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McNamara Papers

Travel
Jan. 1961



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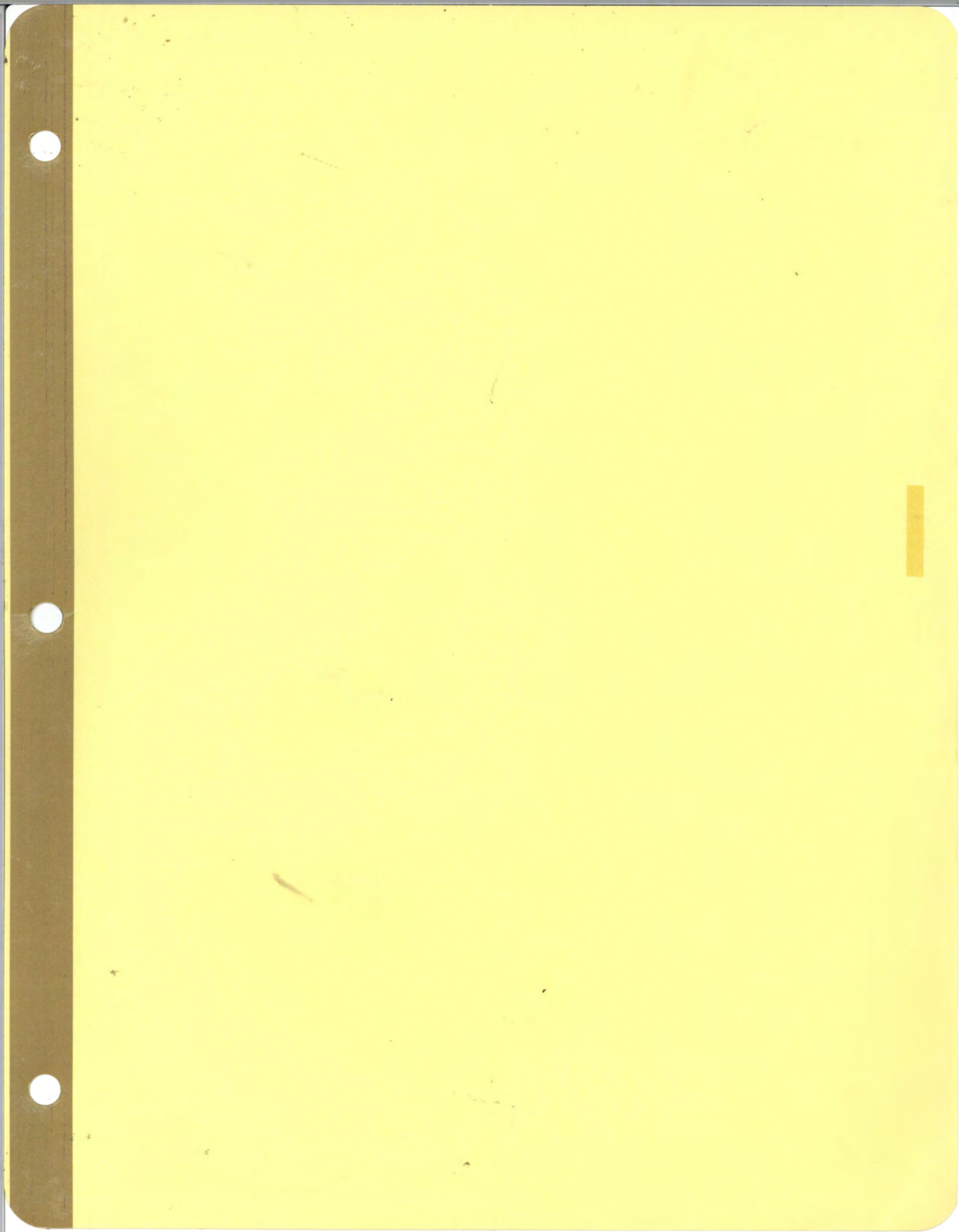
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WBG Archives



KUWAIT

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A

ITINERARY

B

January 9, 1978

Arrival Statement in Kuwait

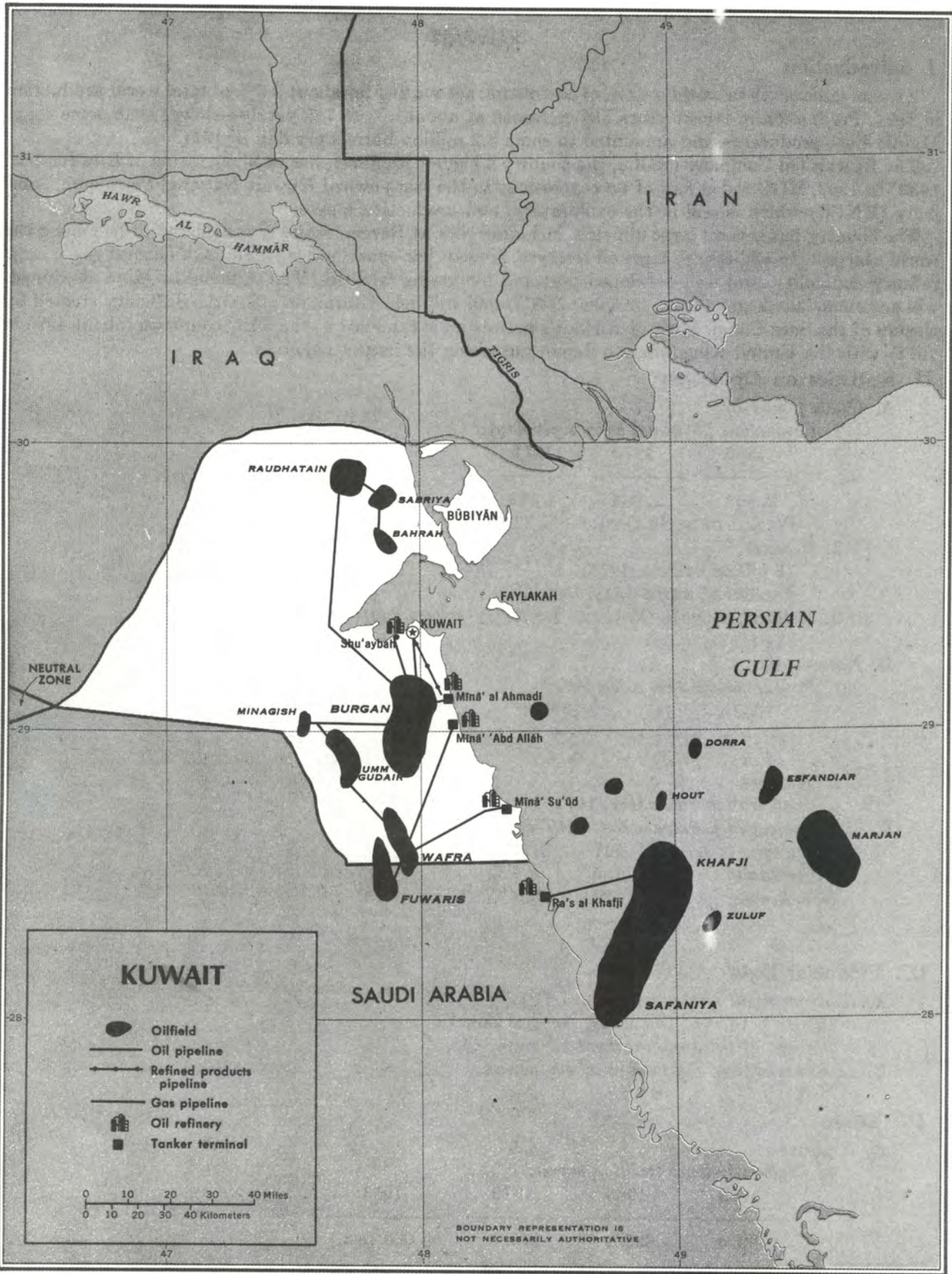
I am very happy to be in Kuwait again, for my fourth visit. The visit gives me an opportunity to personally thank your Government for its generous and sustained support to economic development in general and to the World Bank and its concessionary affiliate, the International Development Association, in particular. You have subscribed to the capital of the World Bank, made nearly \$700 million available for development through the purchase of Bank bonds, and become an important co-financer with the Bank and IDA in its development projects. You are a founding contributor to IDA, and you have participated in all the five replenishments of the resources of IDA. You have agreed to contribute \$200 million for the most recent replenishment.

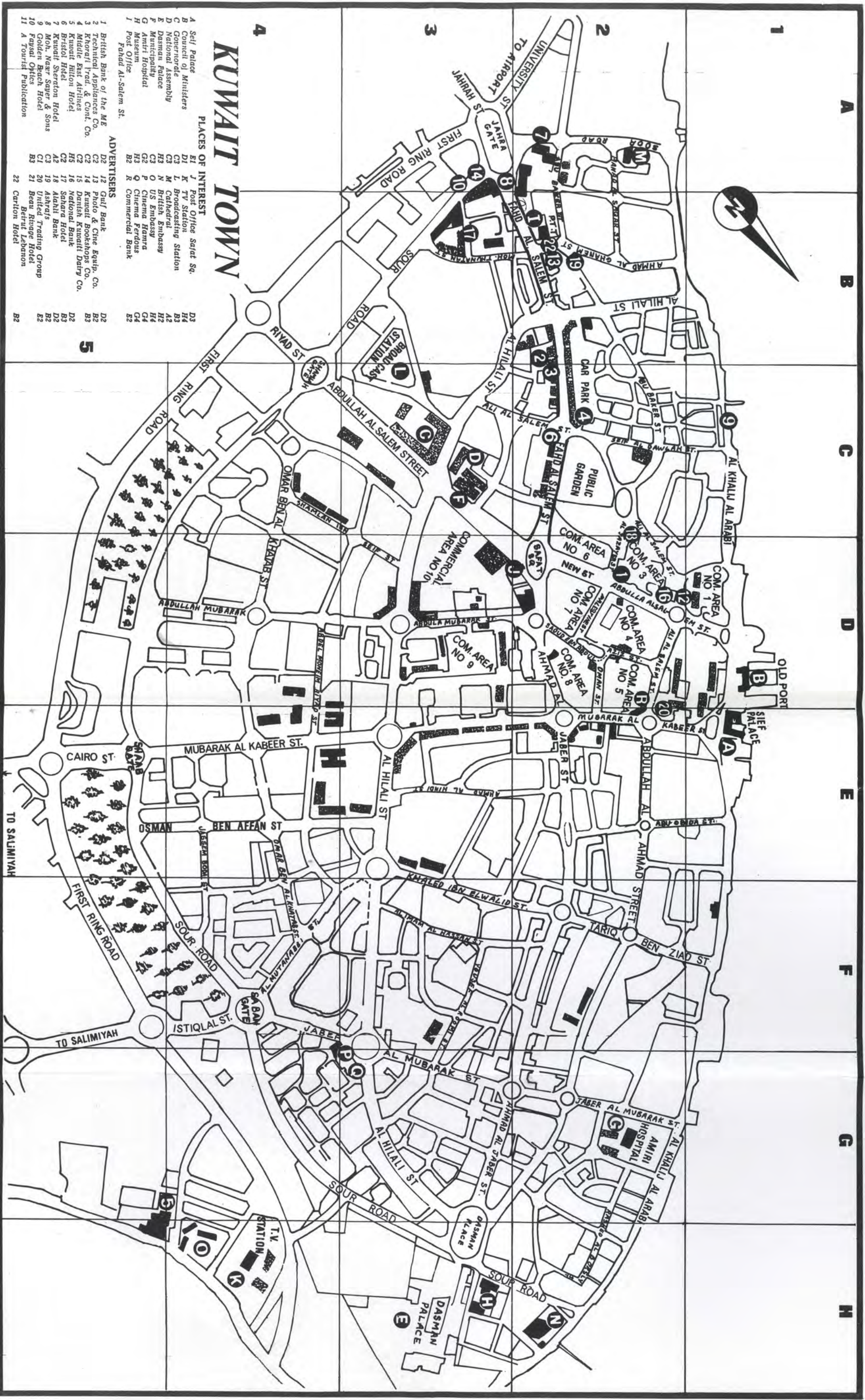
The World Bank has greatly expanded the volume and range of its assistance to the developing countries. We are also improving the quality of such assistance. As part of our global strategy, we have increased our assistance to the Arab world. The Bank's total lending to the Arab countries was \$250 million during the period of 1964-68 -- an average of \$50 million a year. The annual average lending in the region amounted to \$260 million a year during 1970-74. In the last fiscal year we lent \$830 million in the region.

I am particularly encouraged by Kuwait's exemplary role in supporting the World Bank and its efforts to improve the living standards of the poorest people in the poorest countries. Bilaterally, your pioneering effort in establishing the Kuwait Fund for Arab Economic Development in the early 1960's has served as a model. You have also increased the level of your concessionary development assistance.

The World Bank has always been keen to keep up an effective, cordial working relationship with the Kuwait Fund. We have together made notable advances in co-financing development projects in the Middle East and developing countries elsewhere. In the last fiscal year, for instance, we have together provided some \$285 million for seven projects. I hope that Kuwait will continue to have the confidence in us to use the Bank and its projects as a vehicle for the transfer of some of its resources.

C





KUWAIT TOWN

PLACES OF INTEREST

- A Self Palace
- B Council of Ministers
- C Governorate
- D National Assembly
- E Dasmah Palace
- F Municipality
- G Amir Hospital
- H Museum
- I Post Office
- J Fahad Al-Salem St.

ADVERTISERS

- 1 British Bank of the ME
- 2 Technical Appliances Co.
- 3 Khawari Prod. & Cont. Co.
- 4 Kuwait East Airlines
- 5 Kuwait Hilton Hotel
- 6 Bristol Hotel
- 7 Kuwait Sheraton Hotel
- 8 Hon. Nasser Sayer & Sons
- 9 Golden Beach Hotel
- 10 Pasha Office
- 11 A Tourist Publication

PLACES OF INTEREST

- E1 J Post Office Saeid Sq.
- D1 K TV Station
- D1 L Broadcasting Station
- C3 M Cathedral
- H3 N British Embassy
- G3 O US Embassy
- F3 P Cinema Hamra
- H3 Q Cinema Ferdous
- B2 R Commercial Bank

ADVERTISERS

- D2 J2 Gulf Bank
- C2 J3 Photo & Cine Equip. Co.
- C2 J4 Kuwait Bookshops Co.
- C2 J5 Danish Kuwait Dairy Co.
- H5 J6 National Bank
- C2 J7 Sahara Hotel
- A2 J8 Kuwait Bank
- C3 J9 Ashraf's
- C1 J10 United Trading Group
- B3 J11 Beas Rihage Hotel
- B2 J12 Carlton Hotel

background NOTES

Kuwait

department of state * april 1975

OFFICIAL NAME: State of Kuwait

GEOGRAPHY AND PEOPLE

The State of Kuwait is located in the northeastern corner of the Arabian Peninsula, bounded on the north and west by Iraq, on the south by Saudi Arabia, and on the east by the Persian

Gulf. The climate is intensely hot, with summer temperatures reaching as high as 130° F. in the shade. Rainfall averages less than 4 inches annually.

Kuwait City is the capital, major port, and commercial center. More than half the country's population live in

this city and its immediate suburbs.

Kuwaitis are primarily Arab in origin, but less than half are indigenous. Large numbers of Arabs from nearby states have settled in Kuwait, especially since oil production began to bring prosperity in the late 1940's. There is also a sizable Iranian community.

The native Kuwaitis are Sunni Muslims. The literacy rate, estimated at about 60 percent, is one of the highest in the Arab world. This is due in part to government emphasis on Kuwait's educational system. Public school education is free, and the government sends qualified students abroad for university study.

PROFILE

Geography

AREA: about 7,780 sq. mi. (slightly smaller than New Jersey); sandy, riverless desert, small hills, sparse vegetation. CAPITAL: Kuwait (pop. 800,000). OTHER TOWNS: Ahmadi, Fahahil.

People

POPULATION: 925,000 (1974 est.). ANNUAL GROWTH RATE: 2%. DENSITY: 124.2 per sq. mi. ETHNIC GROUPS: Arab (85%), Iranian, Indian, Pakistani (13%). RELIGION: Islam (99%). LANGUAGES: Arabic (official), English widely spoken. LITERACY: ca. 60%.

Government

TYPE: Constitutional monarchy with representative National Assembly. INDEPENDENCE: June 19, 1961. CONSTITUTION: Nov. 12, 1962; provides substantial powers to National Assembly. Judicial system is based on Islamic jurisdiction. POLITICAL SUBDIVISIONS: Government is centralized. SUFFERAGE: Males over 21 have full citizenship.

FLAG: Three horizontal stripes (green, white, and red) joined at the staff side with a black trapezoid.

Economy

GROSS NATIONAL PRODUCT (GNP): \$4.2 billion (FY 1972-73); \$11 billion

(1974-75 proj.). PER CAPITA GNP: More than \$10,000 (FY 1974-75 proj.). PER CAPITA GROWTH RATE: More than 25%.

AGRICULTURE: Land less than 1%. Most food is imported.

INDUSTRY: Petroleum, private business, and government employ most of the labor force; 75% non-Kuwaiti. Products—crude and refined oil, fertilizer, chemicals, building materials, shrimp. Water desalinization capacity about 52 million imperial gallons per day (1974 est.).

NATURAL RESOURCES: Petroleum, fish, shrimp.

TRADE: Exports—\$3 billion (FY ending March 1973 est.); 96% crude and refined petroleum, shrimp. Imports—\$831 million (10 mos., 1973); \$1.25 billion (1974 est.): foodstuffs, automobiles, building materials, machinery, textiles. Partners—Japan, U.S., U.K., Federal Republic of Germany.

OFFICIAL EXCHANGE RATE: 1 Kuwaiti dinar=US\$3.38.

ECONOMIC AID EXTENDED: ca. \$500 million (Kuwait Fund for Arab Economic Development (KFAED) loans, 1960-73); ca. \$1.5 billion (other loans and grants, largely since 1967).

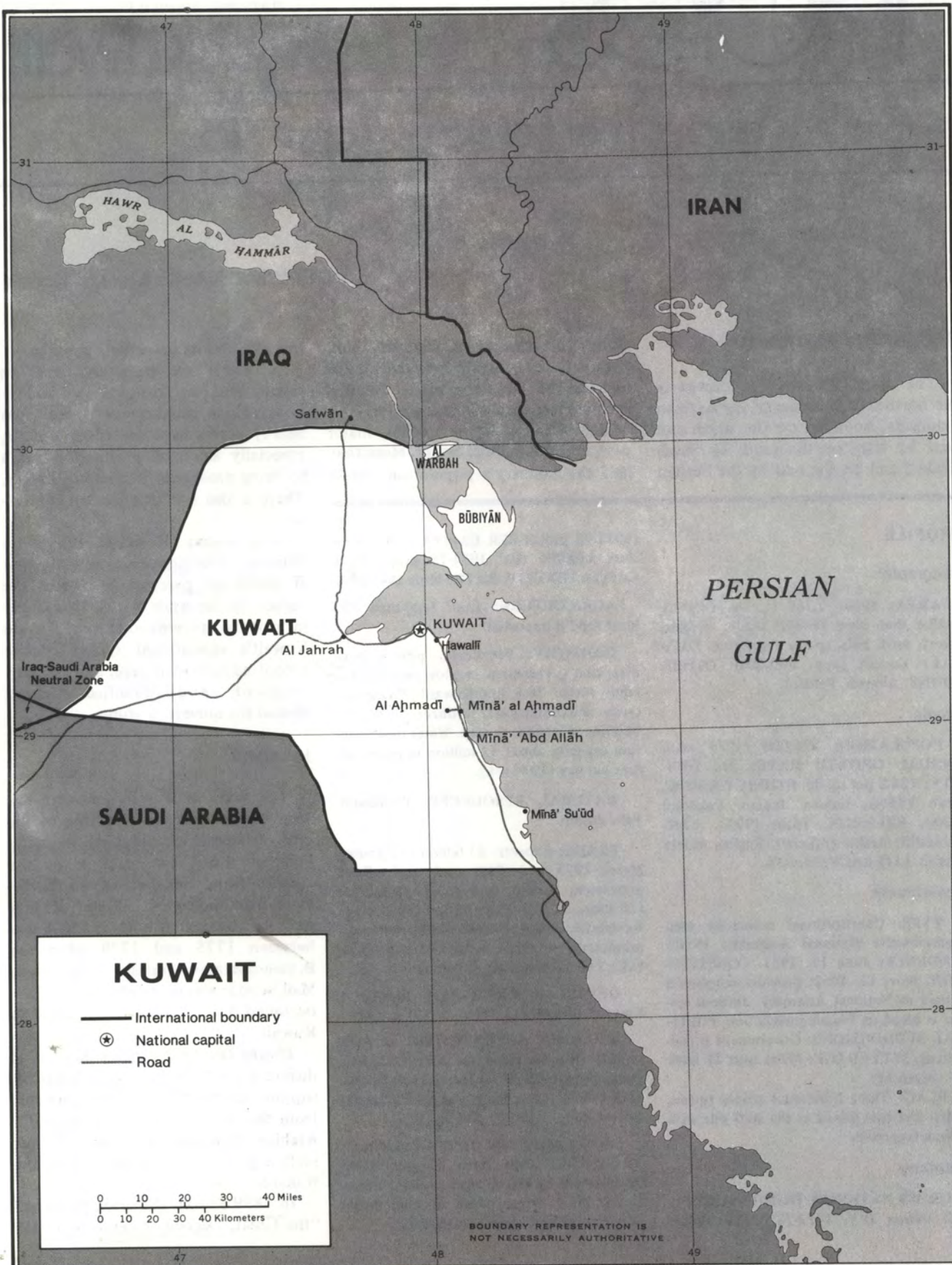
MEMBERSHIP IN INTERNATIONAL ORGANIZATIONS: Arab League, U.N., Organization of Petroleum Exporting Countries (OPEC), Organization of Arab Petroleum Exporting Countries (OAPEC).

HISTORY

The State of Kuwait's modern history began with the founding of the city of Kuwait around 1740 by members of the Uteiba section of the Anaiza tribe, who wandered northward from the region of Qatar. Its first definite contact with other states was between 1775 and 1779 when the British-operated Persian Gulf-Aleppo Mail Service was diverted from Persian-occupied Basra (in Iraq) to go through Kuwait.

During the 19th century Kuwait at different times tried to obtain British support to maintain its independence from the Turks and various powerful Arabian Peninsula tribal movements, including the Ibn Rashids and the Wahabis.

