The capital absorptive capacity of Iraq and Kuwait: a comparative study

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THE CAPITAL ABSORPTIVE CAPACITY OF IRAQ AND KUWAIT: A COMPARATIVE STUDY

by

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To my parents

ABSTRACT

The background to the study is that of a continuously depreciating income accruing to producers of a wasting asset, oil. This income must be fully utilized in the short-run in order to attain a once and for all opportunity for rapid development. The concept of absorptive capacity can be extremely useful in determining how income can be productively employed to take advantage of this opportunity.

The underlying factors for choosing these two particular Arab states are mainly because of their similarities, yet there are certain important disparities in their economic characteristics. Their similarities could be briefly summarised, in that both neighbouring countries belong to the oil-rich Gulf states, both are developing, both are underpopulated, with qualification in the case of Iraq, and both have to utilise fully the revenues from a rapidly depleting oil assets in a comparatively limited time span. Their differences are as great as their similarities, in that Iraq has had the benefit of oil revenues considerably longer than Kuwait, and that its economy is far more diverse, as agriculture was, and still is the main source of employment. This explains the reason underlying the magnitude of the impact that oil made on social fabric and the economic structure was far greater in Kuwait than in Iraq.

In the introductory chapter the relevant definitions of the concept were examined, and the most viable one was chosen for the two countries. The limitations of the concept and the various methods of its measurement were considered and where possible, criticised. The methodology adopted was used as far as possible throughout the study. Chapters 2 and 3 dealt with the economies of Iraq and Kuwait consecutively as a necessary background to the discussion. Chapter 4 examined the concept within the context of the savings investment gap, and the conclusion which emerge from the available empirical evidence. The

components of national income were examined, and analysed. In Chapter 5, an open-economy model was applied, as the aggregate level of economic activity in both Kuwait and Iraq is to a greater or lesser extent exogenonaly determined through their openness. In Chapter 6, the government revenue and expenditure was discussed, their determinants, considered and the two economies compared in the light of the differing priorities which the governments in Kuwait and Baghdad have. Finally, the concluding chapter attempted to synthesize the findings of the study its a summarised form of remarks concerning the absorptive capacity of the two economies.

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CONTENTS

CHAPTER 1

INTRODUCTION

The economic literature has become replete with the term absorptive capacity since the quadrupling of oil prices by the O.P.E.C. members in 1973, as oil revenues accruing to those members have multiplied considerably. These substantial increases invariably exceed the import needs of the less populous oil exporters due to their limited capacity to consume and invest. The absorptive capacity of the oil-producing countries, has consequently become an issue with the industrialized world, as the question of recycling the surplus oil-revenues has been widely discussed in recent economic journals as well as the more popular financial press. Here however, the perspective adopted is not that of the industrialized West, but that of two O.P.E.C. members, Iraq and Kuwait. The choice has been deliberate, in that Iraq is capable of absorbing the bulk of the oil revenues, but Kuwait will be for the foreseeable future a capital-surplus economy. The former has a relatively large population, and considerable industrial and agricultural potential, while Kuwait has small population, a limited market, and an almost non-existent agricultural base. It is admittedly true that,

> "Imports by O.P.E.C. countries have increased at a rate nobody believed possible. Loans and investments have eaten up a sizeable portion of accumulated funds."[1]

Nevertheless the spending boom of the mid 1970's does appear to be coming to an end, as even the surplus states examine more carefully their import needs.

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1. A.Y. Al-Hamad Some Aspects of the Oil Controversy - An Arab Interpretation Kuwait Fund for Arab Economic Development, Kuwait May 1975.

The concept 'absorptive capacity' was originally conceived by the donor institutions in connection with the recipient countries' economies. It therefore became closely associated with aid. Yet neither of the two countries being considered have been major aid recipients, indeed Kuwait has emerged as a substantial donor, while Iraq also grants concessionary loans on a more limited scale.[2] What is relevant for our purposes however, is the specific concept of 'capital absorptive capacity', as opposed to perhaps, the rather amorphous term of absorptive capacity per se. The latter possesses a multitude of facets, the most important being the human factor, which is however outside the scope of the study. It follows that henceforth, whenever absorptive capacity is mentioned in the text, the word, capital is implied throughout, unless explicitly mentioned, or otherwise qualified. Furthermore, the term aggregate absorptive capacity or overall absorptive capacity may be used in the definitions in a strictly theoretical sense, as this includes domestic plus foreign capital resources. In empirical terms however, there will not be need to use this term, as was pointed out above in the sense that for our purposes, both countries are net donors, although Iraqi aid is of much less significance.

Definition of the Concept

If a valid definition is to be arrived at, a survey of the main literature on the concept seems relevant. We must nevertheless proceed gradually from the general, all-embracing type of definition to the more specific, as some of the former are inextricably related to aid. This could be illustrated, in that one writer referred to the concept of technical absorptive capacity.[3] This refers to the limitation of foreign aid given to a particular country, and its efficiency in the use of

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2. Kuwait's aid has ranged between 7% to 10% of GNP since its founding.

3. R.S. Eckaus, "Economic Criteria for Foreign Aid for Economic Development" in J. Bhagwati and R.S. Eckaus (Eds)., Foreign Aid. Penguin Modern Economic Readings, 1970.

resources. The limitations are the lack of technical and professional skills and the complementary physical capacities which hinder the productivity as it were, of those foreign resources. But one of the initial general definitions was,

> "Absorptive capacity depends on natural resources, taxes, the labour supply, the level of labour, technical and managerial skills, entrepreneurial capacity, the efficiency of public administration, the extent of 'technology mindedness' of the population and so on. Such capacity sets a limit to the amount of efficient investment physically possible, and although it can itself be increased through further investment, it does effectively limit the rate of development possible, particularly in the short run."[4]

Another pioneer of defining the concept in general terms was Kindleberger who took the view that the speed at which capital can be absorbed is determined by the available complementary factors.[5] The notions of complementarity, as well as that of transformation are introduced here, as the latter shows how the concept operates when capital is transformed into production. He continues, that there are two stages in absorptive capacity, namely, the capacity to form new capital, and its subsequent efficient use, so that this new capital would contribute to current production, as long as there was an income elastic demand for it. From these general definitions, it is intended that, the more precise definitions of the concept are of great importance, as each category features a particular salient characteristic of the concept. One of the earliest and best known is that which states,

> "The absorptive capacity may now be redefined to mean the ability of individuals and of the society as a whole to manipulate the stream of output increments. This ability is limited because there

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4. United Nations ECAFE, "Programming Techniques for Economic Development". Report of the First Group of Experts on Programming Techniques, Bangkok, 1960 in G.M. Meier (ed)., Leading Issues in Economic Development. Oxford University Press, New York, 1976. p.253.

5. C.P. Kindleberger, Economic Development McGraw-Hill, New York, 1965.

> is a given level and a limited speed of potential expansion of the will to work of the state of health, of the number of skilled workers and scientists and of the institutional adjustments."[6]

Although the above definition is important, and will be encountered later in the discussion, it suffices here to say that it concentrates upon the human factor as a limit to the concept. Another definition which brings forth an important approach to the concept, is that of Higgins, which introduces the important idea of the incremental capital output ratio. This states,

> "It is the amount of investment that can be undertaken, within a five year program, without reducing the marginal contribution of the last 'block' of capital below 'x'. In other words, it is the amount that can be undertaken without raising the incremental capital-output ratio of the last block of investment, or marginal ICOR above 1/x."[7]

The investment would take a period of five to ten years, and would add to income for a period of twenty or more years. This would render the concept to be imprecise, since the long-run is somewhat unpredictable. The writer also regards the fact that x, which is the marginal addition to capital, whose value is unimportant, if it were to equal zero or a low percentage, which might not necessarily be the case. It is imperative here to define precisely the term ICOR,

> "Where ICOR measures the increment in capital required in order to produce an additional £1 worth of output."[8]

$$\text{ICOR for the year } t = \frac{\text{Investment in year } t}{\text{Increase in value of output during year } t} \qquad 9$$

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6. B. Horvat, "The Optimum Rate of Investment." Economic Journal, Volume 68, 1958. p.753.

7. B. Higgins, Economic Development - Principles, problems and policies. Constable, London, 1968, p.579.

8. A.A. Walters "Incremental Capital Output Ratios" Economic Journal, Volume 76, 1966.
Ibid, p.819.

9. What is important in that ICOR's are closely but inversely associated with rates of growth, where the higher the rate of growth, the lower the ICOR. Also, ICOR is positively related to capital-output-ratio, whereas the higher it is, the higher is the ICOR.

A more recent and comprehensive definition is that of Gulhati, which states that,

> "The idea is that at any point of time, or within a specified period of say five years, there exists a limit beyond which investment cannot be raised in recipient economies. This limit is set by the non-financial constraints to development, i.e. by the physical unavailability of other factors of production necessary for further investment."[10]

The writer suggests a schedule of absorptive capacity, where different quantities of investment could be plotted on a horizontal scale, while their associated ICOR's are on the vertical axis.[11] One of the pioneers of the use of ICOR's in the concept is Rosenstein-Rodan, who in his definition,

> "The extent to which increased investments with a high marginal rate of savings can be realized depends on the country's technical absorptive capacity. The capacity to absorb capital is more limited on a low level of development, where a higher proportion of technical assistance must precede a large capital inflow."[12]

This held that absorptive capacity is composed of the capacity to save, by means of maintaining or widening the gap between the average and marginal rates of saving. Secondly, the ability to produce and to invest in increments to the latter over a period of five or more years, and the ability to influence the balance of payments. For our purposes however,

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10. R.I. Gulhati, "The Need for Foreign Assistance, Absorptive Capacity and Debt Servicing Capacity." in J.H. Adler and P.W. Kuznets (eds)., Capital Movements and Economic Development. Proceedings of a Conference held by the International Economic Association. Macmillan, New York, 1967. pp. 240-241.

11. Ibid., p.250.

12. P.N. Rosenstein-Rodan, "International Aid for Underdeveloped Countries." The Review of Economics and Statistics. Volume 63, 1961, p.108.

the relevant component is the second one, namely that of investment. The author uses different ICOR's in order to determine the capital productivity for different categories of developing countries, by their income per capita.

One of the main schools of thoughts on the subject, and it is maintained here the most influential, is the definition by Adler, which states,

> "that amount of investment, or that rate of gross domestic investment expressed as a proportion of GNP, that can be made at an acceptable rate of return, with the supply of co-operant factors considered as given."[13]

The methodology is that of the expected rate of return schedule on capital investment. With the additional quantities of investment, this rate of return decreases at the margin. A steeply sloped investment return curve shows limited absorptive capacity, with a non-steeply sloped curve if there were no limits on complementary or cooperant factors, such as skilled labour and able management. The crucial approach is that the concept applies to the return on the marginal unit of total investment and not on the total amount of capital. What determines the marginal rate of return is the net social return on capital in its least productive use, given that the net yield on investment varies between the different uses of capital. When the rate of return is properly measured over time, the marginal rate of return on each type of investment must be equal to that of any other type. But this may not be possible as an optimizing condition, since the availability or otherwise of complementary factors and entrepreneurial investment decisions are the limits. In the short-run, the minimum expected rate of return limits absorptive capacity, since the latter is limited by both the available

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13. J.H. Adler, "Absorptive Capacity : The Concept and its Determinants" The Brookings Institution, Washington D.C. June 1965. p.5.

cooperative factors and by complementary investments which may compete for those factors. In the long-run however, these limits may be eliminated by a programmed approach to investment, as opposed to the project approach. It may be worth mentioning that a similar definition preceded the above, namely by E.S. Mason (1964) who has defined,

> "capital-absorptive capacity in terms of investment on which the marginal rate of return is equal to the "socially acceptable discount rate".'[14]

The other main school of thought on the subject, and one which is to be adopted in this study, is the famous gap approach, as opposed to the rate of return approach. The gap approach as propounded by Chenery and Strout in their well known model,[15] is investment limited growth referred to as

> "that absorptive capacity for additional investment in any period is limited by the supply of complementary imports, which can only be increased as a result of the development process."[16]

The model is composed of two ex ante gaps during the economic growth process. These are the trade gap, which is the difference between the imports and exports of goods and services, and the savings gap which is the difference between domestic savings and investment. The two ex ante gaps are not identical as the decision to save, invest, import, and export are taken by different groups, who may or may not overlap. But the two gaps must be equal ex post, and the four variables are adjusted ex ante towards equilibrium, which is important, as will be seen in the following discussion.

The three main limitations on economic growth according to the model are the skills limitation pertaining to manpower and organizational ability.

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14. R.F. Mikesell, The Economics of Foreign Aid. Weidenfeld and Nicholson, London, 1970, p.100.

15. H.B. Chenery and A.M. Strout,"Foreign Assistance and Economic Development." American Economic Review, Volume 56, 1966.

16. Ibid., p.686.

This is during what is referred to, as the first phase of the process. The second phase is identified by the limit on investment and the supply of domestic savings in addition to the net foreign capital borrowing. The third phase is by the limits on imports and foreign assistance. All three phases are part of the transitional processes in economic growth. The two ex ante gaps are generated by the following. The savings gap is generated by the ex ante savings function on the one hand, and the relationship between the target growth in GDP and investment through the ICOR on the other. The trade gap is determined by the relationship between growth and the minimum level of imports consistent with that rate of income growth, given that the export growth rate is determined exogenously.[17]

With this background, we can proceed with our definition. If I_a is the total ability to invest productively, which is the aggregate absorptive capacity of the economy,[18] then if S_d, which is the volume of available domestic savings is subtracted from I_a, the result is I_f, the absorptive capacity of foreign funds, which is a residual. Thus,[19]

$$I_a - S_d = I_f \qquad (1)$$

I_a is defined here as,

> "the optimum aggregate amount of private and public investment opportunities that, at a given moment, can be undertaken, successfully implemented, and subsequently productively operated provided sufficient and adequate financial resources are forthcoming."[20]

I_a above differs from I in the national accounting sense, in that the

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17. This is particularly relevant for our two economies, as is amply illustrated by their main export; oil.

18. This follows Hirschman's total ability to invest which will be discussed in Chapter 4.

19. W.J. Stevens, Capital Absorptive Capacity in Developing Countries A.W. Sijthoff, Leiden, 1971, p.39.

20. Ibid., p.40.

former is calculated so that,

> "I_a is the alternative whose marginal financial rate of return coincides with the cut-off rate of return."[21]

If I were greater than I_a, then the capital absorption limits of the economy have been reached. In the case of I_a exceeding I, however, it means that all investment opportunities have not been satisfied or met due to lack of capital or a shortfall in implementation.

In equation (1) above, both I_a and S_d are independent, exogenously determined variables. If optimum investment were to be reached, then more resources than S_d would be required, as the latter is inadequate to sustain that investment. If that were the case, then the supply of real resources would be less than the economy's absorptive capacity. Inflation would occur in the absence of foreign capital if the economy were fully employed, if that optimum investment policy is to be maintained. It would have to be partly foregone in order to alleviate the ensuing inflation. If on the other hand, there is a surplus of domestic savings, this would result in deflationary process, as the available capital exceeds what can be productively utilized. This could be offset by investing abroad as an outlet for those excess resources.[22] In addition, savings here do not influence aggregate absorptive capacity, which may lead to more investment abroad or the lowering of the social marginal rate of return domestically.

The components of savings are denoted by S_{dl} which are savings in local currency, assumed not convertible, and S_{df} which comprise the available foreign exchange due to balance of payments surpluses on the current account, and the part of the local currency savings that is convertible.

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21. Ibid., p.40.

22. This is demonstrated by our two economies. On the one hand inflation is not entirely due to the above, but to other factors, and on the other, the surplus savings are channelled abroad, where Kuwait typifies this case.

Thus,

$$S_d = S_{d.l} + S_{d.f} \qquad (2)$$

The aggregate ability to invest, I_a is composed of $I_{a.d}$, which is the domestic component, the factors of production obtained locally, and $I_{a.f}$, which is the foreign component, or the goods and services that have to be imported from abroad.[23]

$$I_a = I_{a.d} + I_{a.f} \qquad (3)$$

If we substitute (2) and (3) into (1), we have:

$$(I_{a.d} + I_{a.f}) - (S_{d.l} + S_{d.f}) = I_f \qquad (4)$$

$$\text{or} \quad (I_{a.d} - S_{d.l}) + (I_{a.f} - S_{d.f}) = I_f$$

From which,

$$(I_{a.d} - S_{d.l}) \geqslant 0 \qquad (5)$$

This follows the two gap approach by the following methodology. If $(I_{a.d} - S_{d.l}) \geqslant 0$, then there is a shortage of domestic savings, despite the fact that there are domestic investment opportunities. If $(I_{a.d} - S_{d.l}) < 0$ on the other hand, then this shows a surplus domestic savings case, which is more than can be met by the local supply component of the investment programme.[24] The third case is when $(I_{a.f} - S_{d.f}) > 0$ which means that the supply of foreign exchange is unable to meet the import component of the maximum investment programme, which is the main feature of the developing economies. Consequently, they will have to lower the level of investment because of the shortfall in the foreign exchange component, where the background of this was explained above. Finally the case where $(I_{a.f} - S_{d.f}) < 0$, which shows that due to the high level of export earnings, there is a shortage of renumerative investment opportunities which means limited aggregate

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23. Ibid., pp. 43-47.

24. This is true for both our two economies.

absorptive capacity at the margin.[25] When this occurs then there is a switch to investment abroad to partly meet the frustrated savings, or the investment pattern is altered domestically, where preference is given to investment projects with a large foreign exchange component over projects with all or large foreign exchange component over projects with all or the majority is composed of domestic component. This is certainly not the pattern of most developing countries.[26] Where the limits of absorptive capacity I_a have not been met, and there are still investment opportunities. Thus

$(I_{a.d} - S_{dl}) + (I_{a.f} - S_{df}) \geq 0$ which is the

case of a shortfall of domestic resources, or foreign exchange, or both together. Finally, the case where $(I_{a.d} - S_{dl}) + (I_{af} - S_{df}) < 0$ which shows unavailability of investment opportunities.

Finally, the definition to be arrived at is that of the aggregate absorptive capacity, I_a of the economy,

> "it is the optimum aggregate amount of private and public investment opportunities that - within a given time span of three - five years - can be undertaken, successfully implemented and subsequently productively operated under the assumption that adequate domestic ($S_d = S_{d.l} + S_{df}$) and foreign (I_f) savings are forthcoming and that the most appropriate choice of techniques is being used. The residual absorptive capacity for foreign capital (I_f) is that part of this aggregate investment programme that cannot, or not economically be financed out of domestic financial resources, or for which adequate resources are not forthcoming. The reference level for the minimum productivity criterion is for both concepts the international cost of capital."[27]

Measurement of Absorptive Capacity

The three main measurement methodologies used are Adler's marginal rate of return approach, the capital output approach by Horvat and as

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25. Where $I_{af} < S_{df}$ as will be shown in the case of Kuwait in Chapter 4.
26. This again is the non-typical behaviour of the Kuwaiti economy.
27. Ibid., pp. 51-52.

modified by Gulhati, and the gap approach. All are important, notwithstanding that in the study, we had opted for the last method in our definition of the concept.

First Adler's approach is based on the expected rate of return at the margin schedule mentioned above. There are three important contributions made by this approach, namely, the introduction of the two factors relating to the absorption period, where absorptive capacity increases with the longer time taken to overcome the lack or inadequate supply of co-operant factors. Secondly, the delineation of the individual investment projects where private financial profitability would not take account of costs and benefits accruing to society. If on the other hand, a joint analysis of interrelated projects is undertaken, then externalities might be internalized, hence the value of the individual projects is reflected more accurately. Thirdly, the establishment of the annual cash flow of earnings and expenditure of the several integrated programmes, where shadow prices must necessarily be used in developing countries, especially for capital, skilled labour, and foreign exchange. The programmed approach based on backward and forward linkages, where annual cash flows are for the whole period of the program, with the provision that both revenue and expenditure are adjusted to reflect real scarcities. The discount cash flow method is used, with the cut-off rate of return as a discount factor in order to calculate the average returns from these programs. One criticism is what is the marginal rate of the programs, where Adler does not indicate it. But the effective cost of capital inputs are not relevant for the selection of this marginal rate according to the author. The servicing of loans allocates the return accrued and is not connected with the productivity of the investment program which implies that the capacity to absorb grants is not greater than the capacity to absorb loans. The grant element has to be considered as a subsidy obtained externally, and it does not increase the earnings of the program itself. This is criticised

as,

> "the opportunity cost of capital must be the productivity term of reference, and it ought to constitute the lower limit of the cut-off criterion."[28]

This approach is used extensively, at least partly by development institutions. It is very important and arguably employs the best operational methodology of the three. But with our context, the gap approach is more relevant and is adopted, as both countries are surplus donor economies, as opposed to recipient economies where the above approach is ideal.

The second method of measurement is that adopted by Horvat, where he divides Gross Social Product into consumption and investment.[29] The latter is divided into 'investment proper' and the second is 'productive expenditure', which is the financial resources absorbed by the human factor of growth, A,

> "which increases the ability of the society to produce material goods."[30]

It is A which affects the maximization of the economy's output, as once its limits are reached, by additions to the material growth factor will result in the reduction of output. The relationship between A and investment I influences the distinct definition above, whose importance lies in its feature of the stream of output increments. Furthermore, there is a causal relationship between productive investment and output, but the 'maturation effect' refers to the time lag between the cause and its

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28. Ibid., p.93.

29. B. Horvat, E.J., 1958, op.cit., p.747. Where Gross Social product is defined as net of services not intimately connected with material production (public administration, defence expenditure, transport and trade services included).

30. Ibid., p.753, where I = f (A), as investment is defined as a function of A.

effect.[31] In order to measure absorptive capacity, it is assumed that both A and I are a function of each other, where I here is the optimum volume of investment. But, to break this circular argument, an investment programme is proposed with different volumes, and maximum output is arrived at. The investment production function IP, is calculated for each alternative,[32] and the measurement of A entails the integration of all the IP functions, where the maximum possible increase in production in a certain period is represented by the maximum integral.[33] This method of measurement where there is opportunity cost of capital is not reached by the yield on the financial resources is the main criticism against the definition of maximized output by this means.

Gulhati, referred to above, holds that the human, and broadly the non-financial factors are the determinants of capital productivity. Investment falls in three phases, namely, the planning phase where projects are identified, the execution phase, and finally, where the investment program starts production. The measurement methodology is by calculating the corresponding ICOR's for each investment alternative, each with a given effect on GNP, and average annual growth rates. Initially the value of ICOR's decreases due to

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31. Ibid., p.749, where this is referred to as m, the ratio between additional output GP this year t, and investment made (m) years earlier (t-m), the ratio is called the production coefficient p, which is in fact a time adjusted form of ICOR, $p = \frac{\Delta GP_t}{I_t - m}$

32. Ibid, p.753.
The above formula is re-written as $p = F [I(A)]$

33. Such that,

$$\text{Max } \Delta GP = \text{Max} \int_0^{I_m} \Phi (I) \; dI$$

thus I is derived by the division of A by p.

the 'big push effect', then gradually grows higher on the schedule.[34] The main criticism of this approach is that the ICOR's of individual projects do fluctuate, where some are above, and others below the cut-off criterion. This is subject to the limiting factor, that the weighted average is three, as chosen for the cut-off criterion by Gulhati. There is no reason why a marginal project with an ICOR greater than three should be implemented, if it cannot service its capital cost, hence the average productivity is a flow in the argument.[35] This approach however, is more accurate than Horvat's, where the cost of capital is not taken into account, as was pointed out above. The main criticism levelled at this approach, however, is the unreliability of ICOR's generally, since the capital-output ratio can only render approximations of the productivity of capital. Low ratios do not necessarily mean that capital is used profitably, even if unusually high ratios tend to reflect inefficient use of capital. Absorptive capacity relates to the specific value of capital, which these ratios do not indicate, although they convey a comprehensive impression of total productivity.

The other main criticism which could be equally valid for the subsequent paragraph of the gap methodology, is stated in the following

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34. R. Gulhati, 1967, op.cit., p.255.
If K = cut-off criterion defined in terms of the ceiling level of ICOR,
S = initial average gross domestic savings rate,
S^o= marginal gross domestic savings rate,
n = annual rate of growth of GDP.
i = average effective, interest rate on foreign debt.
Then, $K = \frac{So}{r} + \frac{S' - So}{i}$
which is the minimum but not sufficient condition which must be satisfied to avoid an unmanageable debt problem. Unless this equation is fulfilled, outstanding debt and debt service will grow faster than GDP, and this absorbs an ever-rising proportion of total product of the debtor country.

35. W.J. Stevens, 1971, op.cit., p.106.

manner. If the amount of aid a, which is necessary to fill the savings gap, then a = c - s.[36] It is based upon the argument that foreign aid would complement domestic savings thereby lending to a higher rate of capital accumulation, and it would also increase the proportion of income saved by raising the income per capita. The result would be self-sustaining growth, where aid would eventually become unnecessary. But the crucial assumption underlying this is that the marginal propensity to save must always be greater than the average propensity to save. This condition is unlikely to prevail, as the gap will be greater, and consequently the marginal propensity to save must be much greater in order to close it. The empirical evidence of the marginal propensity to save exceeding the average propensity is tenuous and will be shown to be so, subsequently in Chapter 4. But that is the reasoning underlying Gulhati's argument above.[37]

Finally, the Chenery-Strout model is criticised partly by the preceding argument which concerns the savings gap, and partly by the assumption that domestic and foreign resources are unsubstitutable, ex ante, where both gaps are not necessarily equal.[38] Another criticism is that the model makes no distinction between GNP and GDP, which is of vital importance in the case of the two economies under study.[39] The

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36. K. Griffin, 'Foreign Capital, Domestic Savings and Economic Development" Oxford University Institute of Economics and Statistics Bulletin, Volume 33, 1970. p.101. Where S is the proportion of national income saved and invested, and c is the rate of capital necessary to achieve the target growth. This will be derived and elaborated in detail in Chapter 4.

37. See footnote (33) above.

38. K. Griffin, op.cit., p.102, This will be discussed further in Chapter 5.

39. A. Maizels, Exports and Economic Growth of Developing Countries. N.I.E.S.R., Cambridge University Press, Cambridge, 1968, p.9.

disparity between the two magnitudes, as will be seen from the empirical evidence in the text, is too substantial to be ignored, and will therefore be qualified whenever possible. The difference in the oil economies is accounted for by the significant net factor payments abroad. Another point which might be mentioned, is the lack of reliable data which makes it difficult to use the two-gap ex ante method for developing countries. But this has not been a major problem here. What could finally be said about the gap approach is that it follows from Rosenstein-Rodan. It takes absorptive capacity as an aggregate parameter based upon past performances, which is the most important characteristic of this method. This means that the ability of a country of investing is based upon the average increase in that investment over a given period which is the measure of its growth rate.[40]

Limits to Absorptive Capacity

The most important constraint on absorptive capacity is the size of the market or in other words aggregate demand. Second, the shortage of complementary inputs and the inadequacy of infrastructure. Third, planning shortcomings and barriers to implementation of those plans. And finally, the all-embracing institutional factors. The first constraint, market size is particularly valid in the case of Kuwait, where this is the major determinant of the level of investment. It will be shown in Chapter 4, that the level of savings is consistently higher than that of investment, due partly to this factor. Demand is limited in Iraq for other reasons, at least until very recently, but one of the main reasons is the relatively low level of incomes.

The second limitation is shown by the shortage of the labour supply

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40. W.J. Stevens, 1971, op.cit, p.110. Where he states, that this method "is both the most crude and the most operational of the three main approaches".

at all levels of skills in the case of Kuwait, and of inadequate level of skilled labour in the case of Iraq, whose various projects are being held up at the moment for that very reason. It is interesting to note that one of the important current irrigation and agricultural projects is impeded for this very reason, to name only one recent example.[41] This problem has been exacerbated since 1973, as indeed the problem of port congestion, which will be mentioned shortly. The manpower problem is extremely important, and could perhaps be summarised thus,

> "Political factors have also been responsible for several features of the development of the Arab educational system. The problem here is not that Arab governments have been spending too little, but rather that the distribution of their expenditure among the various types of education has been faulty, and that its expansion has been at the expense of the quality of learning. Accepting a class bias against manual labour, Arab governments have allowed general secondary education to outgrow technical and vocational training."[42]

Moreover, both countries, in common with the developing world suffer to a greater or lesser extent from the relative shortage of competent management and organizational skills, which with the above has been a significant impediment to investment in both economies apart from being an important barrier itself. This assumes of course that capital goods are given, due to the favourable foreign exchange position of both countries in importing them.

The infrastructure inadequacies, are relatively not as acute as in some countries in the area, but are considerable barriers. This is particularly exemplified by the bottlenecks created at the ports. The

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41. The Lower Khalis River Irrigation Project, where workers are trained to drive tractors and operate simple agricultural machinery.

