

## Reforms Can Wait, Trust Cannot

*Meritocratic HR Policies, redressing institutions & restoring trust should be the order of the day*

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### I. Geopolitics & the Urgency of Reforms

Reforms are not new in GCC however the pace at which they are unveiled is often dictated by the prevailing oil prices and geopolitics. Higher oil prices and stable geopolitical situation often leads to a sense of complacency and has led to inefficiencies among public institutions. Good times in the GCC region are cheered with populist announcements, such as increased salaries and higher bonuses for public sector employees, which are largely unsustainable in the long run. On the other hand, lower oil prices and the associated negative sentiments have historically led the authorities to launch a series of reforms. However, reduced allowances and incentives, job cuts and other belt tightening measures pursued by authorities in sharp contrast to a period of largesse, as well as, uncertain economic conditions would make introduction of reforms challenging. For instance, in 2016 series of reform across the board were launched; however, the momentum has slowed in 2017 following subsequent recovery in oil prices.

**Table: Oil, Geopolitics & Reforms**

Oil Prices	Geopolitical	Stable	Unstable
High Oil Prices		<ul style="list-style-type: none"> <li>• Set back in institutionalization</li> <li>• Lack of accountability</li> <li>• Delay in reforms</li> </ul>	<ul style="list-style-type: none"> <li>• Serious market volatility</li> <li>• A populist policy at the expense of sustainability</li> </ul>
Low Oil Prices		<ul style="list-style-type: none"> <li>• <span style="color: green;">2016</span></li> <li>• <span style="color: red;">2017</span></li> <li>• Serious Reforms across the board</li> </ul>	<ul style="list-style-type: none"> <li>• Serious economic and political uncertainties</li> </ul>

Source: Marmore

Lowering of oil revenues following the drastic fall in oil price since-2014 has placed immense stress on the sovereign balance sheets of countries that are predominantly dependent on oil revenues. Among GCC nations, sovereign debt of Saudi Arabia, Oman & Bahrain have been downgraded by the rating agencies. Though Kuwait is better placed amongst its GCC peers in terms lower fiscal breakeven oil price and higher fiscal reserves ensuring sustainability of its finances is critical in the current environment. Further, 90% of government expenses are in the form of current expenditures rather than capacity building capital investments.

### Institutional building needs to be focused on

Investment venues in Kuwait are too narrow and too few. Even protectionism (investors' natural behavior in times of crises and geopolitical uncertainty) is not an option given the state and size of Kuwait market and institutions. Admiration of the strong infrastructure of industrial countries should be reflected positively in Kuwait's public and private institutions, and should not be a source of exaggerated political risks. In a nutshell, Kuwait institutions

and market environment should be nurtured, supported and developed to turn them into a safe haven despite the non-ending uncertainties. Inward Foreign Direct Investment (FDI) flows into Kuwait have sequentially declined in the past five years. From a value of USD 3,259mn registered in 2011 it has reduced to a value of USD 293mn by 2015. Moreover, FDI outflows have been among the largest in Kuwait. Away from consecrating protectionism as an option, we should understand that the quality of any economic investment program starts from the strength of our national institutions and its human elements and mechanisms to ensure transparency and effective accountability to achieve the country's goals after clearly defining them.

Abu Dhabi Investment Authority (ADIA) which manages the Sovereign Wealth Fund (SWF) of Abu Dhabi is relatively transparent in its process and operations. It publicly discloses the asset allocation and geographical allocation limits in sharp contrast to its peers.

### **Need for Economic Diversification Can't be overemphasized**

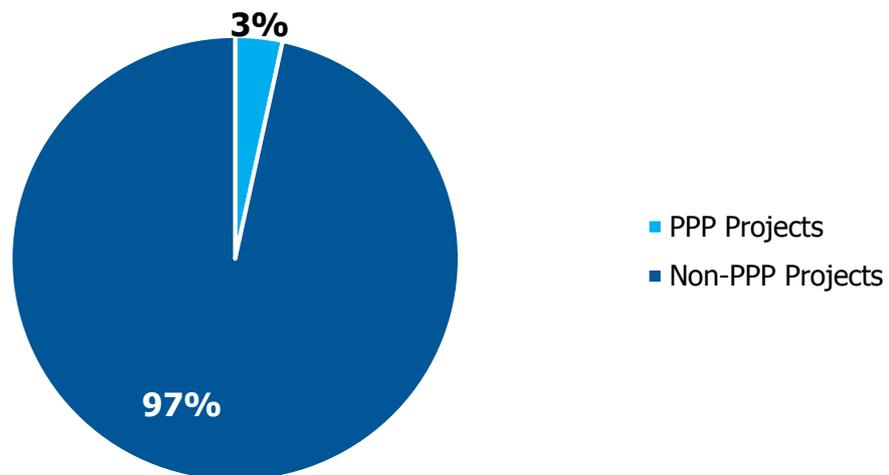
The Economic Complexity Index (ECI) is based on number and the complexity of products that a country exports with comparative advantage. Thus, the study and analysis of the ECI will help in formulating economic strategies around where important gains in productive capabilities can be made, allowing Kuwait to diversify its exports into more complex product areas beyond oil. As complexity in the economy increases, more sustainable would be the GDP growth. Currently, low complexity oil dominates the economy; the increase in diversity will create a more sustainable GDP growth. For example, crude petroleum accounts for 69% of Kuwait economic activity, while it accounts for just 19% in UAE.