In 1899 Shaikh Mubarak, surnamed "the Great," signed an agreement with



the United Kingdom pledging himself and his successors neither to cede any territory nor to receive agents or representatives of any foreign power without British Government consent. The British in return agreed to grant an annual subsidy to support the Shaikh and his heirs and to afford them the United Kingdom's offices. From then until 1961 Kuwait enjoyed special treaty relations with the United Kingdom whereby foreign affairs were handled by the British. There was stability of rule, with Shaikh Ahmad governing from 1921 until his death in 1950 and Shaikh Abdullah from 1950 to 1965. By early 1961 the British had withdrawn their special court system, which handled the cases of foreigners resident in Kuwait, and the Kuwait Government began to exercise legal jurisdiction over all persons under new laws drawn up by an Egyptian jurist.

On June 19, 1961 Kuwait became fully independent by virtue of an exchange of notes with the United Kingdom.

On December 18, 1969 Kuwait and Saudi Arabia signed an agreement formally dividing the Neutral Zone and demarcating a new international boundary between the two countries. Prior to that date the Neutral Zone was an area of about 2,000 square miles adjoining the southern border of Kuwait proper. Both countries continue to share a joint interest in the former Neutral Zone's mineral resources.

GOVERNMENT AND POLITICAL CONDITIONS

Kuwait is a constitutional monarchy. The present Constitution was promulgated on November 12, 1962.

The Amir (ruler) is selected by and from members of the Mubarak lineage of the al-Sabah family, the ruling family of Kuwait. He has great personal prestige as Chief of State. The Prime Minister, who administers the government on a day-to-day basis, is appointed directly by the Amir. He selects the Council of Ministers (cabinet), subject to approval by the Amir and the National Assembly.

The 66-member National Assembly (50 elected members and 16 appointed

ministers) provides a considerable measure of representative government. Members are elected to 4-year terms and represent 10 electoral districts. Although the Assembly can be dissolved at any time by the Amir, to date this has not occurred.

The judicial system in Kuwait was reorganized in 1959 by the promulgation of a law which established courts of law and adopted modern codes to cope with the new necessities of modern society.

Political parties in the Western sense do not exist in Kuwait, although members of the National Assembly reflect a variety of political outlooks. A 1964 law authorized formation of labor unions under detailed government regulation.

Kuwait has experienced an unprecedented era of prosperity and well-being under the guidance of Amir Shaikh Sabah al-Salim al-Sabah and his late brother, Amir Abdullah al-Salim al-Sabah, who died in 1965 after ruling for 15 years. The country has undergone a remarkable transformation into a highly developed welfare state with a free economy.

Principal Government Officials

Amir—His Highness Shaikh Sabah al-Salim al-Sabah
 Prime Minister—Jabir al-Ahmad al-Jabir al-Sabah
 Deputy Prime Minister, Minister of Information—Jabir al-'Ali al-Salim al-Sabah

Other Ministers

Education—Jasim Khalid ad-Dawud al-Marzuq
 Housing—Hamad Mubarak al-'Ayyar
 Public Works—Humud Yusuf al-Nisf
 Interior and Defense—Sa'd al-'Abdallah al-Salim al-Sabah
 Social Affairs and Labor—Salim Sabah al-Salim al-Sabah
 Communications—Sulayman Humud az-Zayd al-Khalid
 Foreign Minister—Sabah al-Ahmad al-Jabir al-Sabah
 Finance—'Abd ar-Rahman Salim al-'Atiqi
 Public Health—'Abd ar-Rahman 'Abdallah al-'Awadi
 Cabinet Affairs—'Abd al-'Aziz Husayn

Justice, Awaqf and Islamic Affairs—'Abdallah Ibrahim al-Mufarrij
 Electricity and Water—'Abdallah Yusuf Ahmad al-Ghanim
 Oil—'Abd al-Muttalib 'Abd al-Husayn al-Kadhimi
 Trade and Industry—'Abd al-Wahhab Yusuf al-Nifisi
 Ambassador to the U.S.—Vacant
 Ambassador to the U.N.—Abdullah Yacoub Bisharah

Kuwait maintains an Embassy in the U.S. at 2940 Tilden St., NW., Washington, D.C. 20008.

ECONOMY

In 1937 the Shaikh of Kuwait granted an oil concession to the

READING LIST

These titles are provided as a general indication of the material published on this country. The Department of State does not endorse the specific views in unofficial publications as representing the position of the U.S. Government.

- American University. *Area Handbook for the Peripheral States of the Arabian Peninsula*. Washington, D.C.: U.S. Government Printing Office, 1971.
- Busch, Briton C. *Britain and the Persian Gulf, 1894-1914*. Berkeley: University of California Press, 1967.
- Dickson, H.R.P. *The Arab of the Desert*. London: Allen and Unwin, 1952.
- Dickson, H.R.P. *Kuwait and Her Neighbors*. London: Allen and Unwin, 1956.
- El Mallakh, Ragaei. *Economic Development and Regional Cooperation: Kuwait*. Chicago: University of Chicago Press, 1968.
- Freeth, Zahra. *Kuwait Was My Home*. London: Allen and Unwin, 1956.
- Hay, Sir Rupert. *The Persian Gulf States*. Washington, D.C.: Middle East Institute, 1959.
- Shehab, Fakri. "Kuwait: A Super-Affluent Society." *Foreign Affairs*, April 1964.

Kuwait Oil Co. (KOC), which is now owned jointly by the government, the British Petroleum Co., and Gulf Oil Corp., but which is likely to come under full government ownership in the near future. Oil was discovered in 1938, but no significant production took place until after World War II. Kuwait is presently the third largest oil producer in the Near East and currently is surpassed in the world only by the United States, the Soviet Union, Venezuela, Saudi Arabia, and Iran.

Kuwait is in the enviable position of having enormous oil wealth in relation to its population. In 1973 crude oil production in Kuwait and its share of the former Neutral Zone's production averaged about 3 million barrels per day. The government's revenues from this oil were estimated at \$8 billion for 1974. Prospects are good for continued receipts of increasing magnitude, with Kuwait processing one of the world's major oil deposits (KOC's Burgan field) and estimated oil reserves of about 75 billion barrels (which include Kuwait's share of the former Neutral Zone) or 14 percent of the world total.

In addition to KOC, four concessionary oil companies operate in the country. Kuwait Shell Petroleum Development Co., owned entirely by the Royal Dutch/Shell group, holds a Kuwait offshore concession granted in 1960. The American Independent Oil Co. (AMINOIL), which was acquired a few years ago by R.J. Reynolds Co., has been producing oil in the former Neutral Zone's onshore area since 1954. The Japanese-owned Arabian Oil Co. has produced oil since 1961 from a former Neutral Zone offshore concession. The Kuwait-Spanish Petroleum Co. (51 percent owned by the Kuwait National Petroleum Co.) has exploration rights in onshore areas relinquished by KOC.

A myriad of social welfare, public works, and development plans have originated under government auspices due to oil wealth. These plans have modified greatly the previously austere lives of the inhabitants. Kuwait's broad range of government social services perhaps surpasses that of the Scandinavian countries in sheer scope

and paternalism. Among the features are free medical services and education at all levels for Kuwaitis. Foreign nationals can pay relatively modest fees and obtain some state welfare services.

Industry

Owing to the abundance and low cost of natural gas in Kuwait, this resource is considered the basic element in the country's industrialization program. Existing industrial activities include water distillation plants (the largest in the world), five oil refineries, an ammonia plant, a desulfurizing plant, fertilizer production, brick and concrete block and cement production, bottling plants, and various light industries. Current development plans provide for further airport construction, water distillation, electrification, and municipal road construction. The construction industry remains an important part of the economy. The Kuwait Planning Board, an autonomous organization created in 1962, has introduced the concept of central planning and coordination.

Agriculture

Agriculture is limited owing to the lack of arable land, but the government has experimented recently in growing food through hydroponics. Fish and shrimp are plentiful in territorial waters, and the large-scale commercial harvesting of this important natural resource has been undertaken locally and in the Indian and Atlantic Oceans.

Trade and Aid

The Kuwait dinar is a strong currency backed 100 percent by gold and foreign exchange holdings. The Kuwait Government's budget for the fiscal year ending March 31, 1975 estimated revenues at more than \$3 billion.

Exports other than petroleum have consistently been of minor significance, but large oil exports have permitted a consistently favorable balance of trade. Kuwait's balance-of-payments surplus was about \$660 million on March 31, 1974.

Kuwait has been a source of economic assistance to other Arab states since 1960, even before it was fully inde-

pendent. The Kuwait Fund for Arab Economic Development (KFAED) is an autonomous state institution patterned after Western and international lending agencies. Beneficiaries include Algeria, Morocco, Jordan, Sudan, Tunisia, and Egypt. In early 1974 the Fund's capitalization was increased to \$3.4 billion and its lending mandate was expanded to include all—not just Arab—developing countries. The Kuwait Government has also bestowed large sums in loans and grants to a number of Arab states: Algeria, Iraq, Jordan, Lebanon, the United Arab Emirates, Egypt, and Yemen Arab Republic. This aid, including payments to Egypt and Jordan agreed upon after the June 1967 war, is entirely separate from KFAED loans. A large portion has been in the form of subsidies to Saudi Arabia and Jordan since the 1967 war.

FOREIGN RELATIONS

Since independence Kuwait has been evolving its own international identity. It joined the Arab League and a number of U.N. specialized agencies, including the International Bank for Reconstruction and Development (IBRD) and the International Monetary Fund (IMF), and was accepted into membership in the United Nations in May 1963.

In foreign policy Kuwait is closely oriented to other Arab states in the defense of general Arab interests. The government and people reflect strong support for Arab causes. Conducting a program of economic and financial assistance for other Arab countries serves to promote the state's basic objective: the preservation and strengthening of its sovereign independence. Kuwait has also played an active role in promoting the economic development and political stability of the smaller Arab Emirates in the Persian Gulf.

The state's main foreign relations problem in its early years of independence was Iraq's claim to the shahkhdom following the June 1961 announcement of Kuwait's independence. Fearing an Iraqi military occupation, the Kuwait Amir requested

TRAVEL NOTES

Clothing—Light clothing most of the year; however, winter months are cold. Women are advised to dress conservatively—miniskirts, shorts, or sleeveless dresses should not be worn in public.

Entry Regulations—Visas must be obtained from the Embassy of Kuwait in Washington or the Consulate in New York City.

Health—Visitors should exercise care regarding what they eat and drink. Several British- and U.S.-trained doctors practice in Kuwait.

Telecommunications—Local telephone service is good; international links are available. A satellite ground station is in operation.

Transportation—Several airlines maintain service to Kuwait from major cities in Europe and the Near East. Kuwait's national airline is expanding its services. Most principal roads in Kuwait are two-lane. All-weather highways run north to Iraq and south to Saudi Arabia.

British assistance in defending his country. The British complied by dis-

patching troops. Kuwait presented its case before the United Nations and successfully preserved its sovereignty. The British forces were later withdrawn and replaced by troops from certain Arab League countries, which in turn were withdrawn at Kuwaiti request in January 1963. Pressures from Iraq for annexation of Kuwait were moderated with the overthrow of the Iraqi regime in February 1963, and the succeeding Iraqi Government signed an agreement in October 1963 recognizing Kuwait's independence. On March 20, 1973 however, several armed clashes underlined Iraq's continuing nonacceptance of portions of the undemarcated boundary between the two countries. This unsatisfactory border situation remains unresolved.

Kuwait established diplomatic relations with the Soviet Union in 1963, and in November 1964 the two countries signed an agreement for economic and technical cooperation.

Kuwait's trade orientation, which is almost entirely toward the West, reinforces its friendly relations with Western nations.

U.S.-KUWAIT RELATIONS

The United States supports Kuwait's independence and orderly development. Kuwait has played a constructive role in the Persian Gulf and shares U.S. views that states in the gulf should work closely together for their own security. There has been no U.S. economic assistance to Kuwait other than Export-Import Bank loans in support of commercial transactions.

A U.S. consulate was opened at Kuwait in October 1951 and elevated to Embassy status at the time of Kuwait's independence 10 years later.

Principal U.S. Officials

Ambassador—William A. Stoltzfus, Jr.
Deputy Chief of Mission—Frank A. Mau
Political Officer—Robert C. Ames
Economic/Commercial Officer—Richard W. Bogosian
Public Affairs Officer—Richard E. Undeland

The U.S. Embassy in Kuwait is located at Bneid al-Gar, Kuwait. The mailing address is P.O. Box 77, Kuwait.

DEPARTMENT OF STATE PUBLICATION 7855
Revised March 1975; released April 1975

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Bureau of Public Affairs

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D

Political Background and Situation

Kuwait is a sovereign state ruled by the Al-Sabah family, in which a democratic form of government has been gradually introduced since the country became fully independent in June 1961.

Background

Early in the eighteenth century, three clans of the Anaiza tribe abandoned nomadism and settled in the north-west angle of the Persian Gulf, bounded by Iraq in the north and Saudi Arabia in the south, which is more or less what Kuwait is today. Sheikh Sabah Al Abdul Al Rahim established his dynastic rule there in 1956. After a Turkish attempt to control Kuwait in the 1890s, its ruling sheikh entered into a treaty relationship with Great Britain in 1899. Following the outbreak of the war with Turkey in 1914, Great Britain recognized Kuwait as a sovereign state, but under British protection. These arrangements continued until June 19, 1961, when Kuwait became fully independent.

Until the late 1920s, relationships between Kuwait and Saudi Arabia were unsatisfactory, essentially on account of unsettled borders. In 1922, however, by the Treaty of Uqair, a compromise was reached between these two countries through the creation of a "Neutral Zone" (measuring 3,563 sq. mi.) south-east of Kuwait. It was however only in December 1969, that the two countries signed an agreement formally dividing the Neutral Zone and demarcating a new international boundary and agreeing to share the mineral resources of the Neutral Zone. As regards its northern frontier with Iraq, the borders were agreed upon in 1926; nevertheless, in 1961, when the 1899 Treaty of Protection with Great Britain was revoked and Kuwait became fully independent, Iraq claimed Kuwait as an integral part of its territory. Threatened with the possibility of Iraqi invasion, the ruling Sheikh at the time, Sheikh Abdullah Al Salim Al-Sabah, appealed for British military aid; Great Britain's response deterred any Iraqi action. Later in that year, when Kuwait joined the Arab League, the British forces were replaced by Arab League forces. However, Kuwait's relations with Iraq still continue to be somewhat uneasy and the last Iraqi military action to shift the borders with Kuwait, occurred as recently as 1973.

Present Political Framework and Recent Developments

The National Assembly. Following Kuwait's establishment as a fully independent sovereign state in 1961, the Emir (the Ruler of Kuwait) extended suffrage to all Kuwaiti males over 21, and a Constitution Assembly was established. This Assembly promulgated Kuwait's Constitution on November 12, 1962. Thereafter, the country's first 50-member National Assembly was elected in January 1963. The last elections were held in January 1975.

Although the Emir promulgates all laws and decrees in Kuwait, the Assembly has legislative powers and has become a forum through which the population's socio-economic needs and discontent have become identified and vocalized.

Kuwait's experiment in democracy came to an end on August 29, 1976 when the Ruler of Kuwait announced that he was suspending the country's Constitution, and dissolving the National Assembly. The announcement was accompanied by a tightening of control over the press. These measures came as a reaction to the increasingly outspoken and critical National Assembly. Some members of the Assembly with leftist tendencies accelerated their criticism of certain Government policies particularly on oil, the Arab-Israeli conflict and misadministration and corruption in Government. These developments, however were strongly influenced by the civil war in Lebanon. The large Palestinian population in Kuwait, with close ties to the Palestinian commandos in Lebanon, became increasingly critical of the Kuwaiti Government and accused it of supporting the anti-Palestinian side in the Lebanese civil war. Bomb explosions were reported and speculations grew that Kuwait was the next spot for civil war in the Middle East.

The Ruling Family and the Government. Effective political power in Kuwait has remained in the hands of the Al-Sabah family. The Emir is selected by and from the members of the Mubarak lineage of that family. He wields great personal authority, as both the Chief of State and as the Head of the Government. He is assisted by a Council of Ministers which he selects. The Prime Minister is directly appointed by the Emir, and by tradition, is usually the Crown Prince who will eventually become the Emir. The recent death on January 1, 1978 of the Amir of Kuwait is expected to bring the present Prime Minister Sheikh Jaber Al-Sabah to the position of the Ruler of Kuwait and his Deputy to the position of Prime Minister. These and other cabinet changes are expected soon.

All important Cabinet posts are still held by members of the various branches of the Al-Sabah family. The only exception has been the present Finance Minister, Mr. Ateeqy, who is not a Sabah, but has held this position for a number of years because of the Emir's and the Crown Prince's confidence in his competence and loyalty.

Kuwait is administratively divided into three Governorates: Kuwait (the capital), Ahamadi and Hawalli, each of which is headed by a Governor appointed by the Amir. The Government is administered through a civil service, consisting of some 6,000 Kuwaitis. Although overall, the form of government is a monarchy, the Al-Sabah family has ruled with benevolence and consciously sought to transfer, not merely share, the benefits of oil affluence to the country's citizens. Indeed, Kuwait today has what are probably the most progressive welfare services in the world, for its citizens.

Foreign Relations

Kuwait joined the Arab League in 1961 and the UN in 1963. Its foreign relations with Saudi Arabia, stabilized after the delineation of the boundaries in the Neutral Zone in 1969, although those with Iraq still remain uneasy. Despite this situation, Kuwait has continued to play a neutral and a conciliatory role amongst Arab countries. It has actively searched for moderation of positions and urged rapprochement on the part of the Arabs with the US, even during

the late sixties and early seventies when Soviet influence was particularly strong in the Middle East. At the same time, Kuwait has been quite active in financially supporting the "front-line Arab countries" in their "war of confrontation" with Israel.

Kuwait has maintained very cordial links with most Western countries, and has also established diplomatic relations with both the USSR and the People's Democratic Republic of China. It has also been in the forefront in the use of fiscal surpluses accrued from its oil, for the economic development of Arab countries and more recently, for that of some of developing Islamic countries in Asia and Africa.

EMLDA
January 1978

LIST OF CABINET MINISTERS *

KUWAIT

Sheikh Jaber Al-Ahmed Al-Jaber Al-Sabah	Prime Minister
Sheikh Jaber Ali Al-Salem	Deputy Premier and Minister of Information
Sheikh Sabah Al-Ahmed Al-Jaber	Minister of Foreign Affairs
Sheikh Saad Al-Abdulla Al-Salem	Minister of Defence & Interior
Mr. Abdel-Muttaleb Al-Kazemi	Minister of Oil
Mr. Abdel-Rahman Salim Al-Ateeqi	Minister of Finance
Mr. Abdel-Wahab Al-Nafisi	Minister of Commerce and Industry
Mr. Humoud Al-Nisf	Minister of Public Works
Mr. Jassim Al-Marzouk	Minister of Education
Mr. Abdulla Al-Mufarrej	Minister of Justice
Mr. Abdulla Youssff Al-Chanim	Minister of Electricity & Water
Dr. Abdel-Rahman Al-Awadi	Minister of Public Health
Mr. Suleiman Humoud Al-Khaled	Minister of Communications
Sheikh Salim Sabah Al-Salem	Minister of Labour and Social Affairs
Mr. Hamad Al-Ayyar	Minister of Housing
Mr. Mohammed Al-Adasani	Minister of Planning
Mr. Youssef Jassim Al-Hajji	Minister of Religious Endowments and Islamic Affairs (AWKAF)
Mr. Abdel-Aziz Hussein	Minister of State for Cabinet Affairs

* Because of the death of the Emir of Kuwait on January 1, 1978, cabinet changes are expected soon.

EMIDA
January 1978

Sheikh Sabah Al-Salim Al-Sabah
Emir of Kuwait

Sheikh Sabah Al-Salim, the youngest son of Sheikh Salim Al-Mubarak Al-Sabah who was the Emir from 1917 to 1921, was born in 1918. His family has ruled Kuwait since 1756.

The Emir was educated in Kuwaiti schools and privately tutored. He entered public service at a young age and worked his way upwards in the Departments of Public Security, Public Health and Public Works during the important formative years of 1946 to 1961 - while Kuwait was still under British tutelage and oil revenues were just beginning to flow in. After Kuwait achieved full independence in 1961, the Emir was named Foreign Minister in the first Cabinet in 1962. In late 1962, he was named Crown Prince. In early 1963, he relinquished the Foreign Affairs portfolio and was named Prime Minister. He headed the Kuwaiti delegation in 1963, when Kuwait was admitted to the United Nations.

He became the Emir in November 1965, following the death of his elder brother, Emir Abdullah Al-Salim Al-Sabah.

Sheikh Sabah Al-Salim is reputed to be a man of courage, with a genuine interest in seeing his country and other developing Arab countries progress economically. Under him, Kuwait has also been able to act as the moderating influence in Arab unity and politics.

Personally, he is an amiable man who likes a good joke and loves to tell stories. His handling of human relationships is characterized by tact and cleverness. Although he is obviously a person with great wealth, he avoids ostentation. (Deceased on January 1, 1978).

Sheikh Jaber Al-Ahmad Al-Jaber Al-Sabah
Crown Prince and Prime Minister

Sheikh Jaber, the third son of Emir Sheikh Ahmad Al-Jaber Al-Sabah (1921-1950) by his first wife (and sister of the present Emir), was born in 1926. He received his education through private tutors.

He commenced his apprenticeship in the civil service. In 1949, he was appointed Chief of Public Security in Ahmadi, the major oil region in Kuwait, with additional responsibility for Neutral Zone affairs. He was made responsible for day-to-day contacts with the Kuwait Oil Company in 1956 and proved himself to be both energetic and astute. A Government reorganization in 1959 brought him to the head of the newly-formed Department of Finance. During the next two years, with the Emir's support, he successfully introduced a system of budgets for governmental departments.

He became Minister of Finance and Industry in Kuwait's first Cabinet in 1962. He was given the additional portfolio of Commerce in 1965. When Emir Abdullah died in November 1965, Jaber Al-Ahmad was named

Prime Minister. He was designated Crown Prince on May 31, 1966. He has held a series of other Cabinet posts also, which have enabled him to plan a significant role in the nation's growing economy. He is a strong advocate of industrialization in Kuwait, and is particularly interested in the establishment of a large petrochemical industry. He has also instituted a number of money-saving governmental reforms.

The Crown Prince has travelled extensively. He led delegations to meetings of the IMF/IBRD in Washington, D.C., in 1962 and 1965. However, since 1969, he has made very few trips out of Kuwait.