42. G. Amin, The Modernization of Poverty. E.J. Brill, Leiden, 1974. pp. 61-62.

problem is less acute in Kuwait of course, due to the small area, and the already existing efficient network of highways, compared with Iraq, whose existing railway, roads, and harbour is hardly adequate for the volume of imports flowing since 1973.[43] It is only since then that the infrastructure is being built in a comprehensive manner, as will be seen subsequently in the text. Now there is a large-scale expansion of road and rail networks, as well as harbour-deepening and construction.

In the case of planning, however, there has been an abundance of plans in Iraq in the past fifteen years, with none fully implemented. Kuwait on the other hand, has had one plan which was never fully implemented, and where it has only recently devised a new plan.[44] This leads us to the last point, namely, the institutional factor which is interrelated with the other factors in the context of planning particularly. In the case of Iraq political instability, doctrinaire policies in allocating priorities, and the commensurate high turnover of personnel at all levels, has resulted in the plans being ineffective. A very significant point, perhaps, is the high degree of uncertainty, which is beyond the feasible horizon of normal risk, that had inhibited the private sector to participate fully in those plans.[45] In Kuwait's case, however, the inadequacies of institutions to carry out the plan then, and perhaps the non-economic factors which inhibited implementing it.[46] Nevertheless, the State here has played and continues to play a very active and constructive role in participating with the private

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43. Where a significant part of Iraq's imports pass via Kuwait's ports and road network.

44. This will be discussed in more detail in Chapter 3.

45. This is apart from the nationalization measures, sequestation without compensation and arbitrary policies based upon political doctrine rather than sound economic reasoning.

46. The free enterprise psyche which may not accomodate too easily with State direction.

sector in domestic investment.

The limitations to absorptive capacity in the Middle Eastern context are perhaps best summed up as follows,

> "There are many cases where idle capacities characterize practically all aspects of life : financial, natural, fixed and working capital, as well as human resources. A number of developing Near East countries, oil-producing as well as non-oil producing provide striking examples.
>
> This phenomenon calls for the extension of the concept of absorptive capacity beyond the constructional phase. Doing that, one is likely to face more severe constraints than those listed before, such as: managerial abilities, and modern systems of management; institutional barriers, and in particular those arising from outdated legislation and administrative procedures; disparities in the economic system, including market and finance institutions, as well as units and practices needed for capital maintenance; imperfections in manpower structures and deficiencies in educational systems; absence or limitation of research activities geared toward solution of difficulties arising during the operational phase....."[47]

47. M.M. El-Imam, "Absorptive Capacity is a mechanical concept. The real criterion is the capacity to develop." Ceres, July-August, 1974. p.80.

CHAPTER 2

THE ECONOMY OF IRAQ

The aim of this Chapter is to set out the necessary background for the economy of Iraq. The period starts from 1921, when the State of modern Iraq as it is known today was established, and continues to the present, with the relevant economic stages, referred to in dated sections in order of sequence. From the economic point of view however, this date can only be of relevance if we consider briefly what preceded it. As one Iraqi economist, M.S. Hasan observes,

> ".... there came the stage of transition from a subsistence economy to a foreign-trade oriented economy during the 1869-1951 period, during which the backward economy of Iraq adjusted itself to the forces of the world market and became increasingly dependent upon it."[1]

What is of importance however, is the fact that from 1952 onwards, the economy has been transformed from a predominantly agricultural one, to that of a major oil-exporter, despite the fact that agriculture still claims the largest share of the economically active population.[2] The economic growth of the country, though impressive by any standards, could be said to be unbalanced, in the sense that this rapid growth has been closely associated with, and highly dependent upon the rate of growth of the oil output. It may be noted here, that Iraq's growth of real GDP during the period 1953-68 was 6 to 7% a year.[3] Nevertheless, the imbalances,

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1. M.S. Hasan, "The Role of Foreign Trade in the Economic Development of Iraq, 1864-1964: A Study in the Growth of a Dependent Economy". in M.A. Cook (ed). Studies in the Economic History of the Middle East. Oxford University Press, London, 1970. p.346.

2. Kuwait Fund for Arab Economic Development, The Arab World Key Indicators, Kuwait, 1975. Table (1.4), p.12. Where this share fell from 53.1% in 1960 to 46.6% in 1970.

3. G. Amin, The Modernization of Poverty, E.J. Brill, Leiden, 1974, p.11.

continue, despite the considerable efforts in industrialization, with the primary aim of import substitution enshrined in successive economic plans. The rate of economic growth perhaps could to a certain extent sustain the relatively high rate of population growth, which stood consistently at 3.2% from 1960 to 1971.[4] From this, if the income per capita GNP is used as a rule of thumb criterion of economic development, then there is a considerable rise from about $210 in 1965[5] to $370 in 1971,[6] and a faster rate of growth during the period 1971-74, as in 1974 it was estimated at $1,110 and the rate probably has risen even faster since.[7] The last rise is attributable mainly to the rise in oil revenues due to the 1973 quadrupling of its prices, and the benefits accruing from that. In the subsequent discussion, what must be of central issue, is the application of the absorptive capacity concept in the Iraqi economy.

The Emerging Economy (1921-50)

Despite Mesopotamia's rich historical background as a prosperous riverine civilization dating back 5,000 years, when the modern state of Iraq emerged in 1921 it was backward by any standards. Progress was made on a limited scale, however, from 1921 onwards bearing in mind the social and economic handicaps that the country was under.

First, there were the turbulent changes that occurred at intervals,

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4. The Arab World Key Indicators, 1975, op.cit., Table (2.1), p.14.

5. U.N.E.S.O.B. "Plan Formulation and Development Perspectives in Iraq" in Studies in Selected Developing Problems in Various Countries in the Middle East, Beirut, 1968, p.1.

6. The Arab World Key Indicators, 1975, op.cit., Table (2.1), p.14.

7. World Bank Atlas 1976.

which is possibly inevitable for any emerging nation. The more serious constraint however, was the consistent shortfall in Government revenues. It was therefore a constant problem throughout the period to balance the budget and meet the rising public expenditure of the new State. The Government did however initiate an extraordinary budget in addition to the ordinary one, which was devoted exclusively for capital expenditure which specified the projects for which the available funds were to be allocated.

During this period, agriculture, the predominant sector in the economy, had already been transformed from a subsistence one to that geared to meet foreign demand. The specialization in barley for export, as well as cotton, in addition to the Iraqi predominance in dates, all helped to increase agricultural production on a substantial scale. While there was an absolute increase in agricultural production primarily in the export-destined crops, there was a simultaneous fall in agricultural productivity due mainly to the increasing salinity of the soil, the static low level of labour skill and the rapid rise in rural population. As a consequence, there was a commensurate decline in agricultural production in relative terms, thus;

> "As a consequence the annual output of grain fell from 1,000 kilos per head of the rural population in the 1880's to 560 kilos during the 1930's and further to 505 kilos during the 1950's."[8]

The increasing agricultural export production, did lead to the establishment of processing industries related to the agricultural produce. The most important of these was date-packing, followed by wool-pressing and cotton-ginning as well as the export of hides and skins. These

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8. M.S. Hasan, 1970, op.cit., p.352.

replaced, and to a certain extent compensated for the loss of the traditional industries such as handicrafts and hand-loom weaving, which had rapidly declined in the face of the unrestricted imported manufactured goods. Investment in productive activities was low during the period, despite the fact that certain consumer industries were established in the 1930's such as cheap textiles, vegetable oils, and soap, and these satisfied most of local demand by the start of the 1950's. This low level investment can be illustrated in that even in 1950, it was not more than ID 17 millions in fixed capital which was in terms of gross investment only 10% of national income and 5% of the latter in terms of net investment.[9]

Towards the end of this period, oil revenues became increasingly significant in the economy of Iraq. They represented 15% of total Government revenue for the period 1931-50, while oil exports accounted for 26% of exports for the same period.[10] Oil had been discovered and extracted in commercial quantities by 1921, but it had not been exported until 1931. The revenues earned for the period are shown in Table 1, but it was not until the following period that oil was to become the major Iraqi export, hence the main source of revenue.

Finally, it may be worth noting that in Table 1, while the rise in oil revenue has been substantial, the rate of increase during the 1960's had been stagnant, or at least lower than the comparable rate of increase in other O.P.E.C. members. The reasons for this will be discussed subsequently, as well as the fact that in 1972, Iraq had nationalized its oil production, which explains the particularly low figure for that year, despite unrecorded revenues where barter agreements were reached.

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9. Ibid., p.358.

10. F. Jalal, The Role of Government in the Industrialization of Iraq 1950-1965. Cass, London, 1972. p.10.

TABLE 1

Government Oil Revenues

Year	Oil Revenue IDm.	Year	Oil Revenue IDm.
1931 a)	0.4	1960	95.1
1932	0.6	1961	94.8
1933	0.7	1962	95.1
1934	0.8	1963	110.0
1935	0.9	1964	126.1
1936	1.2	1965	131.4
1937	1.2	1966	140.8
1938	1.9	1967	131.7
1939	2.2	1968	203.3
1940	1.8	1969	119.6
1941	1.6	1970	213.6
1942	1.7	1971	349.7
1943	2.1	1972	189.1 b)
1944	2.4	1973	550.1
1945	2.6	1974	1,686.4
1946	2.7	1975	2,218.9
1947	2.7		
1948	2.1		
1949	3.1		
1950	6.7		
1951	15.1		
1952	33.1		
1953	51.3		
1954	57.7		
1955	73.7		
1956	68.9		
1957	48.9		
1958	79.9		
1959	86.6		

Sources: For the period (1931-71)

a). O.P.E.C. Annual Statistical Bulletin, 1975, O.P.E.C. Statistics Unit, Vienna, 1976.

For the period (1972-75)

b). Petroleum Economist, September, 1976. p.338. Where the values were given in U.S. $m. and converted to IDm. at the prevailing price of ID.

The impact of oil (1950-60)

In 1951, a very significant development took place in the form of an Agreement between the Iraqi Government, and the oil consortium operating in the country. It stipulated that the companies undertook to pay the Government 50% of the profits accruing to them from their operations in Iraq.[11] This was the most important development to occur in the country's economy, hence the barrier, referred to at the beginning, of revenue shortfall, had been surmounted,.

The Government decided in 1950 to establish an autonomous agency to channel the oil revenues for development purposes, namely the Development Board. At first, all the oil revenues were allocated to it, but after a short period, 70% of the oil revenues were diverted to the Board by parliamentary act, while the remaining 30% went to the various Government Departments.[12] The argument underlying the law was that the relevant departments were to be allowed to carry out their minor capital works without reference to the Board, whose task was to implement the major capital works. This was to remain the case until the abolition of the Board in 1959. But it had lost some of its autonomy in 1953 when in addition, a Ministry of Development was set up, thus bringing it under parliamentary control. The Board was charged with the threefold task of preparing a general plan for developing the country's resources, undertaking the execution of projects, and turning over the completed projects to the ministries concerned for administration and maintenance.

The Board commenced its operations in difficult economic circumstances especially with regard to agriculture. Iraq had been plagued by annual

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11. Government of Iraq - Law No. 23 of 1950.

12. Central Bank of Iraq. Annual Report, 1951, p.42.

devastating floods from the two rivers and their tributaries. In addition, salinity of the soil was, and still is the main obstacle to agriculture. It would follow, that any development programme should rank irrigation and drainage as of the utmost priority, with flood control as the most urgent requirement. It was logical, then, to place flood-control first on the Board's agenda. In fact, work was already in progress when the Board was set up, on the Tharthar Depression Dam and Tharthar-Habaniya complex, where water was diverted from the Tigris and stored, whence the Board took the project over and completed it. This was one of the most vital projects, and a turning point, which protected the country from the threat of future floods.

At approximately the same time, the Government had requested various foreign consultants to survey the Iraqi economy. The most important was the IBRD Mission Report of 1950, which recommended besides irrigation projects, that emphasis should be placed on agriculture. Where industry was established, it was to be for industries dependent upon agriculture, and agricultural produce, such as food processing and canning. This was based upon the argument that a country which was predominantly agricultural, could thus maximize its comparative advantage, at a fairly minimal opportunity cost in terms of factor allocation. The Government took the IBRD's advice, which had been similar in the case of other consultants. As a result of Iraq's substantial potential as an agricultural country, this classical argument held under static conditions, especially when the rise in world demand for agricultural produce in the 1950's was taken into consideration. In addition, the limited skill of local labour, meant that it was best suited to traditional work in agriculture. While this argument held, it did neglect completely the promotion of modern industry, even on a limited scale. The report instead recommended that traditional craft industries should be expanded, as a result of a preliminary survey of the then small-scale

existing industries. The availability of minerals, especially oil meant nevertheless that Iraq had a comparative advantage in some fields. This applied for example to the Bitumen refinery and the Mission recommended that its capacity be expanded to 60,000 tons annually. This was favourable because of the readily available skilled labour near the Mosul oil fields.[13]

The Board had formulated its First Five Year Plan for the period 1951/52 - 1955/56. Most, if not all, of the expenditure was to be on irrigation projects, and the remainder on transport. This Plan was soon to be replaced, the main factor for its replacement being the under-estimation of the oil revenues. The new Plan which may be called the First Six Year Plan 1951/52 - 1956/57 was based upon revenues of ID 168.7 million. It allocated investment expenditure at ID 155.4 million with the irrigation projects such as dams and drainage canals having the largest share. In addition, transport with the preceding item claimed two thirds of the allotted expenditure, while industry obtained 20% of the total. No allocation, however, was made for any specific industrial project, owing to the lack of preliminary studies at that stage. At the same time in 1953, the Ministry of Development was set up, as was mentioned earlier, and the Minister became Chairman of the Board, thus ensuring Parliamentary control.[14]

The Second Plan (1955-59) was formulated before the first Plan was completed. It was necessitated by the sharp increase in the oil revenues which were considerably in excess of the original estimates. The second factor was that the cost estimates of the First Plan had become unrealistic. The third factor was, the changes introduced in the 1953 Law which empowered

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13. I.B.R.D. The Economic Development of Iraq. Johns Hopkins, Baltimore, 1952.

14. A.Y. Badre "Economic Development of Iraq" in C.A. Cooper and S. Alexander (eds). Economic Development and Population Growth in the Middle East, New York, 1972, p.287.

the Board to finance projects belonging to other departments. The total expenditure envisaged in the Plan was almost double that of the First Plan. In the industrial sector, provision was made for specific industrial projects, and the Plan did make a classification of this sector. The Second Plan was not completed however, and was replaced by the Third Plan (1955-60) which was presented in 1956. The main factor which affected its formulation was the same as in the case of the preceding one, namely, the sharp increase in the level of oil revenues. In addition, several studies had been completed and made available to the Board by this time, which were mainly in the fields of irrigation and drainage, communications and housing. The Plan provided for average annual expenditure of ID 90.8 million for the next five years. It contained a greater element of expenditure on social overhead capital than its predecessors, which was mainly on hospitals. With a large increase in the level of disposable revenue the planners decided to make more of this revenue available for such capital works, since the urgent needs of flood control and irrigation had been satisfied. It was also more flexible and the element of project appraisal was introduced, and objective criteria were applied.

In the three Plans mentioned, the share of agriculture was the highest of total expenditure, due mainly to the capital works on irrigation and drainage, while the share of industry had increased in absolute terms, but declined consistently in relative terms. The most significant increase, however, was in the sectors of transport and buildings, particularly in the Third Plan. The Development Board's main feature was the wide discrepancy between planned and actual expenditure. In the period 1951/52 - 1956/57, the planned expenditure was set at ID 218 million, whereas actual expenditure was ID 121 million, or 55% of the planned expenditure.[15] Moreover, actual

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15. Ibid., p.294.

TABLE 2 Revenues and Expenditures of Development Board,[a] Ministry of Development and National Development Plan (ID '000)

Final Year	Revenues	Expenditures	Surplus or Deficit	Accumulated
1950-51	37	15	22	22
1951-52	7,467	3,131	4,336	4,358
1952-53	23,999	12,838	11,161	15,519
1953-54	35,278	12,257	23,021	38,540
1954-55	40,728	20,868	19,860	58,400
1955-56	60,762	34,025	26,737	85,137
1956-57	51,125	43,041	8,084	93,221
1957-58	35,873	57,415	-21,542	71,679
1958-59	61,741	52,215	9,526	81,205
1959-60[b]	32,070	94,022[d]	-61,952	19,253
1959-60[c]	11,497	9,290	2,207	21,460
1960-61	47,678	47,565	113	21,573
1961-62	66,684	66,918	- 234	21,339
1962-63	70,033	59,297	10,736	32,075
1963-64	67,603	54,255	13,348	45,423
1964-65	76,468	75,275	1,193	46,616
1965-66	75,029	59,825	15,204	61,820
1966-67	70,801	82,757	-11,956	49,864
1967-68	81,801	68,915	12,886	62,750
1968-69	88,523	64,406	24,117	86,867
1969-70	90,833	170,749	-79,916	6,951
1970-71	111,167	78,050	33,117	40,951
1971-72	189,281	153,782	35,499	75,567
1972-73	135,882	128,529	7,353	82,920
1973-74	144,838	243,985	197,853	280,773
1974-75	661,751	576,367	85,384	326,157
April - Sept '75	317,554	294,221	23,333	389,490

Source: Central Bank of Iraq Bulletins 1953- to No. 3, 1976.

(a) Development Board started operation in 1951, then was abolished in January 1960.

(b) Represents Revenues and Expenditures of Development Board for period April 1959 - January 1960.

(c) Figures for the period starting January 1960 (date at which the provisional Economic Plan had begun) and ending end of March 1960.

(d) Including ID 53,418 as a loan extended to government and semi-government institutions.

revenue for the period was ID 220 million, which was more than the estimated revenue of ID 210 million, and the surplus for the period was about 45% of total actual revenues as shown on Table 2. This was the main criticism levelled at the Board by the new regime in 1958, whose policy was to eliminate or reduce this surplus. Secondly, it undertook to develop agriculture through the Agrarian Reform measures, to expand manufacturing industry, and to promote social welfare for the poorer sectors of the population, mainly through housing. Actual revenue exceeded actual expenditure in 1951-58 by 31% of the actual revenue, whereas from 1958-65, it was only 12%. What has to be borne in mind is that 50% of oil revenues were devoted to development in the second period as opposed to 70% of the revenues for the first period, but this will be indicated in the following section.

Finally, a brief mention of the level of government expenditure might put the discussion in perspective.[16] The argument will be detailed in Chapter 6, but here it is sufficient to note that, in a study relating to this period, it was found that the Iraqi' Government's revenue as a proportion of national income was 19.8% for 1959, using the 1956 data. The same study classifies Iraq with those countries with per capita income of less than $200 per annum.[17]

Central Planning (1960-70)

In the most important sector, namely, agriculture, output was unstable, while its contribution to GDP declined from an annual average of 29% during 1953-55 period to that of 19% during 1958-60 and 1962-64

16. A. Martin and W.A. Lewis 'Patterns of Public Revenues and Expenditures' The Manchester School of Social and Economic Studies, September, 1956. Their findings for the period 1953-54, based on 6 developed countries. With revenues/GNP (at factor cost) ranging from 23.5% to 37.1% and the less developed countries with ratio of 8.4% to 22.2% of GNP, and a later study by, J.G. Williamson 'Public Expenditure and Revenues: An International Comparison' The Manchester School of Social and Economic Studies, January 1961. It was found that more countries were in the study and with a longer period, 1951-57. Showed that 17 countries with revenues/GNP ratio ranging between 20% and 35% which were high-income countries, and 15 low-income countries with their ratio ranging between 9% and 21%. There was a close fit with $R^2 = 0.73$ using 33 countries.

17. U. Tun Wai "Taxation Problems and Policies of Underdeveloped Countries". I.M.F. Staff Papers, Volume 9, 1962.

periods.[18] This was due mainly to the low priority given to agriculture in the successive plans, where in the early 1960's only 16% of total public investment went into agriculture.[19] This is part of the general lack of investment throughout the economy, where investment in fixed capital formation since had declined from 24% in 1958 to 15% in 1965 as a share in gross national expenditure.[20] Industrial development on the other hand was limited during the period, due to the uncertainty over the successive governments' intentions, which was generally hostile to the private sector on ideological grounds. This had culminated in the 1964 nationalization measures, to be discussed subsequently, which brought all industrial establishments were under public control. In foreign trade, however, the imports of capital goods and construction materials amounted to about 40% of the gross fixed capital formation. Moreover, the value of commodity exports and commodity imports (at constant 1960 prices) more than doubled during the period 1953-65, where crude oil accounted for about 95% of total commodity exports.[21] The rest of the commodity exports may be summed up thus,

> "..... non-oil exports remained relatively insignificant, mainly because of the complex adverse conditions obtaining in the agricultural sector over the past decade. The large trade surplus realized on account of oil exports was largely: absorbed by the deficit incurred in the services account."[22]

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18. U.N.E.S.O.B., 1968, p.1.
19. Y.J. Ahmad Oil Revenues in the Gulf: A Preliminary Estimate of Absorptive Capacity. O.E.C.D. Development Centre, Paris, 1974, p.33. where this represented only 32% of the planned investment for this sector.
20. U.N.E.S.O.B., 1968, op.cit., p.2. "Plan Formulation and Development Perspective in Iraq" in Studies in Selected Development Problems in Various Countries in the Middle East.
21. Ibid., p.2.
22. Ibid., p.2.

In 1959, the Development Board was abolished by the new regime and the Planning Board was set up, as well as the Ministry of Planning.[23] The Planning Board's share of oil revenues was 50%, whereas the Development Board's share had been 70%. The Planning Board's first task was to formulate a provisional plan as the Third Plan had been abolished.

This Plan was characterised by the decline in the total allocation for all the sectors, and the share of the buildings' sector increasing to almost one half of the total allocated to all the sectors combined. This was due to the priority given to housing and public buildings. Following the provisional plan of 1959, a much more detailed one, which may be referred to here as the Fifth Plan (1961-65), was put into effect. An estimated income of ID 315.5 million was to be from oil revenues out of the total estimated income of ID 556.2 million. Meanwhile, the Iraqi Government had arranged in 1961 eastern bloc loans of a total of ID 77.3 million, out of which ID 65 million came from the U.S.S.R. It was to be for specific projects to be drawn upon on a project by project basis. The other Government revenue was estimated to be ID 30.8 million, thus leaving a gap of ID 142.4 million between budgeted revenue and expenditure. The allocations were greater than actual disbursements even in the first full year of operation 1962-64, when only ID 59.3 million was spent against allocation of ID 180.2 million.

Before the end of the fiscal year 1962-63, a new regime abolished the preceding Plan and replaced it with a more realistic one year programme for 1963-64. The expenditure was set at ID 65.9 million, as opposed to the original allocation of ID 125.1 million for that year. But actual expenditure was only ID 54.2 million, while actual revenues had reached ID 67.6 million. This was followed by what may be termed as the 'Interim Plan' (1964-65), which continued from the preceding year. The estimated

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23. Republic of Iraq - Law No. 74 of 1959.

expenditure was ID 106.8 million, but actual expenditure was only ID 75.3 million, which again fell short of budgeted appropriations.

Certain important economic developments which were to have far-reaching effects took place. First, the 1959 Agrarian Reform Law was passed as the first act of the Republican regime. Secondly, in 1961, Law 80 was passed, which restricted the oil companies operating in Iraq to only 0.5% of their former holdings under the original concession. This was also to have an impact since the Iraqi oil exports averaged only 5% annual increase for the period 1960-70 against an average 10.3% of annual increase for the rest of the region during the same period. Finally, the 1964 nationalisation measures which brought all commercial banks, and insurance companies, under public ownership. In addition, large and medium-sized industries were also nationalised. All these measures will be mentioned in subsequent chapters within the context of the level of investment of the private sector in both agriculture and industry, and its comparison with the level of Government investment expenditure. During the period, the Government, in addition to its loans from the Eastern bloc, had borrowed ID 30 million interest-free loan from Kuwait. This was in 1963, and during the same year, it may be noted, the Ministry of Industry was established, which reflected the Government's thinking to the shift of emphasis to industry.

In 1963, the new Sixth Plan (1965-70) was launched, with a total expenditure estimate of ID 666 million which was the highest reached thus far. The allotted sum to the development budget was ID 561.2 million, to be provided by the Government from the Planning Board revenues. The difference was to be made up by a realistic expectation that there would be inevitable shortfalls in actual against planned investment. The objective of the Plan was to accelerate the rate of growth, and the diversification of the economy in order to reduce the heavy reliance upon the oil sector. National income was expected to grow at 8% annually throughout the period, with

growth targets set for agriculture, industry, and building at 7.5%, 12%, and 8% respectively.

Iraq, as a traditionally agricultural country, had annually exported barley, and sometimes wheat and rice. The agrarian reform law which sought a fair distribution of land, failed in a number of ways and agriculture received a setback which it has not recovered from. The direct result of the law was that exports of barley ceased, and 40% of the rice and wheat consumption had to be met by imports, whose proportion had increased in the last ten years. Only a small proportion of land was re-distributed, and the lack of administrative and technical manpower to implement the law, led to the abandonment of land particularly in the South which is rice-growing. In addition in the fertile north where wheat is grown, the civil war which had raged for almost fifteen years harmed production. The main Iraqi agricultural export, dates, were fortunately unaffected, as Iraq's exports of that product, amount to 75% of the total world output. The Government policy in shifting the emphasis to industry played a significant role in the stagnation of the agricultural sector, and the successive Plans devoted the highest expenditure to industry, then to buildings and social welfare expenditures. The latter two were important in a developing country, but were hardly economic decisions. In the case of industry, import substitution was of utmost importance, which went simultaneously with the restriction of imports of foreign goods, especially luxury goods and consumer durables. These measures sought to protect the infant industries, and it is arguable whether they are efficient.

But the most important step in the industrial sector was to establish the National Petroleum Industry 'INOC' in 1964, which was reconstituted in 1967. Production was based upon the rich resources of oil and sulphur. The Government recognised the potential of petrochemical industry for long-term economic growth, and the many forward linkages with the manufacturing industries.

Fertilizer plants were set up and they are being expanded in the latest plan, based in Basrah for ready export.

The average life span of the Five Year Plans has been two years throughout the period. In the period 1953-65, the development expenditures averaged approximately ID 45 million annually. During the same period National Income at factor cost grew from ID 243.95 million in 1953 to ID 632.36 million in 1965, an average increase of ID 30 million annually. If we ignore oil, then the national income becomes ID 114.53 million for 1953 and ID 344.97 million for 1965, hence the annual growth would be ID 18 million. This shows that for ID 1 of growth in national income originating in the non-oil sectors of the economy has been associated with ID 2.6 of development expenditure. In the period 1953-58 the ratio was 2.7, whereas for the period 1959-65 the ratio dropped to 2.5, which could be explained by the fact that long-term investment had matured. The ratios suggest that the non-oil sectors, can achieve a return on government investment. This is also shown by the fact that GDP at factor cost shows an annual growth rate of 8.2% for 1953-65, but when the mining and quarrying sector is taken out, the annual growth rate rises to 8.9%.

GNP at current factor cost rose from ID 265.3 million in 1953 to ID 698.2 million in 1965 which shows annual growth rate of 8.4%. Oil revenues throughout the period were between 0.25 and 0.20 of national income which accounted for most of the growth. Consumption on the other hand rose from ID 178.7 million in 1953 to ID 433 million in 1965, which showed an annual growth rate of 7.65. annually.[24]

Finally, the planning position could be summed up thus,

> "There were no less than four development plans between 1951 and 1958, of which the first and third (both five-year plans) did not last for even a year. The situation

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24. A. Y. Badre, 1972, op.cit., p.304.

TABLE 3

Sector	Fourth Plan (1959-62) Planned Expenditure ID m.	%	Fifth Plan (1961-65) Planned Expenditure ID m.	%	Sixth Plan (1956-69) Planned Expenditure ID m.	%
Agriculture	47.9	12.2	112.9	20.3	173	25.9
Industry	38.7	9.8	116.8	29.9	187	28.1
Transport	100.8	25.7	136.4	24.5	110	16.5
Buildings	191.5	48.7	140.1	25.2	134	20.1
Miscellaneous	14.0	3.6	0	0	62	9.3
Total	392.9	100	556.2	100	666.0	100

Source: F. Jalal The Role of Government in the Industrialization of Iraq 1950-1965 Cass, London, 1972, p.38.

> improved somewhat in the post-Revolution (1958) period : the first four year provisional plan ran for less than two years but the five year detailed plan lasted about four years, and the subsequent (1965-70) plan largely completed its course." [25]

This is shown in Table 3, and 4 where the latter quantifies the degree of plan implementation.

The Rise in Oil Revenues

The discussion in the preceding section should have rendered some idea of the state of planning in Iraq during the 1960's. It is held by some eminent economists that,

> "A national plan should be a blue-print of a cumulative process of economic development in a country, as this process will evolve when started, sustained and controlled by certain induced exogenous changes in the social system, represented by purposeful state interferences as defined in the plan."[26]

An opposite school of thought, however sees planning as an anathema to economic progress,

> "The extensive controls and the heavy taxation imposed under comprehensive planning are not only unrelated to the raising of general living standards but generally contrary to this ostensible aim of the policy. In fact the situation is created where it is the people who are serving the economy rather than the economy serving the people."[27]

Iraq has consistently adhered to the first doctrine, from the 1960's onwards. While positing that planning can be very important in the case of a developing economy, the private sector could also play a significant role within the framework of the plan. The emphasis on

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25. Y.J. Ahmad, 1974, op.cit, p.29.