To attract investments and diversify economy, greater emphasis should be on building consensus among various stakeholders and bolstering capacity in state institutions. We envision action through four strategic pillars:

1. Increased participation of Private sector
2. Defining the role of state in the economy
3. Increased participation of citizens in owning projects
4. Reforming labour market

Among the GCC nations, Kuwait ranks the least at 102 in the Ease of Doing Business - 2017 rankings. Kuwait economy is structurally biased towards exporting capital. 95% of state spending in 2015 went to contractors without any active participation from private sector. Thus, the private sector was unable to create jobs either. In Kuwait, every year 23,000 young men and women get into labour market. However, the public sector accommodates only 6,000 and the private sector is able to generate opportunities for 5,000 leaving 12,000 jobless. The current economic model based on fiscal state spending will continue to have a black hole (repatriation via contractors and banks) as long as the private sector is not empowered through fair and transparent Private and Public Partnership (PPP) programs that use best practices to achieve justice between all related parties. For instance, PPP projects account for mere 3% (by value) of all the ongoing projects in Kuwait.

**Figure: PPP Projects is Negligible Part of Ongoing projects in Kuwait**



Source: Zawya, Marmore Research

## **II. Prerequisites to effective reforms**

### **a. Functioning Institutions**

Whilst many reforms have been introduced in Kuwait, the financial sector accounts for lion's share and it is the most regulated sector in Kuwait. Existence of regulatory institutions such as Capital Markets Authority (CMA) and Central Bank of Kuwait (CBK) enable in the creation of regulatory gap in favor of financial sector in comparison with other sectors. For example, strict Anti-Money Laundering (AML) procedure in financial sectors exceeds other sectors. Despite being well regulated the financial sector suffers from weak sovereign infrastructure that hampers growth and drives out capital.

Access to capital in domestic markets remains weak and investment venues are limited in the region. As a result, financial institutions have remained risk averse, their growth limited and job creation in the sector is meagre. We believe with a competent public sector, the sector has much larger potential to grow. Financial institutions could play a larger role in projects landscape in financing projects, underwriting projects, evaluating project feasibility, offering consultancy services.

Public sector is major entry point to change Kuwait's income culture, achieve social justice and hence trust. Public institutions endowed with large resources and backed by state have struggled to perform, so far, due to weak governance and lack of accountability. Poor performance offers plenty of room to improve given the low competitiveness level on most sectors; huge savings could also be realized given the current spending that remains largely undisciplined in nature. In the absence of a strong and functioning public sector, any talk of private sector job creation is nonrealistic because enabling the private sector will not be achieved without an efficient public sector. In this sense, reform is needed in the public sector to:

- Promote meritocratic HR policies to recognize & reward talent
- Promote accountability
- Bring state institutions on par with world and regional practices
- Improve the Ease of Doing Business rankings