Sheikh Jaber is a rather handsome man of medium height and build. He is an avid sportsman, who excels in horseback riding, swimming, and rifle marksmanship. He is married and has four sons. Sheikh Jaber speaks some English, but prefers to have an interpreter at official meetings.

Abdel-Rahman Salim Al-Ateeqi
Minister of Finance

Mr. Ateeqi was born in 1926, in a prominent middle-class Kuwait family. He has been schooled only up to a secondary level education in Kuwait.

He worked for the Kuwait Oil Company and, in 1950, entered Government service with the Department of Public Security. He later worked with the Department of Public Health. After Kuwait became fully independent in 1961, Mr. Ateeqi joined the Foreign Ministry and came to the USA in the dual capacity of Ambassador to the US and Permanent Representative to the UN. In 1963, Mr. Ateeqi returned to Kuwait, to become the Under Secretary of the Ministry of Foreign Affairs.

He became Minister of Finance and Oil in 1967, a position he has held until the Cabinet change in February 1975. He is now the Minister of Finance. He was the first non-member of the Ruling Family, to hold a top Cabinet post. This fact is indicative not only of his ability, but also of the trust with which he is regarded by the Ruling Family. Mr. Ateeqi is also a member of the newly-formed Petroleum, Finance and Foreign Trade Council in Kuwait.

Despite the lack of a college education, Mr. Ateeqi is generally recognized to be one of the very ablest and shrewdest of Kuwaiti ministers. He is a very strong proponent of the use of Kuwaiti wealth for the economic development of the Arab world and for peace in the Middle East. He is a strong supporter of the Bank Group and one who greatly values the leadership that Mr. McNamara has given to it.

By temperament, he is a quiet and sensitive man, who values his prerogatives as a native Kuwaiti. He is active in the Islamic Guidance Society and has made pilgrimages to Mecca several times. He has travelled extensively in the Middle East, India, the US, UK and USSR. Travel and reading are his chief interests. He is married and has seven children. He has been Governor of the Bank since 1967.

Mr. Abdul-Multaleb Al-Kazemi
Minister of Oil

Mr. Al-Kazemi has been named the Minister of Oil in the new Cabinet appointed in February 1975. Until then, the oil and finance were combined under one Ministry of Finance and Oil.

Mr. Al-Kazemi was born in 1937. He graduated in commerce at the Cairo University and later continued his education in the United States.

He commenced his career in the Kuwaiti civil service and until his entry into politics and election in the last National Assembly of Kuwait, he had served as the Finance Director in the Ministry of Finance and Oil. In the last election to the National Assembly, he once again returned as one of its members.

Abdlatif Y. Al-Hamad
Director General of the Kuwait Fund for Arab Economic Development

Mr. Al-Hamad was born in 1937. He has been extensively schooled abroad first at the American University in Cairo (1955-58) and later at the Claremont College, California, (1958-60) from where he received a B.A. in International Affairs in 1960, and at Harvard.

After his return to Kuwait, Mr. Al-Hamad began his career in the public service of his country. He was a member of the Kuwait delegation to the UN in 1962, when Kuwait became a member of that organization. Since 1963, when the Kuwait Fund started its operations, he has held the position of Director General. Mr. Al-Hamad has also long been associated with the Kuwait Investment Co. as Director (1963), Deputy Chairman (1964), and Managing Director (since 1965). He has also been the Alternate Governor of the Bank since April 1963. Mr. Al-Hamad was prominent during IDA V Replenishment, and he is a member of the Brandt Commission.

Mr. Al-Hamad has also been active in private business. Among other positions, he holds the chairmanships of the Kuwait Prefabricated Buildings Co. (since 1965), and the United Bank of Kuwait Ltd., London (since 1966).

A widely-traveled man, he is highly respected in all developing countries where the Kuwait Fund has been involved. A person with an agile mind, he is also very much interested in social and cultural issues.

E

BRIEFING PAPER

KUWAIT

1. The main point to raise in discussions with the Government is the importance of Kuwait's continued and appreciated efforts in channeling a part of its financial surplus to assist in the economic and social development of the developing countries; whether this takes the form of contributions to IDA, loans to the Bank, participation in cofinancing arrangements with the Bank Group, or assistance to poorer countries through Kuwait's own bilateral aid programs.

IDA V Replenishment

2. You may wish to thank the Government for Kuwait's commitment to contribute \$200 million to the fifth replenishment of IDA.

Borrowing

3. The current status of Bank borrowings from, and other financial relations with Kuwait, is given in Annex I. Kuwait is very likely to continue to run surpluses on its balance of international payments for the foreseeable future. A substantial part of these surpluses is and will continue to be invested in financial instruments abroad. In particular, the "special fund for future generations" which the Government announced last year, and which is meant to save some of today's income for the time when oil runs out, may be a channel for such investments. The Government cannot touch this fund, which started with a capital of KD850 million and will be increased annually by a statutory 10 percent of Government revenues, plus the return on investments from this fund. It may be appropriate to inquire of the Government whether holding some of this fund's assets in secure Bank bonds may not be a proper way of meeting the fund's objectives. The large volume of Bank lending in some Arab League countries could be used in support of the argument that resources diverted to help the Bank's lending program bring benefits to the Arab region.

Bank Group Lending to Arab Countries

4. Bank Group lending to Arab League developing countries in FY77 amounted to \$829.5 million in loans and credits aggregated as follows:

<u>Country</u>	<u>\$ million</u>
Egypt	267.5
Morocco	161.0
Algeria	155.0
Tunisia	87.3
Syria	67.5
Sudan	37.0
Yemen Arab Republic	21.0
Oman	15.0
Somalia	12.0
Mauritania	6.2

The FY77 lending level compares favorably with the \$728.3 million in FY76 (an increase of \$101.2 million), the \$614.7 million in FY75 and the average of \$257.6 million per year over FY70-74. Proposed Bank Group lending in FY78 to Arab developing countries aggregates about \$912 million.

Gulf Organization for the Development of Egypt (GODE)

5. In April 1977, GODE (the \$2.0 billion fund created by Saudi Arabia, Kuwait, UAE and Qatar to participate in financing Egypt's development program) agreed to lend \$1,475 million to the Central Bank of Egypt, in stages, while Egypt carried out its declared policies to correct its balance of payments disequilibrium. Egypt is making uneven progress in transforming its economy while it would be unrealistic to expect much faster progress, you may wish to encourage the Kuwait Government to maintain the pressure which they and other members of GODE have been exerting on the Egyptian Government to undertake the reforms needed. You may also wish to express appreciation for the contribution GODE is making to Egypt's development, and stress Egypt's continued need for cash and commodity aid in the next five years if it is to be able to overcome its development problems. Although GODE was set up in 1976 to provide development assistance to Egypt over a number of years, by end of 1977 it had committed \$1725 million out of its capital of \$2000 million, largely in order to pay off arrears on banking facilities and for balance of payments assistance. There is, therefore, a clear need to seek a replenishment of the organization's funds, however, we do not know the member countries' intentions in this respect.

Consultative Group for Egypt

6. The first meeting of the Consultative Group for Egypt was held on May 11-12, 1977, with Kuwait participating. We expect a further meeting to be held in June 1978. You may wish to express our appreciation for Kuwait's participation in the Consultative Group, and the importance which we and the Government of Egypt attach to their involvement, which is crucial to the Group's success.

Technical Assistance

7. The provision of technical assistance by the Bank to Kuwait has taken the form of responding to requests from the Government or the Kuwait Fund (Annex II). During your last (May 1976) visit to Kuwait, the Minister of Finance requested a review of the Government subsidies in Kuwait. A review was carried out in October/November 1976 and a draft report was sent to the Government in January 1977 (details on this and other technical assistance to Kuwait are found in Annex II).

8. The Government's request never achieved a sustained and predictable level but tended to be sporadic and isolated never exceeding the one manyear per year limit on non-reimbursable technical assistance. This might be indicative of the Government's feeling that it can be self-sufficient in finding expertise from other sources directly and on its own. In these circumstances, it is difficult to anticipate if and when additional requests may be made. At present we do not expect technical assistance requests of more than one manyear per year from the Government and its agencies, including the Industrial Bank of Kuwait (IBK) and the Kuwait Fund. This level of assistance on a non-reimbursable basis was recommended in the SCPP of February 15, 1977.

9. Should the Government raise the matter, we should remain ready, in view of Kuwait's special relationship with the Bank Group, to respond expeditiously to any future requests for technical assistance within the sphere of our institution's expertise and competence.

KUWAIT BORROWING OPERATIONS

Briefing Paper

The Bank's operations in Kuwait commenced in fiscal year 1969 with a Kuwaiti Dinar issue managed by the Kuwait Investment Company (KIC). KIC managed six public issues in Kuwaiti Dinars in the fiscal years 1969-1974.

The issues, as set forth below, were distributed fairly widely in Kuwait, and on occasion also in other countries throughout the Middle East, to banks, individual investors and institutions. We also understand that at times the Kuwaiti Government or government-controlled accounts have bought fairly sizeable blocks from the underwriter or from commercial banks after the issue was sold. The Kuwait Investment Company at the time made a market in our dinar bonds, and although the bonds were not listed on any stock exchange, these were traded in the secondary market. The issues were as follows:

<u>Date</u>	<u>Amount (KD million)</u>	<u>Average Life (in years)</u>	<u>Cost in %</u>
8/68	15	17.25	6.73
11/71	30	6	7.77
4/72	20	6.50	7.13
8/72	15	11.75	7.28
7/73	25	11.75	7.34
12/73	25	9	7.51

After the oil price increase, the discussions with KIC and the Kuwaiti Government centered on further issues in Kuwaiti Dinars, consistent with our past practice. However, these negotiations did not come to fruition because as you may recall, our Board of Executive Directors made it clear that they were reluctant to approve further issues in currencies whose values were not set by market forces. The Kuwaiti Government and particularly Abdlatif Al-Hamad, quite understandably wanted the Kuwaiti Dinar to become the universally traded currency in the Middle East. He hoped and expected that Kuwait might become an "entrepot" financial center like Beirut and that the Dinar, if universally traded and accepted in the Mideast, would support this development. In the absence of short term money market instruments, they were anxious for issuers to denominate their obligations in KD's to facilitate trading throughout the Mideast of a marketable investment which in turn, it was hoped, would lead to a general acceptance and recognition of the dinar. That program did not succeed as few issuers were willing to take the exchange risk.

Attachment 1 shows the volume of international bond issues in KD's for the last four years since the oil price increase and also gives details concerning the seven international KD issues floated during calendar year 1977 totalling KD 36 million (equivalent to about \$125 million). During the past year the market was closed between May and November for foreign issuers. The issuers who used the market in 1977 cannot be considered

top rated credit risks. The rates they had to pay are quite high and would parallel those payable in U.S. dollars. The rates would be about 4% higher than what we would have to pay in Switzerland and 3% higher than our rates in the German market. In addition borrowers have to carry an exchange risk which is difficult to evaluate. Attachment 2 is an analysis of the exchange rate risk concerning the Kuwaiti Dinar. It was prepared by the EMENA Department and reviews developments since 1970. It assesses the impact of interest rate changes on the Kuwaiti balance of payments, the budget and national savings; on income distribution, on domestic inflation and on future economic objectives specified by the Kuwaiti authorities. While we have little expertise in these matters we would only point out that Kuwait has a population of about 1 million; the Government is under pressure to reduce the price of imports in order to stem inflation; the choice and "weighting" of any currency basket against which the Kuwaiti Dinar moves is set administratively by Kuwait. There has been talk recently about plans to reduce the weight of the U.S. dollar in the basket which would, of course, result in an appreciation of the Kuwaiti Dinar.

Several years ago, discussions were opened with a view toward obtaining funds from the Kuwaiti Government by means of direct placements - much in the same form as our Bundesbank, Bank of Japan, SAMA, Venezuelan, Yugoslavian, Nigerian and Libyan operations. The Kuwaiti Government was reluctant, in part because they still preferred to do an issue in Kuwaiti Dinars, and in part because their foreign exchange reserves were primarily held in short term liquid instruments -- particularly bank deposits or short term government paper. We pressed the point. The Ministry of Finance expressed their interest in investing in IBRD bonds other than in Kuwaiti Dinars. In view of the rather low level of interest rates in the shorter maturities in 1976 and 1977, we suggested to the Kuwaiti Government that they consider extending their maturities through the purchase of IBRD obligations in any one of several currencies since (a) it would provide diversification of currency and (b) they could pick up yield. In respect to their inquiry for specifics, we offered specific rates, amounts and currencies and advised the Ministry of Finance "We would, of course, have no objection if you would wish that KIC be used as an intermediary provided that our total costs for the transaction do not exceed those encompassed in the terms and rates set forth above". The "rates" were virtually identical to the yields on a new issue in each of the respective currencies. The response to these offers came from KIC advising us that they were the proper intermediary for such transactions, that dealing with the Ministry of Finance "would get us nowhere" and that our offers should have been sent to KIC and not the Ministry of Finance.

We were advised by KIC and the Ministry that direct loans by the Kuwaiti Government would not be possible since direct "lending" by the Government to the World Bank would require parliamentary approval or, at present, approval by the Council of Ministers which would be quite difficult to obtain. We were advised by KIC, however, that if KIC were to act as an intermediary placements with the Kuwaiti Government could be made. Quite

recently (about six weeks ago) we were told that the Kuwaiti Government requires that its participation be in a public issue and that therefore it is appropriate to use KIC as an underwriter for Swiss franc, yen, Deutsche mark and dollar issues.

The basic issue which remains unanswered is whether the Kuwaiti Government wants, needs or can accept either (a) a publicly quoted readily marketable instrument or (b) a transferable but perhaps not so readily marketable private placement or (c) an illiquid non-marketable investment and whether (a), (b) or (c) would be equally acceptable as long as KIC was used as an intermediary and compensation for this function paid to KIC. I do not know the answer to that question. The remainder of this memorandum sets forth the different options that are open to us in each of the currencies in which Kuwait has expressed an interest.

Swiss Francs

The Swiss authorities have made it clear that all public issues and private placements must be done solely through and with Swiss financial intermediaries. The Swiss National Bank, however, has provided an exception to the general rule that if the transaction is a private placement with an OPEC member, it will permit a direct placement without a Swiss intermediary if the following conditions are met: (a) the issuer must be an international development agency, (b) the transaction is done directly between the issuer and the OPEC country without any intermediaries, (c) the bonds or notes are taken with a view to investment and not for resale or participation with others, (d) the evidence of the obligations will physically be kept in a Swiss bank, (e) the servicing of the debt is done in Switzerland through a Swiss bank. These restrictions are designed specifically to prevent the development of a Swiss franc market in these placements outside of Switzerland.^{1/} It is difficult therefore to see how we can do a Swiss Franc placement with Kuwait unless, of course, they are prepared to meet the foregoing conditions which limit transferability. (SAMA has agreed to these conditions and we have made two Swiss Franc placements directly with them. With Libya we made one placement in 1975 before the above regulations fully evolved, with the BIS being the custodian for the securities. Libya would now accept all the conditions except physical custodianship in a Swiss bank; the Swiss National Bank did not agree to such an exception and we have therefore not done any further transactions with Libya.)

^{1/} These restrictions are rigid. I personally have sought approval for private placements of this type to be done with our borrowers so that they might be held as assets only in amounts equal to their liability to IBRD in Swiss Francs to offset their exchange risk. This exception was rejected on the grounds that the owners were not OPEC governments.

Deutsche Mark

The situation with respect to Deutsche mark is somewhat different. Up to about a year ago, the Bundesbank had a requirement that all private placements and public issues in Deutsche Mark would have to be done with a German bank acting at least as a co-manager -- including private placements done with OPEC members. At that time, there were no exceptions to this requirement which clearly was designed to protect the German banking community. KIC brought to us a proposal for a placement with the Kuwaiti Government in which the Dresdner Bank and they would act as intermediaries and which would be listed in Luxembourg to satisfy Government investment criteria. At that time, I prepared a memorandum clearly opposing the transaction because I did not believe that a placement which I understood would be taken almost exclusively by the Kuwaiti Government should have any intermediary -- German or Kuwaiti. However, since KIC claimed that a considerable portion of the placement would be distributed by them and the Dresdner Bank (we did not know to whom) the issue was brought to the Board and approved although we were criticized by the Board for the use of an intermediary. The Bundesbank later changed their requirements to provide that if the placement were done by an international development institution under circumstances in which there was a single buyer, there would be no need or requirement for any intermediary. Indeed, the Bundesbank has advised Mr. Hittmair that they would not see any reason why we should incur additional cost by compensating intermediaries while dealing directly with OPEC governments. We would simply offer a yield to an OPEC member equivalent to the public market yield for a private placement of the same maturity - not the cost of a private placement in Germany, which of course includes about 30 basis points of commissions, fees, etc. Private placements may have 100-200 customers and are usually sold by several banks.

We therefore can do a direct placement in Deutsche Mark with the Kuwaiti Government. While there are no restrictions on the liquidity of the instrument, it is not likely to be easily marketable since they would be the only holder and there will be no market quotations. This is exactly what we have arranged with SAMA. Further, the Bundesbank would not object if we used KIC as a shadow intermediary, i.e. a vehicle to simply avoid what appears to be a legal restriction which inhibits the Kuwait Government from lending to us directly. There should be no compensation for that function.

Japanese Yen

We have asked the Japanese authorities whether we might issue a yen-denominated obligation to the Government of Kuwait. The matter did not even rise to the level of whether or not the KIC could or should be an intermediary. They have politely but strongly advised us that they would prefer that we do not issue yen-denominated bonds to non-residents. They severely restrict non-resident holdings in Yen. They do not wish, at this time or in the foreseeable future, to see an inflow of dollars for the purpose of permitting further speculation in Yen. To this end, they have severely restricted all non-residents from buying yen-denominated Treasury Bills, have limited the amount of domestic yen bonds which the Japanese underwriters can sell to non-residents and have restricted further "Euro-yen"

issues. SAMA on the other hand has made direct arrangements with the Bank of Japan (as have we) wherein they can prove that they have a flow of yen (oil payments?) for which they "need" yen-denominated investment alternatives. Accordingly, for the time being, yen-denominated placements with Kuwait do not appear possible.

U.S. Dollars

There are no restrictions imposed by the United States which relate to our use of KIC as an intermediary in placements directly with the Kuwaiti Government. Further, if the Kuwaiti Government wishes to have a liquid and marketable instrument, we can arrange a note placement with them in dollars with a provision that we will exchange the notes for registered or bearer bonds in a form and denomination which can be regularly sold directly into the U.S. market. This is typical for placements with insurance companies. We have provided this for Yugoslavia, Venezuela and Nigeria. We can reasonably assure liquidity since the U.S. market and indeed the Eurobond market in dollars is substantial and liquid for dollar denominated obligations. However, there is no need for an intermediary in a private placement of this sort.

General

It is possible, of course, that the Kuwaiti Government would only wish to take a portion of a full and widely distributed public issue. They simply may want KIC to act as one of the managers of our public bond issues. We have no doubt that the Kuwait Government is a buyer of Deutsche Mark, Swiss Franc and dollar public issues. We assume that they are major customers of our Swiss underwriters, our managing underwriters in Germany and our U.S. underwriters. They may feel, however, that if they are expected to take substantial blocks of a true public issue, KIC should share in the commissions.^{1/}

However, we know of no issuer in the world who has used KIC as a managing underwriter or even participatory underwriter of a public issue in the United States, Switzerland or Germany or Japan because of the possible interest of the purchase of some of those bonds by the Government of Kuwait. In each of these countries the public issue underwriting syndicate is made up exclusively of domestic investment bankers or domestic commercial banks. In this sense Mr. El Naggar is quite right. Each country does protect its

^{1/} We have had experience with this in the past with SAMA. In 1968 and 1969, we increased the size of our U.S. public issue to accommodate SAMA which had a rather substantial order. Since the buyer was a government and the order directly arranged by us, the underwriters did not receive a management, underwriting or selling fee for that part of the issue.

financial intermediaries. It also regulates them and controls their activities. Only in the "Eurobond" market are syndicates managed and composed of financial intermediaries from different countries and often syndicates are made up of financial institutions who have "relationships" with some of the potential large buyers. Of course these firms do not have the capital or expertise to underwrite a large issue. They merely "take down" interest they can place. Much more typical in the Eurobond market however is to give a portion of the spread (the "selling commission") directly to any official government buyer (SAMA). It is always asked for and always given, for the benefit of the buyer, for public issues in the Eurobond market. Nonetheless if the World Bank were to do a Eurobond dollar or DM issue we would include KIC (and about 8-10 other large mid-East banks), in the underwriting syndicate. In DM a "Eurobond" issue (which differs from a "domestic" DM issue only in the place of listing and the make-up of the syndicate) would completely overlap our DM "domestic" public issues since these are already widely sold to non-residents including those in the mid-East. It would be most unwise to try to change our German syndicate for the purpose of accommodating one non-resident buyer.

To sum up, we simply do not know at this point whether the Kuwaiti Government's "requirement" for a "public" issue is to support the use of KIC as an underwriter in name (even though the government might be the sole or almost exclusive owner of the obligations) or whether as a matter of "law" they cannot hold illiquid paper. If they need liquidity, we probably can arrange it in dollars and possibly in Deutsche Mark and Swiss Francs -- without the use of any intermediary by adding it on (as we did for SAMA) to a domestic public issue. For dollars and Deutsche Mark we can also provide a non-listed, but transferable marketable piece of paper. It is very hard for us to believe that the Government of Kuwait makes all dollar, Deutsche Mark or Swiss Franc investments of its financial surpluses either only after approval of each specific transaction by the Council of Ministers or from public issues managed by KIC.