26. G. Myrdal Economic Theory and Underdeveloped Region, Methuen, London 1964, p.85.

27. P.T. Bauer, Dissent on Development, Weidenfeld and Nicholson, London 1976. p.86.

the state's provision of funds and the complete control of economic activity as will be shown in Chapter 6 in terms of government expenditure.

This period commences with new Plan (1970-75) which was announced in 1969. The total expenditure was estimated at ID 853.3 million with a further ID 321.8 million represented by self-financing investments by government organisations and semi-autonomous agencies, while the private sector's financing was expected to be ID 285 million. The Plan's main feature was the integration of hydrocarbon industry with the rest of the economy by means of the expansion of oil-refining and chemical industries. The growth rates for the agricultural and industrial sectors were set at 7% and 12% respectively. The Plan's share of the income from oil was estimated to be ID 425 million or ID 85 million annually. After the Tehran Agreement of 1971 however, the average income expected was not less than ID 330 million during the Plan period. The amount of ID 405 million, i.e. ID 202 million annually, improved the chances of actual expenditure within the Plan. This resulted in a revision of the estimates for expenditure in 1970-71 and 1971-72 which were to be ID 116.5 million and ID 202 million respectively, while actual disbursements were ID 78.1 million and ID 152.8 million. This was followed by a sharp drop in allocation in 1972-73 and a larger fall in expenditure as a result of the low level of exports due to the oil nationalisation in 1972.

In 1973, however, Law 157 was passed which gave extraordinary powers to state organisations involved in the implementation of major development schemes. They would now circumvent normal planning, import, and tax procedures in order to ensure rapid implementation of any specific project. The Government had promised a rate of economic growth rise of 13% excluding oil during 1974-75 with per capita incomes rising 33% in a year.

TABLE 4: Planned and Actual Development Expenditure by Main Economic Sectors, 1951/52 - 1966/67 ID millions, percentage

Sector	1951/52 - 1955/56				1956/59 - 1960/61				1961/62 - 1964/65				1965/66 - 1966/67			
	Allo-cation	% of total	Expend-iture	% of total	Allo-cation	% of total	Expend-iture	% of total	Allo-cation	% of total	Expend-iture	% of total	Allo-cation	% of total	Expend-iture	% of total
Agriculture	60.7	44.5	32.2	43.3	124.3	25.6	62.2	25.1	87.5	19.8	28.8	11.4	50.7	23.4	14.2	11.3
Industrial	18.1	13.3	5.5	7.4	66.0	13.6	36.1	14.6	121.1	27.5	43.5	17.2	61.0	28.2	38.0	30.0
Transport & Communications	30.0	22.0	20.2	27.1	136.6	28.2	56.6	22.9	115.0	26.0	67.2	26.5	44.7	20.7	26.9	21.3
Building & Housing	27.5	20.2	16.5	22.2	157.9	32.6	92.4	37.4	118.4	26.7	113.7	44.9	59.9	27.7	47.1	37.3
Sub-total	136.3	100.0	74.4	100.0	484.8	100.0	247.3	100.0	442.6	100.0	253.2	100.0	216.3	100.0	126.2	100.0
Others			8.6				2.8				2.6				-	
			83.0				250.1				255.8				126.2	

Source: UNESOB, "Plan Implementation in Iraq, 1951-1967" p.9. Studies in Selected Development Problems in Various Countries in the Middle East, 1969.

This was a turning point, particularly when an interim investment programme was formulated in 1975 with a total of ID 1508.5 million, the highest allocation of ID 668.5 million going to industry. During 1975, the new Five Year Plan 1976-80 was being formulated, with expenditure estimated at not less than ID 5,000 million and industry's share still the highest at ID 1,400 million, followed by agriculture at ID 1,360 million, which reflected the Government's current thinking with a shift of emphasis to this neglected sector. Communications and transport's estimates were at ID 1,000 million, and buildings, and social services and the item 'other projects', were allocated ID 1,000 million each.[28]

Finally, the economic development of the country has made considerable strides, particularly since 1972, when oil was nationalised, and the austerity measures that accompanied it. Infrastructure improvements encompass rail and road transport, and a deep offshore harbour was built for super-tankers in the Gulf. Moreover, in industry there had been a large increase in the chemical fertilizer plants, and the initiation of petrochemical industries. In addition, there has been expansion in existing industries such as textiles, sugar, and cement, and tractor and truck assembly plants into the planned car assembly plants, as well as new industries such as an aluminium smelting plant, a steel complex, and expansion of plastics industry. Some of these have been implemented within the existing Plan, while others will be carried out soon. The evidence seems to suggest that the country is utilizing an increasing proportion of its resources in domestic investment, the bulk of which is by Government, and is likely to do so for some time to come. There is an increase in the economy's absorptive capacity shown by the fact that the

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28. Q.E.R. No. 4, 1975, Since then the total allocated for the Plan was ID 10 billion based on estimated oil revenues of $5.4 billion in 1975.

increase in oil revenues is barely sufficient to implement the latest provisional 5 Year Plan of 1976-80 which replaced the one referred to previously.[29] The total expenditure of the Plan is expected to be ID 10 billion at current prices.[30] The allocation to agriculture and industry are approximately equally divided with a slight priority given to the latter.

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29. There is a second loan from Japan for $1 billion, which will be shown in Chapter 6.

30. Q.E.R. No. 1, 1977, p.9.

CHAPTER 3

THE ECONOMY OF KUWAIT

Kuwait has undergone one of the most remarkable changes in the last twenty years, in that it has been transformed from a backward and poor economy to one which ranks amongst the world's richest nations in terms of per capita income.[1] The most important factor underlying this transformation was the discovery of oil, which played such a major role in the country's development, both on the supply side through the provision of finance, and on the demand side through extending the local market. One of the main aims of this Chapter is to consider these linkages in historical context.

The economy up to the 1950's could be characterized as one of the most impoverished in the world. The traditional agricultural sector, prominant in the majority of developing nations was non-existent, owing to the harsh climate, the unsuitability of the soil, and lack of water resources. The two important sectors were pearling and trade. The first was the traditional occupation of the majority of the labour force, as was the case with the rest of the Gulf countries. It was however, adversely affected since the 1930's by a combination of the world economic slump and the production of cheaper mass-produced cultural pearls by Japan. In addition, it could be argued that this sector's decline was accelerated by the emergence of the oil industry as labour found more lucrative and less hazardous ways of occupation. The second sector, trade was rendered possible because of Kuwait's unique location on a natural harbour at the northern end

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1. G. Amin, The Modernization of Poverty E.J. Brill, Leiden, 1974, p.11. Where annual growth has been 7% to 8%.

of the Gulf. For centuries, the Kuwaiti merchants were the link between Africa, the Indian sub-continent, and the Arabian hinterland. Not only mercantile skills were prominent but there was also a considerable merchant fleet which traded between Africa, the Gulf ports, and the Indian Ocean. These mercantile skills played and continue to play an important part in Kuwait's economy. Services remain the most prominent sector, in terms of employment today, although now with the modernisation of the economy, these activities embrace banking, insurance, and other financial services, all of which to some extent are generated through the needs of the oil sector. It is expected that they will play an even more important role in the context of the present diversification policies which aim to re-establish Kuwait as an entrepot trading centre in the region.

Oil in Kuwait dates from 1931, when it was discovered on a commercial basis, but not exported until 1946. However oil exports had not reached a substantial amount until 1950, but since then the rate of increase in the level of production has been one of the fastest in the world, and Kuwait had become one of the major oil producers. This could be seen in table 1, where the rise has been steady throughout the period, except for a drop in 1968/69 from 1967/68 level due to the closure of the Suez Canal in 1967. The rise of over more than fourfold in 1974/75 over that of 1973/74 reflects the quadrupling of oil prices by OPEC in 1973, referred to in the preceding Chapter. Then revenues almost halved in the following year 1975/76, which shows a drop in oil production, due partly to deliberate government policy at preservation of a wasting asset, and partly the decrease in demand for high-sulphur heavy crude such as Kuwait's.

The emerging economy (1950-60)

The Kuwait Government sought to utilize the considerable oil revenues from the outset for purposes of development. The issue was whether to invest domestically or overseas, as the latter promised a higher rate of return, at least in the short-run. Once however it was decided to invest

TABLE 1: Government Oil Revenues

Year	Oil Revenues (KDm) (a)
1950	4.9
1951	6.7
1952	20.7
1953	60.2
1954	69.3
1955	100.5
1956	104.3
1957	110.2
1958	128.5
1959 (b)	159.8
1960	158.6
1961/62	167.1
1962/63	173.0
1963/64	190.6
1964/65	206.2
1965/66	216.1
1966/67	231.7
1967/68	263.1
1968/69	246.5
1969/70	279.3
1970/71	297.7
1971/72	354.1
1972/73	506.6
1973/74	530.9
1974/75	2,382.0
1975/76	1,686.7

Source: OPEC Annual Statistical Bulletin 1975, OPEC Statistics Unit, Vienna, 1976.

(a) Starting, 1960 year ending March 31st.

(b) Revenue from (1.1.1959 to 31.3.1960)

domestically, then it was necessary to decide whether priority should be given to social overhead capital which was non-existent, or instead if more directly, productive ventures should be embarked upon. In the event, the expenditure was predominantly allocated to social overhead capital and to welfare. The expenditure went mainly on schools, housing, and water provision projects as well as the adoption of a liberal welfare policy. At the same time, one of the earliest government-participated companies was formed, the Kuwait Oil Tanker Company, thus making the country, a pioneer among Arab oil-producers in owning a national tanker company. This company still remains the largest locally owned tanker venture in the Middle East.[2] In addition to the Development Welfare Board which had been set up to administer the 1952/53 - 1957/58 Plan, an Investment Board was established. Its function was to undertake infra-structure projects, but it controlled a mere third of the funds allocated under the Plan, and remained the poor relation of the Welfare Board. The role of the Investment Board was extended under the Second Plan during 1958/59 - 1963/64 period however, as this provided for a large-scale construction programme. Unfortunately, oil revenues were over-estimated and Kuwait ran into budgetary difficulties as a consequence. This resulted in the suspension of the Plan in 1960/61 and the Investment Board was unable to finalise some of the projects it started. Until this time, the main characteristics of the economy was the high savings rates which amounted to 44% of GNP.[3]

By 1960, the oil sector accounted for 61% of GDP, and more than 94% of the budgetary revenue was due to oil. Though the financial contribution

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2. The entire fleet was handed over in April 1977 as the nucleus to the newly formed Arab Tanker Corporation, set up by OAPEC.

3. R. El-Mallakh Economic Development and Regional Cooperation, Kuwait. Chicago, 1969, p.81.

of the oil sector was welcome, the economy suffered from the fact that traditional activities were affected adversely, as the oil sector expanded as already indicated, and labour, even for unskilled occupations became in scarce supply. Investment opportunities were limited in any case by the extent of the domestic market, and the continuing lack of infrastructure, despite the start made during the first two plans. In the absence of any obvious opportunities for productive investment outside the hydrocarbon sector, the state's continuing preoccupation with social welfare was not surprising, as there was little else for it to do. The most significant step taken by the Government throughout the 1950's and 1960's is the distribution of oil-income, through a large scale programme of land purchase and resale to the private sector. Both World Bank missions recommended a reduction this allocation, and the shift of revenues to Government investment in private and semi-private industries, but it was difficult to see what activities should be usefully expanded.[4] Table 2 shows the land purchase expenditure over the period. From this, it can be seen, that the increase has been consistent if irregular from the beginning of the period till it reaches a peak by 1966/67, then there is a steady fall until the end of the period, which reflects partly the housing shortage due to the population pressure.

Besides the emphasis on infrastructure, the Government concentrated on making the country an efficient regional communications centre, which it succeeded in doing to a large extent. This was important for Kuwait itself as a trading nation with considerable future interest overseas. This with the substantial expenditure on welfare, resulted in there being only a minimal surplus to invest abroad during this period, although private

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4. IBRD The Economic Development of Kuwait, 1961 Mission and 1963 Follow-up Mission. Johns Hopkins, Baltimore, 1965. pp. 87-88.

TABLE 2: LAND ACQUISITION BY GOVERNMENT

YEAR	1 Land Purchase KDm.	2 Index of expenditure on land purchase	3 Total Govt. Expenditure KDm.	4 1 as percent of 3 %
1957	21.9 (a)	100	88.8	25
1958	40.0	183	116.5	34
1959	58.1	265	143.3	41
1960/61	43.0	196	135.1	32
1961/62	58.9	269	161.7	36
1962/63	46.5	212	163.6	28
1963/64	32.0	146	176.3	18
1964/65	45.0 (b)	205	189.6	24
1965/66	79.0	361	260.0	30
1966/67	95.0	434	321.0	30
1967/68	63.0	288	328.2	19
1968/69	17.0	78	283.0	6
1969/70	9.6	44	299.2	3
1970/71	24.3	112	319.3	8
1971/72	19.9	91	365.9	5
1972/73	15.7 (c)	72	409.3	4
1973/74	19.4	89	536.3	2
1974/75	47.7	218	936.7	5
1975/76	111.0 (d)	502	898.5	12

Sources: (a) IBRD The Economic Development of Kuwait. Johns Hopkins, Baltimore, 1965. p. 172
Columns 1 & 3 Columns 2 & 4 were calculated from 1 & 3

(b) Central Bank of Kuwait - Third Annual Report, 1972. p.69.

(c) Central Bank of Kuwait - Economic Report for 1975

(d) Preliminary Results.

investment in the region and overseas did take place. The basis of a sound banking and insurance system were laid down during the period, to meet the demand in increased savings for the first, and commercial activities for the latter.

The Surplus Economy (1960-70)

The growth of the economy has been impressive by the standard criteria in that the rate of growth of GNP at current prices stood at 10% per annum.[5] Capital formation on the other hand, was 22% of GNP and consumption represented only 57% of GNP in 1967-68. The excess of GNP over consumption and capital formation of 21% was found as an approximate measure of large net transfers by Kuwait of resources abroad.[6] The rate of domestic investment achieved in the 1960's was in line with that recommended by the IBRD Mission in 1961, which specified that 28% of the total revenues of the State should be allocated for domestic development.[7] The Government did eventually act upon the IBRD recommendation by attempting to diversify the economy by means of investment in private and semi-private industries. In fact, actual expenditure for public works in 1961/62 - 1962/63 was about KD 35 million per annum, or 19% of total public revenue, as compared with the 22% as suggested by the mission, and the share invested in the private sector was 6%. The land purchase scheme partly made up for this gap as well as the increase in current expenditure.[8]

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5. E.Y. Asfour "Prospects and Problems of Economic Development of Saudi Arabia, Kuwait, and the Gulf Principalities". in C.A. Cooper and S.S. Alexander (eds). Economic Development and Population Growth in the Middle East. New York, 1972, p.383.
6. Ibid., p.384.
7. Ibid., p.3.
8. Ibid., p.3.

The second significant development was the setting up of the Planning Board also in 1962. It formulated the Five Year Plan (1967/68 - 1971/72), whose short-term objectives were firstly, economic development which envisaged an increment of 37% in GDP for the Plan period, averaging an annual increase of 6.5%, whereas the annual average increase in GNP was to be at 6.9%, while national income growth was projected at 6.5%. The other aim was diversification of the economy, by increasing the value added in manufacturing industry from 3.6% of the 1966/67 GDP to about 4.1% of GDP in 1971/72. The diversification was to be mainly in petro-chemicals, development of water resources, and oil refining. The limited absorptive capcity of the economy was to be taken into account as the appropriate measure of the investment.

The Plan was never ratified by Parliament, and thus did not come into effect, with the result that the Plan remains suspended. Moreover, the Board's powers were considerably circumscribed as a consequence, and it became relatively ineffective in formulating economic policy. But the main function of the Board, at least up to 1970, had been to attempt to ensure that the development expenditure undertaken by the public sector remained approximately within the limits laid down in the framework of the Plan. The draft Plan projected development expenditure for the Plan period to reach KD 908.5 million, of which KD 507 million was to come from the public sector, KD 60 million from the mixed sector, and KD 34.5 million from the private sector respectively. The Board also conducts various censuses, both demographic and economic, and recommends certain policies, and has been particularly active in manpower policy, albeit in what might be termed an advisory capacity.

There has been for the Plan period very significant lags in expenditure outlays. This was particularly noticeable for the private sector, as of total allocation on gross capital formation, only 49%

was spent. The national income grew at an average of 7.2%, however, which exceeded the Plan's projection of 6.9% annual growth, while the three sectors, power, transport, and communications realised their targets as set in the Plan. The oil and gas sector accounted for 57% of GDP, and 83% of the total Government receipts.

TABLE 3: Share of Current and Development Expenditures in Total Budgetry Outlays (1961/62 - 1966/67) % of Total Expenditure

	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67
Current	41.5	49.1	50.6	52.9	55.0	55.2
Development	22.1	21.6	26.5	22.3	25.8	33.8
Transfers	-	0.8	1.7	2.6	6.1	6.9
Land Purchase	36.4	28.5	21.6	22.3	13.1	4.1

Source: R. El-Mallakh, Economic Development and Regional Cooperation : Kuwait. Chicago, 1969.

The two major aims of economic planning have been the reduction of Kuwait's heavy dependence on immigrant labour as a source of manpower and on oil exports as the main source of revenue. This is to be achieved by the further expansion of the infrastructure, the diversification into industry, particularly for exports and the improvement of labour productivity and skills, and more intensive capital investment.

The constraints are two-fold in that optimum investment opportunities for the substantial savings, namely, the demand part, and secondly the limitations in manpower and material. Hence the raising of existing levels of technical skills and capital-intensive investment. Domestic investment had shifted to foreign outlets because of limited absorptive capacity. The returns from both public and private foreign investment were KD 43 million in 1964-65 as an example. This represented 45% of fixed capital formation or about 18% of gross national savings, and 8% of national income for that year. The national savings for the same year were KD 240 million which represented 45% of GNP, a rate which was expected to be maintained for

the Five Year Plan. The barriers to domestic investment are considerable, if capital formation for the same year represented only 41% of gross national savings.[9] This could be taken as an indicator for continued foreign investment on a large scale, and the continued growth of income from that investment. The semi-public companies, the two most important being the Kuwait Investment Company and Kuwait Foreign Trading and Contracting Company, are among many which undertake foreign investment. This ranges from Euro-dollar bonds and property in the case of the former to setting up and financing joint-venture projects in the case of the latter.

This period saw the attempts at diversification made by the Government in the form of joint financing with the private sectors of certain industries, and the contraction of the land distribution programme by the end of the period. The banks and other financial institutions were consolidated and increased due to the growing demand on their services. Investment abroad increased, as income on foreign assets grew from KD 31 million in 1962/63 to KD 104 million in 1969/70. Gross fixed capital formation rose faster than consumption from 1962/63 to 1969/70; the rates being 9.9% and 7.7% per annum respectively. GNP grew at an average of 7.7% annually from 1959 to 1962/63, which reflected the growth in the oil sector and the increase in immigration. During the period 1962/63 to 1969/70, the economic growth averaged 9% per annum. It fell to 5.9% in 1969/70 and 5%-6% in 1970/71, partly due to the slowdown of construction expenditure under the Land Acquisition Programme. Both private and public investment expenditure declined, due to the fall of demand in the already largely developed construction sector. However the fall in consumption could be due to the decline of households expenditure for consumer durable goods. Income generated from oil accounted for 57% of GDP in 1969/70. Other sectors grew, and accounted for 43% of GDP, with services accounting for 11.9% of GDP in 1969/70, followed by trade at 8.6%, and public administration at 5.6%. Construction, manufacturing, electricity and water, and transport each contributed from 3.5% to 4% of GDP in 1969/70.

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9. E.Y. Asfour, 1972,op.cit., p.386.

Attempts at Diversification 1970-75

A new Ten Year Plan was drafted in 1969 for the period 1969-78, but no expenditure estimates were given for the whole period, as these were to be determined on an annual basis in line with oil revenue growth. By avoiding specific expenditure commitments, it was hoped to avoid the situation which arose during the first plan when expenditure fell short by 65% of its allocation.[10] It was realised that the continuous demands on the General State Reserves to aid the fellow Arab States, as will be shown subsequently, and the administrative constraints in implementing the Plan, made it difficult to keep to expenditure targets. It is this that makes estimation of future absorptive capacity difficult in an economy like Kuwait, which is changing so rapidly.

In response to a request by the Kuwait Government, the IBRD sent a mission in 1971 to report on diversification of the economy, in order to lessen its heavy dependence upon oil. This mission recommended diversification into export-led industries in support of Government policy. But its main recommendation was the setting up of a bank to finance industry.[11] The Industrial Bank came into being in 1973, with a nominal capital of KD 10 million, provided by the Government from the official reserves. The bank was charged with financing infant industries at very low rates of interest. And in 1975, its capital was raised to KD 100 million by borrowing from the public by means of issue of debentures, while other half was to be a government loan. Whether or not the diversification is completely successful remains to be seen. The

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10. Y.J. Ahmad Oil Revenues in the Gulf: A Preliminary Estimate of Absorptive Capacity OECD Development Centre, Paris, 1974, p.53.

11. IBRD Mission Report 1971: The Promotion of Manufacturing in Kuwait.

limited market, scarcity of labour, and the reluctance of the authorities to add to the already existing foreign labour are important points to be borne in mind. What has occurred is capital intensive export-oriented industries, as well as joint ventures with foreign or regional participation.

The period was also marked by the increase in oil revenues due to the series of agreements starting with the Tripoli and Tehran Agreement, and the gradual participation of the Government in oil operations culminating in total nationalisation in November 1975. The first consequence of the rise in oil revenues, was the increase in the level of aid, where the Kuwait Fund's capital was raised to KD 1000 million in 1974, and its operations extended to the whole of the developing world. It has actually extended loans to various African and Asian countries. Other forms of direct Government aid have also increased. On the one hand there are Kuwait's annual contribution to Egypt, Syria, and Jordan since 1967 in accordance with Khartoum Agreement, and on the other hand direct aid to the same countries, as well as a considerable number of developing countries. Moreover, the Kuwaiti contribution to the original capital of KD 100 million of the Arab Fund for Economic and Social Development whose headquarters had been set up in Kuwait. Kuwait's subscription was one third. The capital had been raised since then to about KD 400 million and Kuwait's contribution has been raised accordingly.[12] Kuwait is a major centre for regional organisations such as the Inter-Arab Investment Guarantee Corporation whose headquarters was set up in 1972, with Kuwait Fund backing, and the UN Sponsored Arab Institute for Social and Economic Planning, to train Arab planners. On the international level, the Kuwait contribution to the IMF oil facility deserves mention as well as the Kuwait purchase through KIC of $400 million of IBRD bonds, and loans to other aid giving organisation on the regional and international level.[13]

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12. It has in fact been raised to 20% of the new capital, which makes it approximately KD 80 million.

13. N. Fallon Middle East Oil Money and its Future Expenditure Graham & Trotman, London, 1975, p.189. Where Kuwait's commitment to the IMF oil facility was SDR 440 million, which by March 1975, SDR-333.7 million had been disbursed.

TABLE 4: COMPONENTS OF GNP AND FOREIGN ASSETS KDm

		Gross fixed capital formation		Consumption		Net foreign assets	
Year	GNP	Private	Public	Private	Public	Banks	Cos.
1962/63	460	45	33	188	80	134	138
1963/64	500	47	45	192	89	176	180
1964/65	542	49	47	200	102	182	191
1965/66	565	70	43	198	105	254	264
1966/67	607	73	64	210	120	251	260
1967/68	734	95	68	280	135	298	315
1968/69						288	327
1969/70							

Source: E.Y. Asfour "Prospects and Problems of Economic Development of Saudi Arabia, Kuwait, and Gulf Principalities" in C.A. Cooper and S.S. Alexander (eds). Economic Development and Population Growth in the Middle East, New York, 1972, p.384.

The investment abroad continues during the period, with an important qualification. At the beginning of the period, both public and private funds were repatriated to Kuwait, largely due to the fluctuations in the major world currencies. On the other hand, the Land Acquisition Programme had been resumed on a large scale, particularly in 1975, after its decline from the mid-1960's. This was partly due to the acute housing shortage prevailing, and the redistribution, simultaneously of the considerable income generated by the increased surplus revenue. At the same time more serious attempts at planning are taking place, with the establishment of the Ministry of Planning at the end of 1976, and a draft Five Year Plan for the 1976/77 - 1980/81 period announced.[14] Nevertheless the main features of the limited absorptive capacity of the Kuwait economy remain the continuous substantial investment abroad and the increasing land acquisition program, in spite of the serious attempts at diversification.[15]

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14. Q.E.R. No. 4, 1976, The allocated expenditure is set at KD 4.4 billion, of which KD 1.05 billion or 24% is devoted to oil and gas development

15. M.E.E.D. 10.12.76., where the Fund for Future Generation has been set up at the end of 1976. It is to have a starting capital of KD 850 million. The sum of KD 217 million representing 10% of the State's general reserves and KD 633 million representing 29% of the reserves of the general budget, have been allocated as the starting capital of the fund, which will grow with future contributions and accrued interest.

CHAPTER 4

SAVINGS AND INVESTMENT

Both savings and investment are inextricably rooted to the issue of development itself in that they are treated within that general context, as well as within the framework of the two economies under study. Thus, the discussion must start with the determinants of investment, and in the case of the latter, the subject of capital accumulation comes to the fore. However,

> "Capital is a necessary but not a sufficient condition of progress".[1]

While there are other factors equally affecting growth, the statement holds for our limited purpose provided it is qualified by theory and subsequent empirical evidence.

It is held here, that while there are ample investible funds generated by the oil-revenues, nevertheless, an insufficiency in the level of investment opportunities exists throughout the period concerned, compared with the level of available investible funds. The problem as it exists is to be examined, and the issue of whether or not the level of investment can or will be raised, and what limitations exist in both economies, albeit that they differ in degree. It therefore follows, that the problem is mainly demand-oriented, where there is a consistent deficiency, as opposed to the supply side of investible funds, where there is a consistent and increasing surplus, at least in the short-run.

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1. R. Nurkse, Problems of Capital Formation in Underdeveloped Countries Blackwell, Oxford, 1966. p.1.

What can be mentioned from the outset as a general comparison between the two countries, is that the share of savings as a percentage of GNP was 45% for Kuwait during the period 1964-68, and that of investment was 19% for the same period.[2] The share of savings for Iraq on the other hand, during 1964-68 period was 18%, and that for investment stood at 17%. The corresponding shares for Iraq were 18.4% and 17.3% respectively for the preceding period 1959-64.[3] From the outset, it could be seen that the level of savings is exceptionally high for Kuwait, and quite high for Iraq, while the level of investment was of equal order of magnitude for both countries. What is significant, however, is the fact that both shares fell in the succeeding period in Iraq. Some of the factors underlying this were discussed in Chapter 2, but the detailed data will subsequently be examined here.

The Availability of Funds

Savings which form an important part of the supply of available funds are to be treated initially. Developing economies suffer from a shortage of available capital which causes low productivity, and this in turn is manifested in low levels of real incomes which affect the level of savings which must inevitably be low.[4] In many less developed countries there are of course often large income disparities, and this helps to raise the savings ratio to some extent assuming higher income earners have a greater propensity to save. This may be limited however by

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2. G. Amin, The Modernization of Poverty E.J. Brill, Leiden, 1974 p.37,
3. Ibid., p.37.
4. R. Nurkse, 1966, op.cit. p.5-6.

the 'demonstration effect', which could be extended internationally, thus accounting for the high marginal propensities to consume, hence low average savings ratios in the developing economies.[5] There is ample available evidence to support the low savings ratio. Dasgupta refers to the study showing the frequency distribution of developing countries according to their net national saving ratios in the period 1965-68 which supports the hypothesis.[6]

While this may well hold, it is argued here, that nevertheless, this generalization must be qualified, and that savings ratios for developing countries do vary, and that a number are considerably high. For example, it was shown that savings as a percentage of GNP, when averaged over the period 1960-67 was 14.8% for the Middle East,[7] where it is meaningful and valid figure in the context of the two economies under discussion. What is more significant is the U.N. findings for the savings ratios of OPEC including (Iraq and Kuwait) as shown in Table 1.

TABLE 1: Percentage ratio of Gross Domestic Savings to GDP

1960-65	1966-70	1971	1972
25	25.5	31.4	32.6

Source: UN World Economic Survey 1974. Part One.

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5. Ibid., pp. 57-61.

6. A.K. Dasgupta - Economic Theory and the Developing Countries, Macmillan, London, 1974, p.36.

Savings (as percentage of national income)	Developing Countries Number	per cent.
25 and above	2	5.7
20-24.9	2	5.7
15-19.9	5	14.3
10-14.9	17	48.6
5- 9.9	8	22.9
Below 5	1	2.9
Total	35	

7. L.B. Pearson, Partners in Development, Report of the Commission on International Development, London, 1970, p.31.

The view held here is that the data available is nevertheless, insufficient to test any hypothesis that might explain the relation between savings and income in the long-run, with the assumption that the average and marginal propensities to save are constant.[8] As already mentioned there is a counter effect in developing economies, namely the greater degree of the disparities of income than in the developed economies which tend to raise the savings ratio.[9] However, this in itself is not sufficient to assure productive accumulation of capital, since the higher income groups is composed mainly of rentier income, as opposed to investment income.

