technical Qualification System” (NTQS) and manages the testing and issuing of the certificates of qualification. In doing so, it needs to ask the industry (firms, i.e. labor demanders) to join in managing NTQS, in order to make the qualification reflect industry skill demands correctly. For example, the experts from the industry may be requested to join in making test questions and in updating the NTQS.
- Fifth, it needs to link vocational training program to NTQS, thereby making training programs more effective for skill formation and employability of workers. Under this system, trainees will get certificates upon successful completion of their training programs.
- Sixth, it provides career counseling services to the job applicants. With the best information on jobs and labor market condition on its hand, MGRP can perform this

function well. After counseling, the job applicants may either receive training or be put into the pool of job placements.

- Seventh, it works out manpower planning so that it is compatible with the 5-year economic-socio plan, by combining the job and labor market information.

Box: The Background of Public Vocational Training System in Korea

At the end of the 1970's, the demand increased significantly for training skills required for the heavy manufacturing industry, such as lathe, milling, welding, electric circuits, etc. While large-scale enterprises had the capability of training their workers in house, small and medium-sized enterprises (SMEs) could not afford their own training programs. Despite the demand from SMEs, however, private training institutions failed to spring up.

In such a circumstance, the Korean government took the initiative to foster vocational training by directly establishing public training facilities. Public provision of training was also appropriate since the most needed industrial skills were of general and standardized nature. Additional significance of the public vocational training was that it provided income earning opportunities for the youth who could not finish high schools due to financial difficulties.

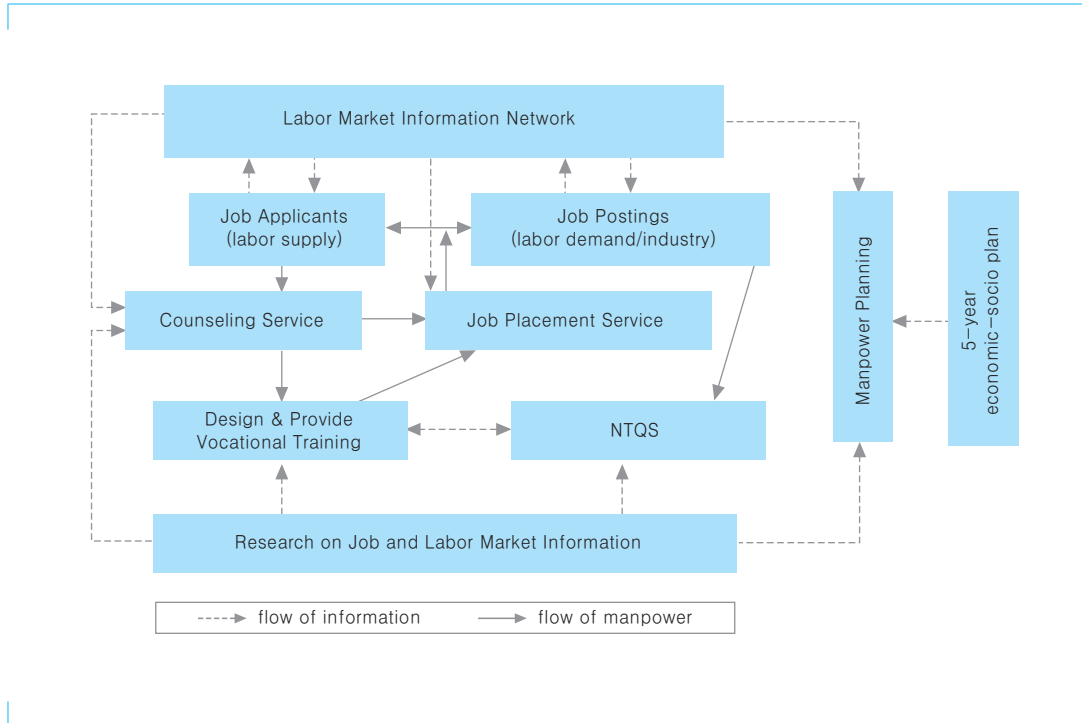
The government has adopted a vocational training levy system to secure the necessary training budget. The modalities of the system were as follows: Large-scale enterprises (with the ability to provide technology, facility, and finance) are obliged to provide vocational training by themselves. If they fail to fulfill this requirement, a levy is imposed, which is used to finance public training.

However, the vocational training system in Korea had gone through big changes after the introduction of 'Employment Insurance (EI)'. Korean EI is a kind of social insurance and its coverage is wider than typical unemployment insurance. On top of the usual unemployment benefits, it includes the programs of 'active labor market policy', such as employment security and vocational training.

Employment security programs are mainly wage subsidies for marginal workers. Vocational training programs fall into the following three types; i) support for employers, ii) support for employees and iii) support for the unemployed.¹ The main part of the support for employers is the financial support for the training programs managed by the employers. When an employer provides incoming or incumbent employees with vocational training, whether directly or indirectly through an outside provider, the employer receives all or part of the training costs. Support for employees includes the subsidies for employees' enrollment in training courses or post-secondary schooling and for qualification fees. The training for the unemployed, whether they are insured or not (i.e., whether they had work experience or not), is also supported by EI.

1. See the details at <http://www.molab.go.kr>

Figure 4-2 | HRD Structure



Box: Korean HRD Institutes

In Korea, HRD-Korea (Human Resource Development Service of Korea) is a specialist organization of national HRD. Its main roles are managing public vocational training (PVT) and national technical qualification system (NTQS). It has 11 Polytechnic Colleges (PTCs) which are equivalent to Junior Colleges of 2-year courses training technicians of the new industrial technologies such as information & telecommunication, manufacturing automation. It also has 19 Vocational Training Institutes (VTI) of 1-year courses, i.e. shorter and lower program than PTC. HRD-Korea also has an important role of management and operating the national technical qualification system. It designs and manages the test questions, and implementation of qualification testing, and registration and management of certificate holders, and organization of refresher courses for certificate holder. (See more details at www.hrdkorea.or.kr).

KEIS (Korean Employment Information Service) is an independent institute for research and data management. It has the roles of (1) researching on job(occupation) information & labor market including manpower planning, and (2) managing labor market information networks, such as “Work-Net” for job-placement by connecting job applicants with job postings.

Box: Manpower Planning in Korea

KEIS conducts employment projection in 10 years, 5 years, 2 years and 1 year. First, the long-term manpower supply forecasting method is summarized as the following steps:

- Breaking down the labor force by gender and age groups.
- For each cell (i.e. gender*age group), forecasting the LFPR (labor force participation rate).
- For each cell, multiplying the forecasted LFPR by the population size estimated from Census data.
- Getting the forecasted labor force for each cell, adding them up and checking the overall size of the labor force.

Second, the long-term manpower demand forecasting method is summarized as the following steps;

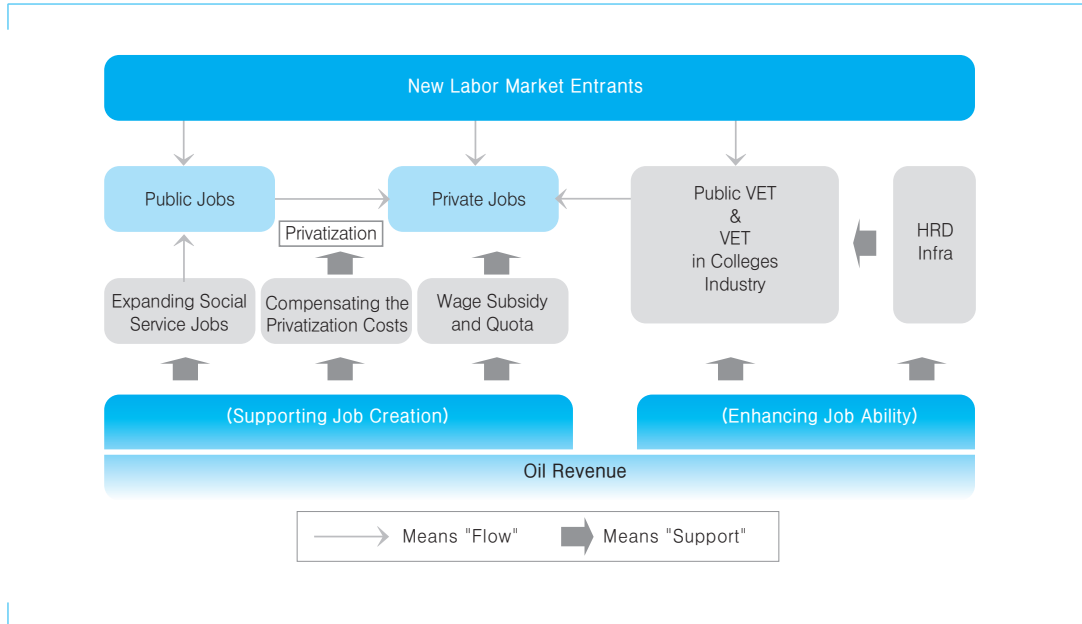
- Breaking down the employment structure by industry and occupation.
- For each industry, forecasting the ratios of occupations.
- For each industry, forecasting the size of employment by multiplying the forecasted coefficients of ‘employment/value added’ and the ‘valued added’ estimated from Input-Output Analysis and macro economic forecasting.
- For each group of industry occupation, forecasting the size of employment by multiplying the estimated industry employment and forecasted ratios of occupation.

5. Evaluation of the Strategies

Figure 4-3 summarizes the strategies and policy measures we have discussed so far.

In conclusion, we briefly evaluate our labor market reform strategies. The evaluation criteria and our subjective evaluations are summarized in the table below. We employ ‘importance’, ‘feasibility’ and ‘concreteness’ as evaluation criteria. ‘Importance’ divides into two sub-criteria, ‘impact’ and ‘urgency’, while ‘feasibility’ divide into ‘political feasibility’ and ‘government’s capability’.

Figure 4-3 | The Strategies and Policy Measures



“Expanding Social Service Jobs” gets high scores for all the criteria. “Wage Subsidy and Employment Quota with Levy” gets a high score in most criteria except “political feasibility,” which gets a medium score. Since most Kuwaitis still have the expectation of “guaranteed public employment,” the state needs to take the time and sequenced efforts to persuade its people and the parliament.

The strategies for HRD (upgrading the quality of workers) enjoy a high political feasibility, because Kuwait has sufficient government budget, and those strategies are not conflicting with the interests of the people. However, the concreteness needs to be complemented by more detailed information on the experiences of other countries such as Korea. The government’s weak capability for national HRD projects is a serious problem especially in the short run, and Kuwait may greatly benefit from specialized supports from other countries for its designing of its own national HRD system and for educating its officials. Nonetheless, for promoting private employment, building a vocational training system, whether public or private in nature, remains to be a pressing need.

Table 4-1 | Reform Strategies and Evaluation Criteria

Evaluation		Importance		Feasibility		Concret- eness
		Impact	Urgency	Political Feasibility	Gov't Capability	
Strategies						
Promoting Private Sector Job Creation	Expanding Social Service Jobs	High	High	High	High	High
	Wage Subsidy, Employment Quota, with Levy & Employment Subsidy	High	High	Medium	High	High
	Compensating for Privatization Policy	High	High	Medium	High	High
Upgrading the Job Ability	National Infrastructure of HRD	Low	Medium	High	Medium/Low	Medium
	Public Vocational Training System	High / Medium	High	High	Medium/ Low	Medium

1. The Effect of Wage Subsidy

Let W_g be the wage in the government sector, W_p be the wage in the private sector, SUB be the wage subsidy, D_i be the “amenities value” of a government job (i.e. the value of the difference between the government job and the private job) for worker i , and P_i be the marginal productivity of worker i .

Then the condition for worker i to choose the private sector job is:

$$W_p + SUB \geq W_g + D_i \quad \text{----- (1)}$$

That is, total compensation in the private sector after subsidy must be no less than the total compensation of the government job including the amenities value (labor supply condition).

Thus, the (market) labor supply function for the private sector job becomes:

$$W_p = (W_g - SUB) + D_i \quad \text{----- (1)'}$$

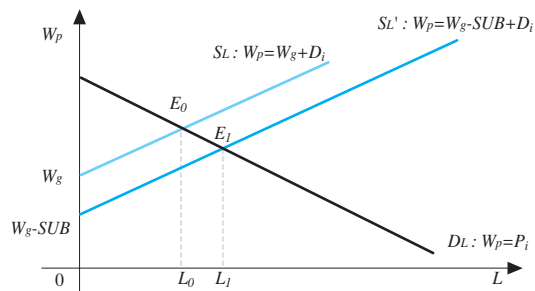
Because its (market) demand function is:

$$W_p = P_i \quad \text{----- (2)}$$

equilibrium condition is therefore:

$$(W_g - SUB) + D_i = P_i \quad \text{----- (3)}$$

Figure A1 | The Effect of Wage Subsidy



Assume for the expositional purpose that workers differ in D_i and P_i and that D_i is increasing in i , while P_i is decreasing in i . Then the effect of wage subsidy can be illustrated by means of typical demand and supply apparatus as in the Figure A1.

In the absence of wage subsidy ($SUB = 0$), the equilibrium will be found at point E_0 , with the equilibrium level of employment determined as L_0 . Now if we introduce wage subsidy amounting to SUB , the labor supply curves will shift to the right (downward by SUB), and the equilibrium level of employment increases to L_2 . Surely, given certain W_g , the higher the wage subsidy is, the greater will be the equilibrium level of employment.

2. The Effect of Quota Cum Levy

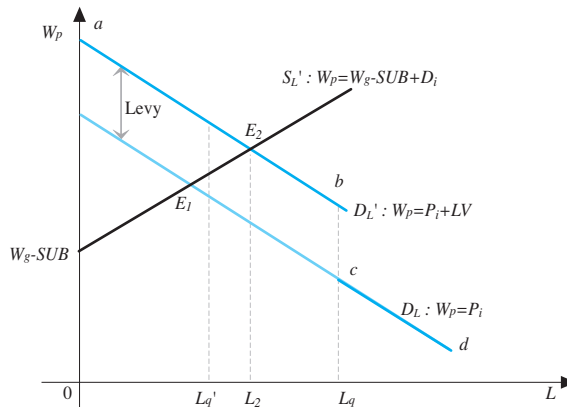
Now consider a system of employment quota with non-compliance penalty (levy). Let L_q be the size of employment quota, and LV the rate of levy (penalty per head for unmet quota). Under such a system, the labor supply function remains intact, but the demand function is affected such that

$$\begin{aligned}
 W_p + LV &= P_i \quad \text{if } L \geq L_q \\
 W_p &= P_i \quad \text{if } L < L_q \quad \text{----- (4)}
 \end{aligned}$$

That is, when the quota is unmet, workers become more costly to hire by the amount of levy (LV). Thus, the labor demand curve will be ‘kink-shaped’ (the ‘line ab’ and ‘line cd’) and equilibrium will be determined as shown in Figure A2 (point E_2).

The effect of quota on employment is clear-cut. It increases employment. A noteworthy point here is that two distinct types of equilibrium are possible under quota. Figure A2 illustrates a situation where the equilibrium level of employment falls short of quota (that is, $L_2 < L_q$). In such a case, the quota is effective in increasing employment to some degree, but the firm chooses to under-fulfill the quota, paying a total amount of levy equal to $(L_q - L_2) * LV$. Note that this is a rational choice for the firm, because when hiring more than L_2 , then for each worker hired beyond L_2 , a loss greater than the levy will be incurred (that is, $W_p - P_i > LV$). Note also that under this situation, a further increase in the quota will not have any effect on employment (non-binding with respect to employment), although it continues to increase the burden of levy to be borne by the firm.

Figure A2 | The Effect of Quota-Cum-Levy



This of course is not the only possible outcome. Suppose now that the given same level of LV , the quota is set below L_2 , say at $L_{q'} < L_2$. As it can be easily inferred from the figure, the equilibrium in this case will be found to the left of E_2 , and the equilibrium level of employment will be equal to the size of quota, $L_{q'}$. In such a case, the quota has ‘just met’, and an increase in the quota has one-to-one impact on the size of employment.

All these discussions indicate that the employment effect of quota varies depending on the size of quota itself. To recapitulate, given certain LV , the equilibrium level of employment will increase with respect to L_q , but only up to certain point. Once L_q is too high already, then a further increase in L_q will not affect employment.

3. The Limit of Levy and Employment Effect

As concerning how the level of levy affects the market equilibrium, it is obvious that the higher the levy, the greater will be the equilibrium level of employment. One caveat here is that the levy should not be set too high. In essence, if the LV is too high, then the private firm might hire ‘paper workers’ who are not actually working while being paid. Under the present setting, the condition for an effective quota ruling out “paper worker” is,

$$LV \leq W_g - SUB \text{ ----- (5)}$$

To understand the condition, suppose $LV > W_g - SUB$. Then we can find W_p such that $LV > W_p > W_g - W_s$. Since, $LV > W_p$, the firm would prefer paying W_p (without the expectation of the employee's working, that is $P_i = 0$) to paying levy ($= LV$). Also, because $W_p > W_g - SUB$, that is because $W_p + SUB > W_g$, the worker will be better off as a paper worker than when working in the government (note that $D_i \leq 0$ in case of paper worker).

Given SUB , since the size of LV is limited to $W_g - SUB$, in case of introducing both SUB and LV , the policy effect of increasing SUB would be offset by decrease of the limit of LV . In equilibrium condition, $W_p = W_g - SUB + D_i = P_i + LV$ and $LV = W_g - SUB$. So, the equilibrium condition of maximum employment turns to be $P_i = D_i$. Let this maximum employment point of equilibrium be L_m .

In summary, first, even if we use both wage subsidy and levy, we cannot increase private employment more than L_m . Second, in order to increase private employment more than L_m , we should decrease D_i or/and increase P_i , that is, the non-pecuniary benefit of government job should be decreased or/and the job abilities of Kuwaiti nationals should be increased.