January 12, 1978

INTERNATIONAL BOND ISSUES IN KUWAIT

I. Total International KD bond issues 1974 - 1977

<u>Calendar Year</u>	<u>In US\$ million equivalent</u>
1974	51.4
1975	164.8
1976	263.5
1977	125.4

(Sources: IBRD "Borrowing in International Capital Markets" updated for 1977 from information by news services)

For comparison our presence in the KD market prior to the oil price increase was as follows:

1968	42.0
1971	84.0
1972	101.6
1973	160.4

January 12, 1978

II. International KD bond issues in calendar 1977

<u>Country and Issuer</u>	<u>Date of Issue</u>	<u>Amount (in KD mill.)</u>	<u>Final Maturity (in yrs.)</u>	<u>Yield (in %)</u>	<u>Underwriters (Lead and Co-Managers)</u>
1. Poland, Bank Handlowy	3/77	4.0	10	8.96	KIIC, Union des Banques Arabes et Francaises (UBAF), Loeb Rhoades
2. Philippines, Republic of	4/77	5.0	6	8.91	KIIC, Merrill Lynch, Arab Malaysian Dev. Bank, Bancom Int. Ltd., Libyan Arab Foreign Bank, Manufacturers Hanover Ltd.
3. African Development Bank	5/77	(A) 2.0 (B) 3.0	10 10	8.57* 8.32*	KIIC, UBAF, Banque Intercontinentale Arabe, Arab African Bank, First Boston
*) Yields are computed to final maturity. Tranche A has sinking fund, Tranche B purchase fund provision of which details are not known to us but which would tend to shorten the average life of the issues. Tranche B can be redeemed at par after 6 years.					
4. Spain, Autopista Vasco-Aragonesa	11/77	5.0	10 (Redeemable after 6 years)	8.57	KIC, Merrill Lynch
5. Mexico, PEMEX	12/77	7.0	10 (Redeemable after 5 years)	8.32	KIC, Banque Arabe Internationale d' Investissements, Citicorporation
6. Yugoslavia, Yugobanka	12/77	5.0	6	8.62	KIC, Loeb Rhoades, Schroder
7. Panama, Republic of	1/1/78	5.0	10	8.85	UBAF, KFTC; Arab Investment Co., Credit Lyonnais, First Boston, Schroder, National Bank of Kuwait, Kuwait Financial Centre, Hambros
	Total	36.0			
		(\$125.4 million equivalent)			

Sources: IBRD "Borrowing in International Capital Markets" and information from news services; such information is often not complete and accurate in details and would require further inquiries and confirmation.

Coupons are assumed to be payable annually as is customary in the international market and yields stated are calculated as semi-annual equivalents.

January 4, 1978

Determinants of Exchange Rate of Kuwaiti Dinar

1. This note responds to your request to Mr. Benjenk to prepare an analysis of factors entering into the determination of the exchange rate of the Kuwaiti Dinar (KD). The principal concern regarding the exchange rate of the KD arises from the fact that it is administratively determined and could be subject to major revaluations in terms of the US dollar. The analysis below shows that the KD has in fact appreciated by 25 percent against the US dollar since 1970.^{1/} The appreciation in the value of the KD has, however, been much less than that of major currencies such as the Swiss franc (SwF), the Deutschemark (DM) and the Japanese Yen (¥). Since 1975, the Kuwaiti authorities have chosen to link the value of the KD to a basket of currencies of Kuwait's major trading partners. Such a link has two important implications: first, there is a market-determined link for the exchange rate of the KD, and its value is therefore not purely administratively determined; secondly, linking the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The evidence shows that since 1975 the KD rate in terms of the US\$ has fluctuated within a very narrow margin, and has exhibited remarkable stability in comparison with the values of major currencies such as the Swiss franc, the Deutschemark, and the Japanese Yen. It seems, from the analysis below, that maintenance of relative stability in the value of the KD (that is, determination of its value in terms of a basket of currencies) is determined by certain basic characteristics of the Kuwaiti economy and is also consistent with the major economic objectives of the Kuwaiti authorities.

2. The future course of the value of the KD will be determined both by political and economic factors. It is conceivable that in order to demonstrate the "strength" of the KD, the Kuwaiti authorities might resort to a major revaluation in terms of the US\$. This course of action, while in the realm of possibility would both be inconsistent with behavior so far and with the country's best economic interests. As a second course of action, it is possible that in the face of the slide in the value of the US\$, consideration might be given to lowering the weight of the US\$ in the basket. Such an action cannot be taken by the Central Bank alone, but rather requires a Cabinet-level decision. To the extent that the slide in the value of the US\$ is considered to be a "temporary" phenomenon, a political decision of this sort is in principle unlikely. Even in the unlikely event that a government decision is taken, it could be reasonably expected that the weight of the US\$ in the basket would be reduced by less than 5%, thus implying only a slightly greater appreciation in the value of the KD in terms of the US\$. The most likely impact of the decrease in the value of the US\$ is that Kuwait would use the "cheaper" US\$'s it earns from its oil exports to buy real assets in the US (rather than in, say, Germany where the real value of the US\$ is lower). On balance, therefore, it seems that the basic characteristics of the Kuwait economy and the economic

^{1/} An appreciation of similar magnitude to that of the Saudi rial.

objectives of the government tend to the conclusion that a continuation of the link between the value of the KD and the values of the currencies of Kuwait's major trading partners would be the appropriate, and likely, course of action for the Kuwaiti authorities. This would imply continuing relative stability in the value of the KD in terms of the US\$. We have discussed the above views with members of the Fund mission who were in Kuwait in April 1977, and they concur with them.

3. The rest of this note discusses developments in the exchange rate of the KD since 1970 and notes special characteristics of the Kuwaiti economy. It then proceeds to analyze the impact of exchange rate changes on the balance of payments; on the budget and national savings; on income distribution; on domestic inflation; and finally on the achievement of certain economic objectives specified by the Kuwaiti authorities.

The Evolution of the Exchange Rate of the Kuwaiti Dinar

4. The rate of the Kuwaiti dinar remained unchanged at SDR2.80 per KD1 following both the general realignment of currencies in 1971 and following the second devaluation of the US dollar in February 1973. Beginning March 1975, Kuwait has maintained the exchange rate of the dinar on the basis of its value in terms of a weighted average of currencies; the composition of the currency basket has not been announced. The Fund staff, however, on the basis of an analysis undertaken in October 1976 concluded that the US dollar had a weight of 74 percent in the basket, in which the currencies of Kuwait's other major trading partners (Germany, Japan, France, and the U.K.) were also represented.^{1/} The link of the value of the KD to a basket of currencies has two important implications: first, there is a market-determined link for the exchange rate of the KD and its value is, therefore, not purely administratively determined; secondly, linking the value of the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The sole administratively-determined element is the choice of weights attached to individual currencies in the basket. In Kuwait, however, changes in the weights require Cabinet-level decisions, rather than action solely by the Central Bank, and would thus be likely to be undertaken only if there were fundamental changes in the economic and political environment. The Kuwaiti dinar was worth US\$3.51 in October 1977. The 25 percent appreciation of the dinar vis-a-vis the US dollar since 1970 reflects largely the depreciation of the US dollar against the SDR (17 percent as of October 1977); the remainder being accounted for by the depreciation of the SDR in relation to its original value. The KD rate in terms of the US\$ has fluctuated within a very narrow margin since 1975, and the KD has exhibited remarkable stability in comparison with other major currencies whose values are determined by market forces. For example, since 1970, in terms of the US dollar, the SwF has appreciated by 89 percent, the DM by 60 percent and the ¥ by 40 percent.

^{1/} There seem to be differences of opinion regarding both the composition of the basket and the weight of the US dollar in it (see Attachment).

Characteristics of the Kuwaiti Economy

5. Special characteristics of Kuwait's economy have determined the role which exchange rate changes could play, and also explain, in substantial degree, why the value of the KD has been kept relatively stable. According to the best available statistics (relating to the years 1974 to 1976), oil accounted for 68 percent of GDP, 93 percent of export earnings and 87 percent of budgetary revenues (investment income accounted for 10 percent of budgetary revenues in 1975/76). Oil prices are quoted in US dollars and payments are made in dollars and sterling at the prevailing dollar rate. The balance of payments has been in continuing surplus for a number of years, and foreign exchange reserves, according to the best available information, are estimated to have been \$18 billion at the end of 1976, or about five years' imports at the 1976 level and this despite the fact that imports in 1976 were more than three times their level in 1973. Budgetary surpluses have been well in excess of KD1,000 million in each of the past four Kuwaiti financial years. Given the openness of the economy, the dominance of oil and the particular arrangements surrounding the pricing of oil, the Kuwaiti dinar is for the domestic economy then nothing more than a numeraire whose value is essentially determined by external considerations. Finally, according to the 1975 census, Kuwaiti citizens represented only 47 percent of the total population of Kuwait which was estimated to be 995,000 persons.

Effects of Revaluation on Balance of Payments

6. In a "traditional" economy, a major revaluation of the currency has its primary and major impact on the economy through the balance of payment -- exports become more expensive in terms of the foreign currency and imports cheaper in terms of the domestic currency and capital flows might also be affected. In the case of Kuwait, a major revaluation in terms of the US dollar would have only a minimal impact on export earnings. Oil earnings constitute about 93 percent of export earnings and an additional 4 percent consists of re-export trade. A change in the exchange rate will leave both completely unaffected, the former since it is denominated in foreign exchange in any case, and the latter because local value added will be minimal. Thus, only 3 percent of Kuwait's exports might be affected by changes in the exchange rate and of these 2 percent consist of chemical fertilizers whose price is closely linked to that of oil. Imports, on the other hand, would become cheaper in terms of Kuwaiti dinars. But, the impact of this relative decline in prices on demand is considerably weakened by the fact that a revaluation results in a decline in income expressed in Kuwaiti dinars for the economy as a whole, since it reduces the value of export earnings in terms of Kuwaiti dinars (even though the value of exports in terms of foreign exchange remains unchanged). Given the limited non-oil productive base of the economy, these two kinds of effects would be partly off-setting, so that the stimulus to additional imports would be relatively smaller. An additional effect of a revaluation would be to benefit the sizable non-citizen population of Kuwait, part of whose income is spent abroad, by increasing the foreign exchange value of their earnings. It is uncertain,

on the basis of available evidence, as to whether or not workers' remittances would increase as a result. Thus, changes in the exchange rate would not, on balance, have a major effect on Kuwait's balance of payments.

Effects of Revaluation on the Budget and on Savings Rate

7. However, a change in the exchange rate does have a major impact on the economy stemming from a peculiar institutional feature of Kuwait, namely that the state is the major recipient of foreign exchange while the private sector is the major user of imported goods. Oil revenues go directly to the budget, and along with investment income, all of which are denominated in foreign exchange, constitute 97 percent of budgetary revenues. A major revaluation would reduce budgetary revenues (denominated in dinars) by a proportional amount. Assuming no change in government expenditures, this would reduce the budget surplus. On the other hand, the private sector would benefit as a result of a decline in the dinar price of imports. Thus the principal impact of a revaluation is to re-distribute purchasing power ("real income") from the public sector to the private sector, including the large non-citizen population (who, as discussed in para. 9 below, have so far not been targetted as beneficiaries of social welfare policies initiated by the Kuwaiti authorities). To the extent that the private sector has a higher consumption ratio than the government, the national savings rate would decline.

8. It is true that, on the surface, the decline in the budget surplus and in the savings ratio might not seem to be causes for concern since budget surpluses have, as noted earlier, been large in recent years, as have concomitantly been the national savings ratio (gross national savings have increased as a proportion of GNP from 47 percent in 1970/71 to 77 percent in 1975/76). However, the levels of the budgetary surplus and the savings ratio although they seem high, cannot be directly compared with those in other countries. Oil is a depletable resource, and the income derived from its sale represents the running down of a capital asset. The high savings rate is an attempt in part to compensate, through the purchase of alternative assets, for presently depreciating this natural resource. The Kuwaiti authorities have given explicit recognition to this factor through the establishment of a "Reserve Fund for Future Generations" to which, *inter alia*, are credited annually 10 percent of total government receipts as well as the income accruing from the investment of financial resources accumulated in this reserve fund. Thus, it seems unlikely that the Kuwaiti authorities would wish to reduce the savings rate. Furthermore, even in the unlikely event that the Government might seek to reduce the overall savings ratio, because exchange rate changes would principally benefit the expatriate population, these would not be the preferred policy tool.

Effects of Revaluation on Domestic Inflation

9. In an economy, such as that of Kuwait, where the bulk of consumer and investment goods have to be imported, a revaluation of the KD would serve to neutralize the effects of international inflation on the domestic economy. On the basis of the cost of living and wholesale price indices, the rate of increase in prices has been tapering off since 1974. The cost

of living index indicated that prices increased by less than 5 percent in 1976 (the wholesale price index increased by less than 7 percent in the same year). These indices, however, tend to underestimate the actual rate of price increase which was probably in excess of 15 percent in 1976. The tapering off of inflationary pressures has reflected the slowdown in the rise of international prices, and the continuing valuation of the KD in terms of a basket of currencies has served to minimize the deviations between the domestic and international rates of inflation. The fact that inflation rates in Kuwait have been so much in excess of international inflation rates is the result not of an inappropriate exchange rate, but rather of the sharp rise in aggregate demand which has strained available physical capacities (particularly of the ports) and been much in excess of supply availabilities, and has concomitantly put upward pressure on prices and wages and on costs of goods. The impact of the inflationary pressures on consumers have been mitigated by either government direct subsidies (as for food items) or welfare programs (such as free education, health care and housing subsidies for low income groups). The bulk of these forms of assistance, however, was largely reserved for Kuwaiti citizens. The Fund staff in its recent discussions in Kuwait urged the adoption of monetary and fiscal measures to reduce inflationary pressures, but in this context made no reference to exchange rate adjustments, because domestic demand and cost factors seemed to be predominant in explaining inflationary pressures.

Revaluation and Other Considerations

10. There are three additional factors that might have worked against a major revaluation. First, it is well known that Kuwait would like to establish itself as an international financial center. To date, no first-class corporate borrower has yet used the Kuwaiti dinar market. This seems to have been due to a combination of fears of possible revaluations and ignorance of the nature of that market (see Attachment). Obviously, a major revaluation would, in such an environment, significantly retard the possibilities of the establishment of Kuwait as an international financial center. Second, Kuwait is attempting to diversify its productive base through the establishment of capital-intensive industries based on its natural resources. There would be a concern under such circumstances that too radical revaluations, which might be justified by oil revenues, might result in the new industries losing their international competitiveness. Finally, an additional consideration may be the affect on the debt service payments of Arab countries that have in recent years borrowed from Kuwait, notably through the Kuwait Fund for Arab Economic Development (KFAED). A revaluation would increase pari passu their debt servicing, a fact that may be considered to be undesirable by Kuwaiti authorities.

Concluding Remarks

11. The KD has appreciated by 25% against the US dollar since 1970 (a level of appreciation similar to that of the Saudi rial). The appreciation in the value of the KD has, however, been much less than that of major currencies such as the Swiss franc, the Deutschmark and the Japanese Yen. Since 1975, the Kuwaiti authorities have chosen to link the value of the KD to a basket of currencies of Kuwait's major trading partners. Such a link

has two important implications: first, there is a market-determined link for the exchange rate of the KD, and its value is therefore not purely administratively-determined; secondly, linking the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The evidence shows that since 1975 the rate of the KD in terms of the US\$ has fluctuated within a very narrow margin and has exhibited remarkable stability in comparison with the major currencies (SwF, DM, and Y). It seems that maintenance of relative stability of the value of the KD is determined by certain basic characteristics of the Kuwait economy. Balance of payment, budgetary, and income distribution considerations would all have argued in the past against major revaluations of the Kuwaiti dinar in terms of the US dollar. In addition, so would have the achievement of the Kuwaiti objectives of the establishment of the country as an international financial center, the diversification of its productive base, and the impact on the LDCs that have borrowed from Kuwait.

12. The future course of the value of the KD will be determined both by political and economic factors. It is conceivable that in order to demonstrate the "strength" of the KD, resort might be had to a major revaluation in terms of the US dollar. Such a course of action would be inconsistent with past behavior and not in the country's best economic interests, and is, therefore, unlikely. It is possible that the slide in the value of the US\$ might provoke a change in its weight in the basket. To the extent that the decline in the value of the US\$ is considered to be "temporary", it is unlikely, in principle, that a Cabinet-level decision which would be required in Kuwait to effectuate such a change, would be taken. Even in the unlikely event that a Government decision is taken, the probable change in the weight of the US\$ is likely to be less than 5%, thus implying only a slightly greater appreciation in the value of the KD in terms of the US\$. The most likely impact of the decline in the value of the US\$ would be to increase the relative attractiveness of real assets available in the US market. On balance, therefore, it seems that the basic characteristics of the Kuwait economy and the objectives of the government tend to the conclusion that a continuation of the link between the value of the KD and the values of the currencies of Kuwait's major trading partners would be the appropriate, and likely, course of action for the Kuwaiti authorities. This would imply continuing relative stability in the value of the KD in terms of the US\$. We have discussed these views with members of a recent Fund mission to Kuwait and they concur with them.

KUWAIT

John Whelan

Sharp rise foreseen for local money market business

Fears of a revaluation and ignorance of the market are two reasons why no first-class borrower has drawn on the KD market, but if the local money market develops as forecast international interest should increase.

Kuwaiti investors will get the chance to subscribe to three new funds in the next six to nine months, which could leave the domestic market with the task of absorbing up to KD 650 million (\$ 2,280 million). This was the projection given at a London conference last week by William Hahn, senior securities trader of the Arab Company for Trading Securities (ACTS). He thought this would strengthen the hand of the Central Bank in taking new powers. A decree has been passed to give it new powers (MEED 18:11:77), but this has yet to be implemented for political reasons.

Hahn said the funding had already affected one-week deposit rates by ½ per cent and had raised questions about just how the market was going to absorb the large amount of investment. The powers now being considered for the Central Bank would authorise it to issue negotiable bonds to be used on the open market.

The fear of a possible revaluation of the Kuwaiti dinar was acknowledged by Hahn and other speakers at the conference on "Opportunities for Financial Services in the Gulf" as being a reason why no first-class corporate borrower has yet used the Kuwaiti dinar market. Hahn said another reason was ignorance of the market among such borrowers and this he partly blamed on Kuwaiti investment companies.

Hahn's company, owned by the Kuwait International Investment Company and the Industrial Bank of Kuwait (IBK), believes it has now successfully established an active short and medium-term money market in Kuwait. He said response had been excellent to the

offering of KD 9 million (\$ 31.5 million) certificates of deposit in October (MEED 18:11:77; 4:11:77), which was the first by a Kuwaiti bank. Hahn said: "The maturities were ideal because they bridged the gap nicely between the regular deposit market and the longer-term bond market." Almost immediately after the rescheduled offering, postponed from August because of technical problems, the Gulf Bank and the IBK announced that on a daily basis that they would start issuing certificates with a longer maturity, to three years. The initial offering was in the three to 11-month maturity range. "Almost overnight, the basis for an active short and medium-term money market had been established in Kuwait," Hahn said.

He argued that the Kuwaiti dinar bond market had been saturated before ACTS was set up and created a secondary market for these bonds. Banks had been legally empowered and willing to issue certificates of deposit, but could not do so due to the lack of a company willing to create the secondary market. Now even 10 or 12-year issues were being contemplated, with coupons as low as 8½ per cent for the right borrowers.

Hahn's optimism about the Kuwaiti financial market owed something to his conviction that the Central Bank would move soon to issue some form of treasury bill or certificate of deposit which would qualify as a liquid asset for the commercial banks. He also thought that there would be a huge expansion in the Kuwaiti dinar certificate of deposit market, both at the short and in the intermediate end. He predicted KD 100 million (\$ 350

million) in certificates of deposit outstanding early next year.

An increasing demand by local companies for financing in Kuwait has also been noticed by ACTS. A start had been made on Kuwaiti dinar denominated longer-term fixed rate financing for both private sector and mixed sector companies. The present legal restriction on lending in Kuwaiti dinars for periods of more than a year at rates exceeding 10 per cent was, Hahn acknowledged, an obstacle to term lending in Kuwait.

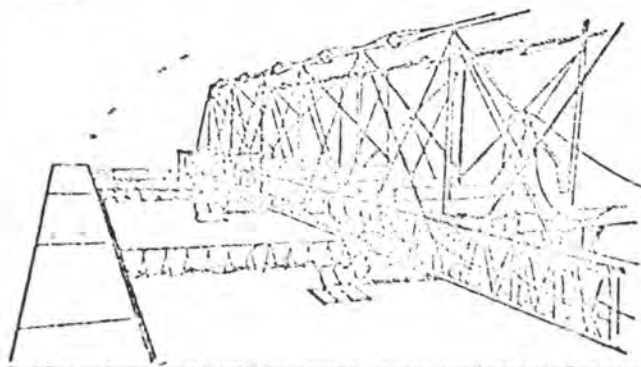
Other contributors at the conference, arranged by Investment Property Studies of the UK, saw this as inhibiting. It was difficult to predict where interest rates would be in four to five years. Kuwaiti dinar interest rates looked cheaper than those for borrowings in major currencies, but the future was more difficult to judge. Hahn agreed that it was difficult to ascertain the value of the Kuwaiti dinar at any one time, but the dollar accounts for 28 to 30 per cent of the SDR basket of 12 currencies, on which the parity of the Kuwaiti dinar was based, and, in Hahn's view, the basket was moving "very much in line with the dollar."

If this confidence can be justified, one early sign could be a revival of new issue activity in the international Kuwaiti dinar bond market. This development can be expected if interest rates on US dollar-denominated issues continue to rise. In that case it would not be surprising to see more of the traditional Euromarket borrowers taking a closer look at the Kuwaiti market as an alternative source of finance.

MEED



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KUWAIT

Technical Assistance

1. The Government has made several requests to the Bank for technical assistance, which the Bank has willingly provided. These are summarized below.
2. In early 1971, the Kuwaiti Government requested the Bank's technical assistance in studying the strategy and policies for industrial development in Kuwait and recommending the institutional framework necessary for this purpose. The Bank responded by sending a five-man mission to Kuwait in May/June 1971, where the original request was somewhat amended by the Government to one for the review of prospects of promoting small- and medium-scale manufacturing activities and the desirability of setting up an industrial development bank for this purpose. The mission's report entitled "The Promotion of Manufacturing in Kuwait" was sent to the Government in December 1971. The mission's basic recommendations were that the growth of small- and medium-scale enterprises could be fostered better through the provision of technical and advisory services rather than by lending, and that such services could be provided initially by a development bank which could be established and which after an initial three to four year period, could also begin to perform development financing activities in Kuwait. The report also recommended that such a development bank should not be conceived as a new, specialized outlet for government funds, but as a private institution with autonomy for its own investment decisions.
3. In early 1974, following the establishment of the Industrial Bank of Kuwait (IBK), Mr. Mohammed Alsharekh, then an Alternate Executive Director in the World Bank and who had been designated as IBK's Chairman, requested Bank help in making a census of existing industrial units and enterprises in Kuwait, so as to enable IBK to have an idea of the business opportunities that it could tap, and to also make an industrial development review in the country. Mr. Alsharekh's request was later supported, in principle, by the Government of Kuwait. Since the Bank had already reviewed in 1971 (as mentioned above) the prospects of promotion of manufacturing in Kuwait and a census of existing industrial enterprises was being regularly maintained by the Government, Mr. Alsharekh then requested the Bank to send experts who, along with other consultants that IBK had engaged, could identify specific business opportunities in Kuwait, which IBK could consider in future. The Bank sent a two-man team, whose expenses were paid by IBK, in May 1974. They, along with other IBK consultants, produced a report in August 1974 on "Manufacturing in Kuwait and the Prospective Role of IBK". This should provide a good basis for IBK to commence its operations.
4. Later in 1974, IBK organized a panel of experts to recommend an industrial development strategy for Kuwait and requested Mr. Walstedt (of the Industrial Projects Department), in his personal capacity, to join the panel. The Bank made his services available for about three weeks in January 1975.