The 'international' demonstration effect holds for the two economies under the study, particularly in an open economy such as Kuwait with one of the highest imports per capita in the world, and high income levels. The high savings ratio however is partly due to the disparities in incomes, but it would be difficult to justify those differences from the point of view of domestic industrial investment. Most savings have gone into property speculation in both Kuwait, and to a lesser extent in Iraq. Moreover, the bulk of Kuwaiti investment has been overseas, while only recently has there been domestic investment in equity which could be said to be productive. Nevertheless the gap still remains in the sense that there is a shortfall in domestic productive investment.

The available evidence therefore suggests that both economies are characterized by high savings ratios which is uncharacteristic of developing economies per se, which supports our thesis that the problem

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8. H.J. Bruton, 'Growth Models and Underdeveloped Economies' in A.N. Agarwala & S.P. Singh (eds). The Economics of Underdevelopment Oxford University Press, 1971.

9. Ibid., p.231-232.

TABLE 2A

IRAQ

Components of National Income (current prices)

Year	1 EXPORTS IDm.	2 IMPORTS IDm.	3 Net Factor Payments Abroad IDm.	4 Balance of Payments IDm. (1-2-3)	5 Gross Fixed Capital Formation	6 Change in Stocks	7 Gross Investment (5+6) IDm	8 Total Savings (4+7) IDm.	9 Index of Gross Investment	10 Index of Total Savings
1953	155.9 a)	83.2	-57.6	15.1	41.0	3.5	44.5	59.6	100	100
1954	189.5	89.8	-67.7	32.0	53.0	4.0	57.0	89.0	130	149
1955	204.4	121.0	-71.2	12.2	76.0	4.1	80.1	92.3	180	155
1956	188.9	134.8	-65.5	-11.4	99.3	4.6	103.9	92.5	233	155
1957	152.3	152.9	-46.4	-47.0	102.1	4.6	106.7	59.7	240	100
1958	226.2	129.4	-78.4	18.4	93.9	5.2	99.1	117.5	223	197
1959	232.1	135.6	-85.7	10.8	99.4	5.4	104.8	115.6	236	194
1960	251.0	164.3	-95.3	- 8.6	87.8	6.0	93.8	85.2	211	143
1961	250.5	174.5	-94.2	-18.2	137.2	6.5	143.7	125.5	323	211
1962	260.6	156.2	-93.2	11.2	119.2	11.6	130.8	142.0	294	238
1963	293.3	145.3	-108.3	39.7	119.9	5.7	125.6	165.3	282	277
1964	324.8	187.9	-118.3	18.6	122.1	12.7	134.8	153.4	303	257
1965	344.3	207.5	-129.4	7.4	129.8	12.2	143.3	150.7	322	253
1966	366.1	221.0	-138.6	6.5	149.6	9.3 b)	158.9	165.4	357	278
1967	326.1	183.2	-122.6	20.3	143.6	14.0	157.6	177.9	354	298
1968	402.7	192.1	-156.8	53.8	143.0	11.5	154.5	208.3	347	349
1969	412.3	205.3	-154.7	52.3	157.2	8.2	165.4	217.7	372	365
1970	437.5	236.6	-166.0	34.9	185.1	17.7	202.8	237.7	456	399
1971	596.5	314.2	-214.9	67.4	194.7	25.0	219.7	287.1	494	482
1972	505.7	294.2	-136.5	75.0	217.1	n.a.	217.1	292.1	488	490
c)1973	720.5	382.7	- 82.0	255.8	288.6	n.a.	288.6	544.4	649	913

Sources: Columns (1), (2), (3), (4), and (5) from (1953-66).
International Monetary Fund : IFS, May 1976.
b) Column (5) from (1966-71) U.N. Statistical Yearbook 1974
c) From (1972-73) IFS, March 1977.

TABLE 2B

KUWAIT

Components of National Income (current prices)

Year	1 EXPORTS KDm	2 IMPORTS KDm	3 Net Factor Income Payments Abroad KDm.	4 Balance of Payments KDm. (1-2-3)	5 Gross Fixed Capital Formation	6 Change in Stocks KDm.	7 Gross Investment (5+6) KDm.	8 Total Savings (4+7) KDm.	9 Index of Gross Investment	10 Index of Total Savings
1962	422	122	-193	107	78	7	85	192	100	100
1963	444	141	-193	110	92	3	95	205	112	107
1964	480	141	-179	160	96	3	99	259	116	135
1965	516	167	-198	151	95	15	110	261	129	136
1966	561	208	-172	181	135	16	151	332	178	173
1967	519	248	-138	133	163	23	186	319	219	166
1968	587	248	-158	181	154	17	171	352	201	183
1969	628	286	-149	193	170	19	189	382	222	199
1970	706	273	-175	258	153	13	166	424	195	221
1971	983	278	-266	439	156	- 8	148	587	174	306
1972	1,108	266	-362	480	153	1	154	634	181	330
1973	1,655	325	-342	988	147	- 1	146	1,134	172	591
1974	2,739	521	- 32	2,186	163	2	165	2,351	194	1,224

Sources: Columns (1), (2), (3), (4), and (5).
International Monetary Fund: IFS, May 1976.

is demand rather than supply oriented. In the absence of comprehensive data on savings, the well-known gap methodology referred to in Chapter 1 is used. Thus the savings - investment gap ex ante equals the balance of payments gap:

$$I - S = M - X$$

$$S = I + X - M$$

Hence the Savings data is obtained as shown in Table 2a and 2b. The period is not strictly comparable, due to lack of comprehensive data for Kuwait prior to 1962, and for Iraq after 1973. Hence the period 1953-73 was used for Iraq and 1962-74 for Kuwait, from the same source for the sake of consistency. It is found that savings doubled and quadrupled at approximately ten and twenty year intervals. In 1957 a fall occurred due to the disruption of oil exports, as a result of the Suez Canal closure caused by the 1956 crisis. More recently, the level fell in 1972 over 1971 due to oil nationalization in 1972. The most significant increase in the level of savings however is that for 1973 which is due to the quadrupling of oil prices for the year reflected in the export figure for the year. The data for Kuwait shows that there has been a steady rise in the level of savings, where again they doubled in a ten-year interval i.e. in 1970, five-fold increase by 1973, and a twelve-fold increase by the end of the period in 1974. What is more relevant for our purposes however, is that Table 3 shows the savings ratio to GNP, which during the given period averaged 23% for Iraq which is high and for Kuwait it was approximately 50% which is very high. Both are not typical in this respect as developing economies. The savings to investment ratio, on the other hand, reveals the average to be 90% for Iraq and 37% for Kuwait respectively. The ratio fluctuated from a maximum of 115% in 1961 for Iraq, to a minimum of 53% in 1973, when there was a surplus of investible funds. The average ratio for Kuwait was more revealing in that it was only 37% with a falling rate for the

Gross National Product, Savings Ratio, and Investment to Savings Ratio

TABLE 3

IRAQ

Year	1 GNP (Current price) IDm.	2 Gross Domestic Investment IDm.	3 Investment Ratio Column (2) as percentage of Column (1) %	4 Total Savings IDm.	5 Savings Ratio Column (4) as Percentage of Column (1) %	6 Ratio of Domestic Investment to Savings. Column (2) as percentage of Column (4) %
1953	286.4	44.5	15.5	59.6	20.8	74.7
1954	329.3	57.0	17.3	89.0	27.0	64.0
1955	340.8	80.1	11.7	92.3	27.1	86.8
1956	388.5	103.9	26.7	92.5	23.8	112.3
1957	412.6	106.7	25.9	59.7	14.5	179.1
1958	435.6	99.1	22.8	117.5	27.0	84.3
1959	452.3	104.8	23.2	115.6	25.6	90.7
1960	470.1	93.8	20.0	85.2	18.1	110.1
1961	520.4	143.7	27.6	125.5	24.1	114.5
1962	593.6	130.8	22.0	142.0	23.9	92.1
1963	598.2	125.6	21.0	165.3	27.6	76.0
1964	717.5	134.8	18.8	153.4	21.4	87.9
1965	784.4	143.3	18.3	150.7	19.2	95.1
1966	851.3	158.9	18.7	165.4	19.4	96.1
1967	875.6	157.6	18.0	177.9	20.3	88.6
1968	976.4	154.5	15.8	208.3	21.3	74.2
1969	1,025.3	165.4	16.1	217.7	21.2	76.0
1970	1,116.5	202.8	18.2	237.7	21.3	85.3
1971	1,251.7	219.7	17.6	287.1	22.9	76.5
a) 1972	1,338.5	217.1	16.2	292.1	21.8	74.3
1973	1,582.1	288.6	18.2	544.4	34.4	53.0
			$\bar{x}$ = 19.5%		$\bar{x}$ = 22.9%	$\bar{x}$ = 90.1%

KUWAIT

	KDm.	KDm.	%	KDm.	%	%
1962	460	85	18.5	192	41.7	44.3
1963	486	95	19.6	205	42.2	46.3
1964	561	99	17.7	259	46.2	38.2
1965	553	110	19.9	261	47.2	42.2
1966	682	151	22.1	332	48.7	45.5
1967	734	186	25.3	319	43.5	58.3
1968	793	171	21.6	352	44.4	48.6
1969	840	189	22.5	382	45.5	49.5
1970	909	166	18.3	424	46.6	39.2
1971	1,151	148	12.9	587	51.0	25.2
1972	1,200	154	12.8	634	52.8	24.3
1973	1,769	146	8.3	1,134	64.1	12.9
1974	3,197 b)	165	5.2	2,351	73.5	7.6
			$\bar{x}$ = 17.3%		$\bar{x}$ = 49.8%	$\bar{x}$ = 37%

a) For Iraq (1972-73), IFS, March 1977.

Source: Table 2a and 2b
International Monetary Fund : IFS, May 1976

last three years of the period, bringing the last year to a minimum of 7%. It can be seen that the average ratio for Kuwait is approximately one third of that for Iraq, whereas the savings to GNP ratio was double that of Iraq. The available empirical evidence seems to suggest that capital absorptive capacity is far more limited in Kuwait than in Iraq.

Kuwait, on the other hand is characterized by very high savings ratios throughout the period, particularly since 1972. The overall framework cannot be said to be complete until the other components of GNP are examined, particularly the level of consumption shown in Table 4. But a tentative conclusion could be reached, namely that savings are amongst the highest in the world in Kuwait and at a high level in Iraq. The most appropriate comparison to support this statement in Table 1 above, where OPEC countries data was taken. For 1972, the latest corresponding year on the data, the ratio was 23% as opposed to 32% for Iraq and about 50% for Kuwait for that year.

The proposition that there was a surplus of investible funds has been supported by the available empirical evidence. The factors underlying it however, may be discussed, and set against the context of the two economies, where perhaps tentative conclusions could be reached. It was seen from the methodology in Chapter 1, which used the two gap approach, that the case when $I_{ad} - S_{dl} < 0$, is the case of our two economies. This means that there is a shortfall of the local supply component in relation to domestic savings, i.e. $I_{ad} < S_{d.l}$.[10]

But perhaps this is shown where those frustrated savings are referred to

> "...., but more likely they will lead to investment activities which do not match the marginal productivity criteria, to increased consumption and considerable amount of time devoted to leisure."[11]

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10. W.J. Stevens Capital Absorptive Capacity in Developing Countries A.W. Sijthoff, Leiden, 1971. p. 44-45.

11. Ibid., p.45.

But perhaps what is more appropriate is where the case referred to again in Chapter 1, namely of $I_{af} - S_{df} < 0$ or $I_{af} < S_{df}$. This is when the foreign exchange component surplus is due to a balance of payments surplus with the investment opportunities at the margin being unremunerative.

Frustrated savings in Kuwait took the form of property speculation the purchase of equities locally, and investment abroad. The local equities have seen a sharp rise in their prices, particularly in the last four years, where the price earning ratios have exceeded 100, and where shares are bought at values bearing little or no relation to the assets of the companies. This was particularly so when private and public funds were repatriated after the major world currencies' devaluations. Land and housing speculation rose sharply in the last two years thus causing a highly inflated property market. Both Government and private funds were invested overseas in very substantial amounts, and to a lesser extent in the neighbouring Arab states and the region. The income accruing from Government investment is shown in Table 4.

TABLE 4: Government Investment Income (KDm)

1970/71	1971/72	1972/73	1973/74	1974/75	1975/76 (a)
31.8	42.3	50.8	89.1	152.1	210.0

Kuwait Government Land Acquisition (KDm)

1970/71	1971/72	1972/73	1973/74	1974/75	1975/76 (b)
24.4	19.9	15.7	19.4	47.7	110.0

Source: Central Bank of Kuwait, 6th Annual Report 1975, for 1971/72-1973/74.
" " " " , Economic Report for 1975 for 1973/74-1975/76.

(a) Preliminary Results.

The hypothesis mentioned above stating that savings ratios will be lower if income is distributed more evenly is refuted. This is because the available disposable income has more than offset the effect of that distribution through the average propensity to save.

The Kuwait Government form of land purchase scheme which had dropped in the 1960's and 1970's but increased in the most notable and effective form of income distribution as shown in Table 4. This is expected to continue increasingly, but from the evidence the savings ratio had increased. The three forms of investment as opposed to productive investment have continued despite the government efforts of participation in industrial concerns with majority share holding, and the setting up of the Industrial Bank of Kuwait in 1974, in order to channel these savings into productive investment. This is based upon the petrochemical industry and related industries to oil and gas where Kuwait enjoys a favourable factor endowment. The effect of forward linkages, must be a predominant factor, and where other light industries such as plastics can use local resources there is obviously scope for them.

In the case of Iraq, on the other hand, savings had taken the form of hoarding, and land speculation. Savings were frustrated essentially because of the nationalization measures passed in the mid 1960's referred to in Chapter 2 which inhibited investment, while this was partly offset in the high level of progressive taxation on disposable income which allowed the government to undertake substantial investment expenditure on its own account. In both economies, however, as the pace of inflation has quickened, liquid assets have been transformed into property and other items. With high and increasing high level imports, imported inflation is more significant in Kuwait where there is the highest level of import per capita whereas in Iraq inflation is demand induced with the five year plans account for the high level of price rises. Finally to sum up it appears the level of savings has been high in both economies, while the supply of available funds exceeds the levels to which they are to be invested, notwithstanding the other bottlenecks limiting the absorptive capacity, notably technological, administrative, institutional, and in addition the

limited population in the case of Kuwait.

The Demand for Available Funds

It is posited here, that on the supply side, there was a surplus of investible funds which assumes a deficiency on the demand side. It is argued by well-known economists that the demand side is governed by the same low productivity - mentioned in the last section - which caused low real incomes which means low purchasing power; deficient final demand thus ultimately inhibiting the level of investment. One of the main causes for the deficiency of the demand side of the model is the limited size of the market which is the limiting factor upon investment.[12] The low level of investment in both economies is shown in Tables 2 and 3 above and from the charts 1 and 2. From the available evidence, it is clear that while the above argument may well hold for developing economies, it is not strictly true of at least for Kuwait. Real incomes are among the highest in the world, and the Iraqi real incomes are substantially above those of LDC's generally. But what does hold is the limited market hypothesis as a constraint on investment which is typified by the Kuwaiti case. Where successful productive investment has been set up, it has been export-oriented, namely petrochemical, and chemical fertilizers, and to a lesser extent in Iraq, with the same products, and also cement which has been successfully exported to the Gulf over the past 10 years. Hirschman asserts that decisions affecting savings and investment are interdependent in developing economies.[13] The rise in savings is more dependent on the increased investment opportunities and the elimination of barriers hindering that investment, rather than on the rise in incomes. Savings are low because investments

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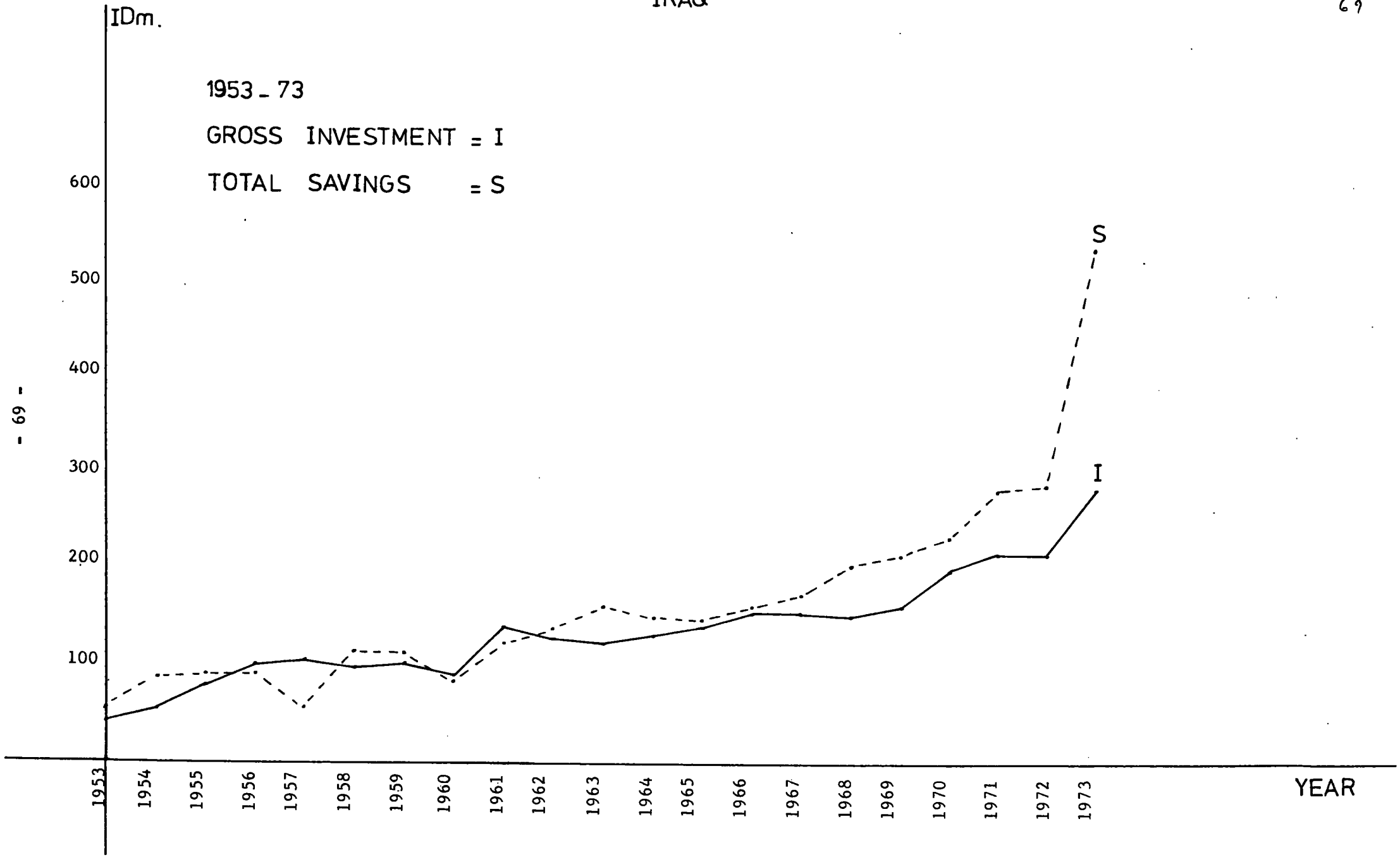
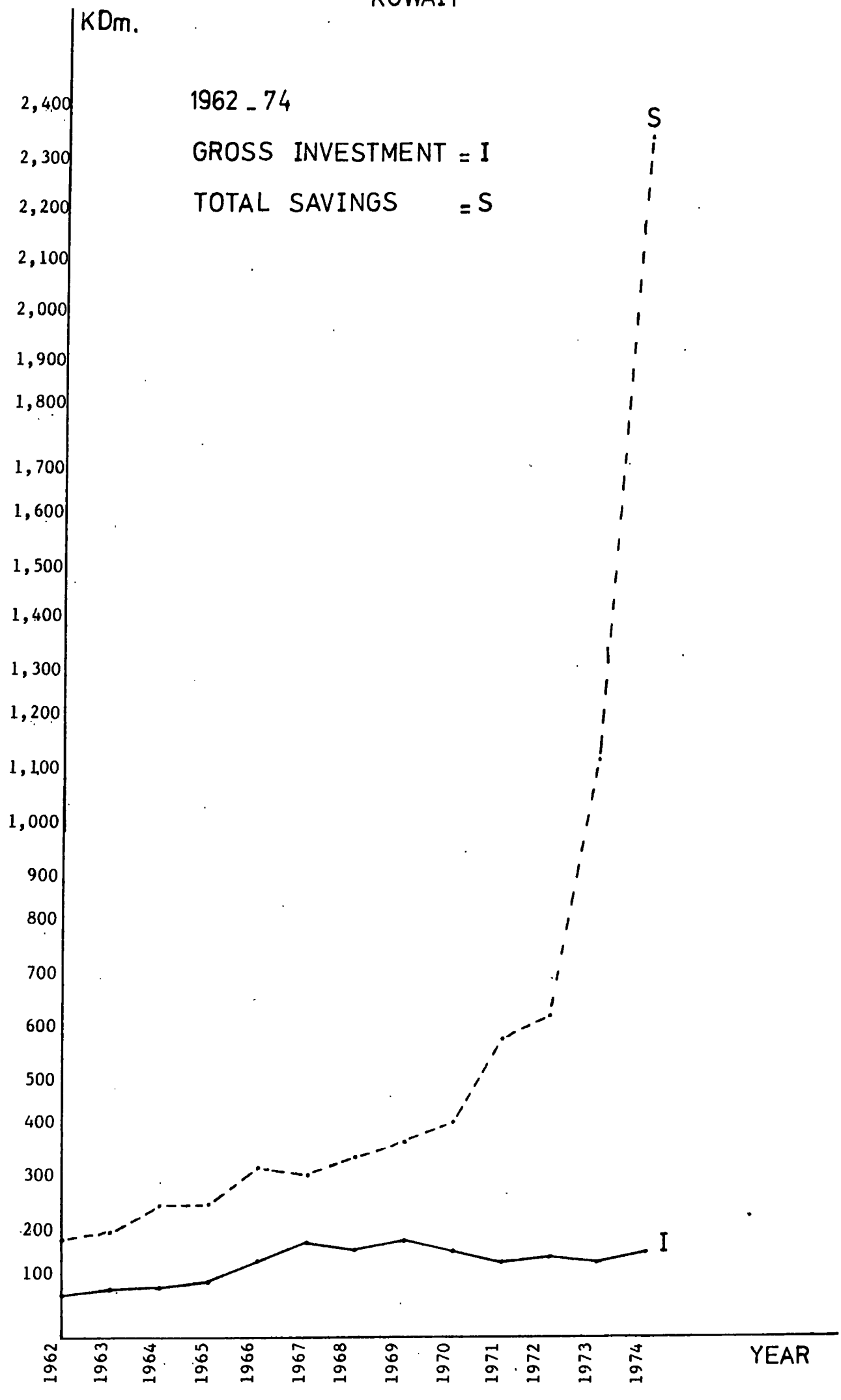
12. Nurkse, op.cit., 1966, p.5-6.

13. A.O. Hirschman The Strategy of Economic Development, Yale University Press, 1973. p.31-44.


IDm.
1953 - 73
GROSS INVESTMENT = I
TOTAL SAVINGS = S
600
500
400
300
200
100
S
I
1953
1954
1955
1956
1957
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
1970
1971
1972
1973
YEAR


KDm.
1962 _ 74
GROSS INVESTMENT = I
TOTAL SAVINGS = S
2,400
2,300
2,200
2,100
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
200
100
S
I
1962
1963
1964
1965
1966
1967
1968
1969
1970
1971
1972
1973
1974
YEAR

are low rather than the other way round. The ability to invest is limited by the difficulty of channelling existing savings into investment, and this holds in our case as it is closely related to the absorptive capacity concept within this context. This means that the ability to absorb capital is lower than the available investible funds. The theory then advances the concept of what is termed the modern sector of the economy that yields a certain amount of investment. In a developing economy, the ability to invest is low because the modern sector is small, rather than because the amount of investment yielded by that sector is low. A modern sector is needed to generate the investing ability and vice versa, from which it could be thought that the total amount of savings available is greater than the total investing capacity regardless of the income distribution in the economy. This has been referred to above, where disparities in income induce hoarding and ostentatious consumption to take place, which is in effect unproductive investment. Where the above theory must be tested, the empirical evidence shown in Table 2 and 4, on the expenditure of GNP in both economies, assumes a closed economy, this is a tenuous assumption and only for our limited purposes here. The exogenous components of both GNP's, where both economies are open by nature, must be borne in mind throughout. In fact, where the growth of GNP is so heavily dependent upon oil revenues, the rise in the level of GNP has been very considerable, as shown by Kuwait's figures, since 1970, and the same would have been observable for Iraq had the data been available since 1971.

A Keynesian approach is used to analyse the available data, since it will show clearly the effect of the rise in income upon investment, in this case GNP on gross investment. In examining Table 5, the ratio of total consumption to GNP was 79% for Iraq and 50% for Kuwait in their respective periods. The level of consumption in Iraq has quadrupled during a 13 year period, where the increase in the latter has been very significant for 1974 over 1973.

GNP AND TOTAL CONSUMPTION

TABLE 5

IRAQ

Year	GNP at (current prices) IDm.	Private Consumption IDm.	Government Consumption Expenditure IDm.	Total Consumption IDm. (2+3)	Index of Total Consumption
1953	286.4	178.7	48.7	227.4	100
1954	329.3	188.0	52.9	240.9	106
1955	340.8	194.5	54.9	249.4	110
1956	388.5	230.4	66.5	296.9	131
1957	412.6	280.0	72.9	352.9	155
1958	435.6	241.0	77.9	318.9	140
1959	452.3	242.1	94.9	337.0	148
1960	470.1	306.0	110.8	416.8	183
1961	520.4	354.0	118.0	472.0	208
1962	593.6	372.0	126.1	498.1	219
1963	598.2	301.3	137.3	438.6	193
1964	717.5	397.8	166.3	564.1	248
1965	784.4	455.1	178.6	633.7	279
1966	851.3	496.8	189.1	685.9	302
1967	875.6	495.9	201.8	697.7	307
1968	976.4	547.7	220.4	768.9	338
1969	1,025.3	569.1	242.5	811.6	357
1970	1,116.5	609.9	268.9	878.8	386
1971	1,251.7	663.0	301.6	964.6	424
a) 1972	1,338.5	n.a.	990.2	990.2	435
1973	1,582.1	n.a.	967.1	967.1	425
			KUWAIT		
	KDm.	KDm.	KDm.	KDm.	
1962	460	188	80	268	100
1963	486	192	89	281	105
1964	561	200	102	302	113
1965	553	191	101	292	109
1966	682	232	118	350	131
1967	734	280	135	415	155
1968	793	297	144	441	165
1969	840	306	152	458	171
1970	909	325	160	485	181
1971	1,151	340	224	564	210
1972	1,200	288	278	566	211
1973	1,769	316	320	636	237
1974	3,197	363	483	846	316

Source: International Monetary Fund: IFS, May 1976.
a). For Iraq, (1972-73) IFS, March 1977.

Consumption both private and public is a function of income in the model, where the latter is shown as Government consumption expenditure and investment. In our case this would be oil revenues less State reserves (savings) less investments abroad as in the case of Kuwait, but that would involve us in questions of definitions. Oil revenues would be the main constituent of national income, as it accounts for most of GNP in both countries, and the ratio would be even higher for net national income. Oil revenues used in the Kuwait model, might perhaps be more realistic, as the independent variable but it is thought that the simple closed economy model would be more consistent with the argument, as well as rendering a true comparison. GNP is not expected to be affected by the level of investment, where the demand for the latter is low. It had been asserted that in a developing economy, the ability to invest is low because the so-called modern sector is low,[14] rather than the investment yielded by this sector is low. This is where the hoarding, foreign exchange surplus or ostentatious consumption occurs. When the modern sector expands, v.Ym,[15] and v is larger than s, will equal SY, then the savings ratio of the total income of the economy is expected to rise. If the economy were to grow beyond this point, then it will be limited by the supply of savings which will be dependent upon the income rise as opposed to investment opportunities. The ability to invest is inextricably connected with absorptive capacity. Because savings and investment are independent, the ability to invest becomes a necessary condition for investment to take place, the same as the propensity to save which is called the complementarity of investment. This is the third function of investment in addition to its two functions of capacity creation and income generation. It follows then that the supply of investment opportunities is a necessary condition for investment.

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14. Ibid., p.37.