Also, note that, given the maximum employment level, the relative dependence (of policy) on levy or wage subsidy determines who would burden the cost. At the equilibrium of L_m , the levy burden by the private firm would be $LV^*(L_g - L_m)$. And, its wage loss would be $L_m^*(W_p - P_i)$.

Since, in equilibrium, $LV = W_g - SUB = W_p - P_i$,

The total burden by private firm would be

$$LV^*(L_q - L_m) + L_m^*LV = LV^*L_q = (W_g - SUB)^*L_q.$$

On the other hand, the government's burden would be L_m^*SUB .

So, if we lower SUB (which is equivalent to higher LV given W_g) then the firm's burden would increase and the government's burden would increase, and vice versa.

4. The Effect of Employment Subsidy

In case of $L_q' < L_2$ in <Figure A2>, that the firm just meets just the quota, we need to introduce another incentive policy for increasing the private employment.

If we provide "employment subsidy" (ES) for the excess employment over the quota, the labor demand curve would change to

$$W_p = LV + P_i \quad \text{if } L \leq L_g'$$

$$W_p = ES + P_i \quad \text{if } L > L_g'$$

Here, if we set $ES = LV$, then the labor demand curve would not be kink-shaped at L_g' and thus would be straight line. And, the equilibrium condition would be:

$$P_i + ES(\text{labor demand}) = (W_p) = W_g - SUB + D_i \quad (\text{labor supply}),$$

$$\text{Since, } ES = LV = W_g - SUB,$$

the equilibrium condition would be $P_i = D_i$ and the employment would increase to L_m .

Updating Education and Human Resources

- 1_ Problems and Prospects
- 2_ Basic Strategy and Policy Suggestions
- Annex

Updating Education and Human Resources

1. Problems and Prospects

Improving education and upgrading human resources represents one of the key strategic objectives of Kuwait in the nation's effort to realize its vision. As H.H. Amir himself has stated: "Education is the main source of creative energies and talented labor. There is a need to concentrate on strengthening the educational process, from kindergarten to university."¹ Indeed, all of the existing vision reports, development plans, and related reports on Kuwait share this view and put forth a largely similar list of reform agendas and policy measures to attain this goal. For instance, the aborted five-year plan of 2001/2-2004/5 identifies education as a central pillar of the so-called 3 tier approach of the plan (together with "economy" and "security"), while highlighting human resource development as one of the four focal areas of reforms (together with financial, economic, administrative reforms). The recent McKinsey report² basically echoes such a perspective and extends its policy suggestions into deeper and more fundamental structural reform agendas, just as the World Bank's 2003 thematic report on Kuwait's educational issues does.³ Within the scope of the new five year plan under consideration, the education system will continue to play a central role in the development of Kuwait's human resources to meet the labor market needs and develop the professional levels of the current and expected Kuwaiti labor force.

1. Al-Qabas newspaper (22-11-2007)

2. Unleashing Kuwait's Growth Potential - A National Reform Agenda

3. State of Kuwait - Education Expenditure Analysis Study

Kuwait has good potential to uplift its educational sector and turn itself into one of the educational hubs in the region. Its educational spending is one of the highest in the GCC region. On top of its almost universalized, secondary education, Kuwait boasts an impressive tradition in post-secondary education. Particularly, Kuwait University (KU), staffed by an excellent faculty, is reputed to provide quality education. Moreover, a considerable number of Kuwaiti students receive college or graduate degrees abroad in the world's leading universities. The Kuwaiti government is also stepping up efforts to invigorate its education sector with commitments to massive investments into its public education system.⁴

Nevertheless, Kuwait's forging ahead in the region with respect to education remains a formidable task. Competition is intensifying within the GCC region both at the secondary and tertiary level, as witnessed by the latest education drive of Qatar. More importantly, Kuwait's educational sector suffers from a myriad of structural problems such as the shortage of competent teachers, lack of competition among schools, and even inadequate attention among many parents on the value of education itself.

The reform directives and policy measures proposed in the existing documents appear basically sound and robust on their own as well as complementary to one another. If properly executed, they may combine to help transform Kuwait's education sector in the desired direction. However, what they critically lack is a bird's eye view of the proposed policy measures and a resultant, more carefully-designed implementation strategy. The table below summarizes the challenges to Kuwait's education sector. While the existing studies or reports tend to emphasize the problems pertaining to "efficiency" and "quality," Kuwait is also faced with serious problems such as with respect to "quantity" and "equity."⁵ In short, the existing reports' scope of policy prescriptions remains limited. As a result, less than adequate attention has been paid to such pivotal issues as those of the higher education sector as well as pre-school education and life-long-learning of adults.

4. For instance, in 2006 Kuwait announced "plan 2010" with the aim of revolutionizing Kuwait's education system with new projects and a healthy injection of cash. The plan entails a total of 68 projects, including a new university for the sciences and extra funding for local education authorities. Altogether, the extra investment boost to education amounts to 33% of the annual education budget, which is about \$2bn. (The Report - Kuwait 2008, Oxford Business Group, 2008)

5. Illustrating the problems pertaining to quantity, enrollment rates of 86% of the population at the primary level and 90% at the secondary level are below those seen in some of GCC countries (e.g. Bahrain 97% and 98% or Qatar 95% and 97% respectively).

Box 5-1: Characteristics & Main Policy Suggestions of Preceding Works

A. The Kuwait Government : 5 years plan of 2001/2-2004/5

A.1. Characteristics

Emphasizes incremental change measures over efficiency-oriented structural reforms

A.2. Main Suggestions (3 areas)

- General Education
 - improve curriculum (more sciences and math courses)
 - reduce drop-outs (high schools)
- University and Higher Education
 - enhance the role of private institutions
 - reduce drop-outs
 - enhance evaluation to better reflect industrial demands
- Vocational Training and Education : improve PAAET

B. The World Bank (2003) :

B.1. Characteristics

Provide comprehensive analysis and detailed policy suggestions distinguishing short-, mid-, and long-term agendas; but tilted to the general/basic education issues

B.2. Main Suggestions (3 areas)

- Financing options
 - greater efficiency in educational budgets
 - formula funding
 - balance between public and private funding
 - more competitive school markets (school choices)
- Develop Education Indicators
- Introduce Program Budget

C. McKinsey (2007)

C. 1. Characteristics

Focus on basic education reform, esp. on measures to improve teacher quality. It also touches on higher education reform, but only in a limited way.

C. 2. Main Suggestions (3 areas)

- Strengthen teacher program
 - recruiting highly qualified teachers and enhance training
- Better manage performance
 - New performance standards and evaluation system for students, teachers, and schools

- Expand and upgrade vocational training
 - Switch to Polytechnics system
 - Attract global leading universities.

Table 5-1 | Problems of Kuwait’s Educational Sector

Areas of Problems	Reported Problems
Quantity	<ul style="list-style-type: none"> - Non-universal basic education - Low enrollment in higher education (20% or so) - Low life-long learning (LLL) - Low pre-school education
Quality	<ul style="list-style-type: none"> - Low test performance (TIMSS, PIRLS etc) - Low teachers quality
Efficiency	<ul style="list-style-type: none"> - High teacher-pupil ratios - High repetition and drop-out rates - Salary-tilted expenditure structure - Limited school choices - Bureaucratic school management / operation etc.
Equity & Others	<ul style="list-style-type: none"> - Uneven tuition burdens between private & public institution (Unfair treatment of expatriate teachers)

2. Basic Strategy and Policy Suggestions

The policy objectives and agendas of Kuwaiti educational reform needs to be broadened to encompass all four issue areas: quantity, quality, efficiency, and equity. The key to success for any educational policy measure would lie in how to strike a balance among the different criteria; for instance, combining and complementing “efficiency reforms” with “access reforms” or those reforms geared to broaden public access to educational opportunities.

Another critical key to Kuwait’s successful educational policy lies in the realm of strategic reform design and effective implementation. Market-oriented reforms tend to be easier to introduce in those sectors which are less rigid and thus more malleable. At present in Kuwait, the higher and pre-school education sectors appear more prone to the market mechanism than other sectors. Thus, Kuwait may want to start its educational reforms first with those more malleable sectors and more gradually spread the “small” successes to other, say, primary and

secondary sectors.

The following refers to some of the key reform strategies and agendas which have been under-emphasized in the existing documents; by rethinking about their respective merits and policy priorities, we suggest some policy suggestions for successful implementation of Kuwait's educational reforms as follows:

2.1. Expand and Heroically Improve Higher Education

2.1.1. Subsidize Private University Enrollments

The current enrollment rate of about 27% at the higher education is too low for the income level or present development stage of Kuwait, let alone to meet the future manpower needs of the country. While it is a sensible move to expand the capacity of Kuwait University(KU)⁶, it needs to be accompanied by a parallel expansion of the capacity and the quality of private universities.⁷ Currently, KU education is offered free of charge, while the students attending private universities pay full tuition. Such a policy will prove costly for the society in the long-run, as it suppresses students' entering private institutions. Such a policy may also be problematic on the equity grounds as well, by rendering tuition burdens to fall on the economically less privileged students.⁸

Private universities in Kuwait appear less than adequate and low in quality. Subsidizing private universities through either direct tuition support in the form of voucher or institutional grants could help expand and upgrade the entire higher educational sector of Kuwait, while alleviating intrinsic equity problems. As concerning the form of subsidy, direct institutional grants are easier to introduce than students vouchers. Institutional grants may be provided on

6. It is reported that there are plans for a new KD1bn (\$3.5bn) campus for Kuwait University, which will bring together the university faculties into one area and increase the capacity from 30,000 to 40,000 students (The Report - Kuwait 2008, Oxford Business Group) .

7. Currently about 7,000 students are reported to be enrolled in private universities. The figure may be incorrect though, as the Arab Open University has a long-distance program, which could mean the university has as many as 9,000 students. Despite lagging behind the public sector, private centers for higher education are now growing quickly. After opening just two and a half years ago, Australian College of Kuwait (ACK), for example, now has 1,900 students enrolled, with 350 of them studying engineering. American University of Kuwait (AUK) currently has around 1,500 students but expects to have around 2,300 by 2010 based on current admission trends, and GUST (Gulf University of Science and Technology) is currently close to 2,000 in enrollment.

8. The presumption is that most college-bound students prefer KU to private universities and the students from relatively wealthier families perform better academically, thereby having higher chance of attend KU. There is no official statistics or rigorous analysis available which compare the family background of the students at KU and in other private universities.

the basis of formula-funding, taking into account those factors such as the number of students, the size of faculty, and the needs of capital accounts. Later on, more discretionary “performance” criterion may be added in allocating subsidy funds.⁹

Box 5-2 : The Higher Education in Korea and the Role of the Private Universities

Korea’s higher education sector has witnessed spectacular quantitative growth and expansion over the past several decades. The quantitative profile of Korea’s higher education is astonishing and truly impressive even for the OECD standard. College education has become virtually universalized, with about 84% of high school graduates advancing to colleges. It is widely acknowledged that the fast expansion of higher education was pivotal to Korea’s successful industrial upgrading and economic development over the past several decades.

Despite such a spectacular quantity expansion, however, the role of the government in financing tertiary education has been very limited. Private expenditure, mainly tuition, has been the main source of financing. In Korea, the private share of higher education expenditure stands at about 80 per cent, while the normal OECD range is below 40 per cent. Such a unique financing structure reflects a unique compositional feature of Korea’s higher education sector, that is, a predominance of private institutions. Indeed, it is the private institutions that drove the rapid expansion of Korea’s higher education throughout the times. Today, about 83 per cent of higher education institutions are private, and they take up about three fourths of students and faculties. Despite their huge market share, the government support for private institutions, including scholarships and student loans, not to mention institutional grants, remain negligible. Although the situation has improved a little lately, private universities still heavily depend on tuition for their revenue (about 67%), while getting less than 5 per cent of their revenue from the government.

The experience of Korea vindicates that the rapid expansion of colleges is possible even when the government lacks financial resources to back it up; promoting private institutions highly dependent on tuition makes a good policy alternative. However, Korea’s model clearly indicates the limitations of such a model at the same time - that is, the rapid quantity expansion drawing mainly on tuition can not deliver enough quality. Indeed, with not enough of investment made in pace with explosive increase in students body in colleges, the overall schooling environment and thus the quality of colleges remain low.

9. As concerning the magnitude of the subsidy, by the end year of the first five year plan, the size of subsidies to private universities may reach as high as 30 percent of the total combined budgets of private universities.

2.1.2. Promote LLL (Life-long Learning) or FET (Further Education and Training) for the adult workers

Only 10% of the Kuwaiti citizens seemed to have received higher education, which is too low by international standards. Also a substantial proportion of Kuwaiti adults have not obtained secondary level of education, let alone the higher education. This implies that there is a great need or market for LLL or FET for the adult workers/parents. This could make a good foundation for the development of colleges and vocational educational sectors in the future. Kuwait may consider a range of programs from general social education to customized vocational training. General social education to parents will be important by enabling them to make better social and political decisions as well as enhance their outlook concerning the value of education for their children.

Table 5-2 | Educational Level of Kuwaiti Labor Force (Kuwaiti nationals only)

No	Low	Medium	High
3.81	35.78	37.7	22.71

Source: SCPD

Various short-term, non-degree programs need to be provided together with degree programs. General social education may be offered on a part time base at PAAET or in a more informal way, for instance via on-line and on-air media instruments. Together with funding, identifying the target group and areas that can respond positively to new policy initiatives would be critical. The target group for general social education programs will be those who have not obtained secondary education. A special emphasis should be placed on “literacy” education,¹⁰ including “English literacy”. The initiatives of local authorities and communities need to be promoted actively with appropriate financial support and guidance from the central government. In designing formal programs offered at colleges, Korea’s social academy programs as detailed in the section on labor market reform, may provide a good reference case.

2.1.3. Reform PAAET and Develop Polytechnic School System

In recent years, some countries in the GCC region like Bahrain have undertaken large scale reforms to enhance vocational training. Kuwait is also greatly seeking for such similar reforms. Even a drastic measure such as restructuring and breaking down of PAAET into several independent units may be considerable. Another policy option may be partial consolidation or

¹⁰. Despite improvements, adult literacy remains below the OECD average (84% vs 99% in 2005)

transformation of existing private vocational training organizations into Polytechnics school system. Expanding the availability of vocational training has significant benefits: students have a larger choice of options and private companies have access to a larger pool of qualified candidates. One may draw reference cases from Bahrain, Finland and Korea.

2.1.4. Attract and Strengthen Ties with Globally-Renowned Universities

Although Kuwait has recently managed to host three new universities from abroad,¹¹ their capacity or quality still leave a lot to be desired. Kuwait may thus need to step up the efforts to attract globally renowned universities, especially in light of the steeply-mounting regional competition for the education market. This will help accelerate transfer of knowledge from top performing countries and increase the knowledge capacity of Kuwait. As McKinsey(2007) points out, it is advisable to try to attract the world’s best-in-class performers in fields that are most relevant for Kuwait’s long-term development vision (e.g., Stanford University in engineering, University of Pennsylvania in finance).

Singapore’s WCCP (World Class Campus Program) is among the best global practices. The leadership for Singapore’s WCCP came from the highest level and EDB(Economic Development Board), an government branch responsible for attraction of FDI, took the lead in collaboration with the Department of Education. Kuwait may consider creating a special, high-power committee whose mission is to attract the world renowned universities or to develop world-class partnership programs. Special allowances such as free-of-charge land access, tax benefits, or even in-kind or cash grants needs to be considered to make Kuwait an attractive place for the prospective foreign educational institutes. Together with Singapore’s experience, Korea’s recent experiences of strengthened partnership programs with foreign universities can also make a good reference case.

2.2. Diversify Basic Education and Upgrade Its Teachers

2.2.1. Introduce Public ‘Magnet’ Schools

Two central objectives of the school reform in Kuwait may be “greater diversity” and “higher quality.” Given the magnitude of the problems in the schooling sector, a good strategic option would be to introduce some “impact” or “pilot” institutes to spark a series of desirable

11. American University, the Australian College, and Maastricht University. In addition GUST (Gulf University of Science and Technology) has established a partnership with the University of Missouri in Saint Louis, US (UMSL)

change.¹² Specifically, Kuwait needs to consider establishing public “magnet schools” as in the US system. As “champion” (vanguard or leading) groups, they may set off “quality” competitions among the public schools, providing the model or a best practice through recruitment of quality teachers, introduction of new curriculum and assessments, and other managerial innovations needed to enhance school performances.

Such reforms would not only improve the quality of public schools, either directly or indirectly through spill-over effects, but also serve to make Kuwait’s schooling system more equitable by allowing the economically less privileged students access quality education as good as that offered by more expensive, top-quality private schools. To be effective, more than one magnet school needs to be established. Kuwait may consider starting with 5-10 magnets schools¹³ with the ultimate goal of expanding it to about 5-10% of the entire public schools at the secondary level. For the orientation of magnet schools, it will be desirable to mix general comprehensive schools with field-specialty schools specializing for instance in IT, finance and banking, etc. Substantial school autonomy must be granted to these schools to allow various educational experiments to take place in respect of curriculum, teacher recruitment and promotion, student selection and assessment, etc.

A new legal framework may be needed at the level of “decree” (not law) to allow for different regulatory schemes and preferential funding arrangements. The budget of a typical magnet school may be 2-3 times as large as that of normal public schools. The presence of a very competent and entrepreneurial school principal is a must for the success of a magnet school, together with a host of competent and devoted teachers. School principals could be recruited from established figures with various career backgrounds including business.

Nurturing magnet schools needs to be pursued in parallel with a promotion of private schools¹⁴ by such means as deregulation, partial formula funding, and vouchers-in the order of short to longer term measures. Korea’s experiences may provide a good reference case on this score as well.

