Kuwait’s budget deficit widened in FY19/20 on lower oil prices

Kuwait’s fiscal position remained under pressure during FY19/20 due to low oil prices, leading to a continued draw down from the government’s financial reserves. The deficit increased to KD 3.9 billion before the transfer of 10% of revenues to the Future Generation Fund (FGF), or 9.8% of 2019 GDP. This compares with a deficit of KD 1.3 billion, or 3.1% of GDP in the previous fiscal year. After the usual FGF transfers, the deficit would be KD 5.6 billion (14.1% of GDP), compared to KD 3.4 billion (7.9% of GDP) a year earlier. (Chart 1.) However parliament have recently approved the suspension of these transfers for last year and any future deficit years. The widening deficit was driven by lower oil prices, the fall in which accelerated sharply in March due to the global spread of the Covid-19 pandemic.

1.1% as per the OPEC+ agreement to cut oil production. As a result, hydrocarbon revenues declined 16.6%, despite some support from rising gas receipts. Still, oil revenues came in at 111% above budget largely due to higher-than-expected oil prices of $61.5/bbl versus $55/bbl projected in the budget.

On the other hand, non-oil revenues fell by 13.1% following an increase of 24% in the previous year, due to a 7.7% decline in taxes and fees. Taxes on foreign corporations decreased 26.1% due to weak economic activity, which was also reflected in lower imports and customs proceeds (-3.6%) compared to FY18/19.

In addition, the proceeds of electricity and water (worth around 15% of total non-oil revenues) plummeted 15.5% and 36.3%, respectively, while earnings from other goods & services fell by 41% to KD 69 million. In contrast, the United Nations Compensation Commission data showed a notable increase in Iraqi compensation transfers to KD 0.3 billion in FY19/20 from KD 0.1 billion in the previous fiscal year.

Chart 2: Kuwait’s oil production* and oil prices

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Meanwhile, the data also reveals that accrued debt due to the government, which includes unpaid utility bills, remains relatively high at 4.1% of GDP. Recouping these amounts would require stricter enforcement and an enhanced level of efficiency in the government collection system.

**Chart 3: Non-oil revenues main components**

(\% of total non-oil revenues)

<table>
<thead>
<tr>
<th>Component</th>
<th>% of Total Non-Oil Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes on Foreign companies</td>
<td>4.4</td>
</tr>
<tr>
<td>Taxes &amp; Zakat on Kuwaiti Companies</td>
<td>2.7</td>
</tr>
<tr>
<td>Customs</td>
<td>18.5</td>
</tr>
<tr>
<td>Social Contributions</td>
<td>5.8</td>
</tr>
<tr>
<td>Water &amp; Electricity</td>
<td>15.3</td>
</tr>
<tr>
<td>Sales of other goods &amp; services</td>
<td>10.7</td>
</tr>
<tr>
<td>Other</td>
<td>42.6</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

**Lower subsidies drove the reduction in current spending**

In the context of a persistent budget deficit and calls to reduce wasteful public spending, the government trimmed its outlays by 3.2% to KD 21.1 billion last year. (Chart 4) This represented 94% of the originally budgeted total. Current spending fell by 2.1% to KD 18.8 billion, mainly driven by a sharp 57% fall in (mostly) oil sector subsidies to KD 0.6 billion. Although the precise cause of this fall is not clear, we think it may be mostly due to a decline in arrears payments made to Kuwait Petroleum Corporation, which were exceptionally large in FY18/19. Excluding this subsidy category, current spending would have risen 2% last year, still pointing to a degree of spending restraint.

**Chart 4: Total government spending**

(\% change)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Total Spending</th>
<th>% Change (RHS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 14/15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 15/16</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 16/17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 17/18</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 18/19</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 19/20</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

**Persistent deficits pressure available reserves**

Upward pressure on spending came from compensation of employees (around 40% of current spending), which increased by 5.6%, following an increase of 6.5% rise in FY18/19. In addition, purchases of goods & services increased by 6.4% on the back of an 11.0% increase in the purchases of fuel for electricity generation and water distillation plants to reach KD 1.5 billion, despite lower fuel prices. Finally, grants – mainly transfers to bodies as Kuwait University, the Public Authority of Manpower, and the Kuwait Authority for Partnership Projects – remained relatively stable at KD 5.3 billion.

Meanwhile, capital spending fell by KD 0.3 billion or 12% to KD 2.3 billion. This represented 70% of its budget allocations, which is the lowest ratio in six years and compares to 80% a year earlier. The decline in capital spending was consistent with weak project activity of recent years, due to prolonged bid negotiations and various technical difficulties. In addition, tight spending constraints aimed at curbing a growing deficit may have been a further contributing factor.

The government also presents spending data in an alternative way, which streamlines some of the above classifications. For example, some payments on wages fall outside of the compensation category mentioned above. Overall, the wage bill amounted to KD12 billion or 57% of all spending and total subsidies (some of which are also classified outside the official ‘subsidies’ categories) a further 19%, adding up to around to 76% of total spending. The broad classification of the spending categories is shown in chart 5 below.