5. The Bank's Personnel Department responded in January 1975 to Mr. Alsharekh's request, by sending one of its staff members (Mr. Trott) to advise IBK on questions of personnel policy. Also, since November 1974, a Senior Investment Officer in IFC (Mr. Toutounji) was released on leave of absence without pay to work for IBK initially for a period of two years, subsequently extended for further two years. More recently, IBK has requested Bank assistance in the form of a mission which would identify jointly with IBK potential investment prospects in the petrochemical and chemical subsectors. A mission (Mr. Pratt) briefly visited Kuwait in March 1976 to discuss the request but was unable to define the task sufficiently to permit any follow-up. Further, IBK requested the Bank's assistance in the recruitment of a Petrochemical Manager, 6 candidates confirmed their interest and their curricula vitae have been submitted to IBK.

6. During your visit in May 1976, Crown Prince cum Prime Minister Sheikh Al Jabir stated his concern about the present structure of Government subsidies in Kuwait and the Minister of Finance requested a review of the prevailing subsidies by Bank staff. A senior economist (Mr. Maiss) visited Kuwait early June for discussions with the authorities concerned to define the task. His findings were confirmed in a letter to the Government of June 14, 1976, proposing a mission of about 2 weeks at the end of October (i.e. after Ramadan) and suggesting that the mission will (i) focus on subsidies for food stuffs, construction materials, water and electricity; (ii) study their financial and economic costs and the efficiency of existing subsidy arrangements to achieve Government objectives; and (iii) identify any undesirable side effects on resource allocation. The Government indicated its agreement to these arrangements. A four-person mission visited Kuwait in October/November 1976 and a draft report entitled "Review of Subsidies for Foodstuffs, Construction Material, Electricity and Water in Kuwait" was sent to the Government in January 1977.

EM1DA
December 1977

KUWAIT FUND FOR ARAB ECONOMIC DEVELOPMENT

Cofinancing

1. You could express satisfaction over the continued good relations ^{1/} between the Kuwait Fund and the Bank Group and the close cooperation in cofinanced projects (Annex I). In FY77, the Kuwait Fund approved loans of \$119.7 million equivalent for seven Bank Group projects. Bank Group lending for these projects amounted to \$164.6 million. This is about the same level as in FY76 when the Kuwait Fund provided \$118.3 million in cofinancing for ten Bank Group projects for which the Bank/IDA contribution was \$152.8 million. Up to the end of FY77 the Kuwait Fund had provided a total of about \$445 million equivalent in cofinancing, complementing about \$578 million of Bank/IDA financing for 34 Bank Group projects.
2. As in the previous fiscal year, a notable feature of joint Bank Group/ Kuwait Fund operations during FY77 continued to be the increased financing of projects outside the Arab World. Such financing absorbed in FY77 over half of total co-lending by the Kuwait Fund for Bank Group projects.
3. You could mention that in view of the increasing needs of developing countries and of the limitations of the Bank Group's program, cofinancing with the Kuwait Fund was expected to remain an important feature of many of our projects. You could express the hope that the Kuwait Fund would continue to use the Bank projects as a vehicle for the transfer of its resources. You may further welcome that the Fund during the past two years assumed an increasingly active role in identification and formulation of joint projects. You could also express hope and optimism that the FY78 program of prospective cofinancing with the Kuwait Fund will materialize.

Technical Assistance

4. It is unlikely that any major requests for Bank technical assistance to the Kuwait Fund would be made. However, should the Government come forward with any such requests during your visit, you may want to reassure them of the Bank's willingness to do its best to assist the Fund to the greatest possible extent within the limits of our expertise and competence. Annex II summarizes Bank technical assistance to the Kuwait Fund to-date.

^{1/} As you know, Mr. Al-Hamad, Director General of the Kuwait Fund, was in the Bank early December for constructive and useful discussions with the Regions. At that occasion, you had lunch with him on December 1. You also met Mr. Al-Hamad during the Annual Meetings (Mr. El-Fishawy's memo on your discussions is in Annex III).

PAST COFINANCING OPERATIONS BETWEEN BANK GROUP AND
 KUWAIT FUND FOR ARAB ECONOMIC DEVELOPMENT
 (in US\$ million equivalent)

The Kuwait Fund for Arab Economic Development (KFAED) serves as the country's main channel of official development assistance. Although it has its own bilateral aid agreements, the Fund has found it fruitful to enter into cofinancing activity with the World Bank Group. The following is a listing of projects financed under such arrangements:

<u>Country/Project</u>	<u>FY</u>	<u>US\$ million equivalent</u>		
		<u>IBRD</u>	<u>IDA</u>	<u>KFAED</u>
<u>Burundi</u>				
Burundi Coffee Improvement II	76		5.2	1.2
<u>Congo</u>				
Railways II	76	38.0		13.6
<u>Cyprus</u>				
Highways II	77	13.6		3.8
<u>Egypt</u>				
Talkha II Fertilizer	74		20.0	23.8
Suez Canal Rehabilitation	75	50.0		34.5
<u>Ghana</u>				
Kpong Hyrdroelectric	77	39.0		30.5
<u>Jordan</u>				
Hussein Thermal Power	73		10.2	10.2
<u>Mauritania</u>				
Highways III	75		3.0	3.8
Nouadhibou Port	76		8.0	8.3
<u>Morocco</u>				
Sidi Cheho - Al Massira Hydro	76	49.0		41.2
<u>Nepal</u>				
Kulekhani Hydroelectric	76		26.0	15.9
<u>Pakistan</u>				
Tenth Railway	77	35.0	25.0	25.0
<u>Somalia</u>				
Drought Rehabilitation	76		8.0	21.0
<u>Sudan</u>				
Rahad Irrigation	73		42.0	11.0
	75		20.0	39.0
Technical Assistance	76		4.0	3.0

<u>Country/Project</u>	<u>FY</u>	<u>US\$ million equivalent</u>		
		<u>IBRD</u>	<u>IDA</u>	<u>KFAED</u>
<u>Sudan</u>				
Fourth Railways	77	12.0	8.0	17.4
<u>Syria</u>				
Mehardeh Thermal Power	74	25.0		18.0
	74			15.0
	75	8.6		
<u>Senegal</u>				
Eastern Senegal Livestock	76		4.2	4.1
<u>Tanzania</u>				
Mwanza Textile	75	15.0		15.0
<u>Tunisia</u>				
Gas Pipeline	71	7.5		2.5
Gafsa Phosphate	73	23.3		0.9
Fourth Water Supply	77	21.0		23.4
<u>YAR</u>				
Tihama Agriculture	73		10.9	6.4
Tihama Agriculture Supplement	76		10.3	9.6
Technical Assistance for Economic Planning	72	0.2		0.2
	74	0.2		0.3
	76	0.1		0.4
Highways II	75		9.0	5.0
Livestock and Processing	77		5.0	11.6
Port Development	77		6.0	8.0
<u>PDRY</u>				
Highways II	75		15.5	15.3
TOTAL		337.5	240.3	444.9
		=====	=====	=====

FY TOTALS

	<u>FY71</u>	<u>FY72</u>	<u>FY73</u>	<u>FY74</u>	<u>FY75</u>	<u>FY76</u>	<u>FY77</u>	<u>TOTAL</u>
IBRD/IDA	7.5	0.2	86.4	45.2	121.1	152.8	164.6	577.8
KFAED	2.5	0.2	34.5	57.1	112.6	118.3	119.7	444.9
No. Operations	1	1	4	4	7	10	7	34

EMIDA
December 1977

Technical Assistance to
Kuwait Fund for Arab Economic Development

1. A member of the Bank's Legal Department (Mr. Saad El-Fishawy) was seconded to the Kuwait Fund from May 1963 to September 1966 when the Kuwait Fund started its operations. He assisted the Kuwait Fund at this initial stage in legal and operational matters. More recently, another member of the Bank's Legal Department (Mr. Frank A. Mwine) has been given initially a two-month leave of absence without pay from mid-January to mid-March 1975 and later a one-year leave of absence without pay from June 1976 to June 1977, to work on legal matters for the Kuwait Fund. During the last year, the Kuwait Fund asked on two occasions the Bank's advice on specialized consulting firms in the fisheries and food processing sectors. Further cooperation with the Fund since then has taken place through joint appraisal for projects cofinanced by the Kuwait Fund and the Bank Group.

2. Despite the considerable progress the Kuwait Fund has made in lending, it still has a small staff in relation to its commitment authority and to the increasing number of projects under supervision. The staff constraint on the Fund operations will continue to be particularly acute over the coming years and it may ask for further operational assistance from the Bank.

3. The Kuwaiti Government and the Kuwait Fund are fully aware that the Bank is willing to respond to requests for technical assistance in any key sector, if and when required. However, in the last five years, the Bank has received only few requests for technical assistance. In the case of the Kuwait Fund, being both the oldest and the largest of the Arab development agencies, we have lately sensed a certain desire for leadership and independence. In these circumstances, it is difficult to anticipate if and when requests may be made. In any event, in view of Kuwait's special relationship with the Bank Group, we should be ready to respond expeditiously to future requests for technical assistance within the sphere of our institution's expertise and competence. At present we do not expect technical assistance requests of more than a one man-year per year from the Government and its agencies, including the Kuwait Fund. This level of assistance on a non-reimbursable basis was recommended in the SCPP of February 15, 1977.

OFFICE MEMORANDUM

ANNEX III

TO: For the Record

DATE: May 17, 1977

FROM: Saad S. El Fishawy

*Saad El Fishawy*SUBJECT: KUWAIT: Mr. McNamara's Meeting with Mr. Al-Hamad

The meeting took place on April 29, 1977 in Mr. McNamara's office.

Present were Messrs. Al-Sayer (Deputy Director of the Kuwait Fund), Al-Khoja (Kuwait Fund Operations), Benjenk, Burmester and myself.

Al-Hamad said that he wanted to discuss three subjects:

(1) Egypt

There was a consensus that the importance of solving the economic problems of Egypt could not be overemphasized. Sadat's political life almost literally depended on it. Although in the field of international foreign relations, the Egyptian Government was doing a very good job and taking courageous steps forward, the same unfortunately could not be said of the government performance in the economic field. In the past, Sadat had been lending attention to the former, but not to the latter. It was now hoped that he would concentrate on the economic problems and give them his personal attention. The economy was terribly mismanaged and the bureaucracies probably the worst the Bank had encountered in any country. As a result, the waste of talent and resources was prodigious.

Al-Hamad said that he would like to propose for the Bank's sympathetic consideration establishing a Bank office in Egypt along the same lines it did in Indonesia. McNamara said that there were three prerequisite conditions for such an office to be effective: (1) the Egyptian Government should realize the need for it and request it, (2) the Bank's man there should be ensured direct access to the highest levels responsible in Egypt for making decisions in the economic field, and (3) he should be of the highest caliber.

Al-Hamad agreed and said he did not expect a "yes" or "no" answer at this point, but he hoped that should the Egyptian Government make such a request, the Bank would consider it sympathetically.

(2) Lebanon

Al-Hamad said that he had the highest regard for the present team in the government, i.e. the President and the Prime Minister. Their presence represented a great opportunity for those who wished to help Lebanon. Kuwait was lending its financial support for the reconstruction efforts. McNamara said that the Bank shared the same views. One of the signs of financial responsibility of the present government was that Lebanon kept on paying its debts, even during its worst periods of fighting. In the coming six weeks, a loan for reconstruction of about \$45 million would be presented to the Executive Directors.

(3) Mauritania

Al-Hamad said that now that the iron-ore being presently mined was running out, there was a danger of substantial infrastructure lay-outs (railways and ports) becoming idle or underutilized. Also, an important part of the labor force would be laid off and become unemployed. The possibility of exploiting secondary mines of lesser ore content should be explored. The exploitation of such marginal mines would require huge capital investments (probably two phases of \$1/2 billion each), but these developments would be vital for the country. Mr. McNamara inquired about the economic rate of return on such a project and a figure of 11% was mentioned. This was considered too low. If it were to be more promising, it would have to be assessed in the context of its order of priority among other feasible projects in the country.

SElFishawy/rh

cc: Messrs. McNamara (2)
Knapp
Cargill
Benjenk

F

January 4, 1978

Determinants of Exchange Rate of Kuwaiti Dinar

1. This note responds to your request to Mr. Benjenk to prepare an analysis of factors entering into the determination of the exchange rate of the Kuwaiti Dinar (KD). The principal concern regarding the exchange rate of the KD arises from the fact that it is administratively determined and could be subject to major revaluations in terms of the US dollar. The analysis below shows that the KD has in fact appreciated by 25 percent against the US dollar since 1970.^{1/} The appreciation in the value of the KD has, however, been much less than that of major currencies such as the Swiss franc (SwF), the Deutschemark (DM) and the Japanese Yen (¥). Since 1975, the Kuwaiti authorities have chosen to link the value of the KD to a basket of currencies of Kuwait's major trading partners. Such a link has two important implications: first, there is a market-determined link for the exchange rate of the KD, and its value is therefore not purely administratively determined; secondly, linking the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The evidence shows that since 1975 the KD rate in terms of the US\$ has fluctuated within a very narrow margin, and has exhibited remarkable stability in comparison with the values of major currencies such as the Swiss franc, the Deutschemark, and the Japanese Yen. It seems, from the analysis below, that maintenance of relative stability in the value of the KD (that is, determination of its value in terms of a basket of currencies) is determined by certain basic characteristics of the Kuwaiti economy and is also consistent with the major economic objectives of the Kuwaiti authorities.

2. The future course of the value of the KD will be determined both by political and economic factors. It is conceivable that in order to demonstrate the "strength" of the KD, the Kuwaiti authorities might resort to a major revaluation in terms of the US\$. This course of action, while in the realm of possibility would both be inconsistent with behavior so far and with the country's best economic interests. As a second course of action, it is possible that in the face of the slide in the value of the US\$, consideration might be given to lowering the weight of the US\$ in the basket. Such an action cannot be taken by the Central Bank alone, but rather requires a Cabinet-level decision. To the extent that the slide in the value of the US\$ is considered to be a "temporary" phenomenon, a political decision of this sort is in principle unlikely. Even in the unlikely event that a government decision is taken, it could be reasonably expected that the weight of the US\$ in the basket would be reduced by less than 5%, thus implying only a slightly greater appreciation in the value of the KD in terms of the US\$. The most likely impact of the decrease in the value of the US\$ is that Kuwait would use the "cheaper" US\$'s it earns from its oil exports to buy real assets in the US (rather than in, say, Germany where the real value of the US\$ is lower). On balance, therefore, it seems that the basic characteristics of the Kuwait economy and the economic

^{1/} An appreciation of similar magnitude to that of the Saudi rial.

objectives of the government tend to the conclusion that a continuation of the link between the value of the KD and the values of the currencies of Kuwait's major trading partners would be the appropriate, and likely, course of action for the Kuwaiti authorities. This would imply continuing relative stability in the value of the KD in terms of the US\$. We have discussed the above views with members of the Fund mission who were in Kuwait in April 1977, and they concur with them.

3. The rest of this note discusses developments in the exchange rate of the KD since 1970 and notes special characteristics of the Kuwaiti economy. It then proceeds to analyze the impact of exchange rate changes on the balance of payments; on the budget and national savings; on income distribution; on domestic inflation; and finally on the achievement of certain economic objectives specified by the Kuwaiti authorities.

The Evolution of the Exchange Rate of the Kuwaiti Dinar

4. The rate of the Kuwaiti dinar remained unchanged at SDR2.80 per KD1 following both the general realignment of currencies in 1971 and following the second devaluation of the US dollar in February 1973. Beginning March 1975, Kuwait has maintained the exchange rate of the dinar on the basis of its value in terms of a weighted average of currencies; the composition of the currency basket has not been announced. The Fund staff, however, on the basis of an analysis undertaken in October 1976 concluded that the US dollar had a weight of 74 percent in the basket, in which the currencies of Kuwait's other major trading partners (Germany, Japan, France, and the U.K.) were also represented.^{1/} The link of the value of the KD to a basket of currencies has two important implications: first, there is a market-determined link for the exchange rate of the KD and its value is, therefore, not purely administratively determined; secondly, linking the value of the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The sole administratively-determined element is the choice of weights attached to individual currencies in the basket. In Kuwait, however, changes in the weights require Cabinet-level decisions, rather than action solely by the Central Bank, and would thus be likely to be undertaken only if there were fundamental changes in the economic and political environment. The Kuwaiti dinar was worth US\$3.51 in October 1977. The 25 percent appreciation of the dinar vis-a-vis the US dollar since 1970 reflects largely the depreciation of the US dollar against the SDR (17 percent as of October 1977); the remainder being accounted for by the depreciation of the SDR in relation to its original value. The KD rate in terms of the US\$ has fluctuated within a very narrow margin since 1975, and the KD has exhibited remarkable stability in comparison with other major currencies whose values are determined by market forces. For example, since 1970, in terms of the US dollar, the SwF has appreciated by 89 percent, the DM by 60 percent and the ¥ by 40 percent.

^{1/} There seem to be differences of opinion regarding both the composition of the basket and the weight of the US dollar in it (see Attachment).

Characteristics of the Kuwaiti Economy

5. Special characteristics of Kuwait's economy have determined the role which exchange rate changes could play, and also explain, in substantial degree, why the value of the KD has been kept relatively stable. According to the best available statistics (relating to the years 1974 to 1976), oil accounted for 68 percent of GDP, 93 percent of export earnings and 87 percent of budgetary revenues (investment income accounted for 10 percent of budgetary revenues in 1975/76). Oil prices are quoted in US dollars and payments are made in dollars and sterling at the prevailing dollar rate. The balance of payments has been in continuing surplus for a number of years, and foreign exchange reserves, according to the best available information, are estimated to have been \$18 billion at the end of 1976, or about five years' imports at the 1976 level and this despite the fact that imports in 1976 were more than three times their level in 1973. Budgetary surpluses have been well in excess of KD1,000 million in each of the past four Kuwaiti financial years. Given the openness of the economy, the dominance of oil and the particular arrangements surrounding the pricing of oil, the Kuwaiti dinar is for the domestic economy then nothing more than a numeraire whose value is essentially determined by external considerations. Finally, according to the 1975 census, Kuwaiti citizens represented only 47 percent of the total population of Kuwait which was estimated to be 995,000 persons.

Effects of Revaluation on Balance of Payments

6. In a "traditional" economy, a major revaluation of the currency has its primary and major impact on the economy through the balance of payment -- exports become more expensive in terms of the foreign currency and imports cheaper in terms of the domestic currency and capital flows might also be affected. In the case of Kuwait, a major revaluation in terms of the US dollar would have only a minimal impact on export earnings. Oil earnings constitute about 93 percent of export earnings and an additional 4 percent consists of re-export trade. A change in the exchange rate will leave both completely unaffected, the former since it is denominated in foreign exchange in any case, and the latter because local value added will be minimal. Thus, only 3 percent of Kuwait's exports might be affected by changes in the exchange rate and of these 2 percent consist of chemical fertilizers whose price is closely linked to that of oil. Imports, on the other hand, would become cheaper in terms of Kuwaiti dinars. But, the impact of this relative decline in prices on demand is considerably weakened by the fact that a revaluation results in a decline in income expressed in Kuwaiti dinars for the economy as a whole, since it reduces the value of export earnings in terms of Kuwaiti dinars (even though the value of exports in terms of foreign exchange remains unchanged). Given the limited non-oil productive base of the economy, these two kinds of effects would be partly off-setting, so that the stimulus to additional imports would be relatively smaller. An additional effect of a revaluation would be to benefit the sizable non-citizen population of Kuwait, part of whose income is spent abroad, by increasing the foreign exchange value of their earnings. It is uncertain,

on the basis of available evidence, as to whether or not workers' remittances would increase as a result. Thus, changes in the exchange rate would not, on balance, have a major effect on Kuwait's balance of payments.

Effects of Revaluation on the Budget and on Savings Rate

7. However, a change in the exchange rate does have a major impact on the economy stemming from a peculiar institutional feature of Kuwait, namely that the state is the major recipient of foreign exchange while the private sector is the major user of imported goods. Oil revenues go directly to the budget, and along with investment income, all of which are denominated in foreign exchange, constitute 97 percent of budgetary revenues. A major revaluation would reduce budgetary revenues (denominated in dinars) by a proportional amount. Assuming no change in government expenditures, this would reduce the budget surplus. On the other hand, the private sector would benefit as a result of a decline in the dinar price of imports. Thus the principal impact of a revaluation is to re-distribute purchasing power ("real income") from the public sector to the private sector, including the large non-citizen population (who, as discussed in para. 9 below, have so far not been targetted as beneficiaries of social welfare policies initiated by the Kuwaiti authorities). To the extent that the private sector has a higher consumption ratio than the government, the national savings rate would decline.

8. It is true that, on the surface, the decline in the budget surplus and in the savings ratio might not seem to be causes for concern since budget surpluses have, as noted earlier, been large in recent years, as have concomitantly been the national savings ratio (gross national savings have increased as a proportion of GNP from 47 percent in 1970/71 to 77 percent in 1975/76). However, the levels of the budgetary surplus and the savings ratio although they seem high, cannot be directly compared with those in other countries. Oil is a depletable resource, and the income derived from its sale represents the running down of a capital asset. The high savings rate is an attempt in part to compensate, through the purchase of alternative assets, for presently depreciating this natural resource. The Kuwaiti authorities have given explicit recognition to this factor through the establishment of a "Reserve Fund for Future Generations" to which, inter alia, are credited annually 10 percent of total government receipts as well as the income accruing from the investment of financial resources accumulated in this reserve fund. Thus, it seems unlikely that the Kuwaiti authorities would wish to reduce the savings rate. Furthermore, even in the unlikely event that the Government might seek to reduce the overall savings ratio, because exchange rate changes would principally benefit the expatriate population, these would not be the preferred policy tool.