12. The secondary education market in Kuwait can be roughly divided into two - Kuwaiti children at public schools, who take standard higher secondary school certificate exams before university and those who attend private and international schools that generally follow the English GCSE, IGCSE and A-levels system. Attendance at state schools is restricted mostly to the children of Kuwaiti nationals, and thus the majority of expatriate families depend on private schools to educate their children, of which nearly half are following non-Arabic curricular.

13. It is reported that now in Kuwait, there are 668 public schools under the jurisdiction of the Ministry of Education.

14. Since the 1990-91 War, there has been an explosion in demand for Western education in Kuwait, and today 30% of Kuwaiti children are attending private schools. Despite comparatively high-fees, schools that teach American and British curricular are very popular.

2.2.2. New Recruitment and Career Development System for Teachers

The quality of teachers seems to have gravely deteriorated since the early 1990s and the schools largely staffed by a collection of under-motivated and under-qualified teachers.¹⁵ Yet, drastic reforms (such as qualification tests or performance requirements for all teachers) geared to massively curtail the number of new or existing teachers may not be politically viable. One option to consider would be to introduce a two-track recruitment and career development system, where those with more than certain level of qualifications are recruited for “regular, highly-paid” teaching positions, while the rest are hired for “supplementary, lower-paid” positions.

If the low social status of teachers remains a big hindrance to attracting bright and talented college graduates into teaching professions, it may be helpful to create a new teacher program for elite teachers. Theoretically, the program may be created within KU or PAAET by restructuring the existing programs, although it may be better if a new institute can be freshly created and dedicated exclusively to produce elite-track teachers.¹⁶ The new institute may well be on a four-year university level, and should select students on a highly competitive basis, while offering very attractive package of incentives including scholarships and preferential job placements. After graduation, they will be guaranteed to be placed in “magnet schools” or any other schools of their choice, and start their career along a “regular, highly-paid” teaching positions track.¹⁷

To overcome the shortage of quality teachers, Kuwait may also try to attract more qualified and dedicated teachers from abroad, offering generous and competitive compensation as those offered to the Kuwaiti nationals. This may be a must for Kuwait to become a regional educational hub.

15. In Kuwait, there is a shared perception that teaching is not socially rewarding: it is not highly regarded as a career track, professional development opportunities are limited, promotion tracks are slow but working conditions (in particular attendance norms) are more stringent than in comparable Government positions.

16. It is reported that the teacher program at KU is wanting. The curriculum at KU’s College of Education incorporates one semester of full-time teaching in classrooms and all fresh graduates receive startup training prior to joining their position. This means that students receive significant exposure only during the last year of their program. Also teaching methods at KU’s College of Education over-emphasizes theory over practical training and are removed from the realities of the classroom.

17. To create a new teacher institute, a separate law needs to be enacted. From preparation to finalization, the law will take about one or one and half year to enact. For the new school to start, it will take about three years. To introduce a two-track recruitment and career development system, the existing law needs to be amended. From the initial drafting, public hearing to final enactment, it would take no less than two or three years. The government leadership to convene public consensus is a must.

Box 5-3: Training and Recruitment of Teachers in Korea

Throughout its educational expansion and economic development, Korea has never suffered from a lack of competent and devoted teachers. High salaries and high social status were two main factors that have helped Korea continually attract the top-tier students into the teaching profession. The underlying factor for all these was a successful system of teachers training and recruitment. Currently, primary school teachers are mostly recruited from the graduates of 11 national educational universities, the students of which usually are comprised of top 5 percent of high school graduates. The secondary school teachers are recruited from a more diverse pool of higher educational institutes ranging from teachers college in regular universities and teaching-track programs open to students of all majors, to graduate educational schools. Usually, there is some minimum GPA requirement (say, B or 80) for the applicants for the secondary school teachers, and even those who meet the requirement can become teachers only when they pass a very competitive selection exam.

2.2.3. Strengthen OJT for teachers

In Kuwait, OJT for teachers is very limited.¹⁸ Moreover, a majority of teachers are reported to suffer from a lack of motif to perform. To overcome this situation, more hours of professional training, but also better quality programs are needed. Rather than being delivered at intermittent times on an ad hoc basis, teacher training should be regularly provided.

Kuwait can greatly benefit from creating a new overseas training program for officials, offered in groups and over a substantial period of time. In re-motivating teachers, this will be more effective than typical programs held on an individual basis and over a short-period of time. Many OJT programs of this type designed for government officials, are productive in instilling desired behavioral and motivational changes in the trainees.

2.3. Capitalize on the Potentials of E-learning

For all levels of education (pre-schools, general schools, higher education, VET), new opportunities provided by ICT and network-based learning instrument need be fully exploited. Given its level of GDP and ICT infrastructure, Kuwait seems ready and able to tap onto the potential of e-learning to greatly upgrade its education. For instance, it could be an effective

18. Less than 1% of total non-salary public expenditure is dedicated to on the job training and training is delivered on an ad hoc basis, when new schoolbooks are introduced for example. In comparison, Singapore guarantees each teacher a mandatory package of 100 hours of training each year.

measure to cope with the problem of the lack in quality teachers. By creating a new market for ICT products, it could also help Kuwait attain its strategic development goal - i.e. develop ICT industries and to advance into an IT powerhouse in the region. Korea's experiences since the financial crisis of 1997 would provide a good reference case.

Box 5-4: ICT-based learning in Korea

Korea started adopting ICT in its education system in the mid 90s. It was at this time when the importance of an educational revolution in achieving a knowledge based society became apparent. In the early stages of ICT introduction, the government developed and implemented a range of different policies under the banner of 'educational informatization'. Most importantly, the government invested heavily to provide PCs, multimedia equipments and broadband internets to schools, teachers and students all around the country. Having successfully completed two 5 year plans of school informatization drive, Korea is now pursuing third round of a 5 year plan, which started in 2006. All these required a lot of trials and errors, but have made Korea's ICT in education systems more mature and competitive. The early use of ICT in education has greatly altered the face of teaching and learning today. Lately, Korea was nominated by UNESCO as the global leader in the e-learning area.

The industrialization process of Korea since the early 1960s can be divided into three phases: (1) the take-off phase of 1961-1972, (2) the heavy-chemical industry (HCI) promotion phase of 1973-1979, and (3) rationalization and liberalization phase since 1980. The education and HRD policies of Korea have evolved over time in compliance with the basic policy goals and orientations prevailing in those three phases. In large part, the Korean government took the initiatives in developing the schooling system such that it can meet the immediate or imminent manpower needs from industries in all succeeding stages of industrialization.

1. The Take-off Phase: 1961-1972

With the launching of the First Five Year Development Plan in 1962, Korea abruptly switched to the so-called outward-looking, export-oriented industrialization and growth strategy. Under this strategy, most other policy objectives were aligned or subjugated to the basic goal of export-promotion, and in order to achieve this goal, the government undertook a package of policy reforms, one after another, regarding exchange rate, currency, budget, and tax system. All these strategies and programs turned out to be highly successful. Exports rose sharply, while the basis of industry and exports kept being solidified and diversified into such light-manufacturing industries in clothing, footwear, and electronics. The average growth rate during this period (1963-72) reached 8.9 percent. The path toward high growth was discovered and requisite measures were enacted.

Throughout this phase of development, Korea has not suffered from any bottleneck in skilled manpower. Thanks to the continued government efforts devoted to adult literacy and provision of basic education, a great reservoir of modestly educated semi-skilled workers were available to meet the demand of the basically manual industries during this phase. Almost complete universal enrollment of the primary-school-age group was attained by the late 1960s, with a great portion advancing to middle schools. Because this early stage of industrialization did not require that much of highly sophisticated skills, the general education of the workforce sufficed. In addition, a small but suitable number of innovative entrepreneurs, government officials, and various professional and clerical personnel were available.

19. This is an excerpt from Cheonsik Woo(1998), *Human Capital and Economic Development of Korea: New Challenges and New Vision*, KDI working paper No 9801, Korea Development Institute.

Box 5-5: Initial HRD Condition in the early 1960s

By 1960 already, Korea's human resource base had been greatly improved far ahead of its stage of economic development. For instance, as a result of adult literacy movements arduously pursued right after liberation, the adult illiteracy, which amounted to 78 percent in 1945, has been reduced to less than 5% by 1960 (KEDI 1997; the exact figure differs depending on sources). Also as result of successful policy efforts to expand basic education for young aged school children, the primary school enrollments have been raised to 86% by 1960 from its 1945 level of 45%. By the mid-1960s, almost all new labor market entrants acquired at least primary education.

Until the middle of this phase, the government efforts directed for specific skill formation have been relatively meek. However, with continued industrialization, the skills demand started to rise rapidly, and the major policy target gradually shifted onto more skill-intensive industries (such as chemical, machinery and steel) especially during the Second Five Year Development Plan (1967-71). Corresponding policy efforts in manpower development followed, aimed at expanding the capacity and improving the quality of vocational education and training (VET) both within and outside the formal education system. Various educational and skill-training programs, each with distinctive characteristics, were implemented in response to the growing diversification of the industrial structure.

Box 5-6: VET of Korea in the earlier phase of industrialization

The government efforts along this line started with the legislation of the vocational training law in 1967. Later, the government constantly expanded vocational training facilities by drawing domestic capitals as well as loans and aids from foreign countries and international organizations. In 1968, the government established the Central Vocational Training Center with aids from ILO and UNDP so as to cultivate vocational training teachers. In 1971, the government made a contract for technical cooperation with the German government and opened the Korea-Germany Vocational Training Center in Pusan. In 1973, government founded the Chungsu Training Center with aids from the US government and set up centers in Chunchon and Taegu with loans from Asian Development Bank. The training centers established with international cooperation and foreign loans were equipped with unusually excellent training facilities compared to then-prevailing Korean standard. Some of them were even evaluated as having better facilities than public vocational high schools.

2. The Heavy-Chemical Industry (HCI) Promotion Phase: 1973-79

The shift from general export promotion to the heavy-chemical industry (HCI) drive was announced in 1973 (The HCI Development Plan). The objective of deepening the industrial structure around HCIs such as chemicals, basic metals, general machinery, shipbuilding and electronics had been seen as a logical response to rapid increase in domestic wage rate, increased global competition in traditional export market, and adverse changes in global, political and economic environments. Under the HCI drive, the government took the initiative in introducing sector-specific, import-substitution measures, while reinforcing and modifying the existing export incentive programs in favor of the selected HCIs. As a result, comparative advantage emerged through the 1970s in industries with higher physical and human capital intensity. Despite the slowdown in export growth, the Korean economy had achieved the average annual growth rate of 8.9 percent in the 1973-79 period.

As the Korean economic growth accelerated, emerging heavy and chemical industries began to require more skilled workers. To meet such requirements, the government launched and funded very ambitious VET programs, providing a new infrastructure for training basic skills. Technical high schools and public vocational training, introduced as two major venues of VET, were almost exclusively for basic training to meet emerging industrial needs. Technical high schools were promoted by broadening the base of skilled workers and providing intensive training in basic knowledge and skills. For instance, under the guideline of the so-called “categorization of technical high schools”, technical high schools were grouped into four categories on a priority basis, with their functions respectively specialized.²⁰ Overall, the share of expenditure for the industry and science related education in government education budget has increased from 2.6 percent in 1970 to 4.1 percent in 1979. Thanks to all these efforts, not only the has the physical capacity of VET expanded, but its quality has improved to some degree.

The increasing shift towards capital-intensive industry also gave an increasing importance to the role of middle-level technicians who could meet the growing sophistication and complexity of the modern manufacturing processes. In recognition of this, the government diversified its educational policy to the development of junior technical colleges offering two-year post-high school programs. Despite massive investments made for this purpose, however, the technician education system had a number of serious problems in both the quantity and quality of technicians it was producing. In response, the government launched a long-term technician

20. The schools in this group were divided into ‘mechanical high schools’, ‘demonstrative technical high schools,’ ‘specialized technical high schools’ and ‘general technical high schools’. In 1981 the technical high schools were re-grouped into two categories-specialized and general technical high schools.

education development plan funded by IBRD loan and matching fund from the government. This plan has played a vital role in upgrading the overall quality of junior technical college education.

Through the early 1970s, the decade-old government policy of tight college quota control was preserved, resulting in a limited expansion of the tertiary education. But moving into the mid-1970s, the role of higher education gained new attention in the nation's development effort. Higher education at the tertiary and graduate levels had to be expanded to produce qualified 'high-level manpower', especially in the fields of science and technology. As a first step, the quota of higher education enrollment was considerably enlarged and adjusted to emphasize natural sciences, engineering, and business management.²¹ Also the highest-caliber Korean manpower resources abroad were called back, while a group of promising students were sent abroad for advanced studies under government sponsorship. As a result of all these concerted efforts, the proportion of scientists and engineers engaged in R&D in Korea came to surpass other East Asian NICs by the late 1970s.

Overall, with the help of government initiatives and funding, the educational system and human resource base of Korea were enormously improved and expanded during the period of the HCI-drive. As a result of the steady and sharp expansion throughout the period, the middle-school-level general education was virtually universalized by 1980,²² while the high school enrolments ratio, owing partly to the effective promotion of vocational high schools, also leaped to 63.3 percent in 1980. On top of this, technical colleges as well as 4-year engineering colleges also began to expand their enrollments.

3. Rationalization and Liberalization Phase: 1980s

By 1979, the Korean economy came to face grave structural and macroeconomic problems such as escalating inflation, faltering exports, and over-capacity in the HCIs. The new government in the early 1980s started various institutional and structural reform programs, establishing new directions for the industrial policy concentrating on technology- and skill-intensive rather than capital intensive industries. These new policy efforts, effectuated with the enactment of a series of requisite laws, led to important steps toward major reforms in four areas, including financial liberalization (deregulations in 1984 and 1988), realignment of the industrial incentive system (Industrial Development Law of 1986), promotion of competition among domestic and foreign firms (Fair Trade Law of 1981), and trade and capital market liberalization (Import Liberalization Program of 1983 and Revised Foreign Capital Inducement Act of 1984).

21. As a result, the tertiary enrollment rate increased sharply from 9.5% in 1975 to 16% by 1980.

22. The middle school enrolment ratio soared from 50.9% in 1970 to 95% in 1980.

The reorientation of industrial policy that began in 1979 have taken roots by the mid-1980s. Most troubled businesses in shipbuilding, shipping and overseas construction, plagued badly by over-capacity and financial distress, have been successfully bailed out or rationalized without leaving grave repercussions on the economy. Through the mid 1980s, Korea regained its growth-momentum, and helped greatly by the resounding exports performances in the second half, could leave this critical period of the 1980s with the average growth rate of 9 percent.

In the fields of education and human resource development, many notable changes have occurred during the 1980s. As for formal education, the long pursued government goal of universal basic education was finally attained, with the middle-school enrollment ratio reaching 100 percent around the mid-1980s. The 1980s witnessed virtual universalization of high-school level education and a marked expansion of higher education. After another decade of rapid expansion, high school enrollment rose to 88 percent. The tertiary educational sector bloomed as well, with enrollment ratios more than doubling over the decade (from 16 percent in 1980 to 38 percent in 1989).

The most notable of Korea's HRD during this period may be the qualitative change in the roles of government and private sector regarding education and skill training. The human resource of Korea, in the preceding two decades, have been developed mainly via formal education and training programs that were initiated and financed by the government. In contrast, the HRD during the 1980s was more private-sector-driven and private-financed, where the government assumed a rather passive role as the legal facilitator and regulator. Concerning the dramatic expansion of the tertiary education, for instance, it may appear that the government took the policy initiative by enlarging college quotas. By all accounts available, however, it may well be stated that the ultimate driving force was not the government vision or foresight pertaining to the future manpower need, but the strong demand for higher education among the public, which the new government of the early 1980s might have felt had to be braced up for political reason. As a result, the quality of higher education did not get any priority; the ostensibly marked expansion of college education in this period heavily concentrated on the low-quality occupational junior colleges and the humanity fields of universities, the major financial sources of which were students' tuition fees.²³

The trend for the reversing government and private-sector roles in the formal educational sector is most clearly indicated by the changing composition of educational financing over the

23. The dramatic expansion of tertiary education after 1980 has occurred through two disjoint waves. The first wave was set in place by the one-time jump in the entry quota in 1981 and subdued through the mid-1980s. The second expansionary wave, still on its way of proceeding, started near the end of the 1980s and has been driven by a moderate but steady increase in the entry quota. As a result of the expansion, the tertiary enrollment rate has increased from 18 percent in 1980 to 35 percent in 1985 and then to 54.6 percent in 1995.

1980s. Until the late 1970s, the majority of the funds for formal education came from the government budget, while the private funds remained a supplemental source.²⁴ The 1980s witnessed the reversal of this pattern. Around 1980, the share of private-financed educational spending overtook the government spending share, with the gap between the two increasing conspicuously throughout the decade. Although a large part of this new trend is ascribable to the rising household spending on private extra-schooling activities in the unorganized (often underground) educational market, this too can be viewed as an outcome of the government failure in making adequate educational investments during this period.

In the field of HRD in general, the role of government has been greatly weakened too. Until the early 1980s, the specific industrial skills needs were largely met by the government-led vocational training system based on governmental regulations and central planning. As Korea advanced into a sophisticated industrial economy, however, the limitations of the centralized HRD policy loomed large: (i) the centralized policy, being rigid and quantity- rather than quality-oriented, could not adequately meet the ever-changing and diversifying manpower demands of the firms, and (ii) the government policy, by treating training and education separately, failed to develop or initiate an effective apprenticeship system and in-plant training within companies.²⁵ Through the mid-1980s, an increasing number of businesses found that knowledge or skills acquired in formal educational institutions was greatly lacking in comparison with what was actually required in workplaces. In response, large enterprises began to commit substantial resources to OJT programs, often setting up and running their own in-company training centers. Amid such efforts, the new decentralized HRD system came to emerge in the business sector, making private businesses more and more responsible for the training of their own employees.²⁶

24. The private funds include tuition, fees, and all other expenses that households bear for schooling-related activities/necessities such as stationery, commuting, and private tutoring, and extra-curricular activities.