15. Where Ym is the economy's modern sector, and the ability to invest is expressed as a coefficient v.

> "The complementarity effect this reinforces and supplements the slowly growing ability to invest of underdeveloped countries. The investments of one period call form complementary investments in the next period with a will and a logic of their own, they block out a part of the road that lies ahead and virtually compel certain additional investment decisions. These decisions are therefore comparatively 'easy to take' and are likely to attract newcomers who will join the rolling development bandwagon, while the operators who have had the benefit of the education afforded by the modern sector of the economy be spared for the many difficult investment decisions that still remain to be taken."[16]

In the case of the two economies, it is doubtful whether this effect had actually taken place, at least in the private sector, which this effect seems to be ascribed to. The governments' role is predominant, and their investment expenditure is substantial, in contrast with the private sector's investment, at least in industry. All the available evidence, however, suggests that most of the funds are channelled to property, mercantilist activities, finance and banking, as in the case of Kuwait. The deficiency in investment could be partly explained by the unrecorded investment in the agricultural sector, as in Iraq's case, and the uncertainty which characterized the period under study in that country, particularly during the 1960's, when the nationalization measures took place, and the frequent political vicissitudes, as will be borne out by the empirical evidence. Thus there are many factors that account for the deficiency in demand for investment which has not been able to match the supply of capital. For example, the effect of investment on GNP may be minimal, at least in the case of autonomous investment, due to large leakages unaccounted for by the high levels of savings. This is after all of central concern in the closed economy model. Moreover, the

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16. Ibid., p. 42-43.

marginal propensity to consume is supposed to be high.[17] Our findings show it is low in Kuwait and Iraq, although this is offset by a high leakage effect. The acceleration effect is expected to be minimal since the total capital coefficient is low. It is expected that the level of GNP will not be affected appreciably by the amount of investment, and that the reverse effect is not anticipated to be considerable, although the accelerator would be greater in Iraq than it is in fact in Kuwait. In order to test the hypotheses against the available empirical evidence, a series of regression analysis were used. The periods were 1953-71 for Iraq and 1962-74 for Kuwait respectively. The strict comparability was somewhat foregone for the sake of the comprehensive availability of the data,

Y = GNP

C = Total Consumption which is Private Consumption + Government Consumption Expenditure

I = Gross Investment

S = Total Savings

For Iraq, the estimated model equations were:

(1) Total Consumption,

$C = 6.643 + 0.783Y \qquad R^2 = 0.987$

(34.772)[18]

(2) Private Consumption,

$C = 36.536 + 0.518Y \qquad R^2 = 0.974$

(24.567)

(3) Investment,

$I = 40.381 + 0.136Y \qquad R^2 = 0.892$

(11.519)

(4) Savings,

$S = 11.084 + 0.204Y \qquad R^2 = 0.925$

(14.528)

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17. G.M. Meier - "The Problems of Limited Economic Development". in A.N. Argarwala and S.P. Singh (eds) - The Economics of Underdevelopment op.cit., 1971, p.69.
18. Numbers in parenthesis are t values of regression coefficients.

And for Kuwait, the estimated model equations were:

(1) Total Consumption,

$$C = 249.530 + 0.205Y \qquad R^2 = 0.884$$
$$(8.709)$$

(2) Savings,

$$S = -237.123 + 0.788Y \qquad R^2 = 0.990$$
$$(33.733)$$

In the case of gross investment, there was a very weak positive correlation, as to render it invalid, and the marginal propensity to invest for Kuwait was almost negligible. At the same time, there was no significance in the regression. Private consumption was also insignificant where there was positive but weak correlation.

The tentative conclusions to be drawn are, that the consumption function for Iraq is very highly correlated to the level of GNP, whereas it is highly correlated for Kuwait. In the case of investment, however, there was no relation for Kuwait, but there was a high correlation rate for Iraq in contrast. In the case of savings, they are both highly correlated, but the marginal propensity to save in Kuwait is about double that of Iraq, with the simultaneous marginal propensity to consume for Kuwait almost a quarter of that of Iraq.

Finally, the summary of the findings is:

	Iraq	Kuwait
1. The marginal propensity to consume	0.783	0.205
2. " " " " invest	0.136	- a)
3. " " " " save	0.204	0.788
4. The autonomous investment multiplier	4.608	1.258

a) The value was < 0.01

The conclusions support what had been mentioned earlier, which refutes the argument of low savings ratios and high consumption expenditures. The effect of changes in the level of GNP, in this case rising, on autonomous investment is weak in the case of Kuwait. This is shown by the low autonomous investment multiplier, where it is particularly low due to the substantial leakages due to the high savings levels. Whereas for Iraq it is almost four times

the value of that for Kuwait. A tentative conclusion could be reached at this stage, that the absorptive capacity in Iraq is greater than Kuwait's for our closed models, given the constraints on that capacity for both models, and that the accelerator effect is weak, as is generally the case in underdeveloped economies. It generates its own trade cycle in a developed economy,

> "whereas in a developing economy it merely receives the fluctuations transmitted to it from outside, although of course the impact need not be smaller for that reason."[19]

While the above model is valid for our purposes, it nevertheless has to be qualified in the sense of the applicability of Keynesian models to developing economies. It is held that the income multiplier is much higher in money terms than in real terms, and to that extent prices rise much faster than increases in aggregate real income. The phenomenon of disguised unemployment prevents the multiplier working in the direction of the rise of the level of output or employment. Money prices and incomes rise much faster than real prices and output because of disguised unemployment. This latter phenomenon widens the difference between the multiplier linking up increments of money investments of with increments of money income from that linking up increments of investment output with increments of total output. Savings fail to equal investment, and inflation sets in earlier, when this is combined with deficit financing.[20] It follows then, that investment supported by deficit financing for the purpose of inducing a given increase in output is much weaker in Kuwait than it is in Iraq, although it is fairly weak in the latter. This is accompanied with leakages from imports, particularly in the case of Kuwait, where the level of imports per capita is among the highest in the world.

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19. H. Myint, "An interpretation of Economic Backwardness". in A.N. Agarwala and S.P. Singh (ed) The Economics of Underdevelopment, 1971, op.cit., p.111-112.
20. V.K.R.V. Rao, 'Investment, Income and the Multiplier in an Underdeveloped Economy', in A.N. Agarwala and S.P. Singh(eds), The Economics of Underdevelopment., 1971, op.cit.

The case for the distinction between the money income multiplier and real income multiplier is emphasized, with the case of the former in an inflationary economy as in the context of developing countries. In inflation, the main determinant of the price multiplier is the marginal propensity to consume, and this depends upon the shifts in the consumption function which is of considerable importance during an expansionary stage. The model is limited in the short-run, however, particularly in a developing economy where disguised unemployment and subsistence economy prevail.[21] The assumption is that the money income multiplier is given by substituting the marginal propensity to consume and to invest in money terms instead of the real propensities in the real income multiplier model, where if the desire to save, depended upon real income alone, the system could not have an equilibrium. The marginal propensity to save out of inflated money income would be zero irrespective of the marginal propensity to consume in real terms and the price multiplier would be infinite.[22] While the above qualifications are not wholly applicable to the models used, they are useful in indicating the problems involved in applying the model in a developing economy, as well as putting our model within this context.

Finally, one of the criticisms of the two gap approach has been put thus,

> "These models assume, almost without exception, first, that the rates of development will increase if the ratio of investment to national income rises, and secondly, that the investment ratio will rise if capital imports increase. Neither of these assumptions is wholly correct. It is now generally agreed, I believe, that increased investment is neither necessary nor sufficient to achieve a high rate of growth in an underdeveloped country."[23]

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21. P. Hasan, "The Investment Multiplier in an Underdeveloped Economy" in I. Livingstone (ed), Economic Policy for Development. Penguin Modern Economic Readings, 1971.

22. Ibid., p.337.

23. K. Griffin "Foreign Capital, Domestic Savings and Economic Development". Oxford University Institute of Economics and Statistics Bulletin. Volume 32, 1970, p.100.

TABLE 6: Savings and Average Propensity to Save[25]

Year	IRAQ GNP IDm.	IRAQ Savings IDm.	IRAQ Average propensity to save 2 ÷ 1	KUWAIT GNP KDm.	KUWAIT Savings KDm.	KUWAIT Average propensity to save 2 ÷ 1
1953	286.4	117.2	0.409	n.a.	n.a.	
1954	329.3	156.7	0.476	"	"	
1955	340.8	163.5	0.486	"	"	
1956	388.5	158.0	0.407	"	"	
1957	412.6	106.1	0.257	"	"	
1958	435.6	195.9	0.450	"	"	
1959	452.6	201.3	0.445	"	"	
1960	470.1	180.5	0.384	"	"	
1961	520.4	219.7	0.422	"	"	
1962	593.6	235.2	0.396	460	385	0.837
1963	598.2	273.6	0.457	486	398	0.819
1964	717.5	271.7	0.379	561	438	0.781
1965	784.4	278.8	0.355	553	459	0.830
1966	851.3	294.7	0.346	682	504	0.739
1967	875.6	286.5	0.327	734	457	0.623
1968	976.4	365.1	0.374	793	510	0.643
1969	1,025.3	372.4	0.363	840	531	0.632
1970	1,116.5	403.7	0.362	909	599	0.659
1971	1,251.7	502.0	0.401	1,151	853	0.741
1972	n.a. a)	n.a.	$\bar{x}$ = 0.394	1,200	996	0.830
1973	n.a.	n.a.		1,769	1,476	0.834
1974	n.a.	n.a.		3,197	2,383	0.745
						$\bar{x}$ = 0.747

a) for consistency with our estimated equations. The period 1953-71 was used for Iraq.

Source: Table 3

25. The Harrod growth equation g = sk, where s is the proportion of national income saved and invested, g, the proportional rate of growth of national income, and k is the ICOR. The amount of aid, a, expressed is a fraction of national income, the growth rate rises to g = (s+a) k.
If g* is a target rate of growth and k is assumed constant, the rate of capital accumulation c, necessary to achieve the target g/k = c.
Then c - s is the savings gap.

It was pointed out in Chapter 1, that following from the above, that given the amount of aid a, which is necessary to fill the gap, then $a = c - s$,[24] where this aid will fill the savings gap, but the underlying assumption of the argument is that the marginal propensity to save must always be greater than the average propensity to save. This condition is unlikely to prevail, as the gap will be greater, hence, the marginal propensity to save must be much greater in order to close that gap. The above equation is derived from $g = (s + a)\ k$ (26).
In order to test this hypothesis, in both cases, the APS is greater than MPS, thus for Iraq APS = 0.394

MPS = 0.343

and for Kuwait APS = 0.747

MPS = 0.707

Therefore the hpothesis does not hold for our two economies.

Conclusions

It has been argued repeatedly that capital formation is necessary for rapid growth, and sufficient because it entails the so-called external effects of investment such as managerial and labour skills required to utilize the modern production process. While this may well hold, the available evidence seems to suggest that there is no shortage of investible funds. It is maintained here, that there is in fact a surplus of those funds, but that the demand for them is deficient, and therefore incapable of matching the level of supply. This is more evident in Kuwait than in Iraq, and the reasons for this have been enumerated within the framework of our closed economy model. This proves, within the constraints, the concept of the limited absorptive capacity. It is argued, however, that this

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24. Ibid., p.101.

concept shows that the less developed economies simply cannot generate enough investment projects with attractive pay-offs to enable a country to invest large amounts of capital. It is argued further that this is based upon the monetary rewards for investment, which highlights the limited number of profitable investment in that economy. If we agree with the external effects of investment, then we must agree that there are a number of investments at any given time that have high social marginal productivities both in infrastructure and in the productive sector.[26] For our purposes, the first part of the statement holds, whereas the second part, where it does hold, strongly suggests that role for Government in the two economies, where it is acknowledged is vitally important. This will be considered in a subsequent chapter.

The problem of the demand for investment is more acute in Kuwait, where a limited market is a barrier, unless investment is in export-oriented industries, which is the case with the very successful petrochemicals. In addition there may be scope for import substitution, as in the case of Iraq, where the market can generate sufficient demand for the final product. This is not the case in Kuwait, however. It is these factors above all else which account for the shortfall in investment despite the surplus of funds.

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26. S.P. Schatz, "The Role of Capital Accumulation in Economic Development", The Journal of Development Studies, Vol. 5, 1968.

CHAPTER 5

THE OPEN ECONOMY

A study of a country's absorptive capacity cannot be said to be complete without investigating its pattern of trade. Both economies under study are export-oriented, relying preponderantly upon the export of a single raw-material, oil, which constitutes around 90% of their total export earnings, making it of particular importance. This has had a more profound effect upon both economies than on any other developing country, except for those O.P.E.C. members in a similar position. The question is not whether oil revenues had had an effect upon development, but on the magnitude of the revenues within that context. A proportion of export earnings have naturally been absorbed through the ambitious development plans which Iraq has pursued, and in Kuwait's case, substantial amounts have been invested abroad.

It has been seen that the openness of the two economies was their main characteristic long before the predominance of oil.[1] In the case of Iraq it was the transferrence of a self-sufficient economy in agriculture, and local crafts for a limited domestic demand to an increasingly export-oriented economy in agricultural products. The entrepot trade in Kuwait on the other hand and its lack of domestic resources, necessarily rendered it dependent entirely upon trade apart from pearling. The discovery and export of oil, which led to increased income, intensified the openness, by making both economies more dependent upon international fluctuations in income. The rising world demand for oil has not made them less dependent, or less vulnerable to those fluctuations. This is amply shown by the stagnant oil revenues for

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1. See Chapters 2 and 3 above.

almost the entire 1960's decade in Iraq.[2] It is only since the beginning of the 1970's that both countries have been able to control prices, hence revenues, as opposed to merely maintaining the status quo in the 1960's when OPEC was first formed. The development programmes that both economies have been implementing have made them through this openness inextricably vulnerable to world inflation via their imports, bearing in mind that the level of inflation has not been due entirely to this factor alone, nevertheless it could be said perhaps, that it is an important factor. The aim of setting up import-substituting industries might perhaps lessen this dependence in the case of Iraq, whereas in the case of Kuwait the setting up of export-oriented industries with backward linkages is a long-term aim, and investment overseas is a short-term one. This has been predominant in the economic thinking of Kuwait, with diversification from oil as the ultimate goal. With more distribution of income, and the simultaneous increase in revenues, both public and private sectors are holding substantial investments abroad. In addition, the semi-public investment corporations both hold and manage varied and large-sized investment portfolios.

Patterns of Trade

The predominant role of foreign trade and its increasing importance in both economies, could best be shown that in the case of Iraq, where by 1958,

> "..... the value of agricultural exports rose to 77 per cent of the total value of the export trade (except oil), while the value of pastoral exports rose to about 16 per cent and the remainder, which accounted for 7 per cent, represented industrial exports."[3]

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2. See Chapter 2, Table 1.

3. M.S. Hasan "The Role of Foreign Trade in the Economic Development of Iraq, 1864-1964: A Study in the Growth of a Dependent Economy." in M. Cook (ed) Studies in the Economic History of the Middle East. Oxford University Press. London, 1970, p.359.

But the predominance of oil as a proportion of total exports has been established, as Iraq suffered a declining terms of trade with her agricultural exports.[4] In addition there was a trade deficit on non-oil exports during the period. In contrast, the persistent surplus due to the predominant export of oil enjoyed by Kuwait has rendered it one of the highest importers per capita in the world.

The setting aside of a fixed proportion of revenue to the State Reserves by statute annually, combined with the income on capital accruing to both public and private sectors means the country is in a unique surplus position as a net exporter of capital.

An examination of both countries' trading pattern reveals that oil is the predominant export, as Table 1A and 1B shows. For the period covered it constituted 87% of total exports for Iraq, and 98% of the total exports for Kuwait. There had been a drop during the period, which had picked up since the increase in oil revenues in 1970 and peaked for both in 1975. Kuwait could be described as an outstanding example of the open economy, where the country has been traditionally a trading nation, and where an active re-export trade has taken place, owing to its favourable geographical location, and more recently its efficient communications facilities. The re-exports form an important constituent of total trade, where the supply exceeds local demand, and the goods thereby exported to neighbouring countries. This contrasts with the relative decline of trade in Iraq, on the other hand, particularly during the period under study. One of the main factors underlying this decline has been the restriction of trade into the public sector, and government policies aimed primarily at import substitution, combined with strict tariff policies and a multitude of government to government barter agreements. The volume of trade has increased

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4. Ibid. p.369, where the terms of trade (excluding oil) were 71 in 1952-58 from 100 in the base years 1938-39.

TABLE 1A

IRAQ

	1	2	3	4	5	6	7
Year	Total Exports IDm.	Oil Exports IDm.	Non-oil Exports IDm.	Transit Trade IDm.	Oil Exports as percentage of Total Exports %	Non-oil exports as percentage of total %	Transit Trade as as percentage of total Export %
1950	45.2 a)	23.6 a)	20.1	4.3	52.2	44.5%	9.5
1951	64.6	35.7	27.0 c)	5.7 c)	55.3	41.8	8.8
1952	99.6	79.6	18.8	6.6	79.9	18.9	6.6
1953	159.6	135.1	19.1	7.3	84.7	12.0	4.6
1954	171.4	147.5	18.0	6.2	86.1	10.5	3.6
1955	182.2	159.9	15.9	6.1	87.8	8.7	3.4
1956	162.5	143.6	13.2	5.8	88.4	8.1	3.6
1957	119.3	102.3	12.9	7.9	85.8	10.8	6.6
1958	196.6	175.4	14.3	8.1	89.2	7.3	4.1
1959	208.4	189.3	11.5	4.1	90.8	5.5	2.0
1960	224.8	208.5	8.0	1.8	92.8	3.6	0.8
1961	226.0	209.7	7.9	1.3	92.8	3.5	0.6
1962	238.1	210.4	19.3	1.3	88.4	8.1	0.6
1963	270.1	243.7	16.7	1.3	90.2	6.2	0.5
1964	292.4	266.4	15.3	1.7	91.1	5.2	0.6
1965	306.9	277.7	18.1	1.7	90.5	5.9	0.6
1966	327.1	293.8	23.2	5.9	89.8	7.1	1.8
1967	285.7	256.9	20.7	11.5	89.9	7.3	4.0
1968	352.0	317.9	23.0	20.5	90.3	6.5	5.8
1969	355.0	320.2	22.0	20.4	90.2	6.2	5.8
1970	365.5	329.8	22.6	27.9	90.2	6.2	7.6
1971	487.5	446.8	22.8	33.8	91.7	4.7	6.9
1972	453.4	408.5	28.6	65.5	90.1	6.3	14.5
1973	744.6	684.7	32.5	56.1	92.0	4.4	7.5
1974	2,154.8	2,044.9	28.1	89.7	94.9	1.3	4.2
1975	2,592.1 b)	2,465.4 b)	35.6 d)	118.1 d)	95.1	1.4	4.6
					$\bar{x}$ = 87.0%	$\bar{x}$ = 9.7%	$\bar{x}$ = 4.6%

Sources: a) Columns (1) and (2), (3), (4), 1950 Central Bank of Iraq Bulletin - 1966.
b) International Monetary Fund: I.F.S., May 1976. (1951-75)
c) Columns (3), (4) (1951-75)
Ministry of Planning : Central Statistical Organization, Foreign Trade Statistics, 1974.
d) Central Bank of Iraq Bulletin, No. 3 , 1976.

TABLE 1B

KUWAIT

	1	2	3	4	5	6	7
YEAR	Total Exports KDm.	Oil Exports KDm.	Non-Oil Exports KDm.	Re-Exports KDm.	Oil Exports as percentage of total exports %	Non-Oil Exports as percentage of total %	Re-exports as percentage of total non-oil exports %
1953	181.1	181.1	n.a.		100		
1954	201.4	201.4	4.3		100	2.1	
1955	232.5	232.5	5.7		100	2.5	
1956	241.1	241.1	5.3		100	2.2	
1957	262.5	262.5	4.9		100	1.9	
1958	332.1	332.1	5.6		100	1.7	
1959	296.4	296.4	7.2		100	2.4	
1960	393.7	385.4	8.3		97.9	2.1	
1961	393.6	384.4	9.5		97.7	2.4	
1962	441.2	443.1	8.1		98.2	1.8	
1963	405.8	395.3	10.5		97.4	2.6	
1964	446.8	434.9	11.8		97.3	2.6	
1965	458.4	444.1	14.1		96.9	3.1	
1966	479.7	465.8	13.6		97.2	2.8	
1967	484.4	469.1	15.3		96.8	3.2	
1968	513.2	469.7	16.7		97.0	3.3	
1969	550.0	527.0	23.1		95.8	4.2	
1970	590.6	564.3	26.4	19.1	95.5	4.5	72.1
1971	893.9	859.4	34.4	30.6	96.1	3.9	75.6
1972	981.2	931.5	49.6	33.5	94.9	5.1	65.0
1973	1,129.7	1,059.9	69.8	45.4	93.8	6.2	57.4
1974	3,056.4	2,939.2	116.8	64.3	96.2	3.8	49.3
1975	2,505.4	2,337.7	170.2	-	93.3	6.8	-
					$\bar{x}$ = 97.5%	$\bar{x}$ = 3.2%	

Source: Columns (1), (2), (1953-75)
International Monetary Fund: IFS, May 1976
Column (3), Planning Board, Central Statistical Office, Statistical Abstract 1976.
Column (4), Central Bank of Kuwait, Economic Report 1975.

since the rise in oil revenues, reflecting the imports in the development plan, but this has been confined to the public sector.

The average for the non-oil exports for Iraq on the other hand was about 10% of total exports, whereas that of transit trade was about 5%. The corresponding ratio for Kuwait for non-oil exports was just over 3%. The examination of tables 2 and 4 reveals, that although transit trade in Iraq is a small proportion of the total, albeit an increasing one, nevertheless has increased significantly over the last decade in absolute terms, and has peaked in 1975 where it is three times the value of non-oil exports and twenty times in the index. This is due mainly for the increasing imports of Kuwait and the Gulf countries. Cement is one of the few merchandise exports to Kuwait and the Gulf. This has more than trebled the rate of manufactured articles in the period 1956-69, where cement's share in the value of total non-oil exports increased from an average of 1.8% in 1956-58 to 17% in 1967-69.[5] The figures also reveal the import-substitution policy, where attention is paid to the expanding local market. This contrasts with the increasing trend in Kuwait's non-oil exports which are mainly export-oriented. Kuwait imposes an ad valorem tax of 4% on imports,[6] 2% on re-exports, and 15% on imports of which there is a locally-manufactured equivalent with complete exemption of food-stuffs and Government imports. While both countries' policies emphasise industrialization, in order to minimise as much as possible, the role of oil as the main source of revenue, industrialization has been far more extensive in Iraq than in Kuwait, where it has been

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5. U.N.E.S.O.B., "Planning the Foreign Trade Sector of Iraq", Studies in Selected Development Problems in Various Countries in the Middle East 1972, Beirut, p.13.

6. I.B.R.D. The Economic Development of Kuwait Johns Hopkins, Baltimore, 1965, p.7.

constrained by the size of the market. For the most part, the industrialization schemes in Kuwait have been aimed at export promotion such as the petrochemical industry, or the chemical fertilizers industry, whose entire output has been geared for the export market. These are outstanding examples where Kuwait enjoys an advantage in raw materials, where natural gas is used as fuel, and the urea and ammonia are extracted from oil, both of which are in abundance. It is thus following the vent for surplus mechanism where trade promotes production. The plants' output is exported from their docks, mainly to the Far East, and East Africa, where another advantage was the closure of the Suez, thus the Kuwaiti fertilizers were cheaper than European competitors with higher transport costs. Moreover, the industry is relatively capital intensive, and labour is relatively expensive in Kuwait. The theory according to the Heckscher-Ohlin version states,

> "that a country will benefit from trade by producing commodities that use more of its relatively abundant factors of production. It will export these commodities and import commodities using more of its relatively scarce factors unless its pattern of domestic demand happens to be biased towards commodities using domestic factors."[7]

Nevertheless the theory has its limitations, the most valid of which is that factor intensity cannot be used as a criterion of comparative advantage or of specialization in international trade. This is because what is termed the 'factor intensity reversal', which is the classification of industries by capital intensity independently of the prevailing factor prices. These rankings would be different in countries with different relative factor prices. This is because the capital to labour ratios do vary with changes in relative factor prices and which may vary between industries. A case in point would be oil-refining whose ratio is fixed,

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7. H.B. Chenery - "Comparative Advantage and Development Policy" American Economic Review, Vol. 51, 1961.

TABLE 2A

IRAQ

YEAR	Oil Exports IDm.	Index of Oil Exports	Non-oil exports IDm.	Index of non-oil exports	Transit Trade IDm.	Index of Transit Trade
1950	23.6	100	20.1	100	4.3	100
1951	35.7	151	27.1	135	5.7	133
1952	79.6	337	18.8	94	6.6	153
1953	135.1	572	19.1	95	7.3	170
1954	147.5	625	18.0	90	6.2	144
1955	159.5	678	15.9	79	6.1	142
1956	143.6	608	13.2	66	5.8	135
1957	102.3	433	12.9	64	7.9	184
1958	175.4	743	14.3	71	8.1	188
1959	189.3	802	11.5	57	4.1	95
1960	208.5	883	8.0	40	1.8	42
1961	209.7	889	7.9	39	1.3	30
1962	210.4	892	19.3	96	1.3	30
1963	243.7	1,033	16.7	83	1.3	30
1964	266.4	1,129	15.3	76	1.7	40
1965	277.7	1,177	18.1	90	1.7	40
1966	293.8	1,245	23.2	115	5.9	137
1967	256.9	1,089	20.7	103	11.5	267
1968	317.9	1,347	23.0	114	20.5	477
1969	320.2	1,357	22.0	109	20.4	474
1970	329.8	1,397	22.6	112	27.9	649
1971	446.8	1,893	22.8	113	33.8	786
1972	408.5	1,731	28.6	142	65.5	1,523
1973	684.7	2,901	32.5	162	56.1	1,304
1974	2,044.9	8,665	28.1	140	89.7	2,086
1975	2,465.4	10,447	35.6	177	118.1	2,747

Source: Table 1A

hence may vary very little with changes in relative prices. The second point is that what is relevant in a country's trading pattern is the fact that it depends on the rates of transformation between goods abroad which is determined by foreign prices and rates at which they can be transformed domestically, which depends on the latter's supply and demand.[8]

Finally, in order to illustrate the point mentioned earlier on with reference to the pattern of trade of the two countries, that whereas re-exports are almost insignificant as a proportion of total Iraqi trade, they form an important part of Kuwait's total exports as shown in Table 3. It shows that although there is a percentage decline out of the total, there is a consistent rise in the absolute value of re-exports, due to the neighbouring countries' increased demand for imports, and the inadequacy in their port-handling facilities, among many of the factors underlying this rise. A proportion of the imports of Iraq, Iran and Saudi Arabia are handled by the port of Kuwait. In Iraq's case, on the other hand, the volume of transit trade has featured as a significant constituent of total trade, and the earnings have increased rapidly. Again this is due to the Gulf countries' increased level of imports, and Iraq's location on the land route from Turkey which links Europe and the Gulf. This is shown in Table 2A. The background may be summarised by, the import substitution approach pursued by Iraq, albeit with certain qualification, where for instance, cement; the largest single industry is vigorously exported to the neighbouring Gulf States, and the export-promotion approach is in the case of Kuwait, within the context of lessening her dependence on oil as a source of income in the long run.

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8. A.K. Dasgupta, Economic Theory and Developing Countries, Macmillan, 1974, pp. 110-114.

TABLE 2B:

KUWAIT

Year	Oil Exports KDm.	Index of oil exports	Non-Oil Exports	Index of Non-Oil Exports
1953	181.1	100		
1954	201.4	111	4.3	100
1955	232.5	128	5.7	133
1956	241.1	133	5.3	123
1957	262.5	145	4.9	114
1958	332.1	183	5.6	130
1959	296.4	164	7.2	167
1960	385.4	213	8.3	193
1961	384.4	212	9.5	221
1962	443.1	245	8.1	188
1963	395.3	218	10.5	244
1964	434.9	240	11.8	274
1965	444.1	245	14.1	328
1966	465.8	257	13.6	316
1967	469.1	259	15.3	356
1968	469.7	259	16.7	388
1969	527.0	291	23.1	537
1970	564.3	312	26.4	614
1971	859.4	475	34.4	800
1972	931.5	514	49.6	1,153
1973	1,059.9	585	69.8	1,623
1974	2,939.2	1,623	116.8	2,716
1975	2,337.7	1,291	170.2	3,958

Source: Table 1B

Absorptive Capacity and Income Effects

In a closed economy model, the equilibrium condition is savings and investment are equal. In the open economy model as is treated here, the gap methodology is followed where investment is divided into two components : domestic investment Id, and foreign investment If. For the equilibrium condition:

$$I_d + I_f = S \qquad (1)$$

Foreign investment is the difference between exports of goods and services, and imports of goods and services:

$$I_f = X - M \qquad (2)$$

Substitute 2 in 1, we then obtain:[9]

$$I_d + X = S + M \qquad (3)$$

This could be re-arranged into:

$$I_d - S = M - X \qquad (4)$$

It means that the import and savings gaps must coincide ex-post. The two gaps may not be equal ex-ante. But the savings gap which is due to a shortfall in domestic savings in order to meet a given level of investment is referred to in the preceding Chapter, and the import gap, which refers to the shortage of foreign exchange for the import requirements of I_d are not applicable to our two economies. If an increase of income requires a certain amount of investment, according to the model, then capital formation leading to economic growth could be determined by the largest of the two gaps. If the import gap is the larger of the two, then the supply of imports would be inadequate to meet the level of domestic savings which is available. If on the other hand, the larger gap is shortage of savings, then its capacity to

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9. B. Södersten - International Economics. Macmillan, London, 1974 p.252.

import would be exhausted. The absorptive capacity constraints would limit growth even if there are adequate savings and sufficient import capacity.