**Chart 5: Total spending main components**

(\% of total spending)

<table>
<thead>
<tr>
<th>Component</th>
<th>% of Total Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages,</td>
<td>56.6</td>
</tr>
<tr>
<td>Subsidies,</td>
<td>19.0</td>
</tr>
<tr>
<td>Capital Spending,</td>
<td>12.5</td>
</tr>
<tr>
<td>Other,</td>
<td>11.9</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

Overall, the size of the deficit came in very close to our expectations and was the government’s sixth consecutive post-transfers annual deficit following the drop in oil prices seen in 2014. While the government retains huge financial resources of more than $500 billion in its main sovereign wealth funds, the
persistent deficits of recent years have drained those available in the General Reserve Fund (GRF) used mainly for budget financing. This has become even more pressing since the expiration of the debt law in 2017, which left GRF reserves as the sole means of financing. According to the State Audit Bureau, the GRF had net assets of KD22.9 billion remaining in June 2019. Based upon reasonable assumptions, this may have declined to around KD18 billion at the end of FY19/20 (Chart 6). The remaining liquid assets are likely to have been considerably lower.

The collapse of oil prices in 2020 will pressure the GRF

The dwindling of GRF resources have continued in the first few months of this fiscal year, given the weakness of oil prices (which averaged just $30/bbl in the first four months) and pressures on spending linked to the Covid-19 pandemic. For FY20/21 as a whole, the deficit could reach more than KD 10 billion, or 32% of GDP based upon an average KEC oil price of just below $40/bbl and a cut in spending of 5% to KD20 billion. This would deplete the majority of the remaining funds in the GRF. Indeed these pressures are already evident with the news that the government swapped KD2.1 billion in GRF assets for more liquid FGF assets recently to keep financing its operations.

The government has proposed a range of potential measures aimed at trimming the deficit going forward. These include implementing both an excise duty and VAT (KD 0.8 billion), a 5% profit tax (KD 0.5 billion), a rise in utility fees (KD0.5 billion) and an increase in charges for other government services. The total impact of these measures are estimated at KD 5.0 billion. However, most of these reforms require parliamentary approval and are unlikely to be implemented soon. We would therefore expect a mild impact on the current fiscal year. In the near term, efforts to address the budget deficit are likely to focus more on cuts in non-essential spending as well as freeing up financing options such as the recent GRF/FGF asset swap and the now-approved suspension of the 10% transfers to the FGF when the budget is in deficit.

However, the need for deep and wide-ranging fiscal reforms is becoming more and more urgent. The recent S&P downgrade to Kuwait’s sovereign credit rating outlook to negative from stable is a warning sign reflecting the depletion of GRF resources and the absence of both a new debt law as well as reforms comparable to those seen in most other Gulf countries. Reforms should target rationalizing spending, promoting public private partnerships to reduce the cost of government projects, and mobilizing more non-oil revenues. Of course, for now, priority should be given to containing and eradicating the Covid-19 pandemic, which makes the passing of the debt law absolutely essential.

Kuwait could benefit from its good rating and low interest rate environment to borrow at competitive rates. But this does not mean that it will be “good debt” unless it is used for productive purposes (efficient physical and human capital investment) based on a clear and comprehensive medium-term reform plan. Such a plan should focus on addressing macroeconomic imbalances, chief among them is fiscal sustainability, and implementing structural reforms aimed at enhancing the role of the private sector in economic activity and creating jobs for the large number of nationals expected to enter the labor force.
Table 1: Public finances, KD billion unless otherwise stated

<table>
<thead>
<tr>
<th>FY</th>
<th>FY17/18</th>
<th>FY18/19</th>
<th>FY19/20</th>
<th>% y/y</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>16.0</td>
<td>20.6</td>
<td>17.2</td>
<td>28.5</td>
<td>-16.2</td>
</tr>
<tr>
<td>Non-oil</td>
<td>1.7</td>
<td>2.1</td>
<td>1.9</td>
<td>24.0</td>
<td>-13.1</td>
</tr>
<tr>
<td>Oil</td>
<td>14.3</td>
<td>18.4</td>
<td>15.4</td>
<td>29.0</td>
<td>-16.6</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>19.3</td>
<td>21.9</td>
<td>21.1</td>
<td>13.6</td>
<td>-3.3</td>
</tr>
<tr>
<td>Current Expenditures</td>
<td>16.7</td>
<td>19.2</td>
<td>18.8</td>
<td>14.9</td>
<td>-2.1</td>
</tr>
<tr>
<td>Compensation of Employees</td>
<td>6.7</td>
<td>7.2</td>
<td>7.6</td>
<td>6.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Goods &amp; Services</td>
<td>2.8</td>
<td>3.0</td>
<td>3.2</td>
<td>6.7</td>
<td>6.4</td>
</tr>
<tr>
<td>Subsidies</td>
<td>0.3</td>
<td>1.4</td>
<td>0.6</td>
<td>...</td>
<td>-56.6</td>
</tr>
<tr>
<td>Grants</td>
<td>4.7</td>
<td>5.2</td>
<td>5.3</td>
<td>12.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Social Subsidies</td>
<td>1.1</td>
<td>1.0</td>
<td>1.0</td>
<td>-7.9</td>
<td>-2.2</td>
</tr>
<tr>
<td>Miscellaneous &amp; Transfers</td>
<td>1.1</td>
<td>1.4</td>
<td>1.2</td>
<td>26.0</td>
<td>-12.0</td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td>2.5</td>
<td>2.6</td>
<td>2.3</td>
<td>5.0</td>
<td>-12.6</td>
</tr>
<tr>
<td>Budget Balance</td>
<td>-3.3</td>
<td>-1.3</td>
<td>-3.9</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>RFFG transfers*</td>
<td>1.6</td>
<td>2.1</td>
<td>1.7</td>
<td>28.5</td>
<td>-16.2</td>
</tr>
<tr>
<td>Budget Bal. after RFFG transfers*</td>
<td>-4.9</td>
<td>-3.4</td>
<td>-5.6</td>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

* Transfers to the FGF were suspended for FY19/20; shown here for illustrative purposes.
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