25. It is not to say that the government did not make any serious attempt to cope with these problems. As for vocational training centers, for instance, the government removed many restrictions imposed on vocational training programs in workplaces, also providing appropriate alternatives for private companies. In addition, the government began to stress further training rather than initial training. Especially the government tried to facilitate the private vocational training centers which provide marketable training programs such as information processing, office automation, and services. All such government efforts, however, were not effective enough to bring any notable improvement in vocational training.

26. Most SMEs (Small and Medium Sized Enterprises), however, were short of funds for such in-plant-training programs. This skill shortage, together with rising wage, came to make SMEs less and less competitive after the mid- 80s.

Fiscal Reform in Kuwait

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- 2_ Reform Direction in the Long Run
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Fiscal Reform in Kuwait

The structural problem that the Kuwaiti economy currently faces can be explained by “The Tragedy of the Commons.” Commons from the abundant external revenue from oil export, have been characterized by rivalry and nonexcludability, which has harmful consequences as expressed in the saying, “freedom in a commons brings ruin to all.

Inefficient public expenditure has been determined through the budget system without no incentive for efficient allocation of public money. Reform needs to create a specific strategy to realize its goals. First, it should determine the exact figures for public expenditures according to a systemized framework, addressing the issue of transparency in the public sector. Second, the government needs to make sure that goals are achieved through public expenditure on some specific government programs, which addresses the issue of inefficiency.

Although Kuwait has endeavored to reform its budget system following upon the IMF recommendations for more transparency and efficiency, the achievements so far have appeared limited. It at least in part reflects the formidable structural problems of the Kuwaiti society, and can not be dealt with and resolved in a short period of time. Under such circumstances, in fact, a full-fledged budget reform aiming at reaching the international level of transparency and efficiency may not be feasible or suitable at least in the short and medium run.

A more realistic and feasible approach then may be first to focus on anchoring some minimal and yet vital changes essential to the success of the five year development plans, and then gradually tackle more technically demanding reform agendas such as performance-based budget, program budgeting, and consolidated government financial structure.

Based on the Korean experiences in fiscal reform, we therefore propose the following four measures or steps for the Kuwaiti government to adopt in a sequential manner: First, the government needs to increase the budget office's leadership and staff capacity to have a firm, top-down control over the budgetary process. Second, the government needs to combine its investment budget with operational budget which includes personnel expenses, monitoring them in a more integrated way. Third, later, gradually and over the longer run, the government may experiment with adopting a medium term expenditure framework system and budgetary process on an at least three-year basis. The Kuwaiti government currently does have a budgetary allocation plan as part of the five-year government investment program. However, it is not a medium term expenditure framework, which requires budget planning on a rolling basis. Fourth, the government may develop more sophisticated and technically harder reforms at a later stage and also more gradually over the medium or long term as the system gets settled down.

As demonstrated in the Korean case, the long-term developmental commitment and capacities of the government budget office official are far more important than any of the sophisticated budgetary techniques for ensuring the closer link between budget and planning in the implementation stage. This is, in fact, how Korea successfully implemented its five-year development plans in its early development decades: Korea practiced a de facto minimalist medium term expenditure framework first without actually calling it that, which began to be (and still is being) adopted and implemented, albeit in a far more sophisticated form, only recently with the introduction of performance management and program budget.

1. Background

The serious problem of Kuwait's public sector lies in the wasteful and inefficient allocation of public resources. The public sector is getting pointlessly bigger in size, and to make matters even worse, it is becoming all the more ill managed. One example is the structure of government expenditure, such that current expenditure occupies almost eighty five percent of total expenditure. Thus it is hard to expect the role of public expenditure in macroeconomic policy tool with such a rigid structure. Moreover, the budget of payment for public officers which has a large portion of current expenditure, is apart from finance ministry which has the function of budget allocation among line ministries.¹ It is weighed down by too much red tape, creating regulations that control and restrain the private sector. These ultimately led to

1. One reason for safe position of public employment is due to Kuwaiti constitution in Article 41 (Right and Duty to Work); "Every Kuwaiti has the right to work and to choose the type of his work."

unnecessary social costs as the private sector takes on a rent-seeking behavior in order to efficiently get around such regulations. An inefficient public sector is not only wasteful in spending public money but also creates an additional social cost by making the private sector inactive.² Consequently, the total cost incurred because of the inefficiency of the public sector is two or three times more than the budget allocated for it. This is the reason why reform in the Kuwaiti public sector is essential in establishing a stronger national economy.

1.1. Structure of Public Finance: Free Government to People

Kuwait obtains huge external revenue from exporting oil, so the Kuwaiti government believes that the country does not really need to put focus on its internal revenue, such as taxes.³ Fiscal revenues are around 70 percent of GDP for 2007, with expenditure around 40 percent of GDP. Even though the public expenditure share is similar to that of advanced economies, enormous revenues allow for high levels of public saving, which is around 30 percent of GDP. Furthermore, of the large public expenditure share which occupies around 40 percent of GDP, around 34 percent of GDP is current spending, and just 6 percent of GDP is capital spending. Thus, publicly provided goods and services are almost free, or market prices are much lower than the production cost. People do not concern themselves with issues such as the inefficiency of the government because for them, as long as government-provided goods and services are free and accessible to them, everything is well. Given this, the public sector has the tendency of expanding in size as there are not enough watchdogs to keep it in check.

Due to the abundant external revenue obtained from Kuwait's oil export, much of its public subsidies are transferred to some subgroups of the society or several economic activities. Such generous subsidy policies and low price of public utilities caused a certain change in the behavior of the Kuwaiti people. They have become negligent of their work because of such disincentives, while they have also increased their consumption of commodities to a level that is more than socially optimal.

2. The social cost of public sector, in addition to the waste of public money, has several elements such as crowding-out effect, rent seeking behavior in private sector, bribery, and excess burden for tax burden. The exact amounts of these social costs has been studied by many researchers, however, their estimates had wide variation in values.

3. The ratio of public money with respect to GDP is the most popular index to compare the relative size in the public sector. Kuwait has the value of seventy percent, however its use is not valid for international comparison. This index is implicitly assumed that the public money is burdened by the people by various taxes. However, Kuwait is completely different, as all burden is not by people but by external source from oil export.

1.2. Budget in Kuwait

Table 6-1 shows the whole figure of the budget structure in Kuwait over several years. Kuwait has three budgets which are the general government budget of ministries and departments, budgets of public authorities which is attached budget, and budget of public enterprise which is independent budget. The attached budget was about 20 percent of total spending, and public enterprises are commercial and self-financing. The external revenue out of oil export occupies around three fourth of total revenues and the rest is from investment income. Current spending outlays has the pattern of growth by around 20 percent per year during 2003-2006.

Kuwait has a broad range of subsidy expenditures, which include the explicit one in the budget as well as the implicit one in off-budget. Around 40 percent of total revenue went to public saving, 20 percent to transfers and subsidies, 30 percent to other current expenditure, and 10 percent to capital expenditure. Off-budget is one of the most serious elements for transparent budget system. One typical example of off-budget subsidy is natural gas. Even on-budget, too generous subsidy policy has been popularly executed. One typical example of such too generous subsidy policies is the pension system, which provides that only 5 percent of earned income is given to the government as contribution, while 10 percent of it will be collected as payments for their retirement fund. Another example is the market price for electricity and water, which are too low that they cover only 10 and 20 percent of their production costs, respectively.⁴ Table 6-2 shows the detailed structure of subsidy in providing those public utilities.

1.3. Review of Policy Suggestions

There has been several documentations which suggested some national directions that Kuwait should pursue for the future. It might be worthwhile to review those recommendations and their characteristics.

1.3.1. Five-Year Development Plan (2001-2005)

The Five-Year Development Plan was created when Kuwait started to feel the dramatic changes in the world oil market due to the severe instability brought about by the financial crisis in most Asian countries. As the revenue from oil was expected to decrease, the government initiated reform in the public as well as the private sector. The reform direction was oriented

4. These estimates are calculated from current cost account under inefficient public enterprise. However, if this public enterprise is under competitive market, total cost might be less than the current one.

Table 6-1 | Public Revenues

Value /Million Dinar Kuwaiti

Period	Tax Revenues					Non Tax Revenues					Grand Total
	Taxes on Net Income and Profits ¹	Taxes and Duties on Property	Entry and Registration	Int' Trade & transactions	Total	Oil Revenues	Operating revenues of government	Sale of Government properties	Other	Total	
2000/2001 ²	11.3	2.2	0.9	58.6	73.0	4,528.0	222.1	1.7	140.7	4,892.5	4,965.5
2001/2002	17.9	5.7	1.1	85.8	110.5	4,525.0	329.0	0.6	371.4	5,226.0	5,336.5
2002/2003	26.4	7.9	1.6	100.6	136.5	5,498.5	346.2	26.2	211.6	6,082.5	6,219.0
2003/2004	29.2	10.5	1.9	146.6	188.2	6,149.9	385.2	37.2	175.6	6,747.9	6,936.1
2004/2005	53.3	11.0	1.5	166.6	232.4	8,170.5	396.4	59.7	103.4	8,730.0	8,962.4
2005/2006	58.4	10.4	2.3	176.0	247.1	12,955.5	411.3	23.0	91.3	13,481.1	13,728.2
2006/2006	48.9	13.6	1.8	190.4	254.7	14,544.3	449.0	18.8	242.4	15,254.5	15,509.2
2007/2008 ³	88.0	12.3	1.7	177.7	279.7	7,449.9	516.4	0.3	74	8,040.6	8,320.3

Source: Ministry of Finance-Closing Account

1. From Non-oil Companies.
2. The fiscal year 2000/2001 (from July 2000 to March 2001).
3. Approved budget

Table 6-2 | Structure of Subsidy

Year	Gallon 1000, Water				Hours / kilowatt, Electricity							
	Total Cost (dinars /gallon)	Subsidy Ratio(%)	Subsidy Value	Production Expenses (Kuwaiti Dinars)	Distribution Expenses (Kuwaiti Dinars)	Final Cost (Kuwaiti Dinars)	Total Cost (fils/ kilowatt)	Support Ratio(%)	Subsidy value	Production Expenses (Kuwaiti/ Dinars)	Distribution Expenses (Kuwaiti Dinars)	Final Cost (million Kuwaiti Dinars)
2001/2000	3.357	76	2.557	135,043,810	29,229,902	164,273,712	20.25	90	18.25	216,313,196	125,949,214	342,262,410
2002/2001	3.069	74	2.269	178,302,464	43,345,938	221,648,402	17.41	89	15.41	306,328,213	141,082,703	447,410,916
2003/2002	3.817	79	3.017	253,106,212	37,067,957	290,174,169	18.40	89	16.40	360,045,082	143,156,655	503,201,737
2003/2004	3.463	77	2.663	235,144,760	37,656,412	272,801,172	18.68	89	16.68	400,265,426	150,922,442	551,187,868
2004/2005	3.116	74	2.316	208,984,069	40,105,462	249,089,531	21.88	91	19.88	546,710,812	148,421,187	695,131,999
2005/2006	3.494	77	2.694	302,958,266	39,756,671	342,714,937	29.08	93	27.08	830,710,699	156,457,411	987,168,110
2006/2007	4.679	83	3.879	411,646,752	50,410,779	462,057,531	28.66	93	26.66	911,219,191	160,493,023	1,071,712,214

Subsidary value of water / fils = total cost - 800 fils (sale price of water)

Subsidary ratio = value Support / Total cost = output%

Subsidary value of electricity / fils = total cost - 2 fils (sale price of water)

Subsidary rate for electricity% = subsidy value /total cost %

toward enhancing the efficiency of the public sector, empowering the private sector, which is the engine of national economic growth, and diversifying revenue sources with various tax subjects. The specific policy directions were as follows: (1) rationalization and control of public expenditure growth rates with the aim of enhancing its productivity, and (2) development of non-oil revenues with the aim of consolidating and diversifying the sources of national income and rationalizing the use of public utilities and services.

This proposal seems to be the benchmark approach for reform direction in the world, which is the increase of private sector involvement in the development process and the limitation of the government's role as a facilitator of the private sector. However, when oil prices were stabilized, government revenues were increased dramatically, ending the necessity to execute the reform plan. Even though this suggestion is not politically feasible with the change in economic environment, this proposal still has much value to discuss the fundamental reform in the long run.

1.3.2. McKinsey Report

The McKinsey report emphasized the role of the private sector as the main engine of economic growth. It also discussed the various issues on the inefficiency of the public sector, including the bureaucracy, low prices in public utilities, and so on. However, it has put more focus on "overcoming the burden of red tape in the public sector." It states that the most serious aspect in the issue of public sector inefficiency is red tape, which creates more regulations hindering the active involvement of the private sector in economic activities. Thus this proposal emphasized the social cost due to the expansion of public sectors. However, this cost is only part of total social cost by the public sector.

1.3.3. IMF(2003)

IMF policy recommendation had focused on a performance-based budgeting system with several specific strategies. It included the establishment of a macro-fiscal unit, the clarification of budget coverage, budget classification to move towards the GFS (Government Financial Statistics), and the establishment of a three-year rolling budget framework.

IMF suggested specific strategies, including the execution process, to successfully achieve the budget reform. However, despite the recommendation's detailed suggestions, its implementation had not been started so far. Thus, the IMF should focus more on how to implement the budget reform rather than waste its time delving into discussions of policy directions.

1.3.4. World Bank(2008)

The policy report by World Bank, which is the most recent one, includes structural frameworks that connect the current issues of inefficiency of the Kuwaiti Government with policy directions. This budget reform shows a broad direction, which includes budget consolidation, the establishment of an international standard classification with GFS, a shift to program budget, and the creation of a new financial management information system. Most of these recommendations are reflective of IMF suggestions. It, however, lacks some serious considerations for implementation strategies.

2. Reform Direction in the Long Run

2.1. What is the fundamental problem?

The structural problem that the Kuwaiti economy currently faces can be explained by the classical issue in public economics, which is called “The Tragedy of the Commons.” Commons have been characterized by rivalry and nonexcludability, which has harmful consequences as expressed in the saying, “freedom in a commons brings ruin to all.” Thus the fundamental problem that the Kuwaiti society currently lies in the institutional environment, not in Kuwaiti people, as the behavior of people is determined by the institutions that the government adapts. Even though commons in Kuwait are not completely free, they have much lower prices than marginal costs. Consequently, this leads to the discrepancy between private cost and social cost, which implies that the level of consumption is much higher than the socially optimal.

2.2. Solutions

Textbooks in public economics give us a clear direction in solving the problem of the Tragedy of the Commons. It is through the allocation of property rights and the lowering of transaction costs that the government can address the issue effectively. Distribution of oil wealth through dividend payments might be one method for the allocation of property rights, as the World Bank also suggested.

As oil money is distributed among Kuwaiti people, publicly provided goods and services will no longer be free, and the government will start having revenue from the taxes imposed on the people. Thus the introduction of a tax system is essential with the allocation of property rights from the government to Kuwaiti people. When the people are required to pay for

government services, they are likely to be more concerned about the efficiency of the public sector, which will subsequently lead to a higher demand for its reform. Thus, it can be seen that this approach is designed to make benefits connect with tax burden for enhancing the efficiency of the public sector.

2.3. Feasibility

The allocation of property rights in addressing the Tragedy of the Commons might be a radical solution, which entails greater acceptance among the Kuwaiti people. Of course, this requires a more detailed mechanism on how to distribute oil income among the Kuwaiti people as the country has a serious problem in terms of income inequality. Thus, this radical but fundamental solution should be discussed further to obtain enough political support, requiring more strategy for practical implementation. However, this only points to the direction where the Kuwait government should go in the long run⁵.

3. Korean Experience

3.1. Korea's Past Reform Efforts and Their Limits⁶

Korea's economic development strategy was government-led, and public finance played a particularly critical role in government's efforts to achieve rapid economic growth during the 1970's.⁷ Public finance was mainly channeled toward building up key industries and developing social infrastructure. This period of state-led development was coordinated via a series of 5-year plans, which outlined the schedule, vision, and targets for national economic development. Linking planning and budget allowed Korea to successfully create a link between plans and resource allocations. The fiscal deficit averaged around 3 percent of GDP during this time and expenditure was contained thanks to the high economic growth rate⁸.

5. From this perspective, the Five-Year Development Plan (2001-2005) might be a valid reference to guide the reform direction, as this proposal was prepared when oil price was decreased.

6. The section that follows draws heavily on Dong Yeon Kim et al., *Paths toward Successful Introduction of Program Budgeting in Korea*, (Seoul: KIPF-WB, 2006).

7. The size of public expenditure expanded greatly to support government-led development. From 1972-1979 the growth rate of public expenditure averaged 33.4%.

8. Average nominal GDP growth was 32.1% and Korea was able to maintain a relatively sound basis for public finance. The ratio of public expenditure to GDP was maintained at around 20% during the 1970s.

The 1980s heralded a shift in policy from economic growth to economic stabilization. The government tightened fiscal policy in response to inflationary pressure and rising aggregate demand. During this period, monetary and fiscal policies were tightened, and the principle of expenditure within revenue or balanced budget principle, was adhered to as more emphasis came to be placed on economic stabilization⁹. Zero-based budgeting was introduced and spending was reprioritized. To support these efforts current and new projects were reviewed in the context of the zero-based budgeting principle by the Budget Review Committee, which was set up to make collective budget decisions in the budget office, to oversee the zero-based budgeting process and to change the budget decision-making process.