If the empirical evidence is examined as set out for both countries in Chapter 4, it does seem to suggest that equation (4) is proven. Savings always exceeds domestic investment by an amount equal to the foreign investment. The exception was in Iraq where investment was more than, or equal to savings during certain years. This point had been discussed at length in Chapters 1 and 4, where in the latter it was treated within the context of the closed economy. The point is again proven in the open economy model, which is the supply for investible funds far exceeds the demand for them. In both cases, the import gap is consistently the larger of the two gaps, hence it has been inadequate to meet the available domestic savings level. This is particularly true of Kuwait, where the market is far larger than the given level of population suggests, due to high incomes, tastes, and the level of savings. Absorptive capacity is limited due to other factors and not to the two gaps referred to above.

If we examine, on the other hand, the theoretical implications of devaluation, and its income effects and the introduction of the absorption approach. Aggregate absorption is defined as the difference of the foreign trade balance subtracted from the total production of goods and services.[10] From this the following equation is derived: $b = (1 - c)\, y + d$ where c, is the propensity to absorb, which is the sum of the propensity to consume and the propensity to invest respectively. It is the direct effect of absorption, which expresses whatever tendency there may be for the devaluation to induce a change in the amount of real absorption at any given level of real income.[11] a, is the change in the total absorption of

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10. S.S. Alexander "Effects of Devaluation on a Trade Balance" I.M.F. Staff Papers, Vol. 2, 1952.

11. Ibid., p.266.

goods and services, b is the change in the foreign balance, and y is the change in the total production of goods and services. The direct effect is the change due to other than the income affect, whereas cy is real consumption and real investment induced by a change in real income as a result of devaluation. If we start with the initial statement and substitute absorption by real hoarding, we get the latter equal to the foreign balance. If the propensity to absorb is greater than unity, a larger increment in absorption of goods and services into consumption and investment is stimulated by income increments, thus the foreign balance will not improve as a result of the increase in output. If on the other hand, the propensity to absorb were less than unity, then the devaluation would be effective as in under-employment conditions. From the estimated equations of our model in Chapter 4, the marginal propensity to consume for Iraq was = 0.783 and the marginal propensity to invest was = 0.136. Therefore the marginal propensity to absorb, which is the sum of the above two, is 0.919. The marginal propensity to consume for Kuwait on the other hand was 0.205 and its marginal propensity to invest was negligible, it follows that its marginal propensity to absorb is not much more than 0.205 or approximately 0.21. It could be concluded, that the marginal propensity to absorb for Iraq was just over four times that of Kuwait.

In both cases the values were less than unity, which seems to support the theory, which states that the foreign balance is improved through increased output. All values taken at current prices, i.e. they are money values as opposed to real values. The latter may mean more accurate results, but for our limited purposes, the former is sufficient, as the latter would create considerable problems such as obtaining accurate wholesale and retail price indices for the period. The above results could be within the context of what is referred to as the idle resource effect. The other effect is the terms of trade effect. When the aggregate income effects (1 - c) are multiplied by the change of income, the latter will have two components. If

positive then we have increased production through devaluation. The negative component is the effect on income of the change in the terms of trade. The other influences are, the direct effect referred to above which is any influence toward lower real expenditure as money income and money prices rise together as a result of the devaluation.[12] It operates under two significant assumptions, that of full-employment, where the real income generated cannot be increased through devaluation; and perfect elasticity of imports' foreign supply and exports' domestic demand, which means constant terms of trade. The other direct sub-effects are, the cash balance affect, which is the most important for our purposes, the redistribution of income effect, and the money illusion effect.

The cash balance effect is where asset prices are brought down by increasing the money amounts of cash balances in order to maintain their real values, given constant money supply. The income-expenditure relationship is a direct consequence where expenditure is lowered to increase cash holdings, and indirectly through the rate of interest where there is a shift from other assets into cash, interest rates could be raised in order to counteract this situation. A possible result might be unemployment due to the difficulty of shifting production from domestic to exports as a result of a reduction in absorption due to cash balance effect. An adverse effect on income would result in the deterioration of the foreign balance if c is less than one, hence offsetting the benefits from the direct absorption effects. Subject to the qualifications made by Alexander to the values of the matrices a, y, c, and p, and as to what sector of the economy is dealt with, the value of c is less than one in both cases as was shown above. There has been effective revaluation of both currencies during the period, hence import prices per se have fallen, subject to the fact that

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12. Ibid., p.270.

import prices have increased due to other factors. In both countries, the opposite has occurred, where asset prices have been high, and relatively low rates of interest, and the switch to assets rather than from them, has occurred which raised prices even higher due to increased demand where there is a given quantity of money. One factor underlying this might be as a precaution against inflation.

The background to the revaluation may be summarised in the fact that both countries were members of the Sterling Area, where the overwhelming bulk of their imports were from the U.K. In 1959, however, Iraq had left the Area, followed by Kuwait in 1966. For most of the period under study, both countries' payments for their major export, oil were made out in Sterling which meant that their currencies remained at par with Sterling. Both countries insisted on payment by Sterling in order to finance the bulk of their trade with the U.K. and because of the attractions of London in holding their reserves, so long as Sterling was a major reserve currency, which would facilitate their financing of trade with other countries which would have insisted in their turn upon payment by Sterling. The Soviet Union which has increasingly become a major trading partner with Iraq, is a case in point. Moreover, most of both Governments' holdings were in London, as well as their other holdings which were also dominated in Sterling.

Absorptive Capacity and Price Effects

It is argued that devaluation would have an adverse effect upon a country's terms of trade, particularly as in the case of the two economies under study, where there is one highly specialized export; oil. It follows, that import prices are less influenced by devaluation than export prices. Hence devaluation can only be effective if it worsened the terms of trade

of the country.[13] But this assertion does not hold within our context, as payments for oil are made in dollars which affect import prices, as those are paid for in them. Imports have necessarily increased in value, marked by the dollar devaluation in 1971 which coincided with the rise in oil prices, hence the increase in the volume of imports. The increased oil revenues, substantial as they are, have been offset considerably by the dollar depreciation, which means higher import prices and hence inflation. This is shown by the import prices in both countries where for 1975, the wholesale prices index increased by 45% over the base year 1972,[14] which is very significant in an open economy. Import prices are shown in Tables 3 and 4 consecutively.

TABLE 3:

IRAQ CONSUMER PRICE CHANGES

(Percent)

YEAR	1972	1973	1974
% Change	3.9	5.2	4.9

Source: U.N. World Economic Survey 1974. Part 2. Current Economic Developments.

13. J.J. Polak & T.C. Chang 'Effects of Exchange Depreciation on a Country's Export Price Level'. IMF Staff Papers. Volume 1, 1950. p.53. 'Depreciation will be more effective in lowering export prices, the greater the elasticity of supply of the depreciating country and the smaller the elasticity of foreign demand. The effectiveness will be equal to unity if either the domestic supply for exports is fully elastic or the foreign demand for the country's exports is fully inelastic. Conversely, it will be equal to zero if either the country's supply is wholly inelastic or the foreign demand for the country's products is completely inelastic.'

14. Central Bank of Kuwait - Economic Report for 1975, p.76.

TABLE 4:

KUWAIT IMPORTS IN CONSTANT PRICES KDm.
(1969 = 100)

	1969	1970	1971	1972	1973	1974	1975[a]
Imports in current prices	231.7	223.3	232.3	362.2	310.6	455.1	656.4
Percentage Change	-	-4	4	13	19	47	44
Import Price Index	100	116	115	123	147	176	207[b]
Imports in Constant prices	231.7	192.3	202.9	213.3	211.3	258.0	317.1
Percentage Change	-	-17	6	5	-1	22	23

Source: Central Bank of Kuwait - Economic Report for 1975
(a) Partial Estimates
(b) Based on the first 9 months of the year.

In view of the preceding Section which dealt purely with the income effects of devaluation, it is held that real absorption is reduced even if money absorption remained constant or increased due to shifts in relative prices and price increase. This reduction in real absorption may be additional to that induced by a reduction in real income. If the terms of trade are assumed to be constant when devaluation occurs, then the increase in import and export domestic prices would be by the same amount. It follows that substitution occurs by consumers from exportable to importable goods and producers would also shift production in a similar pattern, since export goods would command higher prices. Import substitution takes place when resources are allocated to them, which with the reduced supply of domestic goods would cause relative price shifts. This would reduce the value of real absorption which is additional to the reduction in real income.[15]

15. F. Machlup, 'Relative Prices and Aggregate Spending in the Analysis of Devaluation'. American Economic Review - Volume 45, 1955.

The price effects on absorption must be investigated in the light of what has taken place in the two economies. In fact, both currencies' first revaluation occurred in 1966, when the U.K. had devalued the pound, and both had maintained their parity vis-a-vis the dollar. Successive revaluations occurred since the 1971 oil price rises, and continued to the present simply by maintaining the original value of their respective currencies as shown in Table 5.

TABLE 5:

Iraq and Kuwait Currency Values

Year	Iraqi Dinars (in U.S. $)	Kuwaiti Dinars (in U.S. $)
up to 1970	2.80	2.80
1971	2.82	2.81
1972	3.04	3.04
1973	3.35	3.39
1974	3.38	3.41
1975	3.38	3.41

Source: International Monetary Fund: I.F.S., May 1976.

TABLE 6:

Wholesale Price Index in Baghdad
1962 = 100)

Year	Price Index
1965	106.7
1966	106.2
1967	114.0
1968	108.6
1969	111.5
1970	122.3
1971	130.3
1972	125.1
1973	130.9
1974	147.2

Source: Central Bank of Iraq Bulletin, 1974, No. 4.

Both countries' payments are in dollars as mentioned above, with Iraq in a somewhat different position, in that her currency is inconvertible in contrast with the fully convertible Kuwaiti currency. It has also entered into several barter agreements for oil and other products, both agricultural and industrial, with the Eastern bloc. What has effectively occurred was the simultaneous series of revaluations in conjunction with the almost forefold increase in oil prices since 1971. In view of both countries' dependence on imports, the payment of revenues in dollars is of questionable benefit, given the global rates of inflation, and the dollar's instability in the recent past. Until the issue of indexing world commodities is resolved, which seems a distant aim, the payment by dollars method is used, notwithstanding that the latter's value has stabilized, and seems likely to do so in the short-run, due to the American economic recovery. An important step has been taken, namely, the introduction of the so-called 'Basket Valuation of SDR's' which evaluates one SDR as the equivalent of the sum of sixteen currency components, introduced by the I.M.F. in 1974.[16]

Favourable trends could be observed by exports for the period 1959/60 to 1966/70 which has been classified under the 4-7% category for both countries, where Iraq's increase was 5.0% and that of Kuwait 5.6%.[17] While this accounts for the increase in exports, it must be set against the background of the almost constant prices of exports, namely oil, and a few agricultural products mainly dates, for Iraq for the period under study. The data available for Iraq is over a long period, using 1970 as base year, and for both countries from 1972-75.

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16. I.M.F. Survey, July 1974.

17. L.B. Pearson, Partners in Development, Praeger, 1970, p.368.

TABLE 7:

Iraq Export Prices (1970 = 100)

Year	1951	1952	1953	1954	1955	1956	1957	1958	1959
Export Price	92	92	110	110	110	108	112	115	106
Year	1960	1961	1962	1963	1964	1965	1966	1967	1968
Export Price	102	100	100	100	100	100	100	100	100
Year	1969	1970	1971	1972	1973	1974			
	100	100	125						

Source: International Monetary Fund: I.F.S., August 1976.

TABLE 8:

Export Prices $ (1970 = 100)

	1972	1973	1974	1975
Iraq	142	176	585	625
Kuwait	148	202	712	759

Source: International Monetary Fund: I.F.S. August, 1976.

In the context of the terms of trade, however, a general distinction must be made between the commodity terms, and income terms of trade, where they were 94 for the former, and 164 for the latter in 1969, using 1963 as base year.[18] A favourable income terms of trade for the Middle East as a whole, and an unfavourable commodity terms of trade for the same areas is accounted for by the oil producers. Another differentiation must be made in the terms of trade which include oil, hence they clearly show favourable terms, whereas they are adverse when oil is excluded. Nevertheless, it is significant that they were adverse for the group for 1975. A comparison of the terms of trade is shown in Table 9:

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18. G.K. Helleiner, International Trade and Economic Development, Penguin 1972, p.23.

TABLE 9:

	Annual Average	Change from Preceding Year					
	1960-70	1970	1971	1972	1973	1974	1975
Industrial Countries	0.5	0.5	-0.5	0.5	- 2	- 11	3
Primary producing Countries	0.5	-1	-1.5	3.5	10	- 14	- 6
Oil producing Countries	- 2	-2	17	5	17	144	- 4
Non-Oil developing Countries	0.5	-1	- 9	0.5	6.5	- 4.5	-10

Source: International Monetary Fund Annual Report, 1976.

There are no comprehensive figures to show for Iraq, and only limited evidence for Kuwait. Table 10, which includes oil, shows a surprisingly deteriorating terms of trade, with the exception of 1967/68, which accounted for the drastic cut in imports due to the closure of the Suez Canal following the 1967 War. The trend shows improving terms of trade, however. Table 11 on the other hand, shows the favourable terms of trade for the last important sub-period 1971-74 within the period under study. The favourable terms of trade must take into account the higher prices reflected in the wholesale and retail price indices, and the rising cost of living index in each country. An important factor has been the higher import prices. Since both countries' import requirements have increased substantially, particularly since 1971, the import price rises have been reflected in table 10 for Kuwait. There is no comparable available data for Iraq, however, except, some idea might be gathered from the wholesale price index in Baghdad markets, which is the largest in the country, and may be regarded as typical. The total figures were taken for foodstuffs and beverages, construction material, and textiles, all of which contain a substantial import component. The import prices have risen due to the worldwide inflation, which meant that the prices have been reflected domestically, thus leading to either

shortages of essential goods as in Iraq, or to larger government subsidies to stabilize prices of essentials such as tea and sugar as in the case of Kuwait. Finally, the reconciliation of the two approaches to absorption, namely, the income and elasticities approaches could be summarized,

> "An increase in the ratio of international to domestic prices which is essential for a decrease in the import surplus according to the relative - prices approach, can take place if and only if there is a decrease of absorption, and a decrease of absorption can occur only if there is an increase in the general price level. Hence the two approaches to the analysis of devaluation must lead to the same conclusions."[19]

This stresses the importance of the cash-balance effect explained above, particularly in the context of Kuwait's open economy, where interest rates are low, because of the very high asset prices.

TABLE 10:

Kuwait Terms of Trade

	1965/66	1966/67	1967/68	1968/69	1969/70	1970/71
Oil Exports Price Index	100	100.7	101.4	101.8	102.5	113.2
Imports Price Index	100	104.7	97.7	108.9	109.4	120.0
Terms of Trade	100	96.0	104.0	92.0	94.0	94.3

Source: Central Bank of Kuwait Third Annual Report, 1972.

TABLE 11:

West Asia Terms of Trade - % change from previous year

	Average 71-74[20]	x unit value 1971	1972	1973	1974(a)	M unit value 1971	1972	1973	1974	Average 1971-74
Oil-exporting countries	58.3	25.1	14.1	26.8	246.0	5.6	9.0	23.2	36.0	17.8
Others	20.1	7.1	14.9	26.2	34.0	6.9	9.0	23.7	46.0	20.4

Source: U.N. World Economic Survey 1974. Part 2. Current Economic Developments.
a) 1974 - preliminary.

19. M. Michaely "Relative-Prices and Income-Absorptive Approaches to Devaluation : A Partial Reconciliation". American Economic Review, Volume 50, 1960.

TABLE 12

IRAQ

	1 Total Imports IDm.	2 Index of Imports	3 GNP IDm.	4 1 as percentage of 3 %	5 Average propensity to imports 1 ÷ 3
1950	37.6 a)	100	182.0	20.7	0.207
1951	51.0	136	210.0	24.3	0.243
1952	61.9	165	247.0	25.1	0.251
1953	83.2	221	286.4	29.1	0.291
1954	89.8	239	329.3	27.3	0.273
1955	121.0	322	340.8	35.5	0.355
1956	134.8	359	388.5	34.7	0.347
1957	152.9	407	412.6	37.1	0.371
1958	129.4	344	435.6	29.7	0.297
1959	135.6	361	452.3	30.0	0.299
1960	164.3	437	470.1	35.0	0.349
1961	174.5	464	520.4	33.5	0.335
1962	156.2	415	593.6	26.3	0.263
1963	145.3	386	598.2	24.3	0.243
1964	187.9	500	717.5	26.2	0.262
1965	207.5	552	784.4	26.5	0.265
1966	221.0	588	851.3	26.0	0.259
1967	183.2	487	875.6	20.9	0.209
1968	192.1	511	976.4	19.7	0.197
1969	205.3	546	1,025.3	20.0	0.200
1970	236.6	629	1,116.5	21.2	0.212
1971	314.2	836	1,251.7	25.1	0.251
1972	294.2	782	1,338.5	22.0	0.220
1973	382.7 b)	1,018	1,582.1	24.2	0.242
1974	700.1	1,862	n.a.	-	-
1975	1,244.8 c)	3,311	n.a.	-	-
				$\bar{x}$ = 26.8%	$\bar{x}$ = 0.268

Sources: Column 1, Central Bank of Iraq Quarterly Bulletin 1965-76
Ministry of Planning, Central Statistical Organization, Foreign Trade Statistics 1970-75.
Column 3, International Monetary Fund : IFS 1960 - May 1976.

YEAR	KDm.		KDm.	%	
1954	30.0	100	n.a.		
1955	33.7	112	n.a.		
1956	41.2	137	n.a.		
1957	60.0	200	n.a.		
1958	75.0	250	n.a.		
1959	92.2	307	n.a.		
1960	86.4	288	n.a.		
1961	89.0	297	n.a.		
1962	101.8	339	460	22.1	0.221
1963	115.6	385	486	23.8	0.238
1964	115.1	383	561	20.5	0.205
1965	134.7	449	553	24.4	0.244
1966	165.3	551	682	24.2	0.242
1967	211.7	706	734	28.8	0.288
1968	218.3	728	793	27.5	0.275
1969	230.8	769	840	27.5	0.275
1970	223.3	744	909	24.6	0.246
1971	232.3	774	1,151	20.2	0.202
1972	262.2	874	1,200	21.9	0.219
1973	310.6	1,035	1,769	17.6	0.176
1974	455.1	1,517	3,197	14.2	0.142
1975	643.6	2,145			
				$\bar{x}$ = 22.9%	$\bar{x}$ = 0.229

Sources: Column 1, Planning Board, Central Statistical Office, Statistical Abstract Several Issues.
Column 3, International Monetary Fund : IFS May, 1976.

Import Characteristics

Imports formed a remarkably similar proportion of GNP as an average within the limits of the given periods in both countries. They were 27% of GNP for Iraq in the period 1950-73 and 23% for Kuwait for the period 1962-74, as shown in table 12. Tables 13A and 13B reveal again a remarkable similarity as the average for capital goods imports for their given periods was 18% of total imports for both, and for intermediate goods 35% for Iraq and 33% for Kuwait and for consumer goods it was 49% for Kuwait and 46% for Iraq. In fact there was a rising trend for the latter category of imports for Iraq as could be seen from the table.

The estimated open-economy model equations, using the savings data in Chapter 4, and the foreign trade data in this Chapter with GNP, were for Iraq.

Savings:

$$S = 11.084 + 0.204Y \qquad R^2 = 0.925$$
$$(14.528)^{20}$$

Imports:

$$M = 64.896 + 0.163\ Y \qquad R^2 = 0.826$$
$$(8.709)$$

For Kuwait, the Savings equations were:

$$S = -237.123 + 0.788Y \qquad R^2 = 0.990$$
$$(33.733)$$

$$M = 122.660 + 0.126Y \qquad R^2 = 0.893$$
$$(9.135)$$

There was a high correlation between the level of GNP and imports, but both marginal propensities to import were low, where in Kuwait it was slightly lower.

The foreign trade multiplier for Iraq was = $\frac{1}{s + m}$ which is 2.725

20. Numbers in parenthesis are to values of regression coefficients

and for Kuwait 1.094. It could be seen that Iraq's foreign trade multiplier is almost two and a half times that of Kuwait's.

Finally, the composition of imports for both countries must be shown, a breakdown of imports into consumption and investment goods. And a comparable set for Kuwait, where capital, intermediate and consumption goods are shown in Tables (13A) and (13B) respectively. This may help explain the amount imported as a proportion of the increase in national income. The reconciliation of the two approaches to absorption could be summarized,

> "an increase in the ratio of international to domestic prices, which is essential for a decrease in the import surplus according to the relative price approach, can take place if and only if, there is a decrease of absorption. A decrease in absorption can occur only if there is an increase in the general price level."[21]

Since the pattern of exports for both countries is known in the sense that it is dominated by oil exports, and dates in the case of Iraq, petrochemicals in the case of Kuwait, it is sufficient to investigate the import pattern alone. A breakdown of imports into components is shown in Tables (13A) and (13B) respectively.

TABLE (13A)

IRAQ

Import Composition by Type of Commodity by percentage

Year	Capital Goods%	Intermediate Goods%	Consumer Goods %
1965	18.7	33.8	47.5
1966	19.4	36.3	44.3
1967	23.4	36.2	40.4
1968	18.8	33.9	47.2
1969	20.8	35.0	44.0
1970	20.9	32.7	46.3
1971	18.5	35.2	46.1
1972	14.3	37.2	48.3
1973	18.2	35.5	46.2
1974	10.2	38.4	50.6
	$\bar{x}$ = 18.3%	$\bar{x}$ = 35.3%	$\bar{x}$ = 46.1%

Source: Central Bank of Iraq Bulletin 1967-1974

21. M. Michaely, 1960, op.cit., p.146.

TABLE 13B

Kuwait Imports by Type of Usage (KDm.)

	1965/66		1966/67		1967/68		1968/69		1969/70		1970/71		1971/72		1972/73		1973/74		1974/75	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
Capital Goods	23.9	16.6	33.9	19.3	43.4	19.8	35.5	16.7	46.7	20.0	40.6	17.9	39.2	16.6	50.8	18.7	52.5	15.8	92.0	17.8
Intermediate Goods	48.5	33.6	58.5	33.2	72.7	33.2	71.0	33.3	74.5	31.9	73.2	32.2	78.1	33.0	90.2	33.2	111.6	33.7	176.6	34.2
Consumer Goods	71.8	49.8	83.7	47.5	102.9	47.0	106.6	50.0	112.2	48.0	113.0	49.7	118.6	50.2	129.2	47.6	164.2	49.6	244.5	47.3
Not Specified	-	-	-	-	-	-	0.1	-	0.4	0.1	0.5	0.2	0.5	0.2	1.3	0.5	3.0	0.9	3.8	0.7
Total	144.2	100.0	176.1	100.0	219.0	100.0	213.2	100.0	233.8	100.0	227.3	100.0	236.4	100.0	271.5	100.0	331.3	100.0	516.9	100.0

Source: Central Bank of Kuwait, 6th Annual Report 1975, Table (81), p.161.

Kuwait's imports ratio is in fact one of the highest which suggests a very high average propensity to import. But this does not necessarily mean, a high marginal propensity to import as was shown. This provides a contrast with a relatively much lower imports per capita for Iraq,

TABLE 14:

Per capita imports ($m).

Country	1967	1968	1969	1970	1971	1972	1973
Iraq	48.55	44.7	47.1	53.9	67.3	70.9	-
Kuwait	1140.9	970.2	885.4	822.6	833.3	928.9	1192.8
U.S.A.	135.1	165.2	177.4	195.1	220.5	282.2	347.9
U.K.	276.4	342.9	359.4	390.2	438.1	503.3	648.9

Source: Central Bank of Kuwait Annual 5th Report 1974.

though the latter have been rising since 1970.

Subject to strict assumptions it is shown that since income earned Ye and income spent Ys :[22]

$$Ye = C + I + X \qquad (1)$$

$$Ys = C + S + M \qquad (2)$$

and subtracting 1 from 2 :

$$S - I + M = X \qquad (3)$$

where S, I, M are propensities to save, to invest, and to import respectively. The first two propensities i.e. S and I are added together, hence the difference between the two, defined as the propensity to lend abroad:

$$L = S - I$$

The equilibrium condition then becomes:

$$L + M = X \qquad (4)$$

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22. H.G. Johnson "Diagramatic Analysis of Income Variations and the Balance of Payments." Quarterly Journal of Economics, Vol. 64, 1950.

The marginal propensity to lend abroad is positive, if the marginal propensity to save is greater than the marginal propensity to invest, and negative if it is less.[23] The former case holds for both countries, albeit to a much greater extent in Kuwait who is a large-scale lender.

Trade Policies

The trade policies alluded to at the beginning of the Chapter may be elaborated on here. In the case of Kuwait, it was seen that imports are subject to low level duty in contrast with Iraq, which follows a protectionist policy to the hilt with 100% to 120% import duty on consumer goods, or the outright ban on certain imports with other than purely economic considerations in such decision-making. Both issues could be regarded within the wider context of diversification from the over-reliance on oil as the main component of their respective GNP, as a common aim. The methods of pursuing that aim, however, differ widely in the two countries. Both countries are attempting industrialization, where with Kuwait, the emphasism is on petrochemicals with the obvious value-added and the forward backward and forward linkages, as the main industry, with other minor industries, such as construction materials and cement. The history of industrialization in Iraq has been much longer. Cement is one of the oldest industries, but petrochemicals have been growing substantially, as well as other industries such as truck and tractor assembly, steel, textiles, and other consumer durables. Before the arguments for either could be presented then criticized within our framework, the Iraqi policy of import substitution, and Kuwait's export promotion as referred to above could be seen in perspective thus,

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23. In fact as was shown in Chapter 4, Kuwait's marginal propensity to save stood at 0.788 and its marginal propensity to invest was negligible, in the case of Iraq however, its marginal propensity to save was 0.204 and its marginal propensity to invest was 0.136.

> "Export promotion will divert foreign expenditure away from the country's output if the foreign demand is inelastic, while import restriction will divert domestic expenditure abroad if demand for imports is inelastic and the technique of restriction allows the foreigner the benefit of the increased value of imports to domestic consumers."[24]

If we observe the available data of the import pattern of the two countries tables, we find that in Kuwait's case, the import pattern has remained fairly stable in the sense that the average percentages imports of consumer goods has been 48.7% for the period 1965-70, whereas those for capital goods and intermediate goods, they were 17.9% and 33.2% respectively. The fluctuations throughout the period have been insignificant. In Iraq's case, however, the pattern shown on the table 13A for the period 1949-73 has been 41.7%, and for capital goods 48.5%. A more comparable breakdown is shown for Iraq for the period 1965-74 was 18.3%, and for consumer goods was 46%, and for intermediate goods 35.3%, the last two almost similar to Kuwait's case, which suggest that the industrialization programme might not have been fully implemented as planned, throughout the period.

Since import substitution entails the manufacture of consumer goods, there is a misallocation of resources and the hinderance of backward linkages as well as an inflated structure at the final stages of production.[25] The evidence available reports this as we saw from the above tables.

The other arguments against protection is technical inefficiencies

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24. H.G. Johnson 'Towards a General Theory of the Balance of Payments' in American Economic Association (eds). Readings in International Economics Allen & Unwin, London, 1968, p.384.

25. J.H. Power 'Import Substitution as an Industrialization Strategy' G.M. Meier (ed) Leading Issues in Economic Development. Oxford University Press, New York, 1976.

and the permission of a monopolistic situation, and the lack of economies of scale through the dispersion of resources in horizontally - balanced industrial growth would not render the advantages of the economies in technical innovation. This is true in any case for Iraq and Kuwait, since both markets are too small for such economies, albeit Iraq's is relatively much larger. In the latter case, the monopolistic situation is prevalent in any case through the State ownership of industry. Also the bias that import substitution has against savings though low profits via technical inefficiencies.

A very important point to be made is that the export industries which are not protected, do use inputs which are, hence they in turn are taxed by the tariff structure, hence inhibiting their growth. Also protection may be a hindrance to agricultural progress since the increasing productivity in agriculture depends upon the increasing use of manufactured imports, whose taxation would discourage their use thus slowing agricultural growth. This results in a vicious circle starting with the promise by the planners of the very backward agricultural sector and the emphasis on industry, which because of the above would remain backward.[26] This is the case in Iraq, where agricultural productivity has remained dangerously low throughout. Moreover, underdeveloped countries follow the advanced ones in differentiating tariff rates according to the stages of production. Hence the excess cost of domestic production though protection could be considerably higher than it appears from the tariff rates or from the excess of domestic prices over foreign prices. It is

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26. H.G. Johnson 'Tariffs and Economic Development : Some Theoretical Issues' Journal of Development Studies - Volume 1, 1964.

much higher than the assumption of external economies, distorted wage rates, inelasticity of demand for traditional exports, or the over-evaluation of the currency.