Effects of Revaluation on Domestic Inflation

9. In an economy, such as that of Kuwait, where the bulk of consumer and investment goods have to be imported, a revaluation of the KD would serve to neutralize the effects of international inflation on the domestic economy. On the basis of the cost of living and wholesale price indices, the rate of increase in prices has been tapering off since 1974. The cost

of living index indicated that prices increased by less than 5 percent in 1976 (the wholesale price index increased by less than 7 percent in the same year). These indices, however, tend to underestimate the actual rate of price increase which was probably in excess of 15 percent in 1976. The tapering off of inflationary pressures has reflected the slowdown in the rise of international prices, and the continuing valuation of the KD in terms of a basket of currencies has served to minimize the deviations between the domestic and international rates of inflation. The fact that inflation rates in Kuwait have been so much in excess of international inflation rates is the result not of an inappropriate exchange rate, but rather of the sharp rise in aggregate demand which has strained available physical capacities (particularly of the ports) and been much in excess of supply availabilities, and has concomitantly put upward pressure on prices and wages and on costs of goods. The impact of the inflationary pressures on consumers have been mitigated by either government direct subsidies (as for food items) or welfare programs (such as free education, health care and housing subsidies for low income groups). The bulk of these forms of assistance, however, was largely reserved for Kuwaiti citizens. The Fund staff in its recent discussions in Kuwait urged the adoption of monetary and fiscal measures to reduce inflationary pressures, but in this context made no reference to exchange rate adjustments, because domestic demand and cost factors seemed to be predominant in explaining inflationary pressures.

Revaluation and Other Considerations

10. There are three additional factors that might have worked against a major revaluation. First, it is well known that Kuwait would like to establish itself as an international financial center. To date, no first-class corporate borrower has yet used the Kuwaiti dinar market. This seems to have been due to a combination of fears of possible revaluations and ignorance of the nature of that market (see Attachment). Obviously, a major revaluation would, in such an environment, significantly retard the possibilities of the establishment of Kuwait as an international financial center. Second, Kuwait is attempting to diversify its productive base through the establishment of capital-intensive industries based on its natural resources. There would be a concern under such circumstances that too radical revaluations, which might be justified by oil revenues, might result in the new industries losing their international competitiveness. Finally, an additional consideration may be the affect on the debt service payments of Arab countries that have in recent years borrowed from Kuwait, notably through the Kuwait Fund for Arab Economic Development (KFAED). A revaluation would increase pari passu their debt servicing, a fact that may be considered to be undesirable by Kuwaiti authorities.

Concluding Remarks

11. The KD has appreciated by 25% against the US dollar since 1970 (a level of appreciation similar to that of the Saudi rial). The appreciation in the value of the KD has, however, been much less than that of major currencies such as the Swiss franc, the Deutschemark and the Japanese Yen. Since 1975, the Kuwaiti authorities have chosen to link the value of the KD to a basket of currencies of Kuwait's major trading partners. Such a link

has two important implications: first, there is a market-determined link for the exchange rate of the KD, and its value is therefore not purely administratively-determined; secondly, linking the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The evidence shows that since 1975 the rate of the KD in terms of the US\$ has fluctuated within a very narrow margin and has exhibited remarkable stability in comparison with the major currencies (SwF, DM, and Y). It seems that maintenance of relative stability of the value of the KD is determined by certain basic characteristics of the Kuwait economy. Balance of payment, budgetary, and income distribution considerations would all have argued in the past against major revaluations of the Kuwaiti dinar in terms of the US dollar. In addition, so would have the achievement of the Kuwaiti objectives of the establishment of the country as an international financial center, the diversification of its productive base, and the impact on the LDCs that have borrowed from Kuwait.

12. The future course of the value of the KD will be determined both by political and economic factors. It is conceivable that in order to demonstrate the "strength" of the KD, resort might be had to a major revaluation in terms of the US dollar. Such a course of action would be inconsistent with past behavior and not in the country's best economic interests, and is, therefore, unlikely. It is possible that the slide in the value of the US\$ might provoke a change in its weight in the basket. To the extent that the decline in the value of the US\$ is considered to be "temporary", it is unlikely, in principle, that a Cabinet-level decision which would be required in Kuwait to effectuate such a change, would be taken. Even in the unlikely event that a Government decision is taken, the probable change in the weight of the US\$ is likely to be less than 5%, thus implying only a slightly greater appreciation in the value of the KD in terms of the US\$. The most likely impact of the decline in the value of the US\$ would be to increase the relative attractiveness of real assets available in the US market. On balance, therefore, it seems that the basic characteristics of the Kuwait economy and the objectives of the government tend to the conclusion that a continuation of the link between the value of the KD and the values of the currencies of Kuwait's major trading partners would be the appropriate, and likely, course of action for the Kuwaiti authorities. This would imply continuing relative stability in the value of the KD in terms of the US\$. We have discussed these views with members of a recent Fund mission to Kuwait and they concur with them.

KUWAIT

Sharp rise foreseen for local money market business

Fears of a revaluation and ignorance of the market are two reasons why no first-class borrower has drawn on the KD market, but if the local money market develops as forecast international interest should increase.

John Whelan

Kuwaiti investors will get the chance to subscribe to three new funds in the next six to nine months, which could leave the domestic market with the task of absorbing up to KD 650 million (\$ 2,280 million). This was the projection given at a London conference last week by William Hahn, senior securities trader of the Arab Company for Trading Securities (ACTS). He thought this would strengthen the hand of the Central Bank in taking new powers. A decree has been passed to give it new powers (MEED 18:11:77), but this has yet to be implemented for political reasons.

Hahn said the funding had already affected one-week deposit rates by ½ per cent and had raised questions about just how the market was going to absorb the large amount of investment. The powers now being considered for the Central Bank would authorise it to issue negotiable bonds to be used on the open market.

The fear of a possible revaluation of Kuwaiti dinar was acknowledged by Hahn and other speakers at the conference on "Opportunities for Financial Services in the Gulf" as being a reason why no first-class corporate borrower has yet used the Kuwaiti dinar market. Hahn said another reason was ignorance of the market among such borrowers and this he partly blamed on Kuwaiti investment companies.

Hahn's company, owned by the Kuwait International Investment Company and the Industrial Bank of Kuwait (IBK), believes it has now successfully established an active short and medium-term money market in Kuwait. He said response had been excellent to the

offering of KD 9 million (\$ 31.5 million) certificates of deposit in October (MEED 18:11:77; 4:11:77), which was the first by a Kuwaiti bank. Hahn said: "The maturities were ideal because they bridged the gap nicely between the regular deposit market and the longer-term bond market." Almost immediately after the rescheduled offering, postponed from August because of technical problems, the Gulf Bank and the IBK announced that on a daily basis that they would start issuing certificates with a longer maturity, to three years. The initial offering was in the three to 11-month maturity range. "Almost overnight, the basis for an active short and medium-term money market had been established in Kuwait," Hahn said.

He argued that the Kuwaiti dinar bond market had been saturated before ACTS was set up and created a secondary market for these bonds. Banks had been legally empowered and willing to issue certificates of deposit, but could not do so due to the lack of a company willing to create the secondary market. Now even 10 or 12-year issues were being contemplated, with coupons as low as 8½ per cent for the right borrowers.

Hahn's optimism about the Kuwaiti financial market owed something to his conviction that the Central Bank would move soon to issue some form of treasury bill or certificate of deposit which would qualify as a liquid asset for the commercial banks. He also thought that there would be a huge expansion in the Kuwaiti dinar certificate of deposit market, both at the short and in the intermediate end. He predicted KD 100 million (\$ 350

million) in certificates of deposit outstanding early next year.

An increasing demand by local companies for financing in Kuwait has also been noticed by ACTS. A start had been made on Kuwaiti dinar denominated longer-term fixed rate financing for both private sector and mixed sector companies. The present legal restriction on lending in Kuwaiti dinars for periods of more than a year at rates exceeding 10 per cent was, Hahn acknowledged, an obstacle to term lending in Kuwait.

Other contributors at the conference, arranged by Investment Property Studies of the UK, saw this as inhibiting. It was difficult to predict where interest rates would be in four to five years. Kuwaiti dinar interest rates looked cheaper than those for borrowings in major currencies, but the future was more difficult to judge. Hahn agreed that it was difficult to ascertain the value of the Kuwaiti dinar at any one time, but the dollar accounts for 28 to 30 per cent of the SDR basket of 12 currencies, on which the parity of the Kuwaiti dinar was based, and, in Hahn's view, the basket was moving "very much in line with the dollar."

If this confidence can be justified, one early sign could be a revival of new issue activity in the international Kuwaiti dinar bond market. This development can be expected if interest rates on US dollar-denominated issues continue to rise. In that case it would not be surprising to see more of the traditional Euromarket borrowers taking a closer look at the Kuwaiti market as an alternative source of finance.

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December 20, 1977

Mr. Robert S. McNamara

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SUMMARY AND CONCLUSION

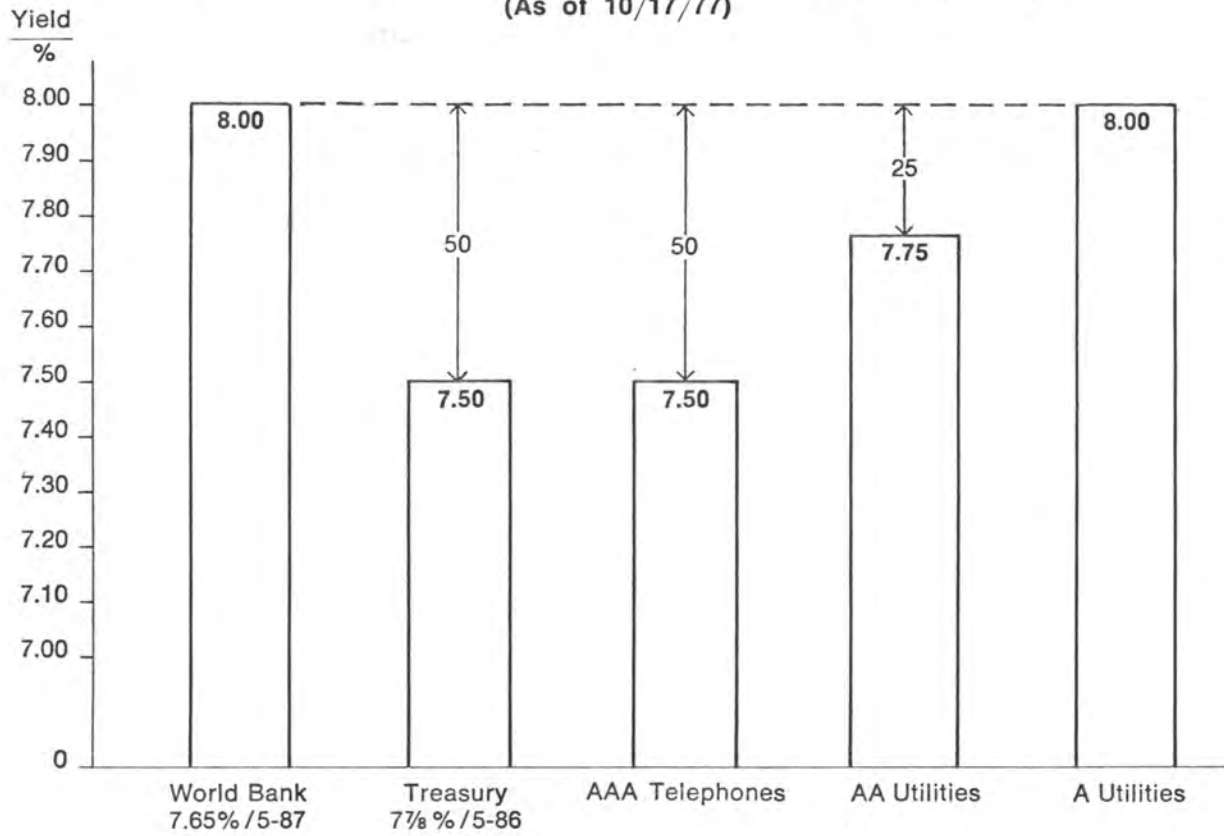
The World Bank is a giant, conservatively capitalized financial institution whose principal purpose is to promote the economic development of its 129 member countries, primarily by providing loans for specific projects and related technical assistance. Loans are made to further long-term growth of international trade as well as to raise standards of living in developing countries by channeling financial resources from the richer nations. All loans are made to, or guaranteed by, members of the Bank with the exception of loans to the affiliated International Finance Corporation (IFC).

Although the World Bank lends to developing countries, its loans are among the last obligations on which a country would default due to the Bank's premier international stature. In fact, in its 30 years of operation the Bank has never suffered any losses on its loans, and delays in the payment on outstanding loans have been insignificant. Moreover, the World Bank, under its current liquidity policy, maintains a substantial percentage of its assets in prime quality, highly liquid investments which afford considerable flexibility in borrowing and lending capabilities. Furthermore, international currency risk is negligible since its resources of capital, borrowings and accumulated earnings, denominated in the various currencies of its members and Switzerland, are held, invested or lent in those same currencies. Of the currencies it receives, the Bank generally invests those on which it can obtain higher yields and disburses, under its loans, other currencies for which there are no suitable investment opportunities.

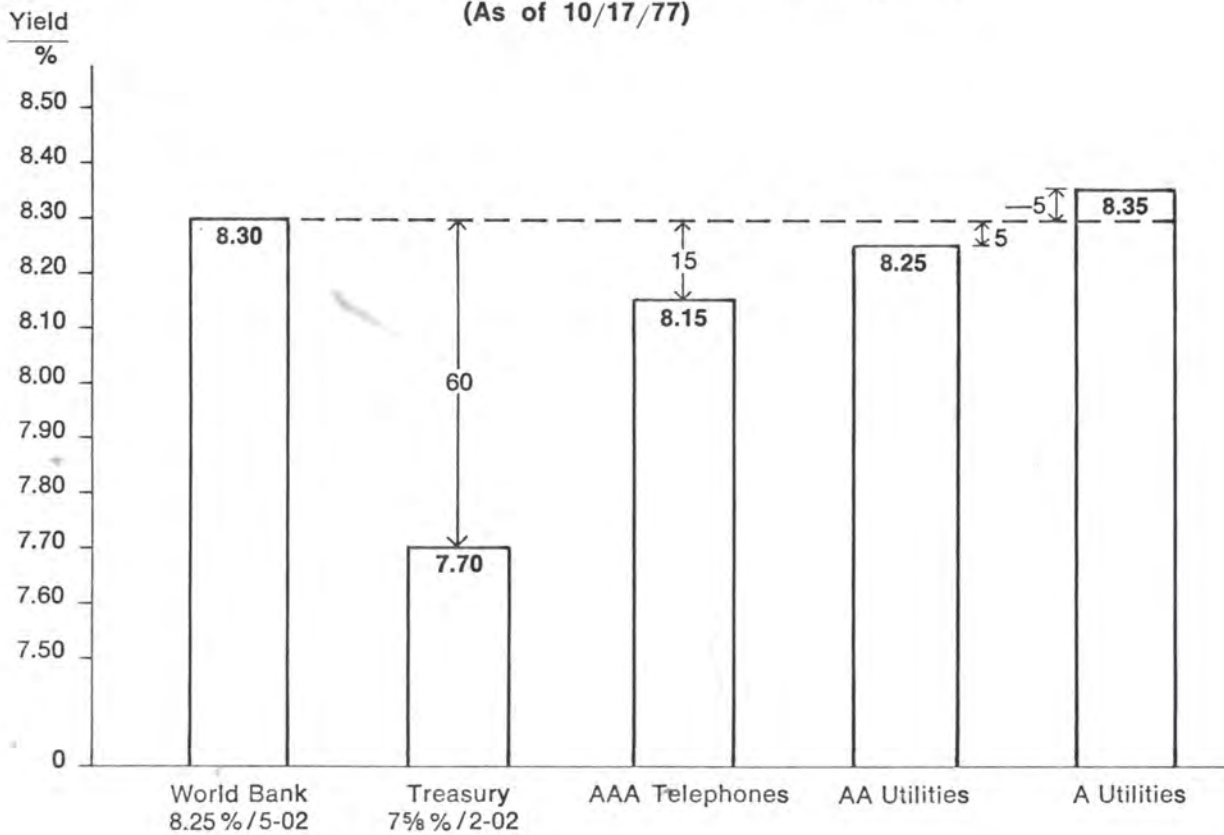
In our opinion, the World Bank's sound management, conservative lending policies, sizeable liquidity portfolio and substantial subscribed but uncalled capital well position this credit in the "Aaa/AAA" rating category. However, lack of investor knowledge and occasional adverse political publicity have resulted in yields considerably higher than those available in comparable or even lower-rated bonds. We believe, therefore, that World Bank bonds provide a unique investment opportunity.

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Intermediate-Term Bond Yields and Spreads (in basis points)
(As of 10/17/77)



Long-Term Bond Yields and Spreads (in basis points)
(As of 10/17/77)



THE BANK

The International Bank for Reconstruction and Development, better known as the World Bank, is an international organization which was established in 1945, began operations on June 25, 1946, and granted its first loan in 1947. Thus, the World Bank is, with the exception of its counterpart the International Monetary Fund, the oldest international financial institution of the post-World War II era. Moreover, its continuous record of operation in the field of development assistance exceeds that of almost any other lending organization, national or international.

THE UNITED STATES AND THE WORLD BANK

The United States became a member of the World Bank pursuant to the Bretton Woods Agreement of 1945. It has subscribed to 64,730 shares of the capital stock of the Bank entitling it to 22.6% of the total votes of all present members (see table on page 4). In current dollars the total U.S. subscription amounts to \$7,808,694,000, of which the uncalled portion (see Capital Stock) is \$7,027,825,000. Under the Bretton Woods Agreement, the U.S. Secretary of the Treasury is authorized to pay this uncalled portion of the U.S. subscription at times when payments are required, without further Congressional appropriation.

CAPITAL STOCK

As of June 30, 1977 (fiscal year end), total subscribed capital stock amounted to \$30.9 billion. Each member country must pay in 10% of its subscription (1% in gold or U.S. dollars and 9% in its own currency), the remaining 90% being subject to call if needed to meet the Bank's obligations. The uncalled amount of subscribed capital, totaling \$27.8 billion at fiscal year end, thus provides a "fail-safe" mechanism which acts as a cushion to further ensure the Bank's ability to meet all its debt obligations even in the unlikely event of loan defaults. In other words, the capital subject to call is there solely for the protection of the bondholder and may not be used for the conduct of operations.

MAJOR SUBSCRIBERS TO CAPITAL STOCK

Members	Subscriptions		Voting Power	
	Current U.S. Dollars (in millions)	% of Total	Number of Votes	% of Total
United States	\$ 7,808.7	25.3	64,980	22.6
United Kingdom	3,136.5	10.2	26,250	9.1
Germany, F.R.	1,647.0	5.3	13,903	4.8
France	1,543.2	5.0	13,042	4.5
Japan	1,234.1	4.0	10,480	3.6
Canada	1,136.2	3.7	9,668	3.4
	<u>\$16,505.7</u>	<u>53.5</u>	<u>138,323</u>	<u>48.0</u>
All Other Countries	\$14,363.6	46.5	149,817	52.0
Total	<u>\$30,869.3</u>	<u>100.0</u>	<u>288,140</u>	<u>100.0</u>

LOAN OPERATIONS

The Bank's capital stock represents only a small source of its loanable funds. The balance of its lending resources is derived from the Bank's funds from operations, including principal repayments on loans and, most important, borrowings in the world's capital markets. Unlike most so-called "banks", the World Bank is not a deposit-receiving institution.

According to its Articles of Agreement, the charter within which the Bank operates, loans are made either to member governments or governmental authorities and/or private enterprises in the territories of member governments. With few exceptions, all loans are committed to the financing of specific development projects, all of which must be justifiable on economic grounds. Furthermore, the Bank must evaluate the prospects of repayment through credit analysis. Countries which do not meet World Bank's credit worthiness standards, cannot borrow from the Bank and must be financed through the International Development Association, a legally separate entity which is financed primarily through government grants. Loans obtainable on reasonable terms in the private market do not qualify for World Bank loans since the Bank is intended to promote private investment, not compete with it. And, lastly, the Bank is obligated to supervise the use of all loan proceeds.

From 1947 to March 31, 1977, the Bank had approved loans in the aggregate amount of \$36.2 billion to finance projects or programs in 98 countries, including loans to the IFC. Effective loans held by the Bank at June 30, 1977, totaled \$27.0 billion, of which the undisbursed portion was \$11.3 billion. Under the Articles, the total amount outstanding of guarantees, direct loans and participations in loans may never exceed the total unimpaired subscribed capital, reserves and surplus of the Bank. Unlike private commercial institutions, an express provision limits to a 1:1 ratio the amount of outstanding loans the Bank can have as compared to capital and reserves.

Karen S. W. Friedman

BALANCE SHEET
(As of June 30, 1977)

ASSETS

		(in millions)
High Quality Liquid Investments		\$ 7,794.4
Loans Committed	\$ 31,087.6	
Less: Loans Approved but not yet effective	<u>4,053.3</u>	
Total Effective Loans (including undisbursed balance of \$11,307.8)		27,034.3
Other Assets		<u>1,506.2</u>
TOTAL ASSETS		\$ <u><u>36,334.9</u></u>

LIABILITIES, CAPITAL AND RESERVES

LIABILITIES		
Borrowings	\$ 18,477.5	
Less: Net unamortized discounts and premiums	<u>18.1</u>	
Net Borrowings		\$ 18,459.4
Undisbursed balance of effective loans		
Held by Bank	\$ 11,307.8	
Agreed to be sold	<u>28.9</u>	
		11,336.7
Other Liabilities		<u>1,216.7</u>
TOTAL LIABILITIES		\$ 31,012.9

CAPITAL AND RESERVES

Capital Stock		
Subscribed Capital	\$ 30,869.2	
Less: Uncalled portion of subscriptions	<u>27,782.3</u>	
Total Paid-In Capital		\$ 3,086.9
Special Reserve		292.5
General Reserve		1,733.1
Accumulated Net Income		<u>209.5</u>
TOTAL EQUITY		<u>5,322.0</u>
TOTAL LIABILITIES, CAPITAL AND RESERVES		\$ <u><u>36,334.9</u></u>

Total Equity	\$ 5,322.0	
Capital Subject to Call	<u>27,782.3</u>	
TOTAL EQUITY AND UNCALLED CAPITAL		\$ 33,104.3

FISCAL 1977 (July 1, 1976 — June 30, 1977)

Borrowings		\$ 4,720.6
Loans Approved		\$ 5,779.3

High yield. Low risk. Get the little known facts about World Bank bonds.

The World Bank is a financial giant—with 130 member nations and over \$36 billion in assets.

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These facts help explain why Moody's and Standard & Poor's have rated World Bank bonds Aaa/AAA—putting them in the lowest possible risk category.