Continued economic growth liberalization and democratization in the 1990s led to new demands being placed on public resources. Despite strong demand, the Korean government successfully maintained expenditure within revenue, which greatly helped Korea's recovery from the financial crisis. After the 1997 crisis hit Korea, a large portion of public money was redirected toward stabilizing the financial system, countering unemployment, and expanding the social safety net. As a result the system saw the national deficit rise from 1.5% of GDP in 1997 to 4.2% of GDP in 1998, mainly due to the issuance of government bonds. The government recognized that Korea's vulnerability to the crisis stemmed from systemic weaknesses, which prompted it to introduce a series of major reform initiatives encompassing the labor, corporate, financial, and public sectors.

Key reforms to Public Financial Management (PFM) were introduced following the financial crisis as part of the public sector reforms. These included Preliminary Feasibility Studies for major projects, streamlining of public funds and incentives for expenditure savings. However, the PFM reforms introduced showed mixed results. This prompted the government to initiate a new round of reforms in 2003, which focused on some of the most critical and persistent shortfalls or weaknesses in Korea's PFM outlined as follows:

3.1.1. Short-term Perspective and Bottom-up Approach

In the pre-reform era, Korea's budget process operated on a short-term perspective (yearly) with a bottom-up approach. Revenues were calculated only for the upcoming year and expenditure was prepared based on anticipated revenues for only that year. These features tended to foster incrementalism and inappropriate incentives among line ministries. The budget's heavy focus on bottom-up approach afforded little encouragement for line ministries to limit their total spending or consider the bigger picture of how to match resources to policy objectives. Rather, line ministries generally sought to get as much of an increase in their

9. Korea went so far as to freeze budget spending for FY1984.

budgets as possible. For example, the rate of increase in budget proposals by line ministries in 2000, 2001, and 2002 was 33.2, 36.9, and 37.0 percent, respectively.

Moreover, the Ministry of Planning and Budget (MPB) reviews spending proposals for the majority of activities every year. Given that there are more than 6,000 items, conducting reviews of most activities proposed by line ministries takes an excessive amount of time and resources¹⁰. As such, there is insufficient time to conduct quality assessments that would allow for proper scrutiny of each activity. The reviews are then succeeded by laborious negotiations between line ministries and the MPB to agree on the budget proposal. The result is persistent incrementalism in the budget and little concentration on how policy objectives are being met through resource allocation.

To address these issues and to improve the linkage between national policy priorities and the budget, a Medium-term Fiscal Plan was developed in 1998. The plan included projections of fiscal aggregates and outlined priorities among 12 broad spending categories for the period 1999-2002. However, the plan provided estimates of the fiscal balance and government debt rather than explicit sectoral ceilings, lacked high-level government support, and was not formally linked to the annual budget. As a result, the plan has been little used in budget proposals and budget formulation. It has also failed to get the full support of line ministries and it has been generally viewed as an extra, unwelcome administrative task. The Medium-term Fiscal Plan has since undergone revision and been renamed the National Fiscal Management Plan (NFMP).

3.1.2. Weak Performance Management System (PMS)

The budget system in Korea paid little attention to performance management. The annual budget contained only financial data and gave inadequate consideration to results or progress in achieving policy objectives. To counter this trend, the Korean government launched a pilot project involving offices and bureaus in 16 ministries to try a PMS in 1999. Under the pilot project, the selected offices and bureaus had to prepare and submit performance plans, including policy objectives, strategies, and performance indicators. Ex post reports were compiled to detail results and align outputs and outcomes to policy objectives. The number of ministries involved in the pilot project expanded from 16 in 1999 to 28 in 2000.

However, several obstacles emerged from the pilot project such as choosing appropriate performance indicators, lack of discretion of line ministries to direct inputs toward achieving

10. According to the MPB's National Resource Allocation Improvement Plan, in 1994 each budget examiner was responsible for around 1 trillion won in the process of formulating the budget proposal but this has expanded to 4.6 trillion won by 2003

policy objectives, and confusion as to how the system was supposed to work and how the information would be used by the MPB in allocating future resources. Line ministries also voiced concerns over their ability to choose indicators that would be appropriate to measure overall performance and to measure performance in an objective manner. The project was generally regarded as being too ambitious and on review the government is looking to refine it by developing a longer-term approach, developing more appropriate performance indicators, increasing discretion of line ministries to foster a greater sense of ownership, and by enhancing accountability.

3.2. Korea's Current Reform Initiatives

In 2003, the new administration under President Roh Moo-Hyun initiated a series of public sector reforms. To oversee the reforms, the Presidential Committee on Government Innovation and Decentralization (PCGID) was set up as a government-civic advisory body reporting directly to the president. This is indicative of the importance the administration has attached to PFM reform¹¹. The MPB works in close consultation with the PCGID to drive forward the PFM reform agenda set out by the current administration. MPB is also the key driver of PFM reform for developing and introducing the Medium Term Expenditure Framework (MTEF).

3.2.1. National Fiscal Management Plan (NFMP)

The introduction of the NFMP is seen as the first step toward developing an MTEF in Korea. Although still in the early stages of being developed, the aim of the NFMP is to create a mid-term perspective for planning and managing public expenditure and to more closely align national policy priorities with resource allocation. It presents the country's national policy priorities and direction for the coming five years, up-dated annually on a rolling basis. This includes medium-term, macro-economic forecasting, and reviews social and economic factors relevant to Korea's fiscal stance, such as the debt ratio to GDP and total expenditure. The MPB provides guidelines to line ministries to develop medium-term project plans covering the coming five years. The plans include analyses of current projects, priorities, performance and future directions. The plans are submitted to the MPB, where they are reviewed and, along with macro-economic forecasts on revenue and economic perspectives, are used to compile the NFMP. The NFMP is then reviewed and approved by the Cabinet.

It is critical to link the NFMP and the budget. However, at this stage the NFMP and annual

11. The reform agenda was based on five pillars: a) fiscal decentralization, b) tax policy and administration reform, c) improvement in expenditure effectiveness, d) improvement in fiscal transparency, and e) upholding fiscal soundness.

budget are not fully integrated as the functional classification of the NFMP and annual budget are different, making any linkage between the two tenuous. The annual budget has 20 functions (Jang) and 66 sub-functions (Kwan) while the NFMP has 14 functions and 56 sub-functions. For example, the annual budget identifies Housing and Social Development, National Territory Preservation and Development, and Transportation and Communication classifications whereas in the NFMP all these fit under the category of Social Overhead Capital.

3.2.2. Top-down Budgeting

Top-down budgeting is one of the most important PFM reforms being introduced in Korea. The Korean government is focusing on enhancing resource allocation for strategic objectives but top-down budgeting also targets aggregate fiscal discipline and operational efficiency¹². A key reason for this focus is that Korea's budget decision making process depends heavily on incrementalism, making it difficult to reallocate resources. For example, expenditure on "economic affairs," the biggest item by function, has remained at relatively the same level between 1970 (27.4% of GDP) and 2000 (25.2% of GDP) even though the importance of spending for economic development has declined in that period. However, according to the MPB's plan, expenditure on economic affairs, will decline from 21.8 percent of GDP in 2004 to 19.2 percent by 2008 to reflect this declining priority. The top-down approach adopts a 5-year perspective corresponding with the NFMP. It also addresses concerns regarding future fiscal risks such as Korea's rapidly aging population and potential unification costs, which are threatening to undermine fiscal soundness.

The top-down approach adopted in Korea includes a medium-term perspective, two-stage budgetary decision-making process. To shift the approach to budgeting from bottom-up to top-down, the Government has introduced budget ceilings as a first step in developing the annual budget. This includes setting the budget aggregate, and sectoral and ministerial ceilings prior to budget formulation. Once the ceilings are set, line ministries formulate their budget proposals to fit within the ceilings. This is followed by consultations and review of the proposals by the MPB. Line ministries may consult with the MPB in formulating their proposals. The process of decision-making has been altered to shift existing trends in allocation and to minimize line ministries' self-interest in policy priority setting. Throughout the process, the MPB interacts closely with the President's Office and review of the budget is subject to cabinet scrutiny. Gaining cabinet approval and support further seeks to obtain high-level government support, to foster consensus, and to provide a mechanism to better link government's policy priorities with the annual budget.

12. This is based on three levels where the budget impacts: fiscal soundness, resource allocation and use based on strategic priorities, and efficiency and effectiveness of programs and service delivery.

Setting sectoral and ministerial ceilings aims to facilitate policy prioritization and improve resource allocations in the budget, and to promote more responsible budget proposals of line ministries. Within the ceilings, line ministries are given much more flexibility in deciding how to allocate resources to meet policy objectives. Whereas line ministries typically prepared budget proposals based on what they wanted, they are now required to match their proposals within pre-determined limits.

3.2.3. Performance Management System (PMS)

Based on the lessons of the original pilot project involving 16 ministries, the government made some adjustments to their plan for performance-oriented budgeting, and selected 22 line ministries to participate in the next trial starting in 2003. Under the revised plan, line ministries are required to set performance goals and indicators and prepare an annual performance plan, which is then submitted to the MPB before the annual budget cycle. This time the revised project excludes smaller budgetary activities as well as those for which the benefits of performance monitoring are expected to be small¹³. Programs from the general account, special accounts and 42 out of the 57 public funds are included in the new pilot scheme.

The pilot program was developed to proceed over a period of six years (2003-2008) to allow more time for the full effects of the program to be determined. 22 ministries were selected as lead ministries with the remaining ministries following with a lag period of one year between these two groups. This way, any weaknesses identified in the lead ministries, could be adjusted for and the changes could be implemented by the non-leading group.

3.2.4. Budgetary Basics

The Korean government is also seeking to strengthen budgetary basics, which include introducing accrual budgeting and accounting, double-entry accounting, Integrated Financial Management Information System (IFMIS), and program budgeting. The government set up the Budget and Accounting Reinvention Office (BARO) in 2004 to direct Program budgeting as an enabler of better resource allocating efforts. Accrual and double-entry accounting aim to enhance transparency of government accounts. They will further enable better forecasting of medium and long-term fiscal risks. Currently, BARO is evaluating government assets and liabilities in preparation of implementing the new accounting system as well as preparing guidelines for line ministries and establishing principles to guide the implementation of program budgeting in Korea.

13. For example, wages and salaries, and other general administrative expenses were excluded.

4. Fiscal Reform in Kuwait

Public expenditure is determined through the budget system, and reform of such system is necessary to enhance the efficiency of the public sector. Reform, however, is too much of an abstract concept so the government needs to create a specific strategy to realize its goals. First, it should determine the exact figures for public expenditures according to a systemized framework, addressing the issue of transparency in the public sector. Second, the government needs to make sure that goals are achieved through public expenditure on some specific government programs, which addresses the issue of inefficiency.

4.1. Transparency

4.1.1. Budget Scope

The government has an incentive in the management of public expenditures through the off-budget rather than the on-budget system, as it is much easier to expand in terms of size. The expenditure through off-budget, including public funds, the expenditure of public enterprises, etc, does not need to get the approval from national parliament and can be easily hidden from the public concern as those information are not disclosed to the public. The phenomenon of off-budget expenditure, which is also differently termed as “underground government,” is a typical behavior that has been systematically explained by public choice scholars.

The Kuwaiti government has huge amounts of public expenditure through the off-budget system, which comprises almost 50% of the total public expenditure. For example, much proportion of subsidies for health, education, and natural gas are likely to be categorized as off-budget expenditure. As long as off-budget expenditure continues to have a large portion in public expenditure, the government will not realize the seriousness of the problem in the public financial structure.

All spending under the off-budget system should be reviewed to evaluate their appropriateness and be reorganized so as to fall under the on-budget category. This is likely to be much easier to undertake as there is little conflict among stakeholders. This is the most urgent issue among all tasks needed, to accomplish the budget reform.

4.1.2. Consolidated Government Financial Structure

The budget structure should be consistent with international standards in order to easily

examine the efficiency and effectiveness of the budget system of each country. IMF recommended applying the Government Finance Statistics (GFS) framework for the evaluation of the budget system based on an economic perspective. Most countries under budget reform have adapted the GFS framework, as their final objective is to enhance the efficiency of public spending. Furthermore, the establishment of GFS is the necessary condition for the creation of a performance-based budget system.

All public spending should be reorganized into item-by-item budgets using the economic classification of the IMF. It might take a long time to rearrange all budget items on the program basis, but since there would not be any conflict among stakeholders, this will be relatively easy to execute.

The next step is to establish the government financial information management system. This is another challenging task as it also takes time to complete. However, the practical application of an efficient budget system, which means easy access to budget information, is one of the most important strategies in achieving an efficient budget system.

The current budget system based on cash is easy and practical to manage; this is the reason why cash accounting has been popularly used in the public sector. However, it is very difficult to measure the economic cost for each program because the performance of each program cannot be associated with economic costs. Accrual accounting, which has been popular in the private sector, is an ideal method to examine the real economic cost of a public program even though it may entail many technical difficulties for practical application.

4.2. Efficiency

4.2.1. Performance-based Budget

The success of public sector reform depends on the establishment of a connection between public expenditure and economic evaluation based on public sector performance. The current system of item budget cannot give any indication whether or not government spending is effective and efficient. Performance-based budget allocation is the only universally accepted method to enhance efficiency in the public sector as it does not have the market force to achieve such efficiency through competition. Its successful establishment requires much patience as the prerequisite tasks including extension of budget coverage and consolidating government finance system should be done before the execution of the performance-based budget system.

Even though the importance in budget reform is established, the practical implementation requires much time and effort. Such effort may include persuasion of anti-reform groups, in

particular, public officers. Therefore, the blueprint of this new system should be formulated in order to persuade the people and obtain sufficient political support for this policy direction. This is because the impact of introducing the performance-based budget system in the national economic structure is likely to be considered as radical.

4.2.2. Medium-term Budget Planning

Medium-term budget planning should be done for two reasons. One is that the efficient allocation of public expenditure needs more than a year to accomplish; in fact, most public programs require more than a year to complete. The other reason is to strengthen the role of macroeconomic policy with the use of a budget policy. The one year-based budget system tends to focus on allocating public expenditure in such a way that give constraints on revenue. Presently, Kuwait has a consensus on the proposal of a three-year rolling budget, which was recommended by most international institutions. Its implementation is relatively easy in terms of task process and political support.¹⁴

4.3. Administrative Organization

It has been commonly accepted that the national planning with priority setting should be put with the budget allocation. As all line ministries have incentives to increase the size of their spendings irrespective of national agenda, they should be effectively controlled by budget allocation with the consistency of national priority over public spendings. The practical implementation needs more concern on organization which is in charge of these two functions.

Currently, planning and budget allocation are being charged by different ministries which seem to have good relationships for harmonizing these two functions. However, when these ministries have some conflicts with each other, national planning will not steer public resources into appropriate sectors. It is suggested that one ministry should have the national planning as well as budget allocation functions together. To drive the tight connection between planning and budget allocation might bring about a stronger force.

4.4. Political Feasibility

The policy direction of budget reform had been suggested by the IMF several years ago, and it includes detailed technical assistance. However, its execution has not been started so far even

14. Currently, Kuwait has the five years plan, but with only one year rolling basis, which is different from medium-term planning with multiple rolling basis.

though several other policy recommendations basically had the same direction for reform. Now, the stage is set for the analysis on why it has not been executed and for the presentation of the detailed strategy for practical implementations, not reform direction itself. One of the most important element is how to deal with stakeholders' interests. Budget reform has two main stakeholders, public officers and the Kuwaiti people. Probably, public officers might be the most affected stakeholders when the reform takes place as their stakes will be reduced due to the enhanced efficiency of the public sector. Public officers are not only affected by the budget reform itself but also by the important actors that push the budget reform into reality. This is why budget reform takes so long to accomplish-the key actors to implement it are the stakeholders who will be negatively affected by it.

One way to make public officers voluntarily execute the budget reform is to give some economic incentives, depending upon the performance that each line ministry achieves. Of course, it is also necessary to give some sequential education to emphasize the necessity of the budget reform to public officers. However, the impact of this might be minor as compared to giving some economic incentives.

The biggest stakeholder of the budget reform is the Kuwaiti people. However, as long as they have a free government, they are not likely to have serious concerns on the budget reform, showcasing their rationally ignorant behavior. Political support for the budget reform from the people is expected to be difficult. One minor way is to educate people about the necessity of such reform for the security of their future, where there is a huge possibility that oil money would no longer produce enough government revenue.

4.5. Key Lessons from Korea's Reform

Government reform often fails because it is poorly implemented. The design may be sound, but if its purposes are not clearly understood, or if stakeholders view it as a threat or burden, reform will wither. To succeed, reformers must win over those who produce information, provide services, and manage bureaus and agencies. The fate of reform rests not in the hands of a small band of innovators who sit at the center of government, but in the hands of those who implement the reform. In modern times, reform must be consultative and participatory, taking account of the motives and incentives of those whose careers may be changed by new systems and procedures. These stakeholders have to be drawn into the reform process, they must understand its logic and aims, and they must comprehend why change is desirable. Reforming government is hard work for it requires both leadership and partnership, and thus people in charge must be determined to alter the machinery of the government, while being open to those who will be impacted by the changes. Some key lessons from the Korean PFM experiences include the following:

4.5.1. Program Budgeting as an Enabler of Better Resource Allocation

Program budgeting should be an enabler of better resource allocation, not just a technical change in the way the budget data are classified. Program budgeting in Korea has two principal aims: to base budget allocations on the purposes and objectives of the government; and to give line managers greater operating freedom by reducing the approximately 6,000 activities in the current budget structure to a more manageable number.