In conclusion,

> "Progressive import substitution could therefore easily absorb or more than absorb the potential increase in real income that would normally accrue from technical improvement and capital accumulation, and permit a country to accumulate capital at a substantial rate without achieving a significant increase in real income or in real income per head. In other words, potential increase in real income could easily be squandered on buying the luxury of high-cost local production of industrial goods previously imported. This situation could become a vicious circle, and the policy appear to be justified by its own consequences, if import - substitution were accompanied by inflationary development policies leading to chronic balance of payments problems.[27]

In conclusion the 'infant industry' argument employed by both countries is more than outweighed by the arguments above. The situation in Kuwait, however, is somewhat different in that the advantage of export-promotion is taking advantage of the factor-endowments, with the value-added advantages, and the new investment opportunities created through diversification, which will in turn lead to 'complementary investment opportunities. With Hirschman's forward and backward linkages, this may well be extremely beneficial.[28]

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27. Ibid., p.28.

28. M.W. Khouja, "Al-Khasaes Al-Moumayezah Lil-Iktisad Al-Kuwaiti". (The Distinctive Characteristics of the Kuwaiti Economy), Kuwait : Mimeographed paper, Kuwait Economic Society, 1974.

CHAPTER 6

THE GOVERNMENT

The aim of this chapter is to set out the role of government in the economic development of Iraq and Kuwait. Vital though this has been, it must, however be considered within the framework of the subject under study. The background has already been explained when considering the economic histories of both economies.[1] Despite their ideological differences, both governments have been patently active in their respective economies. Throughout the 20 year period, a considerable proportion of the Iraqi Government's revenues were allocated for gross capital formation, mostly on social overhead capital.[2] A comparable role has been played by the Kuwaiti Government since the 1950's, when oil revenues were accruing on a substantive basis. A fairly comprehensive welfare state has been consequently established, with simultaneous emphasis on infra-structure.

Both governments' preponderant role has been underlined by the fact that they are the sole recipient of oil revenues, which means they weild considerable economic power. The size and structure of those revenues will be examined in detail, as well as their relative importance. Furthermore, the determinants of the levels of government expenditure will be analysed and it appears that the most significant factor is the absorptive capacity constraint on that expenditure. The limits to this capacity largely determine the levels of expenditure, while bearing in mind

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1. See Chapters 2 and 3.

2. F. Jalal, The Role of Government in the Industrialization of Iraq, 1950-65. Cass, London, 1972, p.127.

the policy approach to central planning, and the extent to which it has been implemented, especially in the case of Iraq. The points of comparison will be borne out in the following discussion, from both points of revenues and expenditure. In the case of the former, the structure is important, in the sense that oil revenues constitute an even larger share of total revenues in Kuwait than they do in Iraq, whose direct and indirect taxes contrast with the absence of direct taxes in Kuwait.[3] In the context of expenditure, however, the question arises as to what is the actual as opposed to the allocated levels, given the constraints referred to above. Finally, it is appropriate here to consider whether,

> "It is shortage of resources, and not inadequate incentives, which limits the pace of economic development. Indeed, the importance of public revenue from the point of view of accelerated economic development could hardly be exaggerated."[4]

This statement as a whole cannot be disputed, except in so far as the two economies under study are the exception rather than the rule. The first part does not hold here, while the second part is a necessary but not a sufficient condition, as it is the limits to economic development, which is the absorptive capacity constraint. This creates the barrier to government expenditure of the given adequate revenues, hence the ultimate problem becomes one in which to what extent they do so.

Sources of Revenue

In examining the sources of revenues for the two countries' governments, there are two main points to perceive. First, the size

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3. Taxes on oil companies, are regarded as part of the oil revenues throughout for our purposes.

4. N. Kaldor 'Taxation for Economic Development' in I. Livingstone (ed). Economic Policy for Development Selected Readings, Penguin Modern Economic Readings, London 1971. p.313.

TABLE 1

IRAQ IDm.

1	2	3	4	5	6	7	8	9	10
Year	GNP at Current Prices IDm.	Total tax Revenue IDm.	Non-Tax Revenue IDm.	Total non-oil revenue (4+3) IDm.	5 as percent of 2 %	Oil Revenue IDm.	7 as percent of % 2	Total Govt. Revenue I Dm.	9 as percent of % 2
1952-53	247.0	23.7	7.2	30.9	12.5	33.1	13.4	64.0	25.9
1953-54	286.4	25.8	6.9	32.7	11.4	51.3	17.9	84.0	29.3
1954-55	329.3	28.9	6.1	35.0	10.6	57.7	17.5	92.7	28.2
1955-56	340.8	31.9	8.1	40.0	11.7	73.7	21.6	113.7	33.4
1956-57	388.5	32.5	9.5	42.0	10.8	68.9	17.7	110.9	28.5
1957-58	412.6	36.9	10.2	47.1	11.4	48.9	11.9	96.0	23.3
1958-59	435.6	36.2	13.3	49.5	11.4	79.9	18.3	129.4	29.7
1959-60	452.3	35.6	10.9	46.5	10.3	86.6	19.2	133.1	29.4
1960-61	470.1	42.9	13.1	56.0	11.9	95.1	20.2	151.1	32.1
1961-62	520.4	46.5	16.1	62.6	12.0	94.8	18.2	157.4	30.3
1962-63	593.6	47.9	18.3	66.2	11.2	95.1	16.0	161.3	27.2
1963-64	598.2	47.3	22.3	69.6	11.6	110.0	18.4	179.6	30.0
1964-65	717.5	56.1	25.0	81.1	11.3	126.1	17.6	207.1	28.9
1965-66	784.4	59.7	51.7	111.4	14.2	131.4	16.7	242.8	31.0
1966-67	851.3	68.2	29.3	97.5	11.5	140.8	16.5	238.3	28.0
1967-68	875.6	63.3	71.3	134.6	15.4	131.7	15.0	266.3	30.4
1968-69	976.4	71.7	57.7	128.8	13.2	203.3	20.8	332.1	34.0
1969-70	1,025.3	83.3	82.8	166.1	16.2	199.6	19.5	365.7	35.7
1970-71	1,116.5	93.6	84.5	178.1	16.0	213.6	19.1	391.7	35.1
1971-72	1,251.7	104.8	60.7	165.5	13.2	349.7	27.9	515.2	41.2
1972-73	1,338.5	104.1	57.1	161.2	12.0	189.1	14.1	350.3	26.2
1973-74	1,582.1	116.6	69.6	186.2	11.8	550.1	34.8	736.3	46.5
1974-75	n.a.	159.6	117.3	276.9	-	1,686.4	-	1,963.3	-
					$\bar{x}$ = 12.3%		$\bar{x}$ = 18.8%		$\bar{x}$ = 31.1%

Sources Iraq: a) Central Bank of Iraq Bulletin No. 4, 1974 for Columns 2 and 3.
b) For (1951-73) International Monetary Fund : IFS, (1955 - March 1977).
c) Central Bank of Iraq Bulletin, No. 2, 1976.

	KUWAIT					
	KDm.	KDm.	%	KDm.	%	KDm.	%
1953	n.a.	1.5		60.2		61.7	
1954	-	2.8		69.3		72.1	
1955	-	3.7		100.5		104.2	
1956	-	8.9		104.3		113.2	
1957	-	12.7		110.2		122.9	
1958	-	18.4		128.5		146.9	
1959-60	-	16.8		159.8		176.6	
1960-61	-	14.4		159.5		173.9	
1961-62	-	13.8		167.0		180.8	
1962-63	460	16.8	3.7	173.0	37.6	189.8	41.3
1963-64	486	16.8	3.5	190.6	39.2	207.4	42.7
1964-65	561	15.9	2.8	206.2	36.8	222.2	39.6
1965-66	553	19.5	3.5	216.1	39.1	235.6	42.6
1966-67	682	19.5	2.9	225.3	33.0	224.8	35.9
1967-68	734	49.7	6.8	231.7	31.6	281.4	38.3
1968-69	793	25.3	3.2	263.1	33.2	288.4	36.4
1969-70	840	26.1	3.1	279.3	33.3	305.4	36.4
1970-71	909	46.1	5.1	297.7	32.8	343.8	37.8
1971-72	1,151	29.3	2.6	354.1	30.8	383.4	33.3
1972-73	1,200	42.5	3.5	506.6	42.2	549.1	45.8
1973-74	1,769	44.0	2.5	530.9	30.0	574.9	32.5
1974-75	3,197	64.8	2.0	2,382.0	74.5	2,446.8	76.5
1975-76	n.a.		$\bar{x}$ = 3.5%		$\bar{x}$ = 37.9%		$\bar{x}$ = 41.5%

Sources: Column 2 for Iraq and Kuwait International Monetary Fund : IFS May, 1976.

Columns 3 & 4 for Iraq : Calculated from Government Revenue Tables : Central Bank of Iraq Bulletin 1955-76.

Column 5 for Kuwait : Central Bank Reports 1970-75
Planning Board, Statistical Abstract 1965-75

Column 7 for Iraq and Kuwait : OPEC Annual Statistical Bulletin 1975, OPEC Statistics Unit, Vienna, 1976.

of revenues as a proportion of GNP, and its implications.[5] Other explanations have been offered as determinants of size.[6] Second, the structure of these revenues, which could be broadly divided into oil and non-oil revenues. The latter, particularly in Iraq's case, are sub-divided into direct and indirect taxes. Tables 1 and 2 set out in detail, the proportion of the different constituents of government revenues to GNP and the total revenues to GNP, which could be easily contrasted. The evidence seems to suggest in the first instance, that both share this high ratio of total revenue to national income with the developed economies, as the average ratio for Iraq is 31% and for Kuwait, 42% where this will be subsequently qualified. However, in a well-known study, the data for 72 developed and developing countries was taken, and ranked accordingly to their tax ratios.[7] The highest ranking of 1 was France, as would be expected for a developed economy, which had a tax ratio of 37.7%, and the lowest of 72 as for Afghanistan with a tax ratio of 5.9%, which is equally predictable for an L.D.C. Iraq had ranked 32 with a tax ratio of 18.4% for the period 1962-64, and its ranking was 20 as an average tax effort country out of a sample of 52 low-income countries. It was found that the most important factor was the level of economic

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5. See Chapter 2 for a background on the size of expenditure.

6. H.H. Hinrichs 'Determinants of Government Revenue Shares Among Less Developed Countries'. Economic Journal, Volume 75, 1965. The study was for a sample of 60 countries, which were grouped into income per capita limits. A multiple regression of government share of GNP, openness, and per capita income were the variables for the period 1957-60. Iraq was in Group II where N/Y was $150-$299, and its Government share was 30%, its degree of openness, M/Y was 30%, and Y/N was $161. The conclusion reached was, that for L.D.C.'s, openness and not the per capita income was the key determinant of government revenue shares'. However, a strong positive relationship exists between goverment revenue shares and per capita income for $300-$750 group. And a high level of economic development (a per capita income of about $750) is a sufficient though not a necessary condition for R/Y of 18% or greater. (This may be termed a 'threshold of criticality'). Both countries' share of government revenue is above this threshold.

7. J.R. Lotz and E.R. Morss 'Measuring Tax Efforts in Developing Countries' I.M.F. Staff Papers, 1967.

TABLE 2

IRAQ

1	2	3	4	5	6
Year	Total Government Revenue IDm.	Tax Revenues as % of 2	Non-Tax Revenues Revenue as % of 2	Oil Revenues as % of 2	Columns (3 + 4) as % of 2
1952-53	64.0	37.0	11.3	51.7	47.4
1953-54	84.0	30.7	8.2	61.1	38.9
1954-55	92.7	31.2	6.6	62.2	37.8
1955-56	113.7	28.1	7.1	64.8	35.2
1956-57	110.9	29.3	8.6	62.1	37.9
1957-58	96.0	38.4	10.6	50.9	49.0
1958-59	129.4	28.0	10.3	61.8	38.3
1959-60	133.1	26.8	8.2	65.1	35.0
1960-61	151.1	28.4	8.7	62.9	37.1
1961-62	157.4	29.5	10.2	60.2	39.7
1962-63	161.4	29.7	11.4	59.0	41.1
1963-64	179.6	26.3	12.4	61.3	38.7
1964-65	207.1	27.1	12.1	60.9	39.2
1965-66	242.8	24.6	21.3	54.1	45.9
1966-67	238.3	28.6	12.3	59.1	40.9
1967-68	266.3	23.8	26.8	49.5	50.6
1968-69	332.1	21.6	17.4	61.2	39.0
1969-70	365.7	22.8	22.8	54.5	45.6
1970-71	391.7	23.9	21.6	54.5	45.5
1971-72	515.2	20.3	11.8	67.9	32.1
1972-73	350.3	29.7	16.3	54.0	46.0
1973-74	736.3	15.8	9.5	74.7	25.3
1974-75	1,963.3	8.1	6.0	85.9	-
		$\bar{x}$ = 26.5%	$\bar{x}$=12.7%	$\bar{x}$ = 60.8%	$\bar{x}$ = 40.2%
			KUWAIT		
1953	61.7			97.6	2.4
1954	72.1			96.1	3.9
1955	104.2			96.5	3.6
1956	113.1			92.1	7.9
1957	122.9			89.7	10.3
1958	146.9			87.5	12.5
1959-60	176.6			90.5	9.5
1960-61	173.9			91.7	8.3
1961-62	180.8			92.4	7.6
1962-63	189.8			91.2	8.9
1963-64	207.4			91.9	8.1
1964-65	222.2			92.8	7.2
1965-66	235.6			91.7	8.3
1966-67	244.8			92.0	8.0
1967-68	281.4			92.3	17.7
1968-69	288.4			91.2	8.8
1969-70	305.4			91.5	8.6
1970-71	343.8			86.6	13.4
1971-72	383.4			92.4	7.6
1972-73	549.1			92.3	7.7
1973-74	574.9			92.4	7.7
1974-75	2,446.8			97.4	2.7
				$\bar{x}$ = 92.3%	$\bar{x}$ = 8.2%

Source: Table 1

development and the per capita income. The study had revealed that taxable capacity increases with the size of the foreign trade sector due to the ease of administering its collection during the first stages of development, and the 'degree of openness' which facilitate internal taxation. The average openness for Iraq during 1962-64 was 66.7, and that for the U.K. 30.5, where the latter is an example of the developed economy for the period 1963-65. If however, the structure of both governments' total revenue is examined, then the same table shows that the average total oil revenues' ratio of GNP is 19% for Iraq and 38% for Kuwait for their given periods. Table 2 however, renders a more accurate impression by showing the average ratio of total oil revenues to total government revenues to be 61% for Iraq and 92% for Kuwait respectively for their given periods. This share of oil revenues is predominantly larger in both cases, and as could be seen is higher for Kuwait than it is for Iraq. The total non-oil revenues as a whole on the other hand, accounted for 40% of total government revenues, in Iraq which is five times that of Kuwait which stood at 8% of its total revenues. It follows that on closer examination, our first impression does not hold.[8]

Finally, the substantial increases the total government revenues since 1971, were accounted for by the oil price rises in that year and subsequent years, which were reflected in the oil revenue figures since that date.[9]

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8. K. Shin 'International Difference in Tax Ratio' Review of Economics and Statistics, Volume 51, 1969. In a study of 47 countries of two groups, high and low income respectively, the former tend to have higher tax ratios than the latter. It was found that the differences between the two groups may be caused by other factors than per capita GNP and openness. These were the degree of industrialization, the rate of growth of population, and the rate of change of prices, which were deemed significant. The result does not reject the conclusions of Lotz and Morss above. It concludes that the ratio of high income countries is more an index of political preference for an appropriate size of the government's role than an index of taxable capacity.

9. See Chapters 2 and 3 for the background on oil price rises.

The oil revenues in both cases is composed of the income tax imposed by the host governments on the operating companies as well as royalties, but as has been pointed above, it does not hold accurately for either case.[10]

The other main constituent of government revenue is classified convnetionally into direct and indirect taxes. A strict comparison of the non-oil revenues in the two countries cannot be adhered to since there are no direct taxes as such in Kuwait.[11] There have been several attempts in Iraq for progressive taxation, which may not have been unsuccessful. Nevertheless its system shares the features common to developing countries, where the proportion of indirect taxes out of total revenue exceeds that of direct taxes. Other considerations, however,

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10. There has not been a detailed account of Iraqi direct oil sales since the nationalization measures of 1972. Part of the sales were under barter agreements, particularly with the Soviet Union. It may be assumed that the oil revenues constitute direct sales since then. It may also be noted that oil-revenues per se, though they constitute direct taxes on companies plus royalties, are in a separate category as they are subject to exogenous factors. The situation has been altered further, since 1972 for Iraq, and the 1974 Participation Agreement in Kuwait, in which the Government's stake in oil production became 60%, and its subsequent complete take-over in 1976. The government's oil revenues are calculated thus: if the posted price is p, production cost c, income tax rate i, and royalty rate n, then income tax $I = (p - (pr + c))i$.
Since 1972, the Opec system by product unit has been used, where the royalty is 12.5% of the posted price, and the tax on profits is a minimum of 55% of profits. The latter per product unit is equal to posted price less the product costs and the royalty in J.M. Chevalier, translated by I. Rock - The New Oil States, Penguin, 1975, p.156.

11. Direct taxes in Iraq are on income (personal and company) tax, property tax, legacy tax, and agricultural land tax. There are no comparable taxes as such in Kuwait. Indirect taxes include import duties, customs and excise, transit dues, and the now abolished agricultural consumption tax. In Kuwait on the other hand, the only form of direct taxation is an income tax on foreign business (where there is participation). It is 50% on total net income of the business when such net income is more than KD 375,000. Indirect taxes also include customs and excise, and an ad valorem tax of 4% on all imports, except when there is an equivalent good manufactured locally, then the duty is 15%.

were taken into account than the purely economic arguments for direct tax policies, though their purported aim had been the equitable distribution of income. Direct taxes in Iraq are mainly, the personal income tax whose rate ranges from a minimum of 3% for a taxable income of ID 300 per annum, to a maximum of 70% for a taxable income of over ID 15,000.[12] Second, the joint stock companies which are classified into industrial and non-industrial. They both now start with a minimum of 10% for a taxable income of ID 1,000 and a maximum of 45% for a taxable income of over ID 10,000. The limited liability companies are similarly classified, where a minimum of 10% of up to a taxable income of ID 1,000 and a maximum of 50% of income over ID 12,000.[13] The legacy tax rates start with exemption up to ID, 1,000, with a minimum rate of 5% at that level, and a maximum of 35% for over ID 10,000.[14] The Real Estate tax on the other hand, starts with a surtax rate of 2% at ID 1,000 to ID 2,000 rental value and a maximum of 15% for a rental value of over ID 10,000 of rental value per annum. This is over and above the 10% flat rate tax which operates from ID 1,000 rental value.[15] Finally, the agricultural land tax on all land of certain area, if irrigated, and double that area if rain-fed.[16] The indirect taxes, which were

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12. Republic of Iraq. Income Tax Law No. 95 (1959) - Section 13 (as amended) by Laws No. 178 (1959), No. 44 (1960), No. 11 (1961), Nos. 18 and 113 (1963), Nos. 129 and 174 (1964), No. 6 (1966), Nos. 23, 75, and 5 (1967), No. 44 (1968), Nos. 5 and 75 (1969), and Nos. 31, 82, 95, 223 (1970).

13. Republic of Iraq - Income Tax Law No. (1959) Section 13 - (as amended) Laws Nos. 101 and 103 (1964), Nos. 122 and 157 (1969), No. 97 (1970).

14. Republic of Iraq - Legacy and Inheritance Tax Law No. 157 (1959) as amended by Law No. 130 (1964), No. 7 (1966), No. 53 (1969).

15. Republic of Iraq - Real Estate Tax Law No. 162 (1959) as amended by Law No. 16 (1961), No. 162, and No. 94 (1970).

16. Agricultural Land Tax Law No. 60 (1960) as amended by Law No. 175 (1968).

TABLE 3

IRAQ

Direct & Indirect Taxes

Year	1 Total Government Revenue. IDm.	2 Direct Taxes IDm.	3 2 as percent of 1 %	4 Indirect Taxes IDm.	5 4 as percent of 1 %
1952-53	71.0	7.5	10.6	23.4	33.0
1953-54	91.0	6.4	7.0	26.3	28.9
1954-55	99.3	6.4	6.4	28.7	28.9
1955-56	113.7	5.6	4.9	34.4	30.3
1956-57	110.8	5.9	5.3	36.1	32.6
1957-58	95.9	6.5	6.8	40.6	42.3
1958-59	129.3	7.2	5.6	42.3	32.7
1959-60	133.1	7.0	5.3	39.5	29.7
1960-61	151.1	8.2	5.4	47.8	31.6
1961-62	156.7	8.0	5.1	54.6	34.8
1962-63	161.3	10.6	6.6	55.8	34.6
1963-64	179.6	11.4	6.3	56.4	31.4
1964-65	207.1	12.7	6.1	68.3	33.0
1965-66	245.4	13.7	5.6	97.8	39.8
1966-67	229.2	15.4	6.7	82.0	35.8
1967-68	337.9	17.0	5.0	117.5	34.8
1968-69	328.4	20.2	6.2	108.5	33.0
1969-70	379.7	23.7	6.2	142.4	37.5
1970-71	527.8	27.5	5.2	150.6	28.5
1971-72	344.8	30.7	8.9	134.8	39.1
1972-73	270.5	36.1	13.3	125.1	46.2
1973-74	597.9	36.4	6.1	149.9	25.1
a) 1974-75	1,283.7	30.8	2.4	129.6	10.1
b) 1975/76	678.5	25.2	3.7	153.3	22.6
			$\bar{x}$ = 6.3%		$\bar{x}$ = 32.3%

a) Revised Estimate
b) Estimate

Source: For Columns 1,2,3, and 4 Republic of Iraq - Ministry of Planning, Central Statistical Organisation Annual Abstract of Statistics 1970-75.

pointed out above,[17] to which is added the revenue from the various government-owned and run establishments, particularly in industry, banking, and insurance, all of which the private sector is almost absent, except on a very small scale in industry.

The average tax revenue for Iraq as a proportion of total government revenue was 27% for its given period, whereas that of Kuwait was 2% for its given period respectively, as could be seen from Table 2.[18] In the case of Iraq however, the average ratios of direct taxes to total government revenue for the period was 6%, and that of indirect taxes of 32%, which is over five times the former, for the given period, which had supported the earlier studies referred to above. No comparable figures for Kuwait are available, because of the lack of direct taxation per se, as has been pointed out. Both direct and indirect taxes have increased in absolute terms in Iraq, where the indirect taxes increase has been five times that of the rate of income of direct taxes due to tax evasion, in the case of the latter. However, their relative ratios have remained constant throughout the period, if the last two years' figures are not taken into account, because of the substantial impact of the rise in oil revenues, which may distort the picture.[19] In testing

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17. Custom Duties - Tariff Law No. 77 (1955), as amended by Law No. 128 (1965).

18. R.W. Bahl - 'A Regression Approach to Tax Effort and Tax Ratio Analysis'. IMF Staff Papers, Volume 18, 1971. Where a study by UNCTAD for 36 countries for the period (1950-66) of cross section and time series data and pooling the results indicated that the highest tax ratio were in the open economies, in which the level of the share of agricultural income is relatively low, and tax ratio are lowest for countries with closed economies in which the share of agriculture is relatively high.

19. R.J. Chelliah - 'Trends in Taxation in Developing Countries'. IMF Staff Papers, Volume 18, 1971. The study covered the period (1953/55 - 1966/68), whose major finding was that taxes grew faster than GNP in developing countries, with the consequent rise in their ratio in a sample of 27 countries. Their average ratio rose from 11% in 1953/55 to 14% in 1966/68. The average income elasticity of total tax revenue was 1.4, where 1% rise in GNP is accompanied by 1.4% increase in tax revenue. The underlying factors are, the composition of income where there is a negative correlation between the agricultural sector and terms of employment and per capita income, and a positive one in the mining and extractive sector income and tax ratio. Secondly, the degree of openness, and finally, the level of development and income. It may be noted that the average tax ratio for Middle East and North Africa, was found to be the highest among the regions of the developing countries, and which stood at 17.9%.

TABLE 4:

Kuwait Foreign Investment

	Foreign Investment KDm.	Income from Foreign Investment KDm.	Index of Investment income
1969/70	509.4	43.2	100
1970/71	550.4	38.5	89
1971/72	607.3	46.6	108
1972/73	685.5	60.3	140
1974/75		89.0	206
a) 1975/76		152.1	252
		210.0	486

a) preliminary result

Source: Central Bank of Kuwait 1974 and 1975 Annual Reports

" " " " Economic Report for 1975.

the findings of the study for Iraq and Kuwait, it was found that the average ratio of total tax and non-tax revenue was 12% of GNP for Iraq and approximately 4% i.e. a third of it for Kuwait. Oil revenues as a percentage of GNP where 38% in Kuwait and 19% for Iraq. Finally, the most recent study showed that the tax ratio in the developing countries is continually increasing, though it is still lower than that of the developed countries. The data shows the increasing trend for the period 1969-71, as the average ratio for Europe and North America was 26.2% for the period, and 15.1% for the developing countries.[20] The composition of taxes in the latter group was mainly in international transactions and on production, and by taxes on income. However, the latter had increased from 23.5% in 1966-68 to 27.3% in 1969-71, whereas indirect taxes had declined from 65.8% during the first period to 63.9% for the second. It was also found that in about two thirds of the developing countries in the sample, income taxes constituted more than 2% of GNP, and more than a quarter of the countries raise more than 5% of GNP in income taxes (including royalties on minerals), which would be relevant for our two countries.[21] In fact, due to this factor the Middle East and North Africa region, had the highest ratio of income tax to GNP, which stood at 5.6% for 1969-71.

In conclusion, a significant constituent of the Kuwait Government, revenues is in the form of income accruing from investment overseas as shown in Table 4, where an increasing trend is revealed, though it only records direct Government investments, without taking into account income accruing from large-scale investments by semi-public corporations. The private sector investments are entirely ignored for purposes of the study,

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20. R.J. Chelliah, H.J. Baas, and M.R. Kelly 'Tax Ratio and Tax Effort in Developing Countries, 1969-71'. IMF Staff Papers, Volume 22, 1975.

21. Ibid., p.198.

TABLE 5:

IRAQ PUBLIC DEBT IDm.

End of Period	Govt. Bonds	Treasury Bills	Total	Foreign Loans	Total
1955	9.0	-	9.0	-	9.0
1956	12.0	-	12.0	5.0	17.0
1957	11.0	-	11.0	9.1	20.1
1958	11.0	-	11.0	11.0	22.0
1959	11.0	5.0	16.0	8.7	24.7
1960	10.2	15	25.2	6.2	31.4
1961	9.4	20	29.4	7.1	36.5
1962	8.6	33	41.6	16.5	58.1
1963	7.8	17	24.8	56.6	81.4
1964	6.0	30	36.0	66.6	102.6
1965	11.0	50	60.9	70.8	131.8
1966	11.0	65	76.0	73.1	149.1
1967	11.0	75	86.0	87.9	173.8
1968	8.0	75	83.0	87.4	170.4
1969	18.0	75	93.0	87.2	180.2
1970	24.0	85	109	100.7	209.7
1971	22.9	85	107.9	118.8	226.7
1972	22.9	85	107.9	148.1	256.1

Source: Central Bank of Iraq Quarterly Bulletin
(1960 to July - September 1976)

however, they are on an increasingly substantial scale. In fact the average income from foreign investment stood at $1,000 million per annum. In contrast, the Iraqi Government's position is shown in Table where the trend in the public debt has increased, particularly the foreign debt component. It is regarded as revenue in the short-run for our own purposes. But this stands in contrast, in that the Government is a net borrower, as opposed to Kuwait, which is a net lender on a large scale. The most important loan to Iraq, has been the $1,000 million loan from Japan, in order to facilitate Iraq's Government purchase of capital equipment for the chemical fertilizer plant and Japanese participation in the Economic Plan. Part of the repayment is in the form of crude-oil.[22]

Revenue Requisites

In discussing the aims of Government expenditure, notwithstanding the different social and political systems in the two countries, an account of the structure of that expenditure will be rendered. The background to both Government expenditures was elucidated above.[23] The pattern of expenditure of both governments has been detailed for Iraq and Kuwait in tables 6A and 6B consecutively for their relevant periods. Tables 7A and 7B show the results for both countries, where in the case of Iraq, it is revealed that there has been an increase in both the absolute and relative terms in government expenditure. The ratio of total expenditure to GNP has increased throughout the period, while averaging 33% and 35% for Iraq and Kuwait respectively which could be categorized with the developed countries.[24]

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22. Financial Times January 26, 1977. In fact, a second $1,000 million loan has been re-negotiated with Japan. 75% of the loan is to be provided by the Export Import Bank of Japan and 25% by the Japanese Government, at 5% and repayment over 20 years. The above bank's rate of interest is at 6 to 7%. Again the complete building of fertilizer plants and large-scale power projects. And the loan is then denominated, presumably to facilitate the purchase of equipment from the lending country.