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few people understand just what the World Bank does; so too few people realize how undervalued the bonds really are.

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INTERNATIONAL BANK FOR
RECONSTRUCTION & DEVELOPMENT

("WORLD BANK")
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SUMMARY AND CONCLUSION

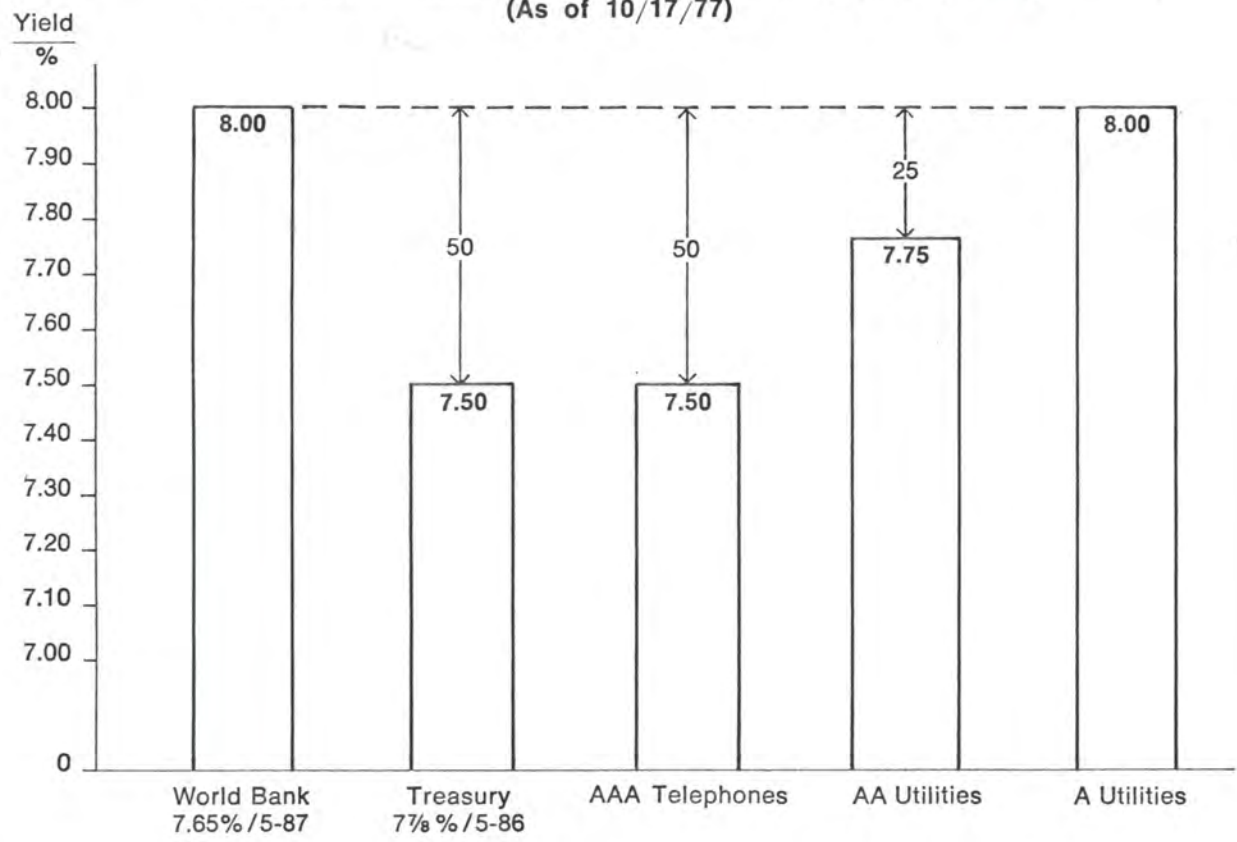
The World Bank is a giant, conservatively capitalized financial institution whose principal purpose is to promote the economic development of its 129 member countries, primarily by providing loans for specific projects and related technical assistance. Loans are made to further long-term growth of international trade as well as to raise standards of living in developing countries by channeling financial resources from the richer nations. All loans are made to, or guaranteed by, members of the Bank with the exception of loans to the affiliated International Finance Corporation (IFC).

Although the World Bank lends to developing countries, its loans are among the last obligations on which a country would default due to the Bank's premier international stature. In fact, in its 30 years of operation the Bank has never suffered any losses on its loans, and delays in the payment on outstanding loans have been insignificant. Moreover, the World Bank, under its current liquidity policy, maintains a substantial percentage of its assets in prime quality, highly liquid investments which afford considerable flexibility in borrowing and lending capabilities. Furthermore, international currency risk is negligible since its resources of capital, borrowings and accumulated earnings, denominated in the various currencies of its members and Switzerland, are held, invested or lent in those same currencies. Of the currencies it receives, the Bank generally invests those on which it can obtain higher yields and disburses, under its loans, other currencies for which there are no suitable investment opportunities.

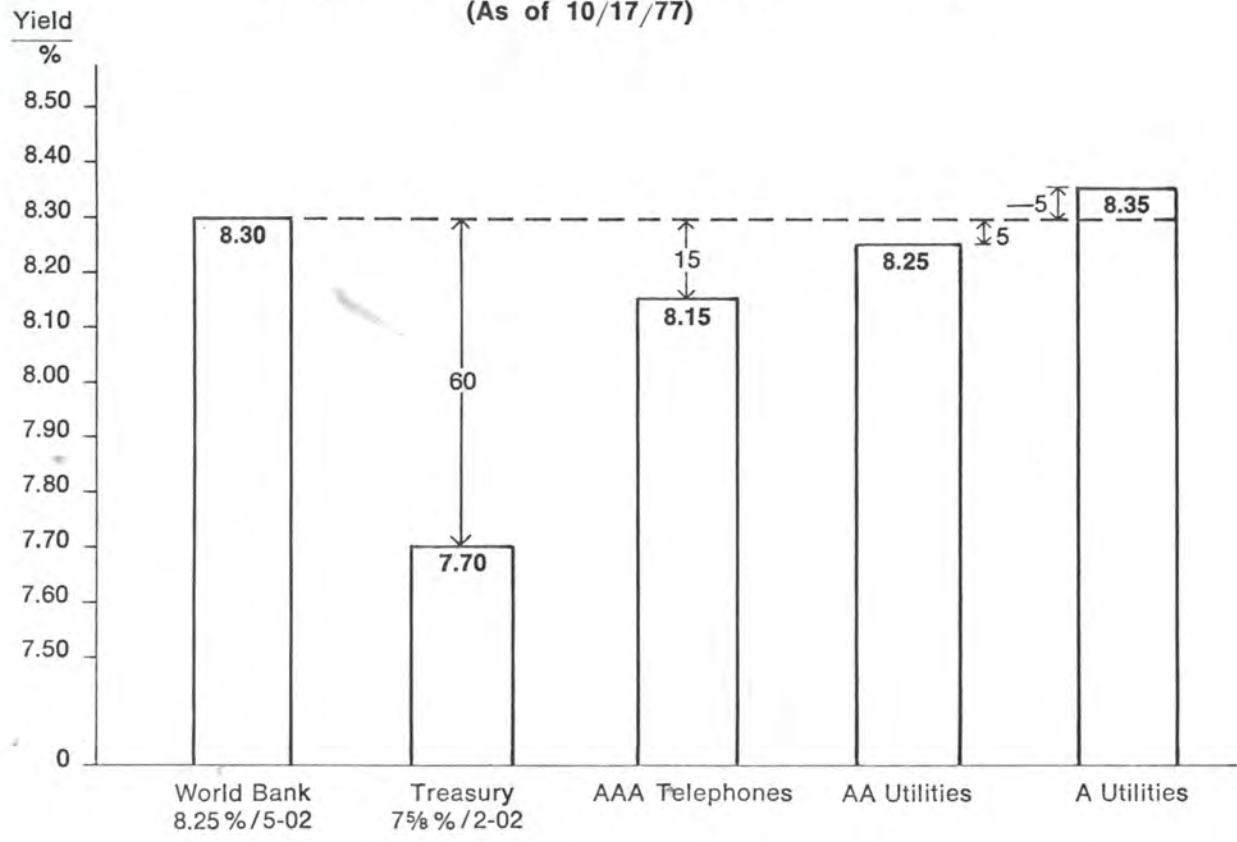
In our opinion, the World Bank's sound management, conservative lending policies, sizeable liquidity portfolio and substantial subscribed but uncalled capital well position this credit in the "Aaa/AAA" rating category. However, lack of investor knowledge and occasional adverse political publicity have resulted in yields considerably higher than those available in comparable or even lower-rated bonds. We believe, therefore, that World Bank bonds provide a unique investment opportunity.

This bulletin is based on company reports, standard reference manuals and other sources which we believe to be reliable. It is not intended to be a complete description of the company(ies) referred to or its (their) securities and we do not guarantee its accuracy. Paine, Webber, Jackson & Curtis Incorporated and/or its officers, directors, employees or stockholders may, in the normal course of business, have a position, including an arbitrage or option position, in the securities mentioned above and may sell or buy them to or from customers. Paine Webber may also act as agent for both the buyer and the seller in connection with the execution of transactions in these securities. Any opinion or recommendations expressed are based upon information available to us and upon our general experience and judgement of securities.

Intermediate-Term Bond Yields and Spreads (in basis points)
(As of 10/17/77)



Long-Term Bond Yields and Spreads (in basis points)
(As of 10/17/77)



THE BANK

The International Bank for Reconstruction and Development, better known as the World Bank, is an international organization which was established in 1945, began operations on June 25, 1946, and granted its first loan in 1947. Thus, the World Bank is, with the exception of its counterpart the International Monetary Fund, the oldest international financial institution of the post-World War II era. Moreover, its continuous record of operation in the field of development assistance exceeds that of almost any other lending organization, national or international.

THE UNITED STATES AND THE WORLD BANK

The United States became a member of the World Bank pursuant to the Bretton Woods Agreement of 1945. It has subscribed to 64,730 shares of the capital stock of the Bank entitling it to 22.6% of the total votes of all present members (see table on page 4). In current dollars the total U.S. subscription amounts to \$7,808,694,000, of which the uncalled portion (see Capital Stock) is \$7,027,825,000. Under the Bretton Woods Agreement, the U.S. Secretary of the Treasury is authorized to pay this uncalled portion of the U.S. subscription at times when payments are required, without further Congressional appropriation.

CAPITAL STOCK

As of June 30, 1977 (fiscal year end), total subscribed capital stock amounted to \$30.9 billion. Each member country must pay in 10% of its subscription (1% in gold or U.S. dollars and 9% in its own currency), the remaining 90% being subject to call if needed to meet the Bank's obligations. The uncalled amount of subscribed capital, totaling \$27.8 billion at fiscal year end, thus provides a "fail-safe" mechanism which acts as a cushion to further ensure the Bank's ability to meet all its debt obligations even in the unlikely event of loan defaults. In other words, the capital subject to call is there solely for the protection of the bondholder and may not be used for the conduct of operations.

MAJOR SUBSCRIBERS TO CAPITAL STOCK

Members	Subscriptions		Voting Power	
	Current U.S. Dollars (in millions)	% of Total	Number of Votes	% of Total
United States	\$ 7,808.7	25.3	64,980	22.6
United Kingdom	3,136.5	10.2	26,250	9.1
Germany, F.R.	1,647.0	5.3	13,903	4.8
France	1,543.2	5.0	13,042	4.5
Japan	1,234.1	4.0	10,480	3.6
Canada	1,136.2	3.7	9,668	3.4
	<u>\$16,505.7</u>	<u>53.5</u>	<u>138,323</u>	<u>48.0</u>
All Other Countries	\$14,363.6	46.5	149,817	52.0
Total	<u>\$30,869.3</u>	<u>100.0</u>	<u>288,140</u>	<u>100.0</u>

LOAN OPERATIONS

The Bank's capital stock represents only a small source of its loanable funds. The balance of its lending resources is derived from the Bank's funds from operations, including principal repayments on loans and, most important, borrowings in the world's capital markets. Unlike most so-called "banks", the World Bank is not a deposit-accepting institution.

According to its Articles of Agreement, the charter within which the Bank operates, loans are made either to member governments or governmental authorities and/or private enterprises in the territories of member governments. With few exceptions, all loans are committed to the financing of specific development projects, all of which must be justifiable on economic grounds. Furthermore, the Bank must evaluate the prospects of repayment through credit analysis. Countries which do not meet World Bank's credit worthiness standards, cannot borrow from the Bank and must be financed through the International Development Association, a legally separate entity which is financed primarily through government grants. Loans obtainable on reasonable terms in the private market do not qualify for World Bank loans since the Bank is intended to promote private investment, not compete with it. And, lastly, the Bank is obligated to supervise the use of all loan proceeds.

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Karen S. W. Friedman

BALANCE SHEET
(As of June 30, 1977)

ASSETS

High Quality Liquid Investments		(in millions)
Loans Committed	\$ 31,087.6	\$ 7,794.4
Less: Loans Approved but not yet effective	4,053.3	
Total Effective Loans (including undisbursed balance of \$11,307.8)		27,034.3
Other Assets		1,506.2
TOTAL ASSETS		\$ <u>36,334.9</u>

LIABILITIES, CAPITAL AND RESERVES

LIABILITIES		
Borrowings	\$ 18,477.5	
Less: Net unamortized discounts and premiums	18.1	
Net Borrowings		\$ 18,459.4
Undisbursed balance of effective loans		
Held by Bank	\$ 11,307.8	
Agreed to be sold	28.9	
Other Liabilities		11,336.7
TOTAL LIABILITIES		\$ <u>31,012.9</u>
CAPITAL AND RESERVES		
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FISCAL 1977 (July 1, 1976 — June 30, 1977)

Borrowings		\$ 4,720.6
Loans Approved		\$ 5,779.3

January 4, 1978

Determinants of Exchange Rate of Kuwaiti Dinar

1. This note responds to your request to Mr. Benjenk to prepare an analysis of factors entering into the determination of the exchange rate of the Kuwaiti Dinar (KD). The principal concern regarding the exchange rate of the KD arises from the fact that it is administratively determined and could be subject to major revaluations in terms of the US dollar. The analysis below shows that the KD has in fact appreciated by 25 percent against the US dollar since 1970.^{1/} The appreciation in the value of the KD has, however, been much less than that of major currencies such as the Swiss franc (SwF), the Deutschemark (DM) and the Japanese Yen (¥). Since 1975, the Kuwaiti authorities have chosen to link the value of the KD to a basket of currencies of Kuwait's major trading partners. Such a link has two important implications: first, there is a market-determined link for the exchange rate of the KD, and its value is therefore not purely administratively determined; secondly, linking the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The evidence shows that since 1975 the KD rate in terms of the US\$ has fluctuated within a very narrow margin, and has exhibited remarkable stability in comparison with the values of major currencies such as the Swiss franc, the Deutschemark, and the Japanese Yen. It seems, from the analysis below, that maintenance of relative stability in the value of the KD (that is, determination of its value in terms of a basket of currencies) is determined by certain basic characteristics of the Kuwaiti economy and is also consistent with the major economic objectives of the Kuwaiti authorities.

2. The future course of the value of the KD will be determined both by political and economic factors. It is conceivable that in order to demonstrate the "strength" of the KD, the Kuwaiti authorities might resort to a major revaluation in terms of the US\$. This course of action, while in the realm of possibility would both be inconsistent with behavior so far and with the country's best economic interests. As a second course of action, it is possible that in the face of the slide in the value of the US\$, consideration might be given to lowering the weight of the US\$ in the basket. Such an action cannot be taken by the Central Bank alone, but rather requires a Cabinet-level decision. To the extent that the slide in the value of the US\$ is considered to be a "temporary" phenomenon, a political decision of this sort is in principle unlikely. Even in the unlikely event that a government decision is taken, it could be reasonably expected that the weight of the US\$ in the basket would be reduced by less than 5%, thus implying only a slightly greater appreciation in the value of the KD in terms of the US\$. The most likely impact of the decrease in the value of the US\$ is that Kuwait would use the "cheaper" US\$'s it earns from its oil exports to buy real assets in the US (rather than in, say, Germany where the real value of the US\$ is lower). On balance, therefore, it seems that the basic characteristics of the Kuwait economy and the economic

^{1/} An appreciation of similar magnitude to that of the Saudi rial.

objectives of the government tend to the conclusion that a continuation of the link between the value of the KD and the values of the currencies of Kuwait's major trading partners would be the appropriate, and likely, course of action for the Kuwaiti authorities. This would imply continuing relative stability in the value of the KD in terms of the US\$. We have discussed the above views with members of the Fund mission who were in Kuwait in April 1977, and they concur with them.

3. The rest of this note discusses developments in the exchange rate of the KD since 1970 and notes special characteristics of the Kuwaiti economy. It then proceeds to analyze the impact of exchange rate changes on the balance of payments; on the budget and national savings; on income distribution; on domestic inflation; and finally on the achievement of certain economic objectives specified by the Kuwaiti authorities.

The Evolution of the Exchange Rate of the Kuwaiti Dinar

4. The rate of the Kuwaiti dinar remained unchanged at SDR2.80 per KDI following both the general realignment of currencies in 1971 and following the second devaluation of the US dollar in February 1973. Beginning March 1975, Kuwait has maintained the exchange rate of the dinar on the basis of its value in terms of a weighted average of currencies; the composition of the currency basket has not been announced. The Fund staff, however, on the basis of an analysis undertaken in October 1976 concluded that the US dollar had a weight of 74 percent in the basket, in which the currencies of Kuwait's other major trading partners (Germany, Japan, France, and the U.K.) were also represented.^{1/} The link of the value of the KD to a basket of currencies has two important implications: first, there is a market-determined link for the exchange rate of the KD and its value is, therefore, not purely administratively determined; secondly, linking the value of the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The sole administratively-determined element is the choice of weights attached to individual currencies in the basket. In Kuwait, however, changes in the weights require Cabinet-level decisions, rather than action solely by the Central Bank, and would thus be likely to be undertaken only if there were fundamental changes in the economic and political environment. The Kuwaiti dinar was worth US\$3.51 in October 1977. The 25 percent appreciation of the dinar vis-a-vis the US dollar since 1970 reflects largely the depreciation of the US dollar against the SDR (17 percent as of October 1977); the remainder being accounted for by the depreciation of the SDR in relation to its original value. The KD rate in terms of the US\$ has fluctuated within a very narrow margin since 1975, and the KD has exhibited remarkable stability in comparison with other major currencies whose values are determined by market forces. For example, since 1970, in terms of the US dollar, the SwF has appreciated by 89 percent, the DM by 60 percent and the ¥ by 40 percent.

^{1/} There seem to be differences of opinion regarding both the composition of the basket and the weight of the US dollar in it (see Attachment).

Characteristics of the Kuwaiti Economy

5. Special characteristics of Kuwait's economy have determined the role which exchange rate changes could play, and also explain, in substantial degree, why the value of the KD has been kept relatively stable. According to the best available statistics (relating to the years 1974 to 1976), oil accounted for 68 percent of GDP, 93 percent of export earnings and 87 percent of budgetary revenues (investment income accounted for 10 percent of budgetary revenues in 1975/76). Oil prices are quoted in US dollars and payments are made in dollars and sterling at the prevailing dollar rate. The balance of payments has been in continuing surplus for a number of years, and foreign exchange reserves, according to the best available information, are estimated to have been \$18 billion at the end of 1976, or about five years' imports at the 1976 level and this despite the fact that imports in 1976 were more than three times their level in 1973. Budgetary surpluses have been well in excess of KD1,000 million in each of the past four Kuwaiti financial years. Given the openness of the economy, the dominance of oil and the particular arrangements surrounding the pricing of oil, the Kuwaiti dinar is for the domestic economy then nothing more than a numeraire whose value is essentially determined by external considerations. Finally, according to the 1975 census, Kuwaiti citizens represented only 47 percent of the total population of Kuwait which was estimated to be 995,000 persons.

Effects of Revaluation on Balance of Payments

6. In a "traditional" economy, a major revaluation of the currency has its primary and major impact on the economy through the balance of payment -- exports become more expensive in terms of the foreign currency and imports cheaper in terms of the domestic currency and capital flows might also be affected. In the case of Kuwait, a major revaluation in terms of the US dollar would have only a minimal impact on export earnings. Oil earnings constitute about 93 percent of export earnings and an additional 4 percent consists of re-export trade. A change in the exchange rate will leave both completely unaffected, the former since it is denominated in foreign exchange in any case, and the latter because local value added will be minimal. Thus, only 3 percent of Kuwait's exports might be affected by changes in the exchange rate and of these 2 percent consist of chemical fertilizers whose price is closely linked to that of oil. Imports, on the other hand, would become cheaper in terms of Kuwaiti dinars. But, the impact of this relative decline in prices on demand is considerably weakened by the fact that a revaluation results in a decline in income expressed in Kuwaiti dinars for the economy as a whole, since it reduces the value of export earnings in terms of Kuwaiti dinars (even though the value of exports in terms of foreign exchange remains unchanged). Given the limited non-oil productive base of the economy, these two kinds of effects would be partly off-setting, so that the stimulus to additional imports would be relatively smaller. An additional effect of a revaluation would be to benefit the sizable non-citizen population of Kuwait, part of whose income is spent abroad, by increasing the foreign exchange value of their earnings. It is uncertain,

on the basis of available evidence, as to whether or not workers' remittances would increase as a result. Thus, changes in the exchange rate would not, on balance, have a major effect on Kuwait's balance of payments.

Effects of Revaluation on the Budget and on Savings Rate

7. However, a change in the exchange rate does have a major impact on the economy stemming from a peculiar institutional feature of Kuwait, namely that the state is the major recipient of foreign exchange while the private sector is the major user of imported goods. Oil revenues go directly to the budget, and along with investment income, all of which are denominated in foreign exchange, constitute 97 percent of budgetary revenues. A major revaluation would reduce budgetary revenues (denominated in dinars) by a proportional amount. Assuming no change in government expenditures, this would reduce the budget surplus. On the other hand, the private sector would benefit as a result of a decline in the dinar price of imports. Thus the principal impact of a revaluation is to re-distribute purchasing power ("real income") from the public sector to the private sector, including the large non-citizen population (who, as discussed in para. 9 below, have so far not been targetted as beneficiaries of social welfare policies initiated by the Kuwaiti authorities). To the extent that the private sector has a higher consumption ratio than the government, the national savings rate would decline.