4.5.2. Policy Guidance through Top-down Budgeting

Top-down budgeting must be a process for giving policy guidance to ministries. The manner in which Korea's top-down budgeting has been launched has some problems. One problem is that the ceilings have not been sufficiently based on consultations within the government or on bilateral discussions with line ministries. A second problem is that the ceilings have been bereft of policy guidance. A third serious defect is that without linkage to an ongoing fiscal management process, the ceilings may be interpreted by spending units as floors, thereby generating upward pressure on future budgets. The initial round of ceilings appears to have stirred much confusion in spending units. Some of these problems derive from the way top-down budgeting has been implemented and some from the inevitable tension that comes from restructuring budget rules and relationships. Still, the goal of top-down budgeting lies in constraining the incessant rise in public spending as a share of GDP.

4.5.3. Linking the Annual Budget and Fiscal Management Plan

The relationship of the annual budget and the fiscal management plan in the MTEF should be clearly defined. Clearly, there are advantages in integrating budgeting and planning by putting the fiscal management plan on a rolling basis. This would have the effect of making the budget the first year of the plan; it would not be a separate decision process. A rolling plan would encourage the government to focus each year's budget decisions on policy changes, as measured against the baseline. While this approach would be a retreat from comprehensive planning, it might generate more policy changes than would support a process that purports to review all spending decisions every year. A rolling plan does require that the government maintain a baseline; otherwise, it would lack the capacity to project future budget impacts.

4.5.4. The Performance Management System (PMS)

The PMS should be deployed to sensitize politicians and managers to the results of public expenditure. The MPB is still pondering the design of PMS, and key decisions lie ahead. Some decisions relate to the types of indicators, but these are secondary to the larger question of how the new performance information will be used. The MPB seems undecided on two questions:

the extent to which performance information should be published; and whether this information should be formally linked to the budget. These issues have to be resolved before Korea can effectively launch the PMS.

4.5.5. Others

Perhaps one cannot overemphasize the importance of a central agency or ministry coordinating the reform activities, although Korea itself has not as yet been quite successful at that. Yet ensuring some managerial autonomy of the line ministries is necessary. The PMS (and other budget reforms) can succeed only if the managers are given substantial freedom in using resources and in operation of their ministries or agencies. All in all, the single most pressing task may be that of bringing human resource management within the ambit of reform; it would indeed be crucial not only to deepen the scope of reform and but also to expand the ranks of reformers.

1. Target

Kuwait spends a very large share of its oil revenues, with its public spending crowding out the private sector; however, it is not sustainable, especially since easy money leads to bad policies. In fact, Norway¹⁶ itself, the model country in terms of managing its oil revenues, learnt from its policy mistakes of the 1970s and 1980s, when the spending of its large oil revenues crowded out its manufacturing industry, developed a bubble economy, and as a result, faced wide fluctuations in domestic demand before the bubble burst in 1986 with the drop in oil prices. It established the Norwegian Government Petroleum Fund¹⁷ in 1990 so that all of Norway’s oil revenues go directly to the Fund in their entirety, while only the expected real return on the Fund can be phased into the Norwegian economy approximately in pace with non-oil budget deficit.

What Kuwait can and needs to do is to set up its own Government Petroleum Fund and transfer all the surplus oil revenues, which are substantial thanks to the current oil boom, to the Fund to be invested abroad (for exchange rate stability) as a long-term savings vehicle for the posterity, which would entail more predictable spending of oil revenues largely independent of current oil revenues. In order for the Fund to decouple government spending from oil revenue flows, it is important that only the expected returns on the Fund get phased into the government’s net cash flow. The Fund would also provide a nice investment competition with the Kuwait Investment Fund.

2. Implementation Mechanism

If the Norwegian model is followed, the Ministry of Finance (MOF) may take on the task of preparing the necessary legislation on the Government Petroleum Fund, taking the responsibility for the Fund management and defining the long-term investment strategy, and delegating the day-to-day operation of the Fund on its behalf to the Central Bank of Kuwait (CBK).

16. As of 2005, the hydrocarbon sector in Norway accounted for 25% of GDP, 33% of the total government revenue, 24% of the country’s total real investments and 52% of total exports.

17. The Fund was renamed the Government Pension Fund-Global in January 2006.

3. Institutional Requirement

For the task of day-to-day operation of the Norwegian Fund, the choice of the Central Bank of Norway (CBN) stemmed from: 1) the CBN's knowledge of the legislative set up and background for the Fund; 2) the close relationship between the fund mechanism and monetary policy; and 3) the CBN's experience in managing its exchange reserves. However, the CBN's Investment Management office manages the Fund, and although it reports to the CBN, it is strictly separated from and independent of the CBN's other activities.

Therefore, in setting up the Kuwaiti system for managing its own Government Petroleum Fund, it is critical to meet the following three ingredients for success: The first is professionalism, which calls for ensuring full use of the capabilities of the CBK, while building skills and capabilities of the MOF. It may also call for extensive use of external fund managers in case the CBK has little prior experience with managing such a fund. The second refers to accountability: a system of checks and balances to ensure accountability and a clear division of responsibilities between the MOF and the CBK. The third concerns transparency. To make the creation and maintenance of the Government Petroleum Fund acceptable to the Kuwaiti citizens requires the government to inform them on exactly how the money is invested and what the returns are.

4. Human Resource Requirement

People are what makes the difference, and once again, recruiting and maintaining an elite cadre of competent and dedicated officials would be critical to the success of this executive program in particular and the government's long-term development plan in general.

5. Budgetary Requirement

The budgetary requirement arises due to (1) the fixed cost to set up an operational arm for the Government Petroleum Fund and (2) remuneration for recruiting and maintaining an elite cadre of competent and dedicated officials who would be critical to the success of this executive program.

Other Focal Areas Of Policy Initiatives For The Upcoming Five-Year Development Plan

- 1_ Policy Initiatives for Privatization
- 2_ Policy Initiatives for the Foreign Direct Investment
- 3_ Promoting Public-Private Partnership(PPP) Programs
- 4_ Kuwait's Electric Power Sector: Changing the Pricing Scheme as the First Step towards Reform
- 5_ Policy Initiatives on the Health Care Sector

Other Focal Areas Of Policy Initiatives For The Upcoming Five-Year Development Plan

1. Policy Initiatives for Privatization

1.1. The General Privatization Law

1.1.1. Target

Establishing the general privatization law (the general rules for the privatization process) and applying it universally to all the to-be-privatized organizations.

1.1.2. Implementation Mechanism

If the privatization processes are individualized or different across the to-be-privatized organizations, the stakeholders at the to-be-privatized organizations are most likely to hold up as much as possible, so as to secure the most favorable conditions for themselves. This could cause long delays in the entire privatization processes in the whole economy, possibly making it increasingly politically non-viable to continue.

The labor protection issue shows this point clearly. Should the protection schemes (i.e. the compensation rules) be different across privatized organizations, labor unions (or employees) would resist as much as possible so as to secure the most favorable compensation out of their respective negotiation process. The employees at an already-privatized firm may also step out again asking for re-negotiation. Therefore, the protection scheme needs to be set as a privatization law or general rule and applied universally to all the affected organizations within

Kuwait.

The general privatization law should have several important elements to be applied universally to all the to-be-privatized organizations.

(1) Schemes for protecting the employees at the to-be-privatized organizations.

This will be discussed separately in the next initiative.

(2) If the to-be-privatized organizations were producing the goods or services which have impact on the welfare of the general public, the scheme for regulating the behaviors (e.g., prices or anti-competitive behaviors) of the privatized firm should be well designed before privatization. For instance, setting up an efficient and capable regulatory body is a prerequisite for privatizing the public providers of the communication services.

But, setting up several well-functioning sectoral regulators at the same time might be too costly for the Kuwaiti economy, since each sectoral regulator requires its own well-trained officials. In such a case, Kuwait might consider building up the general competition authority first.

(3) Fair procedures for evaluating the assets and liabilities of the to-be-privatized organizations.

(4) Fair procedures for choosing the concessionaire.

1.1.3. Requirements

(1) Legislation or Regulation

Legislation is necessary to have the general privatization law. The essential elements of the general privatization law are discussed above.

(2) Institution

The Privatization Council may be created to be in charge of all the matters relating to the general privatization law. Prime Minister shall chair the Privatization Council, and all the relevant Ministers in the Cabinet shall be ex-officio members of the Privatization Council. The important stakeholders in the private sector shall also be members of the Privatization Council.

(3) HR

The Privatization Council should be supported by an efficient and well-functioning Secretariat. The Secretariat should have a group of well-trained capable government

officials. For this, the training programs could be offered in groups and over a substantial period of time.

In building up a competition authority or sectoral regulators, training the government officials should be given the number one priority. In this regard, Kuwait could benchmark some countries which are regarded as exemplary. Kuwait may even consider creating a new overseas training program. For instance, OECD has been actively engaged in disseminating the know-how of implementing competition policy around the world. OECD has set up regional competition centers and been training the officials at the burgeoning competition authorities around the world. Currently the OECD regional competition centers have been set up in Korea and Hungary.

(4) Financial Requirements

Budget to cover the cost of setting up general competition authority or sectoral regulators.

Also budget to provide the training program for the officials at the general competition authority or the oral regulators.

1.2. The Establishment of “Privatization Fund” or “Kuwait Restructuring Fund” as a Way to Compensate for the Incumbent Workers at the to-be-Privatized Organizations

(The same initiative as this one is included in the initiatives for the labor market)

1.2.1. Target

The target lies in setting up of Kuwait Restructuring Fund or Privatization Fund as a way to compensate for the existing workers at the to-be-privatized organizations.

1.2.2. Implementation Mechanism

- First, the job security of all employees needs to be ensured at least for some years. For example, the newly privatized firm needs to commit itself to keeping all employees from the existing firm.
- Second, after privatization, all employees will be guaranteed their jobs for a certain period of time (e.g., 5 years). If downsizing is unavoidable, some workers may be temporarily laid-off. But they will be laid-off for a finite period of time (e.g. up to 5 years) and guaranteed a substantially high unemployment benefit (say, 80~90% of the last salary) during the lay-off period.
- Third, if a permanent downsizing is inevitable after a certain period, then the firm may

recourse to the income security plan. One plausible compensation scheme is the “early-retirement bonus.” The amount of bonus may vary depending on the employee’s salary level and length of service. The retiree may have an option to choose between a “lump-sum bonus” and “retirement-pension for a certain period” (e.g. up to whichever time is earlier between “5 years after” and “by the time of being reemployed”). Stock-options may be an additional, useful form of exit compensation.

- Fourth, the government needs to set up special funds to finance all of the above types of labor protection measures. Specifically, construct a public fund, entitled for instance, “Kuwait Restructuring Fund” (KRF) or “Privatization Fund” (PF). Unemployment benefits for the laid-off and the bonus for the early retiree may be borne by both PF and “privatized firms,” in order to prevent the moral hazard of “casual downsizing” by privatized firms. In order to institutionalize the burden by privatized firms, the government may better obligate the privatized firms to establish a ‘private fund’, the cost of which will be shared by employer and employees. The private fund will then function as a kind of “Private Unemployment Insurance,” designed to protect the employees from the prospective risk of being laid-off or leaving early.

1.2.3. Requirements

(1) Legislation or Regulation

- The above protection scheme needs to be set as a privatization law or general rule and applied universally to all affected firms within Kuwait. Should the protection schemes (i.e. the compensation rules) be individualized or different across privatized firms, labor unions (or employees) would resist or hold up as much as possible so as to secure the most favorable compensation out of their respective negotiation process. The employees at an already-privatized firm may also step out again asking for re-negotiation. This could cause long delays in the entire privatization process, possibly making it increasingly politically non-viable to continue in the worst case scenario.
- Legislation may be necessary to create the Privatization Fund as well as to the private funds to be established by the privatized firms.

(2) Institutional Requirement

- Kuwait has a central institute in charge of national HRD, namely Manpower and Government Restructuring Program (MGRP). However, MGRP does not seem to be fully established yet, with its mission and main activities limited in scope and the organization as a whole less than fully empowered. The role of MGRP may be expanded and reconfigured to take on the task of implementing this executive program, in conjunction with the Civil Service Commission.

(3) HR

- No separate or particular HR measure may be necessary.

(4) Financial Requirements

- Unemployment benefit for the temporarily laid-off : the targeted number of employees x 5 years x the unemployment benefit (=80% of the last salary)
- Early retirement bonus: Last Salary x 0.5 x the remaining number of years on tenure

1.3. Prioritizing the Areas or Targets of Privatization

1.3.1. Target

The areas or targets of privatization need to be prioritized in order to make the whole privatization processes in the Kuwaiti economy successful. The small success stories are a prerequisite for the full-scale privatization efforts in the later stage.

1.3.2. Implementation Mechanism

Establish standards in prioritizing the targets of privatization. Below some key guiding principles are suggested as a starting point. In the implementation stage, those guiding principles should be refined further to reflect the reality.

If the to-be-privatized organizations do not have many Kuwaiti employees and play an important role in providing economic infrastructure, they should have high priorities as the target of privatization. For those organizations, the political resistance from the Kuwaiti employees will be much less. Furthermore, the success stories from those privatization examples (e.g., improving the quality of services) will strengthen the case for privatization in general. Airport service is a good example of this category. One could think of several other examples in this category (e.g., port facilities).

If the Kuwaiti government aims to privatize communications services (e.g., telephone services or internet based services), a well-functioning regulator should be built up alongside with the privatization process.

Next, the various public firms at the downstream levels of oil production (e.g., petrochemicals) could be the targets of privatization. Since they do not provide public utilities, the complexities involved with privatization should be much less.

In the case of the electricity industry, although it would be desirable to introduce a merit-

order system to improve the efficiency of power generation and desalination, vertical separation and entry by private-sector players should be considered only after the current tariff structure has been replaced by a new scheme based more firmly on economic principles.

Where privatization encounters political opposition, Private Participation in Infrastructure (or Public Private Partnership, PPP) could be an effective alternative.

Kuwait aims to become a regional financial and trading center. To provide an adequate infrastructure for it, the main facilities concerned would include economic infrastructure (port facilities, airport facilities, highways, urban transport system, and others) and social infrastructure (health, education, and others). To promote private sector participation and to minimize public user resistance in these areas, providing a wide range of PPP schemes is necessary.

First, introduce BLT scheme or the UK Private Finance Initiative (PFI). Under the BLT, the investment made by private sector is returned from lease fee paid by the government. Therefore, where it is difficult to levy user fees or fully recover the investment cost from only levying the fees, BLT is more suitable to the project. For instance, social infrastructure would be a case in point, where user fees are not charged (for example, construction of schools, hospitals, etc.). Also, in comparison to BOT, BLT, which is recognized as more of a low-risk, low-return scheme, is more investment friendly at the initial stage of PPP.

Second, more detailed programs such as “shadow tolls” should be crafted in the BOT scheme. The concept of shadow tolls was first introduced by the UK Conservative government in 1993 and is currently in operation on some roads in the UK and the United States. Shadow tolls are payments made by the government to the private sector operator of a road based on the number of vehicles using the road and the road’s availability. These tolls are usually applied when real tolls are unacceptable given the political economic situation.

For more details, see the initiatives for the PPP.

1.3.3. Requirements

In general, legislation is not necessary once the general privatization law is established. In some cases, however, the legislation is necessary to set up the regulators for the public utility services.

2. Policy Initiatives for the Foreign Direct Investment (FDI)

2.1. Establishing A Target-Oriented FDI System

2.1.1. Target

- The target lies in establishing a target-oriented FDI system in order to attract FDI in the most beneficial way to the Kuwaiti economic development.

2.1.2. Implementation Mechanism

- Among others, the target areas or sectors of FDI should be identified. Those target areas are the ones where foreign expertise or knowledge can benefit the Kuwaiti economy the most. Knowledge spillover effect is also an important factor in identifying the target areas of FDI. The foreign expertise or knowledge in those target sectors cannot be purchased by money. Some foreign experts could be brought into Kuwait individually, but the effect will be very limited.
- Attracting world-renowned universities into Kuwait could be one example of the target oriented FDI. The Kuwaiti government could try to attract the world's best-in-class performers in fields that are most relevant for Kuwait's long-term development vision (e.g., Stanford University in engineering, University of Pennsylvania in finance). For selective attraction of foreign universities, benchmark Singapore's WCCP (World Class Campus Program). For more detail, see the initiative on the education development (1.3. Attract and Strengthen Ties with World-Renowned Universities). Special allowances such as free-of-charge land access, tax benefits, or even in-kind or cash grants needs to be considered to make Kuwait an attractive place for the prospective foreign educational institutes.
- Attracting world-renowned specialty medical hospitals (and their research centers) could be another example of target oriented FDI.
- For target oriented FDI, benchmark the Ireland's FDI system. Ireland identified the target areas of FDI in areas such as knowledge-intensive areas or high value-added areas such as information communications technology, medical technology, pharmaceuticals, R&D centers, etc. Then, Ireland actively searched for the potential foreign firms which could benefit the Irish economy and attracted them into Ireland by the systematic and efficient government efforts.

2.1.3. Requirements

(1) Legislation or Regulation

- The current FDI law needs to be rewritten as a target-oriented FDI law. In this regard, Ireland's target-oriented FDI system could provide a useful benchmark.
- Industrial Development Act in Ireland identifies the target areas of FDI and specifies the incentive system for FDI firms.
- The target areas of FDI in Ireland are as follows: Pharmaceuticals, Information Communications Technology, Medical Technologies, International Financial Services, Engineering, International Services, Consumer Products, Chemicals, Biometrics
- The incentive system in Ireland's Industrial Development Act is as follows.