23. See Chapters 2 and 3 above.

24. See Chapter 2, where the rate of 19-22% expenditure of GNP was suggested as the most appropriate size for underdeveloped countries by Martin and Lewis.

TABLE 6A

IRAQ

1 Year	2 GNP (current prices) IDm.	3 Total Government Expenditure. IDm.	4 Index of GNP.	5 Index of Total Government Expenditure
1951/52	210.0	33.9	100	100
1952/53	247.0	57.3	118	169
1953/54	286.4	62.4	135	184
1954/55	329.3	74.7	157	220
1955/56	340.8	89.3	162	263
1956/57	388.5	113.3	185	334
1957/58	412.6	131.2	196	387
1958/59	435.6	131.4	207	388
1959/60	452.5	203.5	215	600
1960/61	470.1	161.9	224	478
1961/62	520.4	186.1	248	549
1962/63	593.6	187.7	283	554
1963/64	598.2	203.5	285	600
1964/65	717.5	255.4	342	753
1965/66	784.4	247.4	374	731
1966/67	851.3	275.2	405	812
1967/68	875.6	273.7	417	807
1968/69	976.4	306.3	465	904
1969/70	1,025.3	460.0	488	1,357
1970/71	1,116.5	381.5	532	1,125
1971/72	1,251.7	495.2	596	1,461
1972/73	1,338.5	473.9	637	1,398
1973/74	1,582.1	698.9	753	2,062

Source:
Column 2, International Monetary Fund : IFS 1960 - May 1976.
Column 4. Ministry of Planning, Central Statistical Organization, Annual Abstract of Statistics 1965-75.

TABLE 6B

KUWAIT

1 Year	2 GNP at market prices KDm.	3 Index of GNP	4 Total Government Expenditures KDm.	5 Index of total Government Expenditure 1962/63 = 100	6 Index of total Government Expenditure 1956 = 100
1956	n.a.		59.4		100
1957	n.a.		90.8		153
1958	n.a.		118.0		199
1959/60	n.a.		198.7		335
1960/61	n.a.		135.1		227
1961/62	n.a.		161.7		272
1962/63	460	100	165.2	100	278
1963/64	486	106	176.3	107	297
1964/65	561	122	189.6	115	319
1965/66	553	120	260.0	157	438
1966/67	682	148	321.0	194	540
1967/68	734	160	334.0	202	562
1968/69	793	172	274.5	166	462
1969/70	840	183	298.8	181	503
1970/71	909	198	320.3	194	539
1971/72	1,151	250	365.1	221	615
1972/73	1,200	261	415.7	252	700
1973/74	1,769	385	556.8	337	937
1974/75	3,197	695	1,113.2	674	1,874

Source: Column 2, International Monetary Fund:IFS, May 1976.

Column 4, Planning Board, Central Statistical Office Statistical Abstract 1965-75.

In order to elaborate within this context, is a study of countries grouped by per capita product for the period (1950-59), the cross-section data showed that central government expenditure rose from an average of about 13% of GNP for countries of less than $200 per capita income, to an average level of 24% for countries with per capita income of more than $1,200.[25]

> "Briefly the hypothesis that is set forth is that the social and political tendencies that are inherent in the process of economic development result in a rate of growth of public social expenditures substantially in excess of the rate of growth of national product while other public expenditures taken together tend to grow at a substantially lesser rate than social expenditures but not at a low enough rate to offset the growth in social expenditures so that the ratio of total public expenditures GNP tends to rise historically."[26]

From this hypothesis, arises several empirical propositions which may be set out briefly. First, as per capita national product rises, government expenditure tends to rise at a faster rate than the national product. Moreover, the rates of growth of government revenues and public expenditures tend to equalize. In examining the data for the two countries, we find that the above proposition holds, as is shown in tables 9 and 10. It is more pronounced in the case of Kuwait, however, than it is with Iraq. Even when the rate of increase of GNP in both countries far exceeds that of Government expenditures, due to the distortion caused by the oil revenue increases. Nevertheless, it is maintained here, that this phenomenon is a short-run one, in the sense that the trend will prevail, whereby the rate of increase of government expenditure exceeds that of the rate of

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25. R.S. Thorn 'The Evolution of Public Finance During Economic Development' The Manchester School of Economic and Social Studies, Volume 35, 1967. pp. 20-21.

26. Ibid. pp. 22-23.

TABLE 7A

IRAQ

TOTAL AND PER CAPITA EXPENDITURE IN IRAQ

1	2	3	4	5	6
Year	GNP (current prices) IDm.	Population (millions)	Total Govt. Expenditure IDm.	Per Capita Government Expenditure Col. (4) ÷ Col. (3) ID.	Size of Government Sector Col. (4) ÷ Col. (2)
1951/52	210.0	5.34	33.9	6.3	16.1%
1952/53	247.0	5.48	57.3	10.5	23.2%
1953/54	286.4	5.64	62.4	11.1	21.8%
1954/55	329.3	5.79	74.7	12.9	22.7%
1955/56	340.8	5.96	89.3	15.0	26.2%
1956/57	388.5	6.13	113.3	18.5	29.2%
1957/58	412.6	6.30	131.2	20.8	31.8%
1958/59	435.6	6.49	131.4	20.2	30.2%
1959/60	452.5	6.68	203.5	30.5	45.0%
1960/61	470.1	6.89	161.9	23.5	34.4%
1961/62	520.4	7.10	186.1	26.2	35.8%
1962/63	593.6	7.32	187.7	25.6	31.6%
1963/64	598.2	7.55	203.5	26.9	34.0%
1964/65	717.5	7.80	255.4	32.7	35.6%
1965/66	784.4	8.05	247.4	30.7	31.5%
1966/67	851.3	8.31	275.2	33.1	32.3%
1967/68	875.6	8.58	273.7	31.9	31.3%
1968/69	976.4	8.86	306.3	34.6	31.4%
1969/70	1,025.3	9.15	460.0	50.3	44.9%
1970/71	1,116.5	9.44	381.5	40.4	34.2%
1971/72	1,251.7	9.75	495.2	50.8	39.6%
1972/73	1,338.5	10.07	473.9	47.1	44.2%
1973/74	1,582.1	10.41	698.9	67.1	37.5%
1974/75	3,354.5	10.77	1,824.1	169.4	54.4%
				$\bar{x}$ = 34.8	$\bar{x}$ = 33.3%

Sources: Columns (2) & (3) International Monetary Fund: IFS (1957-76)

Column (4) Central Bank of Iraq Bulletins 1960-76
Ministry of Planning, Central Statistical Organization, Annual Abstract of Statistics, Several issues.

Column (5) Calculated from Columns 3 and 4.

TABLE 7B

KUWAIT

TOTAL AND PER CAPITA EXPENDITURE IN KUWAIT 1956 - 75

1	2	3	4	5	6
Year	GNP (current prices) KDm.	Population (millions)	Total Govt. Expenditure KDm.	Per Capita Govt. Expenditure Col. (4) ÷ Col. (3) KD.	Size of Government Sector Col. (4) ÷ Col. (2)
1956	n.a.	n.a.	59.4	-	-
1957	n.a.	0.22	90.8	412.7	-
1958	n.a.	0.24	118.0	491.7	-
1959/60	n.a.	0.25	198.7	794.8	-
1960/61	n.a.	0.25	135.1	540.4	-
1961/62	n.a.	0.32	161.7	505.3	-
1962/63	460	0.35	165.2	472.0	35.9%
1963/64	486	0.39	176.3	452.1	36.3%
1964/65	561	0.43	189.6	440.9	33.8%
1965/66	553	0.48	260.0	541.7	47.0%
1966/67	682	0.52	321.0	617.3	47.1%
1967/68	734	0.57	334.0 a)	586.0	45.5%
1968/69	793	0.63	274.5	435.7	34.6%
1969/70	840	0.69	298.8	433.0	35.6%
1970/71	909	0.75	320.3	427.1	35.2%
1971/72	1,151	0.79	365.1	462.2	31.7%
1972/73	1,200	0.85	415.7	489.1	34.6%
1973/74	1,769	0.89	556.8	625.6	31.5%
1974/75	3,197	0.94	1,113.2	1,184.3	34.8%
1975/76		1.00	875.4	875.4	
				$\bar{x}$ = 567.8	$\bar{x}$ = 34.5%

Sources: Column (2) & (3) International Monetary Fund: IFS (1967-76)

Column (4) 1972/73 - 1975/76 - Central Bank of Kuwait - Economic Report for 1975.

Column (5) Calculated from Columns (3) and (4).

increase of GNP. If the data is examined more closely, it is found that in certain years, there has been a negative percentage rate of increase in government expenditure over the preceding year. In the case of Iraq, the factors underlying this phenomenon, have been set out in Chapter 2, where successive revisions of economic plans have taken place, and are taking place, as the last economic plan has been continuously revised due to the shortfall in expected oil revenues in the last financial year, and the forthcoming one.[27] In the case of Kuwait, on the other hand, it is maintained that the Government expenditure falls short of its revenues, and the problem becomes one of limited absorptive capacity.

The structure of Government expenditure is shown on table 8, where the two main constituents are the ordinary budget expenditure, and development expenditure.[28] As has been pointed out above, oil revenues are allocated between the two, in the form of the budget for current expenditure and the Planning Ministry, or Planning Board for development expenditure. For our purposes, the budgets of other Government establishment are not considered, since they are not relevant. In the case of Kuwait on the other hand, the two categories are capital expenditure and current expenditures in the budget itself, shown in table 9, as their period study is noted for the absence of a comprehensive economic plan.[29] However, since 1976, a

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27. M.E.E.D. Jan. 14, 1977. Where in fact, Iraq enjoyed a surplus, which increased the ordinary budget expenditure to ID 1,653 million from the preceding year of ID 1,583 million which is 4.2% rise.

28. For a detailed background see Chapter 2.

29. See Chapter 3 for the background. 1967/68-71/72 Plan was never ratified by Parliament.

TABLE 8
IRAQ

1 Year	2 Total Government Expenditure. IDm.	3 Ordinary Budget Expenditure IDm.	4 Column (3) as a % of Column (2).	5 Development Budget Expenditure. IDm.	6 Column (5) as % of Column (2).
1951/52	33.9	30.8	90.9%	3.1	9.1%
1952/53	57.3	44.5	77.7%	12.8	22.3%
1953/54	62.4	50.2	80.4%	12.3	19.7%
1954/55	74.7	53.8	72.0%	20.9	28.0%
1955/56	89.3	55.3	61.9%	34.0	38.1%
1956/57	113.3	70.3	62.0%	43.0	38.0%
1957/58	131.2	73.8	56.3%	57.4	43.8%
1958/59	131.4	79.2	60.3%	52.2	39.7%
1959/60	203.5	100.2	49.2%	103.3	50.8%
1960/61	161.9	114.3	70.6%	47.6	29.4%
1961/62	186.1	119.2	64.1%	66.9	35.9%
1962/63	187.7	128.4	68.4%	59.3	31.6%
1963/64	203.3	149.0	73.3%	54.3	26.7%
1964/65	255.4	180.1	70.5%	75.3	29.5%
1965/66	247.4	187.5	75.8%	59.8	24.2%
1966/67	275.2	192.4	69.9%	82.8	30.1%
1967/68	273.7	205.5	75.1%	68.9	25.2%
1968/69	306.3	241.9	79.0%	64.4	21.0%
1969/70	460.0	289.2	62.9%	170.7	37.1%
1970/71	381.5	303.4	79.5%	78.1	20.5%
1971/72	495.2	341.4	68.9%	153.8	31.1%
1972/73	473.9	345.4	72.9%	128.5	21.1%
1973/74	698.9	454.9	65.1%	244.0	53.6%
1974/75 a)	1,824.1	1,358.6	74.5%	465.5	25.5%
			$\bar{x}$ = 70.1%		$\bar{x}$ = 30.5%

a) Estimate

Source: Ministry of Planning, Central Statistical Organization, Annual Abstract of Statistics 1965-75
Central Bank of Iraq Bulletins 1965-1976.

TABLE 9

KUWAIT

1 Year	2 Total Government Expenditure KDm.	3 Current Expenditure KDm.	4 Column (3) as % of Column (2)	5 Capital Expenditure	6 Column (5) as % of Column (2).	Current Expenditure per capita. KDm.
1956	59.4					
1957	90.8	58.7	64.6%	30.8	33.9%	266.8
1958	118.0	91.6	77.6%	26.4	22.4%	110.0
1959/60	198.7	156.7	78.9%	37.1	18.7%	148.4
1960/61	135.1	99.7	73.8%	26.7	19.8%	106.8
1961/62	161.7	126.3	78.1%	26.3	16.3%	82.2
1962/63	165.2	129.6	78.5%	26.8	16.2%	76.6
1963/64	176.3	107.3	60.9%	36.8	20.9%	94.4
1964/65	189.6	154.1	81.3%	35.5	23.0%	358.4
1965/66	260.0	220.1	84.7%	39.9	15.3%	458.5
1966/67	321.0	240.2	74.8%	80.8	25.2%	461.9
1967/68	328.2	271.6	82.8%	56.6	17.2%	476.5
1968/69	283.0	229.7	81.2%	53.3	18.8%	364.6
1969/70	299.2	233.8	78.1%	65.4	21.9%	338.8
1970/71	319.3	256.7	80.4%	62.6	19.6%	342.3
1971/72	365.9	297.7	81.4%	68.2	18.6%	376.8
1972/73	409.3	264.6	64.6%	61.6	15.1%	325.9
1973/74	536.3	291.2	54.3%	69.4	12.9%	327.2
1974/75	936.7	523.4	55.9%	111.5	11.9%	556.8
1975/76	898.5	494.5	55.0%	193.6	21.5%	494.5
			$\bar{x}$ = 72.9		$\bar{x}$ = 19.4%	
			$\bar{x}$ = 73%			

Source: Columns 2, 3 and 5 Central Bank of Kuwait Annual Reports 1970-75
Planning Board, Central Statistical Office, Statistical Abstract 1965-75

Ministry of Planning has been created, thus replacing the largely advisory Planning Board. The Plan 1976/77 to 1980/81, allocated a total of $15.2 bn. It may be appropriate to finalize the argument about the extent of government expenditure. It was found that the share of total government expenditure of GNP of the developing countries, increases with per capita income, though for the poorest of these countries, the openness of the economy seems to be of greater influence on income. Also, current expenditure increases as a share of the national product with rising incomes while social expenditure increases as a percentage of total government expenditure with rising incomes.[30] The conclusions were that there were no significant relationships between per capita GNP and total government expenditure expressed as percentage of GDP for any group or groups of countries. The same was for current expenditure. However, the per capita income explained relatively small part of changes in components of government expenditure, nor did the level of development have a significant effect upon government expenditure. In the discussion of planning, however, the criteria to be met by the government are important.[31] It is in the field of economic stabilization that the main functions of government policy must be set out.[32]

Tables 8 and 9 illustrate the ordinary budget expenditure and

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30. S. Lall 'A Note on Government Expenditure in Developing Countries'. Economic Journal, Volume 79, 1969. The study categorized three groups of developing countries, 2 per capita GNP of $125 - $129, 3. per capita GNP of $250 - $675 and 1. per capita GNP of up to $124. Regression analysis was applied to test the above hypotheses.

31. R.O. Khalid 'Fiscal Policy, Development Planning and Annual Budgeting'. IMF Staff Papers, Volume 16, 1969. Where the government expenditure is characterized by a larger share of total expenditure allocated to investment in infrastructure, and a lower share devoted to social transfer payments. Finally, the cost of administrative services is fairly high in the total expenditure pattern.

32. Ibid. Where the aims are the building up of foreign exchange during a boom, while keeping the expenditure programme flexible, and fianlly the coordination between the annual budget with the development plan.

Development Board expenditure and revenues. This is shown in the tables in Chapter 2, where there has been a continuous surplus in the latter, thus suggesting a constraint on absorptive capacity in capital expenditure, while current expenditure has simultaneously increased as shown in the budgets.

The available data gives the estimated total aggregate government expenditure C_g with GNP, was for Iraq: (1953-71):

$$C_g = -29.893 + \underset{(43.833)}{0.265Y}^{33} \qquad R^2 = 0.992$$

and for Kuwait: (1962-74) :

$$C_g = 30.832 + \underset{(14.119)}{0.150Y} \qquad R^2 = 0.952$$

Both are highly correlated, but both are of low government marginal propensity to consume. It shows that the regression reveals that the marginal propensity to consume for government in Iraq is almost twice that of Kuwait. In both cases however, the marginal propensity to consume would have been higher, if current expenditure only were to be taken as the dependent variable. In Kuwait on the other hand, table 10 shows the main categories of government expenditure.[34]

It was pointed out from the outset of this Chapter, that the government's role was vital to both economies. Within the context of the fiscal policy pursued, and while taking into account the comprehensive taxation system in Iraq, and its seemingly progressive nature, with the absence of such a system, at least in terms of direct taxation in Kuwait, the fact remains that this policy is pursued by both governments at varying degrees. The aims of progressive taxation are implied in the equitable distribution of income in Iraq's case, which may not be altogether a purely economic view, and the same goal is attempted at in Kuwait, as was seen above through the land purchase schemes, with the certain disadvantages of that particular policy. But our discussion here, centres round the forced savings, and the increment of income via those savings through investment. Both countries, as was revealed at an earlier stage of the

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33. Numbers in parenthesis are t values of regression coefficients

34. The other category, Land Acquisition was shown in Chapter 3, table 2.

study, are not typical of the developing countries, in the sense that both had comparatively low marginal propensities to consume, hence relatively high marginal propensities to save which means low multipliers which was fully explained in Chapter 4. Nevertheless, the characteristics of underdevelopment do exist. The evidence does suggest that the combination of investment, which is largely undertaken by the Government, almost totally in Iraq, coupled with deficit financing, in the general sense that this term means, would lead to inflation.[35] It follows that deficit financing would not necessarily lead to an increase in output and employment, but would rather increase the level of prices.[36] This is due to the money multiplier as opposed to the Keynesian real multiplier. But the most important point is,

> "The economic process consists of two distinct categories, one where which given the level of economic development, move from low employment at a given level of economic development to full employment at the next level of economic development."[37]

The other main point to be made here, is the questionable applicability of deficit-financing as a counter-cyclical measure in predominantly export-oriented economies, such as the two under study which are typical, and where fluctuations in foreign demand, would have an immediate effect on an inflationary or deflationary movement.[38] The point is typically illustrated in its most vital impact, where the international fall in the demand for oil during 1975/76, both countries' revenues fell, hence their expenditures fell, as shown from the tables above, over the fiscal year 1974/75. In fact, in the case of Kuwait, its GDP fell from KD 3,229 million in 1974 to KD 3,028 million on the latest figure available in 1976.[39] Moreover, investment forms a small proportion of GNP, and while as was shown in Chapter 4, the leakages due to savings which consistently exceeded investment, it was not of

35. The fact that both governments are enjoying a surplus, and that the investment allocation exceeds expenditure does not alter the term in its broad sense

36. V.K.R.V. Rao 'Investment, Income and the Multiplier in an Underdeveloped Economy'. A.N. Agarwala and S.P. Singh (eds.) The Economies of Underdevelopment. Oxford University Press, 1971.

37. Ibid., p.218.

38. R.J. Chelliah Fiscal Policy in Underdeveloped Countries Allen & Unwin, London, 1969.

39. 31st July, 1976.

TABLE 10

KUWAIT

FOREIGN EXPENDITURE

1	2	3	4
Year	Total Expenditure KDm.	Foreign Expenditure KDm.	(3) as % of (2).
1964/65	189.6	10.9	5.7%
1965/66	260.0	21.3	8.2%
1966/67	321.0	18.5	5.8%
1967/68	328.2	67.3	20.5%
1968/69	283.0	55.3	19.5%
1969/70	299.2	55.5	18.5%
1970/71	319.3	54.8	17.2%
1971/72	365.9	38.3	10.5%
1972/73	409.3	44.9	11.0%
1973/74	536.3	106.3	19.8%
1974/75	936.7	324.1	34.6%
1975/76	898.5	80.1	8.9%
			$\bar{x}$ = 15.0%

Source: Central Bank of Kuwait Annual Reports 1970-75.

significance from the point of view of fiscal policy. What is at issue however, is that exports assume the role of investment, as determinants of the economic level of activity. Within the two inflationary economies, a rise in incomes would demonstrably lead to a rise in imports. The inflation would be of the demand-pull nature. It follows that a fall in demand would therefore have to be exogenous in the two open economies. Costs are kept at a constant level by both governments through subsidizing a limited list of essential foodstuffs and construction materials, notably cement in the case of Kuwait, and in Iraq, where sunsidies run through the whole gamut of consumer goods, coupled with other measures such as rationing. Both governments' contribution to inflation has been considerable, as in Kuwait's case, where land-purchase schemes encouraged land speculation. The phenomenon of a fall in revenues and a simultaneous rise in imports in order to embark upon or continue large-scale capital profits is somewhat mitigated by the substantial foreign reserves at both countries' disposal particularly in Kuwait's case.[40] While in Iraq, import controls are sought as a remedy which would lead to a shift of demand to domestic resources, which may also result in higher prices due to inelasticities of supply, immobility of resources, and bottlenecks due to rigidites as has in fact occurred.[41]

Finally, the rigid application of the Keynesian system is questionable within the context of developing economies, and its validity may not be demonstrable, as has been argued above. Therefore, as was shown in Chapter 2 for Iraq in detail for the whole period, the level of expenditure

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40. The most valid case, given the expenditure programme for both countries', their posture as part of the majority of OPEC members at the November, 1976 meeting in Doha, Qatar.

41. A notable example in the lengthy periods of ships' delays in both countries' congested ports, although both are relatively better than the rest of the Gulf countries.

was consistently below that of the level of revenues, although both rose in absolute terms, while Kuwait did meet just over 90% of the planned expenditure in its first plan.[42] Nevertheless, this is due more to the rising rate of increased revenues, and by far the more important factor, the accelerating rate of inflation in an open economy than the actual intended aim of meeting the planned targets. Lastly, the degree of government activity in the economy has been substantial, given the differing policies and aims of both countries.

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42. Financial Times, 25th February, 1977.

CHAPTER 7

CONCLUSIONS

The general absorptive capacity concept was confined to the specific one of capital absorptive capacity in the study. In the introduction, a survey of a number of alternative definitions of the latter was conducted, with the attempted aim of arriving at the most viable and relevant one for our purposes. This had to be considered against a background with which the concept is not normally associated with, namely that the two countries are not aid recipients in the acknowledged sense. Kuwait is outside this scope in that it is itself a donor country on a large scale relative to its GNP, while Iraq on balance is neither donor nor recipient. It is important to bear this in mind, since our definition did break with the conventional definitions made thus far, which deal with the problem from a donor's point of view. Nevertheless, the theory was incorporated, as it was essential to build upon both in the definition, and the several relevant methods of measurements of the concept. The methodology was discussed fully and criticised, within the limits of the study.

The reasons for choosing these two countries are evident, as despite their similarities, the contrasts in the characteristics of their two economies, have possibly been revealed which has been one of the aims of the study. What emerges is that although there is a limited absorptive capacity in the majority of the Arab oil-producers, the main problem is to quantify this limited capacity. In the background chapters it was shown that, while both economies had achieved remarkable progress, the limitations and constraints to growth were severe. In the case of Kuwait, the main limits were manpower at all levels, and the small size of the market. The conclusions to emerge for Iraq on the other hand, were the stagnation that had beset the economy during the 1960's decade, due mainly to uncertainties relating to the political and institutional transformations

emanating from those changes. The study had shown in a limited manner, one facet of those changes, which was economic, and clearly of central concern to us, but is nevertheless part of a much larger framework. The fact that a series of successive plans were promulgated then abandoned at some stage before being completed is indicative of that political uncertainty, and hence is said to be a non-capital constraint on absorptive capacity. This, notwithstanding, Iraq's absorptive capacity to all intents and purposes contrasts sharply with that of Kuwait, which is a limited one, as already indicated.

Both economies to a lesser or greater extent differed from the general developing economies in that, during the periods under study, there was no shortage of capital, and that on the contrary, the demand for the available capital was deficient. The periods chosen for comprehensive data availability and relevance were 1952-71 for Iraq, and 1962-74 for Kuwait respectively, and wherever possible, the data went beyond 1971 for Iraq and 1974 for Kuwait as it was felt that was crucial in the light of what had occurred since the 1971 oil price rise and the much greater one of 1973. In the attempt to assess whether or not there was a limited absorptive capacity and to quantify it, the well-known gap methodology was used. In the most important elements of the economy, namely savings and investment, the study found that savings had consistently exceeded investment in Kuwait, but did not behave in the same manner for Iraq, where this was only true for the late 1960's and early 1970's. Savings were less than, or equal to investment for Iraq, particularly in the 1950's and 1960's, which tends to confirm a priori thinking. The empirical evidence seems to suggest that in both economies, the level of investment is only affected by the level of GNP in a limited manner, although there was a high correlation for Iraq, and significantly, there was no relation for Kuwait. The bulk of investment in the latter has been directed abroad.

The trend might be changing however, with the diversification attempts taking place in Kuwait at present. Savings on the other hand were highly correlated with the level of GNP in both cases, but the marginal savings ratio was very high for Kuwait, and a more thpical one for Iraq, although the latter could be regarded as high within the developing countries' context. The crucial ratio of investment to savings was high in Iraq, and very low in Kuwait, especially during the last three years of the period, where the level of investment has remained fairly constant, against a rapidly accelerating savings level. This has to be considered when diversification attempts are discussed, where those efforts are regarded as part of domestic investment, and the change in that level of investment. The results reflect the fact that it has one of the highest levels of savings in the world, with the total level of savings substantially in excess of domestic investment. The contention that Kuwait has a limited absorptive capacity is thus illustrated. For Iraq on the other hand, the findings suggest that if anything there might have been a deficiency of savings from the 1950's up to the mid 1960's, but an excess of savings over investment developed by the 1970's at an accelerating pace. Moreover, the low multiplier in Kuwait, which was about a quarter that of Iraq is mainly accounted for by the substantial leakages due to the consistently high level of savings.

In discussing the open-economy model from the absorptive capacity point of view, it was found that a priori Kuwait has one of the highest imports per capita in the world, yet its marginal propensity to import was low, although it was also low but slightly higher for Iraq. Both levels of imports were highly correlated with their corresponding GNP, but both had relatively low marginal propensities to import despite the considerable rise in the imports level in absolute terms during the last two years of the period under study. Both foreign trade multipliers were low, the

significance lying the fact that Iraq's was about twice that of Kuwait's. This is due mainly to the leakage effect of the latter's high savings ratio.

The level of government consumption was high throughout the period in absolute terms, and highly correlated with the level of GNP. The public sector marginal propensity to consume was very low for both states, but it was slightly higher for Iraq. The private sector's marginal propensity to consume was very low for Kuwait and about twice its magnitude for Iraq, where it could be said to be neither high nor low. In both cases of Kuwait, the marginal propensity to consume for the public sector would have been higher, had the regression analysis taken it to be current government expenditure. The empirical evidence supports this, hence it partly explains the low marginal propensity to consume particularly for Kuwait. The fact that it enjoys a comprehensive welfare system, and to a high but lesser extent in Iraq, is shown in the substantial government current consumption expenditure. While it is felt that the gap between allocated and planned expenditure is wide in both cases, the factors contributing to this are many and have been discussed throughout. Nevertheless, the gap has actually disappeared in Iraq, where the latest plan has constantly been revised downward, due to the lower oil revenues expected. The same is said for Kuwait despite the chronic surplus it has consistently enjoyed. In fact Iraq could be said to be a net borrower as was seen in the last Chapter, and in Kuwait the level of government expenditure has been cut due to the substantial reduction in the oil revenues.

Finally, in the medium term as was stated in the beginning of the study, both economies do have a limited absorptive capacity. The aim was to quantify this as much as is possible, hence the concept per se was relative. It was seen that Kuwait's was more limited than that of Iraq in terms of consumption, imports, and domestic investment, both public and private.

It is difficult to reach a definitive conclusion in the study about the issues emanating from the concept as defined. Moreover, a meaningful prediction beyond the inevitable arbitrary time span is beyond its scope. This is due to the fact that the issue of capital absorptive capacity hinges upon, and must necessarily be linked with the exogenously determined income from oil revenues. The latter's stagnant level had affected the pattern of expenditure in Iraq during the 1960's. The situation is reversed now as was seen, as those revenues no longer have to be supplemented by other means. What can be concluded, however is that in both countries, the long-run aim in order to decrease the constraints on the concept must be to fully utilize the available capital resources in the short-run. This will of course be consistent with the full development policy pursued in both economies, and may help towards achieving it.

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