8. It is true that, on the surface, the decline in the budget surplus and in the savings ratio might not seem to be causes for concern since budget surpluses have, as noted earlier, been large in recent years, as have concomitantly been the national savings ratio (gross national savings have increased as a proportion of GNP from 47 percent in 1970/71 to 77 percent in 1975/76). However, the levels of the budgetary surplus and the savings ratio although they seem high, cannot be directly compared with those in other countries. Oil is a depletable resource, and the income derived from its sale represents the running down of a capital asset. The high savings rate is an attempt in part to compensate, through the purchase of alternative assets, for presently depreciating this natural resource. The Kuwaiti authorities have given explicit recognition to this factor through the establishment of a "Reserve Fund for Future Generations" to which, inter alia, are credited annually 10 percent of total government receipts as well as the income accruing from the investment of financial resources accumulated in this reserve fund. Thus, it seems unlikely that the Kuwaiti authorities would wish to reduce the savings rate. Furthermore, even in the unlikely event that the Government might seek to reduce the overall savings ratio, because exchange rate changes would principally benefit the expatriate population, these would not be the preferred policy tool.

Effects of Revaluation on Domestic Inflation

9. In an economy, such as that of Kuwait, where the bulk of consumer and investment goods have to be imported, a revaluation of the KD would serve to neutralize the effects of international inflation on the domestic economy. On the basis of the cost of living and wholesale price indices, the rate of increase in prices has been tapering off since 1974. The cost

of living index indicated that prices increased by less than 5 percent in 1976 (the wholesale price index increased by less than 7 percent in the same year). These indices, however, tend to underestimate the actual rate of price increase which was probably in excess of 15 percent in 1976. The tapering off of inflationary pressures has reflected the slowdown in the rise of international prices, and the continuing valuation of the KD in terms of a basket of currencies has served to minimize the deviations between the domestic and international rates of inflation. The fact that inflation rates in Kuwait have been so much in excess of international inflation rates is the result not of an inappropriate exchange rate, but rather of the sharp rise in aggregate demand which has strained available physical capacities (particularly of the ports) and been much in excess of supply availabilities, and has concomitantly put upward pressure on prices and wages and on costs of goods. The impact of the inflationary pressures on consumers have been mitigated by either government direct subsidies (as for food items) or welfare programs (such as free education, health care and housing subsidies for low income groups). The bulk of these forms of assistance, however, was largely reserved for Kuwaiti citizens. The Fund staff in its recent discussions in Kuwait urged the adoption of monetary and fiscal measures to reduce inflationary pressures, but in this context made no reference to exchange rate adjustments, because domestic demand and cost factors seemed to be predominant in explaining inflationary pressures.

Revaluation and Other Considerations

10. There are three additional factors that might have worked against a major revaluation. First, it is well known that Kuwait would like to establish itself as an international financial center. To date, no first-class corporate borrower has yet used the Kuwaiti dinar market. This seems to have been due to a combination of fears of possible revaluations and ignorance of the nature of that market (see Attachment). Obviously, a major revaluation would, in such an environment, significantly retard the possibilities of the establishment of Kuwait as an international financial center. Second, Kuwait is attempting to diversify its productive base through the establishment of capital-intensive industries based on its natural resources. There would be a concern under such circumstances that too radical revaluations, which might be justified by oil revenues, might result in the new industries losing their international competitiveness. Finally, an additional consideration may be the affect on the debt service payments of Arab countries that have in recent years borrowed from Kuwait, notably through the Kuwait Fund for Arab Economic Development (KFAED). A revaluation would increase pari passu their debt servicing, a fact that may be considered to be undesirable by Kuwaiti authorities.

Concluding Remarks

11. The KD has appreciated by 25% against the US dollar since 1970 (a level of appreciation similar to that of the Saudi rial). The appreciation in the value of the KD has, however, been much less than that of major currencies such as the Swiss franc, the Deutschemark and the Japanese Yen. Since 1975, the Kuwaiti authorities have chosen to link the value of the KD to a basket of currencies of Kuwait's major trading partners. Such a link

has two important implications: first, there is a market-determined link for the exchange rate of the KD, and its value is therefore not purely administratively-determined; secondly, linking the value of the KD to a basket of currencies ensures it of greater stability than if it were linked to one single currency. The evidence shows that since 1975 the rate of the KD in terms of the US\$ has fluctuated within a very narrow margin and has exhibited remarkable stability in comparison with the major currencies (SwF, DM, and Y). It seems that maintenance of relative stability of the value of the KD is determined by certain basic characteristics of the Kuwait economy. Balance of payment, budgetary, and income distribution considerations would all have argued in the past against major revaluations of the Kuwaiti dinar in terms of the US dollar. In addition, so would have the achievement of the Kuwaiti objectives of the establishment of the country as an international financial center, the diversification of its productive base, and the impact on the LDCs that have borrowed from Kuwait.

12. The future course of the value of the KD will be determined both by political and economic factors. It is conceivable that in order to demonstrate the "strength" of the KD, resort might be had to a major revaluation in terms of the US dollar. Such a course of action would be inconsistent with past behavior and not in the country's best economic interests, and is, therefore, unlikely. It is possible that the slide in the value of the US\$ might provoke a change in its weight in the basket. To the extent that the decline in the value of the US\$ is considered to be "temporary", it is unlikely, in principle, that a Cabinet-level decision which would be required in Kuwait to effectuate such a change, would be taken. Even in the unlikely event that a Government decision is taken, the probable change in the weight of the US\$ is likely to be less than 5%, thus implying only a slightly greater appreciation in the value of the KD in terms of the US\$. The most likely impact of the decline in the value of the US\$ would be to increase the relative attractiveness of real assets available in the US market. On balance, therefore, it seems that the basic characteristics of the Kuwait economy and the objectives of the government tend to the conclusion that a continuation of the link between the value of the KD and the values of the currencies of Kuwait's major trading partners would be the appropriate, and likely, course of action for the Kuwaiti authorities. This would imply continuing relative stability in the value of the KD in terms of the US\$. We have discussed these views with members of a recent Fund mission to Kuwait and they concur with them.

KUWAIT

Sharp rise foreseen for local money market business

John Whelan

Fears of a revaluation and ignorance of the market are two reasons why no first-class borrower has drawn on the KD market, but if the local money market develops as forecast international interest should increase.

Kuwaiti investors will get the chance to subscribe to three new funds in the next six to nine months, which could leave the domestic market with the task of absorbing up to KD 650 million (\$ 2,280 million). This was the projection given at a London conference last week by William Hahn, senior securities trader of the Arab Company for Trading Securities (ACTS). He thought this would strengthen the hand of the Central Bank in taking new powers. A decree has been passed to give it new powers (MEED 18:11:77), but this has yet to be implemented for political reasons.

Hahn said the funding had already affected one-week deposit rates by ½ per cent and had raised questions about just how the market was going to absorb the large amount of investment. The powers now being considered for the Central Bank would authorise it to issue negotiable bonds to be used on the open market.

A fear of a possible revaluation of the Kuwaiti dinar was acknowledged by Hahn and other speakers at the conference on "Opportunities for Financial Services in the Gulf" as being a reason why no first-class corporate borrower has yet used the Kuwaiti dinar market. Hahn said another reason was ignorance of the market among such borrowers and this he partly blamed on Kuwaiti investment companies.

Hahn's company, owned by the Kuwait International Investment Company and the Industrial Bank of Kuwait (IBK), believes it has now successfully established an active short and medium-term money market in Kuwait. He said response had been excellent to the

offering of KD 9 million (\$ 31.5 million) certificates of deposit in October (MEED 18:11:77; 4:11:77), which was the first by a Kuwaiti bank. Hahn said: "The maturities were ideal because they bridged the gap nicely between the regular deposit market and the longer-term bond market." Almost immediately after the rescheduled offering, postponed from August because of technical problems, the Gulf Bank and the IBK announced that on a daily basis that they would start issuing certificates with a longer maturity, to three years. The initial offering was in the three to 11-month maturity range. "Almost overnight, the basis for an active short and medium-term money market had been established in Kuwait," Hahn said.

He argued that the Kuwaiti dinar bond market had been saturated before ACTS was set up and created a secondary market for these bonds. Banks had been legally empowered and willing to issue certificates of deposit, but could not do so due to the lack of a company willing to create the secondary market. Now even 10 or 12-year issues were being contemplated, with coupons as low as 8½ per cent for the right borrowers.

Hahn's optimism about the Kuwaiti financial market owed something to his conviction that the Central Bank would move soon to issue some form of treasury bill or certificate of deposit which would qualify as a liquid asset for the commercial banks. He also thought that there would be a huge expansion in the Kuwaiti dinar certificate of deposit market, both at the short and in the intermediate end. He predicted KD 100 million (\$ 350

million) in certificates of deposit outstanding early next year.

An increasing demand by local companies for financing in Kuwait has also been noticed by ACTS. A start had been made on Kuwaiti dinar denominated longer-term fixed rate financing for both private sector and mixed sector companies. The present legal restriction on lending in Kuwaiti dinars for periods of more than a year at rates exceeding 10 per cent was, Hahn acknowledged, an obstacle to term lending in Kuwait.

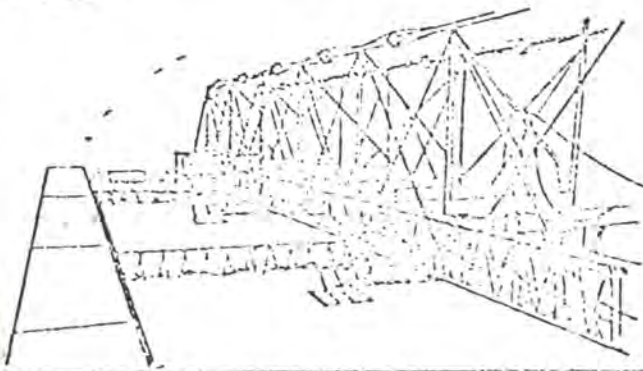
Other contributors at the conference, arranged by Investment Property Studies of the UK, saw this as inhibiting. It was difficult to predict where interest rates would be in four to five years. Kuwaiti dinar interest rates looked cheaper than those for borrowings in major currencies, but the future was more difficult to judge. Hahn agreed that it was difficult to ascertain the value of the Kuwaiti dinar at any one time, but the dollar accounts for 28 to 30 per cent of the SDR basket of 12 currencies, on which the parity of the Kuwaiti dinar was based, and, in Hahn's view, the basket was moving "very much in line with the dollar."

If this confidence can be justified, one early sign could be a revival of new issue activity in the international Kuwaiti dinar bond market. This development can be expected if interest rates on US dollar-denominated issues continue to rise. In that case it would not be surprising to see more of the traditional Euromarket borrowers taking a closer look at the Kuwaiti market as an alternative source of finance.

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January 9, 1978

Mr. Bader Al-Dawood
Chairman and Managing Director
Kuwait Investment Company
P.O. Box 1005, Kuwait
KUWAIT

Dear Bader:

I was away a great deal in December and consequently only now have found the time to write to you about the lending proposals that you put to me in November. Looking back on it I can well see how misunderstandings on both sides occur.

When we spoke at the Annual Meetings I was thinking in terms of KIC underwriting the dinar issue. This is a discussion we have been having with you and your authorities ever since I took over this work. Within the Bank, I think everyone concerned has come round to the view that the objections raised to dinar issues in '74 no longer carry much weight. However, when you told me at the Annual Meetings that any borrowing by the Bank in Kuwait at this time would be inopportune from the point of view of public relations, I assumed that this consideration would apply equally to issues denominated in currencies other than the dinar. Furthermore, I had in mind the point that you have always made to me that the issues KIC has made for us in the past have been genuine underwriting with the public and not simply investment of government reserves. I readily accepted your judgment that the time for any issue was inopportune and accordingly when I put forward proposals for Bank borrowings in fiscal '78 I made no recommendations for a Kuwaiti issue. The proposals I made were approved by the Executive Directors on October 11.

During the Annual Meetings, we had discussed with other governments about the possibility of Bank issues in their markets especially in Germany, Switzerland and Japan. By the time you spoke to me on October 31 and again on November 4, we were already close to agreement with our underwriters around the world on the timing and amounts of various borrowings which would have taken us up to the level approved by the Executive Directors. It was then a question to see whether it would be too late to substitute a Kuwaiti issue denominated in a currency other than the dinar for some other issue.

I was still under the impression that you were talking about a public issue underwritten by KIC and was surprised, as I told you on the phone, that Kuwait would have any sizeable interest for Swiss franc denominated bonds in view of the low yield and the restrictions that the Swiss Government placed on the

marketability of these bonds. As a matter of fact, these restrictions would have been, I think, as much of a handicap for a placement with the Government because in the past the Finance Minister has made it plain that he would wish to have complete freedom to trade any bonds issued by the Bank no matter what the currency denomination might be. With regard to a Deutsche Mark issue we made enquiries through our underwriters and were told again what we have been told before and during the Annual Meetings that the Government would not wish us to have any public issue in the months of November and December and this was again confirmed to us even after your enquiries from the Dresdner Bank. In addition, of course, the terms of the Gentlemen's Agreement between the Bundesbank and German issuing banks would have applied to a public issue or private placement unless the operation was a direct transaction solely with the Kuwaiti Government. This left Japan, and at the time you spoke to me our people from Treasurer's Department were already in Tokyo preparing for an issue that was to be offered in the second half of November. Matters had already moved too far for us to make any major change without considerable embarrassment to the financial community and authorities in Tokyo. As you may recall, we had in July last simultaneous offerings of Yen bonds in the Euromarket (Yen 20 billion) and in Tokyo (Yen 30 billion). On this occasion the Japanese Government had told us that they did not wish to have any yen denominated issue sold abroad, but instead permitted us to borrow a total of Yen 50 billion in Tokyo. The reason for their reluctance to allow such an issue outside Tokyo was that this would mean an accretion of their already excessive reserves. Had you told me at the time of our discussion at the Annual Meetings about the interest of the Government of Kuwait in making a placement of part of its reserves it would probably have been possible to have made some arrangement both in Deutsche Mark and in Yen that would have been attractive both to the Bank and to Kuwait. By the time of your visit to Washington, of course, our discussions with all our other underwriters had gone too far to make anything but minor changes in our borrowing program for this financial year and therefore we did not even take up some of the other questions and issues related to regulations in some of our important national markets.

When you met me here in Washington you wondered whether there were any political reasons underlying the difficulties. Let me assure you that this is not the case. The restrictions imposed by the Swiss Government would apply to any non-resident issue in Swiss francs and have been applied to countries such as the U.K. Both the German Government and the Japanese Government would be very ready to entertain proposals for the Bank to borrow Deutsche Mark and Yen already owned by Kuwait and I am sure that this will be the case for some time to come. I myself am very anxious that the Bank should maintain its relationship with Kuwait in these matters because we have benefitted greatly in the past from such a relationship and hope to do so in the future. I myself will be coming to the Gulf in the Spring and if you still wish to pursue the idea of

Mr. Bader Al-Dawood

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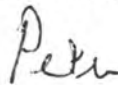
January 9, 1978

lending the Bank money in currencies other than the dinar we could begin discussions at that time. For the time being, let me say how sorry I am that we could not work out the arrangements on this occasion but you can see, given the history of the affair, that there was ample room for misunderstandings.

As Abdel Latif al Hamad was involved in some discussions about the possibility of borrowing in Switzerland during the Annual Meetings, I am sending him a copy of this letter.

. With best wishes for 1978.

Yours sincerely,



I.P.M. Cargill
Vice President - Finance

cc: Mr, Abdel Latif al Hamad

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara (through Mr. Cargill)

FROM: John H. Adler *JH*

SUBJECT: Borrowing in Kuwaiti Dinars

DATE: May 9, 1977

1. This note deals with the question as to whether the Bank should resume selling to Kuwaiti lenders bonds denominated in Kuwaiti dinars. It concludes that the risks incurred by the Bank and its borrowers in doing so would not be greater, and perhaps on balance smaller, than those assumed by borrowers of any strong currency and that, therefore, the Kuwaiti dinar denomination of bonds should not stand in the way of borrowing in Kuwait.
2. The question taken up in this note has been with the Bank for several years. Between FY69 and FY74 the Bank sold six issues denominated in Kuwaiti dinars, with an original US equivalent of \$388 million, to the Kuwaiti Investment Company (KIC) as underwriters. It did so with some reluctance because it felt uneasy about incurring, and passing on to its borrowers, obligations denominated in a currency with an exchange rate which was not determined by market forces but could be changed at will by the country's monetary authorities. This concern, together with difficulties which Bank borrowers encountered intermittently with the purchase of non-trading currencies to pay amounts due to the Bank, has led to a decision to discontinue borrowing operations in non-trading currencies and to borrow only, or at least preferably, in currencies with exchange rates determined basically by market forces. While until FY74 we borrowed not only in Kuwaiti dinars but also in Lybian pounds and Lebanese pounds, from then on we insisted, with only two exceptions, on borrowing in trading currencies. Thus, we sold bond issues denominated in US dollars, DM, and SwF to Kuwait, Saudi Arabia, Lybia, and Venezuela. The two exceptions to this new rule were an issue of Riyal 500 million (US \$140.8 million) sold to Saudi Arabia on July 1, 1974, the first day of FY75, but negotiated previously, and an issue of Venezuelan bolivares 225 million (US \$100 million) to "top up" an issue of \$400 million denominated in US dollars made simultaneously in September 1974.
3. As to borrowing from Kuwait, there has been only one issue since FY74, namely an issue of DM 400 million (US \$155.3 million). Since then prolonged discussions regarding issues denominated in trading currencies (DM, SwF, ¥) with the Kuwaiti authorities have come to naught, essentially for two reasons. The Kuwaitis were and continue to be anxious to promote the use of their currency in international finance and are therefore reluctant to put up with conditions which the authorities of the countries in whose currencies the borrowing from Kuwait would be denominated would insist on. On the other hand, the countries in whose currencies the bonds are to be denominated insist that the bond issues conform to the regulations governing all bond issues in their countries. To abide by the

regulations involves the participation of a national financial institution and additional expenses which have to be borne by the lenders or, indirectly, by the borrower, i.e. the Bank. Swiss regulations permit the direct issuance of Swiss-franc denominated notes to foreign lenders only to governments and the notes would have to be held in a Swiss bank in an existing account of a government. In the past such an arrangement has not been acceptable to the Kuwaiti authorities because the Kuwaiti Government has maintained that a direct purchase by the government would require parliamentary approval, which the government has been reluctant to seek. (The avoidance of seeking parliamentary approval was also given as the main reason for the use of the Kuwaiti Investment Company as an underwriter; at present this argument is not valid because the legislature has been dissolved). German regulations regarding a DM denominated issue sold to Kuwaiti investors are less restrictive, but they would require a German "lead" underwriter in addition to the KIC, at a cost. A yen issue could be sold to KIC only with a Japanese securities house acting as the managing underwriter and a Japanese bank acting as fiscal agent, again at a cost.

4. Thus, the question arises whether the Bank should modify its position regarding the sale of bonds denominated in KDs. The answer depends almost entirely on an evaluation of the risk arising from the possibility that the Kuwaiti dinar would be arbitrarily revalued vis-à-vis the major trading currencies, thus raising the cost, in real terms, of the debt service on KD-denominated loans. The short analysis that follows concludes that the probability of Kuwait revaluing its currency is small. True, Kuwait could revalue, by almost any proportion, but such a move would be decidedly not in the country's interest. Kuwait's foreign exchange earnings consist almost entirely (93%) of the proceeds of oil exports. Oil prices are quoted in US dollars, and payments are made by the American companies buying the oil in dollars and by the British companies (BP) in sterling at the prevailing dollar rate. An appreciation of the KD would leave the foreign exchange earnings unchanged, but reduce their KD equivalent and thereby government revenues, expressed in KDs. Conversely, it would raise that part of the cost of production which is incurred in KD and indirectly affect the balance of payments. According to the latest estimate of the population of Kuwait of mid-1976, of one million, approximately 570,000 are non-Kuwaitis. Many of them are permanent residents, but a large minority - at least 200,000 - are recent immigrants or migrant workers who remit part of their earnings abroad. If the KD is appreciated, the transfer of the same amount of KDs would require a larger amount of foreign exchange and thus reduce foreign exchange reserves.

5. Moreover, an appreciation of the KD would adversely affect the relations of Kuwait with Arab countries who have borrowed from the Kuwait Fund for Arab Economic Development and whose debt, and debt service, would increase pari passu with the extent of the appreciation.

6. There is nothing in the recent history of the monetary management of Kuwait which would suggest that attempts were being made to raise the

May 9, 1977

foreign exchange value of the KD, and it is hard to conceive circumstances under which the Kuwaitis would contemplate doing so in the future. Until 1967 the KD was held at par with sterling, but when sterling was devalued from \$2.80 to \$2.40 that year, the KD stayed at the old par value of \$2.80. It stayed at that level in terms of the pre-devaluation (or gold) dollar when the dollar was devalued in 1971 and 1973; it is now worth \$3.47. The 24% appreciation vis-à-vis the US dollar reflects largely the depreciation of the US dollar (at present 16% against the SDR); the remainder is accounted for by the "depreciation" of the SDR vis-à-vis its original value. Compared with strong "market" currencies, these movements represent a high degree of stability. In the same period, i.e. between the end of 1970 and March 1977, the DM appreciated vis-à-vis the dollar by 53%, the SwF by 69%, and the ¥ by 29%. In other words, borrowers of market currencies other than US dollars whose export earnings are in US dollars, are much worse off now than borrowers to whom we disbursed in KDs.

7. There remains one other objection against the Bank borrowing and relending in KDs. That is the possibility that Bank borrowers find it difficult to obtain KDs when they need them to service their debt to the Bank. This problem, which persists for a number of currencies which are not traded in the exchange markets, appears to have been solved as far as KDs are concerned since the United Bank of Kuwait in London, a subsidiary owned by all major Kuwaiti banks, is providing KDs on request. Moreover, the problem for all currencies has been practically eliminated by the standing offer, by the Bank, to buy the required currencies for the account of the borrowers.

8. Finally, one aspect of engaging in borrowing operations in KDs deserves mention. That is whether or not the sale of KD bonds would set a precedent of similar operations in other non-market currencies. There is no simple answer to this question, since it depends on a constellation of many factors, such as the likelihood of an arbitrary change in the exchange value of the currency in question, who would buy the bonds - the government and/or some other lenders - whether the purchase, by IBRD borrowers, of the currency is easy or difficult, and, finally, how much additional borrowing we could expect if we were to borrow in a particular non-trading currency.

9. To agree to sell to Kuwait KD-denominated bonds would not preclude the possibility of selling them from time to time if they want to do so, bonds denominated in other currencies, either in addition to, or in lieu of, the sale of KD issue.

cc: Mr. I.P.M. Cargill ✓

JHA/msg