Box: The Ireland's Industrial Development Act

(a) Section 21 (Capital Grant)

- (1) The Authority may make a grant, on such terms and conditions as it thinks proper, towards the cost of fixed assets of or for an industrial undertaking to which this section applies.
- (2) The amount of a grant under subsection (1) shall not exceed 60 percent of the cost of the fixed assets in the case of an industrial undertaking in a designated area or 45 percent of the cost of the fixed assets in the case of an industrial undertaking elsewhere than in a designated area.
- (3) This section applies to an industrial undertaking in respect of which the Authority is satisfied that it?
 - a. will produce products for sale primarily on world markets, in particular those products which will result in the development or utilisation of local materials, agricultural products or other natural resources; or
 - b. will produce products of an advanced technological nature for supply to internationally trading or skilled sub-supply firms within the State; or
 - c. will produce products for sectors of the Irish market which are subject to international competition; or
 - d. is a service industry as specified by the Minister by order under section 3.
- (4) The industrial undertaking shall also satisfy the Authority that?
 - a. financial assistance is necessary to ensure the establishment or development of the undertaking;
 - b. the investment proposed is commercially viable;
 - c. it has an adequate equity base;
 - d. it has prepared a suitable company development plan; and
 - e. it will provide new employment or maintain employment in the State that would not be maintained without assistance given under this Act and increase output and value added

within the economy.

(5)

- a. The Authority may, in the case of small industrial undertakings as defined from time to time by the Minister, make a grant on such terms and conditions as it thinks proper in respect of any additional person employed in such an undertaking.
- b. A grant under this subsection shall be subject to such financial limits and such other terms and conditions as may from time to time be specified in a scheme governing the making of such grants sanctioned by the Minister with the concurrence of the Minister for Finance.
- c. A grant under this subsection shall not be reckoned in the calculation of the maximum grants payable to the undertaking concerned for the purposes of subsection (2) and section 33.

(b) Section 29 (Employment Grant)

- (1) The Authority may make a grant on such terms and conditions as it thinks proper in respect of a person employed in an industrial undertaking which conforms to the criteria set out in subsections (3) and (4) of section 21.
- (2) Without the prior permission of the Government, the total amount of money granted to a particular undertaking under this section shall not exceed in the aggregate the higher of?
 - a. €5,000,000, or
 - b. €5,000,000 in excess of the aggregate amount of such expenditure for which the prior permission of the Government has previously been obtained.”.

(c) Section 31 (Research Grant)

- (1) Following consultation with such bodies as may be specified by the Minister from time to time, the Authority may make a grant (in this section referred to as a research grant), subject to subsection (5), on such terms and conditions as it thinks proper towards the cost of research and development to which this section applies.
- (2) This section applies to research and development which?
 - a. has as its primary object the promotion or development of new or improved industrial processes, methods or products, and, in particular, such processes, methods or products as are likely either to involve the use or development of local materials, agricultural products or other natural resources or to offer prospects of expansion in existing industry, promotion of new industry or to increase industrial employment or to enhance the viability, competitiveness or strategic importance of existing industry in the State, and
 - b. is carried out wholly or mainly in the State and wholly or mainly sponsored by one or more than one industrial undertaking in the State.
- (3) For the purpose of a research grant the Authority may consult such adviser, consultant, institute or other organisation or person as it considers proper.
- (4)
 - a. Subject to paragraph (b), the amount of a research grant shall not exceed 50 per cent of the

approved costs of the research and development concerned or €2,500,000 whichever is the smaller sum.

- b. The amount of a research grant may, with the approval of the Government in a particular case, exceed €2,500,000 by such sum as the Government shall in that case specify, provided that the percentage limit specified in paragraph (a) is not exceeded.
- c. In this section ‘approved costs’ means in relation to a particular research grant, such expenditure by the industrial undertaking or undertakings concerned as the Authority is satisfied has been or will be incurred for the purpose of promoting the research and development concerned and has been or will be expended on?
 - i. the provision of sites or premises (including the acquisition of land), the construction and adaptation of buildings, and the provision of services and other works;
 - ii. the provision of plant, machinery, equipment and materials;
 - iii. the payment of fees or other remuneration to technical advisers consulted in connection with the research and development;
 - iv. the salaries and wages paid to and the travel and subsistence expenses of persons engaged on the research and development or in identifying product or process development prospects within the industrial undertaking; and
 - v. overhead charges associated with the research and development concerned.
- (5) The Authority may, in the case of small industrial undertakings as defined from time to time by the Minister, make payment of up to one-third of a research grant prior to the approved costs being incurred on condition that the amount so paid shall be repaid to the Authority if the research or development project concerned has not been carried out to the satisfaction of the Authority.
- (6) The Authority shall not make a payment under subsection (5) unless it is satisfied that the industrial undertaking has available to it sufficient assets to cover its liability under that subsection.
- (7) The Authority shall not, without the prior permission of the Government, give in respect of a particular industrial undertaking, research grants exceeding in the aggregate the higher of?
 - a. €2,500,000; or
 - b. €2,500,000 in excess of the aggregate amount of research grants for which the permission of the Government has previously been obtained by the Authority.”.

(d) Section 28 (Training Grant)

- (1) Following consultation with An Comhairle Oili-na, the Authority may make a grant (in this section referred to as a training grant), on such terms and conditions as it thinks proper, for the training (either in the State or elsewhere) of persons in the processes of an industrial undertaking, if the undertaking conforms to the criteria set out in subsections (3) and (4) of section 21 and the training so provided will assist the undertaking to achieve the objectives of the said subsection (3).
- (2) A training grant may be made for the training of persons for positions of supervision or management in an industrial undertaking or for the engagement of instructors, technical

advisers or consultants to train (or assist in the training of) persons for such positions.

- (3) The amount of training grants made in respect of a particular industrial undertaking shall not exceed the sum of the amount of wages or salaries paid by the undertaking during the period of training to the persons being trained, the amount of expenses paid to those persons by the undertaking for travel and subsistence and the amount paid by the undertaking in respect of fees (including fees and remuneration of instructors, advisers and consultants) and similar expenses connected with the training.
- (4) The Authority shall not, without the prior permission of the Government, give in respect of a particular industrial undertaking training grants exceeding in the aggregate £2,000,000.

(2) Institutional, Human resource, and Budgetary Requirement

See the next initiative for the details (empowering the government agency whose mission is to attract world-class foreign firms in the target areas of FDI).

2.1.4. Empowering the Government Agency whose Mission is to Attract World-Class Foreign Firms in the Target Areas of FDI

To implement the target-oriented FDI system, a strong government agency with an elite cadre of officials should take the lead.

Kuwait should consider creating (or upgrading substantially the current Kuwait Foreign Investment Bureau into) a special, high-powered government agency whose mission is to attract the world-class foreign firms in the target areas of FDI. For this purpose, Ireland's Industrial Development Agency could provide a useful benchmark to start with.

In Ireland, Industrial Development Agency (IDA) was created in 1993 according to the revised Industrial Development Act. The IDA is a strong government agency in Ireland in charge of attracting foreign firms. The IDA identifies the potential group of foreign firms, supports them through various target-oriented incentives, are in charge of developing and operating the industrial clusters, and takes care of all the matters relating to the ex-post management of the FDI firms. The IDA has a high degree of autonomy in deciding its budgetary and human resource requirements. The IDA is regarded as successful in accomplishing the mission of the target-oriented FDI in Ireland.

< Requirements >

(1) Legislation or Regulation

Legislation is needed to create a special, high-powered government agency whose mission is to attract world-class foreign firms in the target areas of FDI. Instead of creating a new agency, upgrading substantially the current Kuwait Foreign Investment Bureau may also be considered.

(2) Institution

The leadership for the target-oriented FDI system must come from the highest level. Then under the leadership a strong government agency responsible for the attraction of target-oriented FDI should take the lead in collaboration with other economic ministries. As mentioned above, Kuwait must consider creating (or upgrading substantially the current Kuwait Foreign Investment Bureau into) a special, high-powered government agency whose mission is to attract the world-class foreign firms in the target areas of FDI.

(3) HR

The elite cadre of officials at the FDI agency is a critical precondition for the successful implementation of the target-oriented FDI policy. The elite cadre of officials should have a good command of English and a good understanding of world market. Kuwait may consider creating a new overseas training program (at the Ireland's Industrial Development Agency) for the elite cadre of officials at the FDI agency. The training programs could be offered in groups and over a substantial period of time.

(4) Financial Requirements

Budget to cover the remuneration and training cost for the elite cadre of officials at the FDI agency.

3. Promoting Public-Private Partnership (PPP) Programs

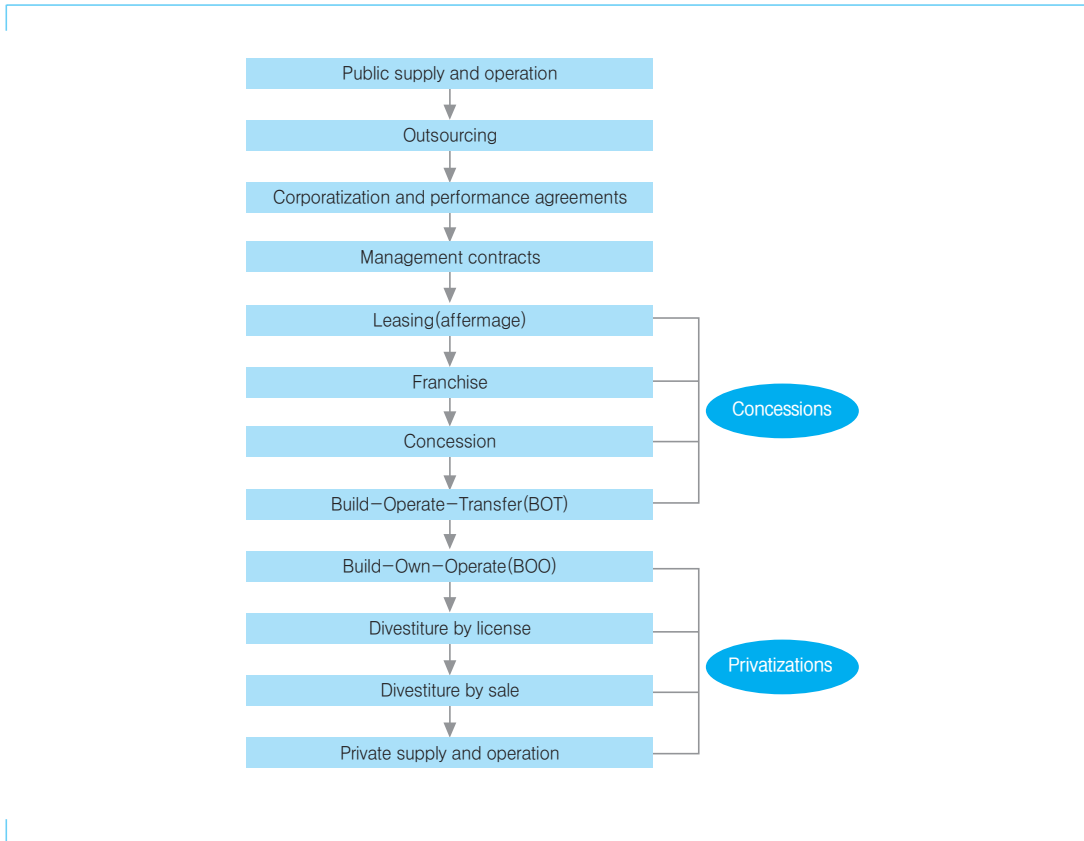
3.1. Target

This executive program proposes to make some key legislative, regulatory and institutional changes to better promote PPP programs of Kuwait. PPP programs play a key role in the development of private sector-led economy through increased private sector participation and market discipline in the Kuwaiti economy. It would contribute to transform the Kuwaiti economy into a more competitive, dynamic and sustainable one.

Developed over the last two decades, PPP programs towards increased private sector participation and market discipline have become a general trend in the world. PPP is a term used internationally with a wide variety of meanings, ranging from outsourcing to privatization. Basically, privatization is a means of a radical and irreversible change in the way of economic structure whereas PPPs based on risk-sharing mechanism are one of options of public procurement. Therefore privatization is distinguished from PPP in terms of public ownership and public accountabilities remaining. To make private sector lead the economy ultimately,

privatization would be best if it works. However, introducing PPP programs is more desirable in dealing with the problem of resistance arising from the current employees’ fear of losing their jobs in the process of privatization. PPP programs do not reduce the size of the current labor force or public sector activities, but just contains them.

Figure 7-1 | Types of Private Participation in Infrastructure



Thus, in a nutshell, the program’s objectives are:

- (1) Increase private sector participation and market discipline in the Kuwaiti economy.
- (2) Enhance high efficiency or quality of services and bring competitiveness and fair competition in the market as a consequence of liberalization and deregulation of related sector policies.
- (3) Contribute to the development of financial markets.

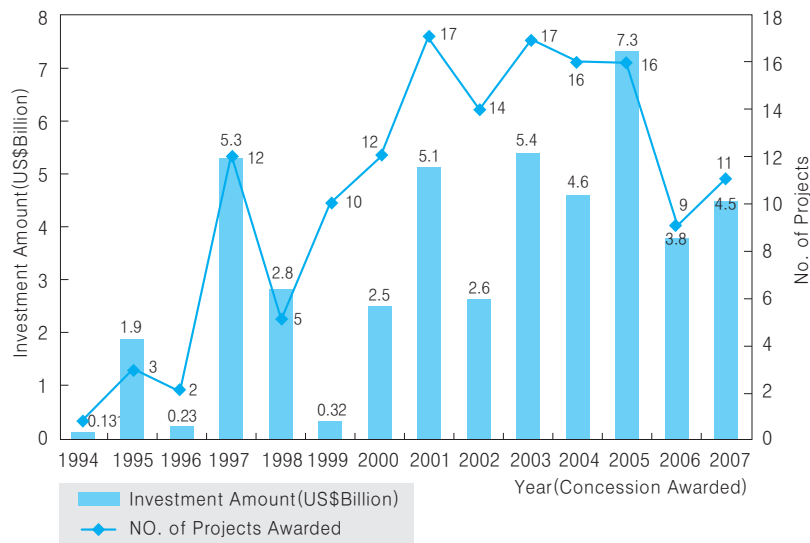
Korean Experience: Performance

Main sources of funding for Korea’s infrastructure investment included: taxation, designated funds (special accounts), public pension funds, and private funds. Recently, public financing of

infrastructure projects has been progressively replaced by private investments.

Efforts to develop private investments in infrastructure were initiated in the early 1990s. In 1994, the Private Capital Inducement Promotion Act was enacted to promote private participation in public investment. As of December 2007, out of 176 projects, 145 concessions at both central and local government levels have been awarded of which 75 (17 central, 58 local) have completed construction and are in operation, and the others are under construction, preparing to begin construction, or under negotiation. Local and central governments have been increasingly involved in developing PPP projects. These projects involved major urban infrastructures such as bridges, expressways, tunnels, and water treatment plants. This has involved a total investment of about USD 60.3 billion, predominantly funded in local capital and commercial bank markets, with only a few projects tapping the international capital markets.

Figure 7-2 | Number of PPP Projects Approved



Source: PIMAC (Dec. 2007)

Bank financing of PPP projects increased tremendously. Bank financing of PPP projects reached a total of KRW 20 trillion in 2002 compared to KRW 2.5 trillion in 1995 when the first PPP legislation was enacted. But most bank financing went to projects supported by the central government whereas the number of projects promoted by local governments has remained predominant.

The amount of private sector participation in infrastructure investment compared to government budget amount has been increasing. The ratio of private investment over government investment recorded 3.9% in 1998, 6.6% in 2000, 9.8% in 2004 and 17.4% in 2006.

Table 7-1 | Ratio of Private Infrastructure Investment over Public Investment (unit: billion USD, %)

	1998	2000	2001 ¹⁾	2002	2003	2004	2005	2006 ²⁾
Private Infrastructure Investment (A)	0.5	1.0	0.6	1.2	1.2	1.7	2.6	3.2
Public Infrastructure Investment (B) ³⁾	12.7	15.2	16.0	16.0	18.4	17.4	18.3	18.4
(A)/(B) (%)	3.9	6.6	3.4	7.5	6.6	9.8	14.2	17.4

Note: 1) In 2001, the figure decreased temporarily due to the completion of New Airport Highway.

2) Tentative.

3) Investment amount input by central government.

3.2. Implementation Mechanisms

3.2.1. Prioritizing Target Facilities

Kuwait's past PPP experiences are characterized by land based BOT projects which could not be much successful both in light of equity and efficiency. Prioritizing target facilities is critical to the success of PPP programs through effective allocation of resources and efforts. Kuwait is seeking to become a regional financial and trading center. To provide an adequate infrastructure for it, main facilities concerned would include economic infrastructure (port, airport facilities, urban transport system, water, waste treatment) and social infrastructure (health, education and other). Attracting FDI may be a way to induce high technology facilities. In the case of Korea, the government prepares the list of priority PPP projects through a ten-year PPP plan.

3.2.2. Diversify the PPP Scheme or System

According to new BOT Law, BOT system, BAOT system or any other similar system is mentioned for the PPP system. In fact, to promote private sector participation and to minimize public user resistance is to provide a wide range of PPP schemes. First, introduce the BLT scheme or the UK Private Finance Initiative (PFI). Under the BLT, the investment made by private sector is returned from lease fee paid by government. Therefore BLT is more suitable to the project, where it is difficult to levy user fees or fully recover the investment cost from only levying the fees. For instance, social infrastructure would be a case in point, where user fee is not charged (for example, construction of schools, hospitals, apartment, etc.). Also, in

comparison to BOT, BLT, which is recognized as more of a low-risk, low-return scheme, is more investment friendly at the initial stage of PPP. Second, more detailed programs such as “shadow tolls” should be crafted in the BOT scheme. Shadow tolls may apply when real tolls are unacceptable given the political economic situation. Shadow tolls are payments made by government to the private sector operator of a road based on the number of vehicles using the road and the road’s availability. First proposed in the UK by the Conservative government in 1993, they are currently in operation on some roads in the UK and the United States.

Korean Experience: BTL Scheme

In 2005, the Korean government announced to introduce a new scheme for PPP project implementation, that is Build-Transfer-Lease scheme or BTL. Under this scheme, the private concessionaire makes an investment in constructing social infrastructure facility, which is transferred to the government for ownership upon construction completion. The government grants the right to management and operation back to the concessionaire, and the concessionaire leases the facility for an agreed period of time and gets return on investment from the lease rent.

In BTL scheme, facility lease term is defined as 10 to 30 years. The project rate of return is determined by the market rate based on a 5-year maturity government bond interest rate plus alpha ($+\alpha$) for each project. The value α is supposed to reflect long-term premium, risks involved in individual facility construction and operations, etc. BTL private investors establish special purpose companies (SPCs) that take charge in design, financing, construction, and operation (or maintenance and repair). The investor composition for SPCs would mostly be financial investors, construction companies, operating companies, etc.

In March 2005, the MOSF announced a three-year plan of BTL investment, including investment scope of KRW 23 trillion in 2005-2007. The government induces participation from regional small and medium-sized construction companies through guarantees by providing preferential treatment on the equity ratio of regional construction companies at the time the proposal is evaluated, or providing a credit guarantee on borrowing construction funds for regional construction companies.

3.3. Requirements

3.3.1. Legislation or Regulation

Major progress for improving transparency and setting up regulatory and institutional framework has been done through amendment of the Law Decree no. (8) of 1988. It includes 1) setting up general rules and regulatory framework for the projects and initiatives, 2) envisaging the principles of equity, transparency and equal opportunity among investors, 3) introducing

competition to selection procedure and 4) establishment of a Higher Committee and a Technical Body.

However, more reforms are needed to encourage the private sector to participate in the development of projects as follows:

(1) Restriction of ownership on the project company should be lifted or eased to attract more private, if especially foreign, companies to participate.

Article (5) of new law has governed the mechanism for erecting a Kuwaiti Public Shareholding Company for projects the total estimated value exceeded 60 million Kuwaiti Dinars. 40% of shareholdings shall be offered in a public auction among the listed companies in the Kuwait Stock Exchange as well as other companies whose participation shall be approved by the Higher Committee, and 10% to be allocated to the originator of the expectable initiative under certain conditions provided for in this article, as well as allocating fifty percent for public subscription by Kuwaiti citizens.

(2) Introduce VFM Test

It is found in many countries where PPPs are confronted with genuine concerns by many stakeholders. Therefore it will be better to clarify the benefit of PPP in advance and to communicate with stakeholders to get impetus to implement PPPs successfully. As a way of verifying PPP as a right procurement method in addition to investment decision, VFM Test is useful tool.

[Korean Practice: Value for Money Test](#)

The feasibility of every project needs to be reviewed and screened through the value for money (VFM) test since 2005. Very recently, the Public and Private Infrastructure Investment Management Agency (PIMAC) at the Korea Development Institute (KDI) published a manual for guiding the test. The VFM test is divided into three phases as follows. At the first phase, main point of the test is to answer the question “Decision to Invest.” The point is to confirm whether or not a project is worth the social benefit. When the project in review has gone through a feasibility study at the time of implementation as publicly-financed project, the same study will be conducted even if it would be a PPP project. When the project in review has not gone through a feasibility study but rather has been determined of its feasibility based on the judgment of the relevant ministry, the same level of consideration is accepted in place of a feasibility study. Projects that are deemed feasible to implement by PPPs are carried on to the next phase.

Main point of the second phase is to answer the question “Decision to Implement by PPP.” VFM review is carried out in order to determine whether a project is suitable to be implemented by private finance initiative (PFI) after comparing with the public sector comparator (PSC). The

suitability of a project to implement by PPP is determined after analyzing the results of qualitative VFM and quantitative VFM evaluations. The quantitative VFM compares the life-cycle costs of PSC and the case when implemented by PFI. The qualitative VFM compares the level of service quality. When the project in review is deemed suitable to be implemented by PPP, it is then carried over to the third phase.

In the third phase, an alternative PPP implementation is searched and presented. Projects that are deemed suitable to be implemented by PPP are carried through additional financial analysis to calculate expected amount of government subsidy (compensatory portion for construction costs and operation costs). The subsidy amount serves as an important guideline in the evaluation process for selecting potential concessionaire and in the negotiations.

3.3.2. Institutional Requirement

The success of PPP Programs largely depends on strong enabling institutional framework and improving the performance of institutes surrounding PPPs. Institutional framework has been successfully formulated by amendment of Law.

According to new Law, Article (11) stipulates the formation of a Higher Committee under the Minister of Finance and its roles setting general policies for the projects and initiatives of strategic and development importance for the national economy as well as specifying the project competent public authority and finally approving on the termination or cancellation of the contract. Also, Article (12) provides for the formation and jurisdictions of the competent technical body which will assist the Higher Committee.

However, the implementation level framework should be clearly formulated and disseminated to stakeholders. Some measures include:

(1) To complement the legal framework of PPP, provide detailed policy directions and practical guidelines to clarify the “rules of game”.

[Korean Experience: Practical Guidelines on Annual PPP Plan](#)

The PPP Act directs the MOSF and PIMAC to issue an Annual PPP Plan that provides detailed and practical guidelines for implementing PPP projects.

MOSF announces Annual Plan including:

- The yearly focus of PPP policy
- Details in PPP project implementation procedures
- Financing and re-financing guidelines
- Risk allocation/ Minimum revenue guarantee

- Payment of government subsidy
- Documentation direction

PIMAC has developed PPP Guidelines to deliver transparency and objectivity in PPP project implementation.

- Guidelines for VFM test
- Guidelines for RFP preparation
- Standard output specification by facility (school, military housing, integrated school facility)
- Guidelines for tender evaluation
- Standard PPP concession agreements
- Guidelines for BTL project management

(2) Lay out and present the detailed procedure and process.

[Korean case: Implementation Procedures of PPP Projects](#)

The competent authority, the Ministry of Land, Transport and Maritime Affairs (MLTM) in the case of transport infrastructure project, undertakes the initial development of the project. The MLTM is responsible for conducting the feasibility study and VFM test, formulating the invitation for proposal (IFP), evaluating the proposal, designating the potential concessionaire, approval of the engineering plan, and confirmation of project completion. Upon request, PIMAC shall provide a technical assistance for the MLTM in executing feasibility study, formulating the IFP, evaluating the proposal, and the negotiations.

The Ministry of Strategy and Finance (MOSF) can request relevant data and information from competent authorities and related private concessionaires in order to be aware of the status of the PPP projects. Every competent authority shall submit to the MOSF a quarterly status report of the current PPP implementation contents. The MOSF Minister can organize and chair an advisory group committee called the PPP Project Committee. The Committee will review the following: major policies for PPP program, establishment and modification of the Annual PPP Plan, designation and cancellation of a solicited project, designation of a private concessionaire, and other matters which the Minister of Strategy and Finance proposes for promoting PPP projects.

Figure 7-3 | PPP Project Implementation Procedure for Solicited Projects

Implementation Process	Details	Acting Body
Formulate Annual Investment Plan		Competent authority
Select Project	<ul style="list-style-type: none"> • Designate appropriate project size or bundling individual projects 	Competent authority
Preliminary feasibility study	<ul style="list-style-type: none"> • Conducted for projects of KRW 50 billion in total project cost • Exempted for already established architectural projects 	Competent authority
Feasibility study & VFM test	<ul style="list-style-type: none"> • Cost benefit analysis conducted • Comparison of PSC and PFI alternatives Conducted 	Competent authority/ PIMAC
Formulate RFP / Announce invitation to bid	<ul style="list-style-type: none"> • Establish evaluation score guidelines 	Competent authority
Submit project proposal	<ul style="list-style-type: none"> • Induce creativity from the private sector 	Private concessionaire
Evaluation / Designation of potential concessionaire	<ul style="list-style-type: none"> • Utilize pre-qualification (PQ) system 	Competent authority/ PIMAC
Conclusion of concession agreement	<ul style="list-style-type: none"> • Shorten negotiation time by proposing standard concession agreement guidelines 	Competent authority/ PIMAC
Approval of implementation design/plan	<ul style="list-style-type: none"> • Provide early approval of environmental impact analysis 	Competent authority
Begin construction		Private concessionaire

(3) Take necessary measures to speed up the project implementation. If it takes years to get the project started because a lot of licenses are required from various government agencies, it is undesirable and may result in project failure. Therefore, to speed up project implementation, measures to enhance coordination between ministries for licensing,

permit etc, should be prepared.

(4) Initiate government-solicited projects aggressively to lead PPP programs.

A solicited project is that the competent authority identifies a project for private investment and announces a RFP. It is differentiated by unsolicited projects in which a private company (project proponent) submits a project proposal, and then the competent authority examines and designates it as a PPP project.

(5) Provide proper incentives to private sectors for their assumed risks by offering financial supports including subsidy, minimum revenue guarantee and termination payment. Projects need to make reasonable profit as well as achieve social and environmental goals. The contract or the regulatory framework needs to clearly specify the role of the government in terms of financial aspects and administrative aspects. The level of government support may vary depending on sectors.

There are no quick fixes, and good governance takes time to build. Therefore, at the implementation stage, it would be wise to have opportunities to learn best practices from leading PPP program countries periodically and establish monitoring mechanism of the performance of PPP to refine the PPP policy. Furthermore more attention should be paid to the training of public officials as their quality may determine the level of success.

4. Kuwait's Electric Power Sector: Changing the Pricing Scheme as the First Step towards Reform

4.1. Target

Kuwait has one of the highest per capita electricity consumption in the world¹ largely due to exceedingly low tariffs. For industrial customers, a flat rate of 1 fil/kWh (US 0.25 cents) is charged; for residential customers, 2 fils/kWh (US 0.50 cents). There is no separation between basic charges (covering fixed costs) and energy charges (covering variable costs) in a two-part tariff structure. There is no time-of-use charge based on the peak-load pricing principle.

1. In 2000, Kuwait generated 32 Twh of electricity and 82 billion gallons of desalinated water. Peak electricity demand was 6500 MW and water demand 285 million gallons per day. Per capita power consumption is estimated at 14,250 kWh/capita in 2001, which is 50 percent higher than the corresponding figure in UAE (World Bank 2001: 5). In Kuwait, electricity and water are essentially joint products given the prevailing technology of power generation and desalination.

According to an expert we interviewed, the tariff rates were set 30 years ago and have been frozen since². The Parliament has rejected proposals to raise electricity tariffs. As a result, the current tariffs have little relationship with cost fundamentals.

Furthermore, Kuwait suffers from a low collection rate. It is against the law to cut off electricity. There is no penalty against deferred payments.

The current electricity tariffs cover less than 10 percent of the estimated cost of power.³ They are about a quarter of those charged in energy-rich neighbors like the UAE and Saudi Arabia.⁴ Clearly, this system is not sustainable without fiscal transfers.⁵ The hidden fiscal subsidy is regressive in that heavier electricity consumers (presumably richer people) benefit proportionately more from fiscal transfers.

MEW has designed its investment program without considering any demand-side measures that could ameliorate peak load issues. As a result, MEW is left with very expensive infrastructure which can still require rationing at times of peak demand (such as the scheduled outages in summer 2007).

In short, the most serious problem in the Kuwaiti electric power sector is the pricing scheme that bears hardly any relationship to cost fundamentals. Therefore, this executive program proposes the following:

Instead of focusing only on supply-side measures such as building more power plants to meet peak demand, Kuwait should take active demand-side measures so that consumers receive more accurate price signals. However, as raising tariffs for basic necessities (e.g., electricity and water) is a politically sensitive matter in any society, the government should exercise a great deal of caution and follow a step-by-step approach.

(1) Impose a penalty on deferred utility bill payments and enforce it, if necessary as a means of last resort, cutting off electricity after a legally specified period if consumers do not pay the bills.

- The basic idea is to improve the collection rate so that those who pay their bills are no longer unjustly penalized by those who do not.

2. Interview with Dr. Ali Arifa (Kuwait City, 1 June 2008).

3. The best estimate for the cost of power produced in Kuwait is about 18-20 fils/kWh (World Bank 2001: 5).

4. The average tariff is 14 ha/kWh in Saudi Arabia and 15 fils/kWh in Dubai (World Bank 2001: 5).

5. The estimated subsidy is about US \$2.0 billion for electricity and \$US 0.8-1.0 billion for water (World Bank 2001: 5).

(2) Replace the fiscal subsidy to public utilities with a direct income subsidy to consumers and adjust prices so that they better reflect costs.

- The basic idea is to introduce more accurate price signals even as the values of the welfare society are preserved. The Kuwaiti people will have access to basic necessities, but they will face prices reflecting costs and make their consumption choices based on their preferences.
- The income subsidy should be progressive.

(3) Introduce a progressive pricing scheme as an interim measure.

- The idea is to make price normalization more palatable to consumers. Charge a low rate up to the consumption level for the average consumer. Progressively increase tariff rates as consumption rises.

(4) Introduce a two-part tariff structure and time-of-use charge based on the peak-load pricing principle.

- The idea is to make consumers face the marginal cost of their consumption. This pricing scheme will greatly improve peak-demand management.

(5) Electric power sector restructuring should be considered after the new pricing schemes have been firmly established.

- Under the existing tariff structure, new entrants would demand a fiscal subsidy as they cannot make their ends meet.

Some experts argue that fuel costs are high due to use of oil, not gas, in power generation.⁶ The government has long-term plans to use imports from Qatar and development of associated gas to increase efficiency, but both are subject to major uncertainty. (Qatar has placed a moratorium on further expansion in gas suppliers until the capacity of its huge North Field can be verified.) Given this uncertainty, including energy security issues, it is not clear if a complete fuel switch from oil to gas would be desirable. Nor is it clear that Kuwait's current technology of combining power generation and desalination is necessarily unsuitable for the local conditions.

Other experts have called for a fundamental restructuring of the electric power sector, in part as a means of private sector development. They argue that the MEW should divide its business units that would allow an allocation of demand to more efficient power generators and water distillers in the short term. In the medium term, they suggest that the government open up

6. KPC charges MEW the export price of fuel oil—that is, the opportunity cost of fuel oil rather than its production cost. But MEW does not pay KPC for the fuel supplied since the tariffs cover only a small fraction of the fuel cost.

power generation and desalination to private operation, while keeping the grid as a regulated natural monopoly. While it would be desirable to introduce a merit-order system to improve the efficiency of power generation and desalination, vertical separation and entry by private-sector players should be considered only after the current tariff structure has been replaced by a new scheme based more firmly on economic principles.

4.2. Implementation Mechanism

The Ministry of Electricity and Water (MEW), which directly runs key utilities, may take on the implementation of this executive program.

5. Policy Initiatives on the Health Care Sector

5.1. Diagnosis

5.1.1. Positive side

Kuwaiti citizens have universal access to health care services.

5.1.2. Negative side

Growing public budget for the health care sector does not translate into high quality service delivery. Specifically, the problems in the health care sector are as follows.

The government often has to send Kuwaitis abroad for treatment. There is a lack of specialists in most fields, while nursing and lab technicians are viewed as low paying positions despite their pivotal role in the day-to-day experience of patients. These problems are compounded by the ineffective management of facilities, which are often built without adequate provisions for operations and maintenance funding. The fact that the government will pay for people to go abroad crowds out the local private provision of specialist care.

There is no functioning private health insurance system, with the result that care received in private clinics are mostly an out-of-pocket expense for Kuwaitis - yet, resulting from the higher quality of care in these clinics, increasing numbers of people are willing to forgo their nominal benefit in the public system. However, it is encouraging that the government has recently brought in private insurance for expatriates, which will help create a market-driven segment for

provision of healthcare and thereby boost the overall capacity in their systems.

(The private health insurance to the employers in the companies and Oil companies seems to be a kind of public health insurance in nature, since the Oil companies are basically the public enterprises.)

(Ministry of Health's view) There is a mounting challenge emanating from the higher cost of providing free medical services to locals (with nominal charges for expatriates). Higher cost is due to: (1) population increase, (2) higher life expectancy, (3) rising cost of medical treatment abroad for complicated cases, and (4) encouragement of private hospital to provide medical services with reasonable pricing schemes.

5.2. Policy Recommendations

(1) Implement the management and budgeting reforms of the health care sector. In other words, apply the principle of “money follows the patient.”

The mechanism is that public funding comes to (public and private) hospitals in the form of allocating for each patient rather than a block allocation to support the overall functioning of the hospital. The link between patient services and revenue will introduce stronger quality incentives than are possible when a hospital is receiving aggregate funding on an open-ended basis. It also introduces the scope for private clinics to treat publicly-funded patients on the same basis as those with private insurance.

In addition to the above, the government needs to design and implement the management contract with the head of the public hospital. The management contracts should include an incentive system for the high quality performer and a penalty system for the low quality performer. Alongside with the management contracts, the government needs to give to the head of the public hospital a high degree of autonomy through the use of the budget (including remuneration for medical doctors and other staffs in order to attract high quality people) and the policy on the hospital's personnel.

(2) Instead of (1), Kuwait may consider introducing the public health insurance system to the Kuwaiti citizens. This will make it much easier to apply the principle of “money follows the patient.” The Kuwaiti citizens' contribution to the public insurance fund could vary progressively with their income levels. To ensure continuity from the present system, the government could exempt the contribution to the public insurance fund by the Kuwaiti citizens whose income levels are less than the national average. This new system will induce much stronger competition between public and private hospitals since the patients could go easily to

private hospitals with public health insurance.

In this case, the government still needs to design and implement the management contract with the head of the public hospital.

(3) Implement the target oriented FDI policy, in particular for the case of attracting the world-renowned specialty medical hospitals and research centers into Kuwait. This will help cure the problems originating from the fact that the government often has to send Kuwaitis abroad for treatment.

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