## Case Study: Functioning Institutions/Efficiency Islands - Kuwait Direct Investment Promotion Authority (KDIPA)

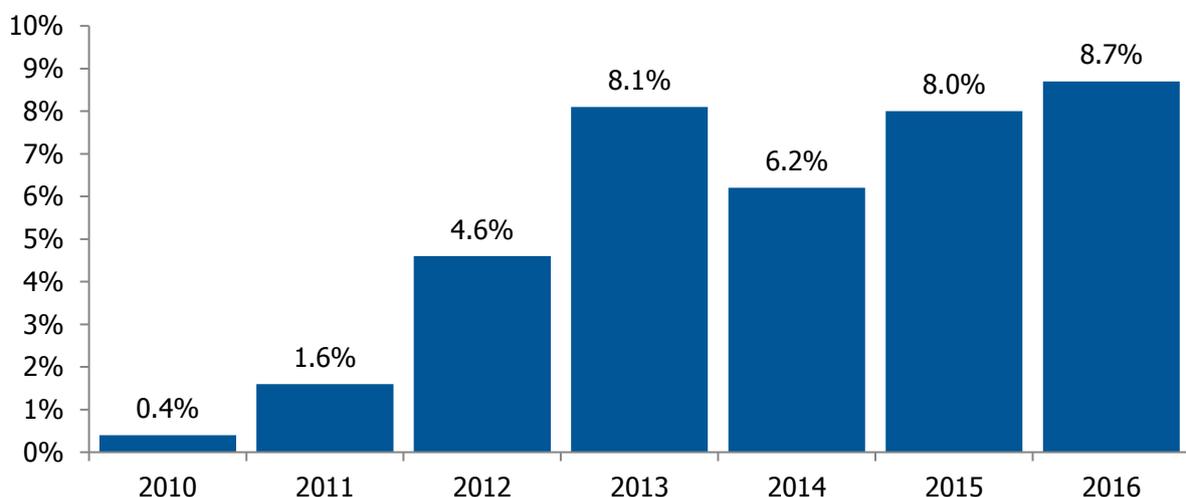
Functioning and efficient public institutions among state institutions are a rarity and thus it could be considered as an 'Efficiency Island'. In Kuwait, Kuwait Direct Investment Promotion Authority (KDIPA) is an island of efficiency. KDIPA was established to boost foreign investments in the country by streamlining procedures and incentivizing investors through tax credits. In its first year of operations it signed deals with leading international players such as IBM, GE, and Hawaii and consequently attracted Foreign Domestic Investment (FD) to the tune of USD 2bn. Additionally deal flow for various other new projects is expected to create 995 jobs for Kuwaitis in the coming five years.

Considering the circumstances such as declining trend of FDI in Kuwait and deteriorating business environment, success achieved by KDIPA in the first year of operations is stellar. The success could be attributed to HR policies seeking excellence, internal control systems and sophisticated accountability.

**Key Takeaway:** Institution excellence can only be achieved through healthy HR policies, establishing clear KPI's, and through good governance frameworks.

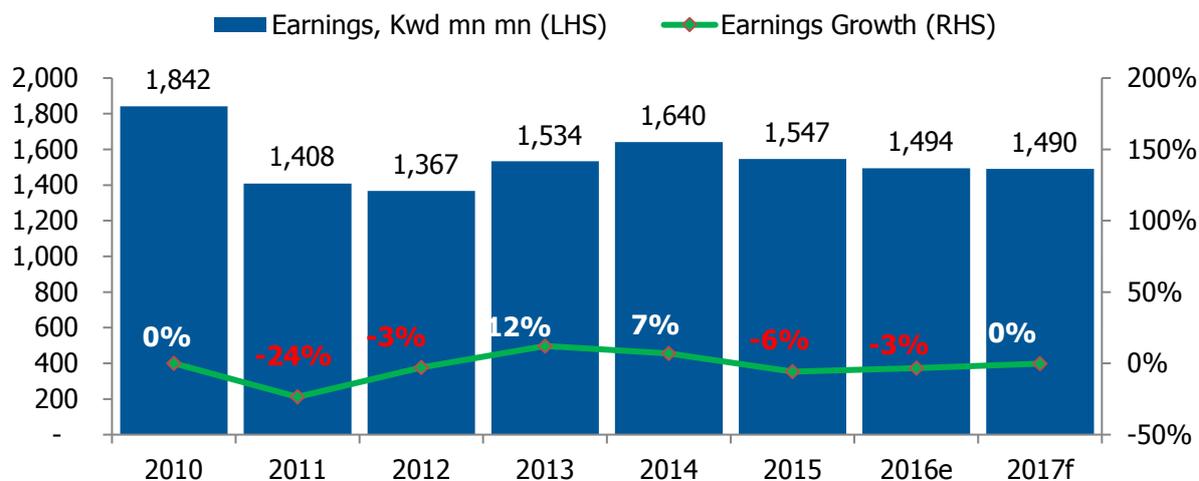
Despite the high volume of tenders being floated by the government, the same is not reflected in the expansion of private sector or banks activities. Credit growth remains meager while corporate earnings are largely stagnant. Kuwait banks continue to remain risk averse. Contracting businesses are predominantly family owned in the region; hence Kuwait Stock Exchange (KSE) is not geared to benefit from the mega contracting projects. Dysfunctional privatization has also made it equally difficult to involve private sector in massive job creating infrastructure programs.

**Figure: Kuwait Overall Credit Growth (YoY)**



Source: Central Bank of Kuwait

**Figure: Kuwait Corporate Earnings**



Source: Reuters, Mamore Research

### **Good governance in state institutions and due administrative reforms**

Citizens’ rights to obtain services meeting his needs and its relation to sound governance should be accorded priority. To establish good governance, a charter of governance and transparency for public institutions could be unveiled. Obstacles to good governance such as conflict of interest should be removed. Further, grooming leaders according to meritocracy without social and political considerations would ensure greater accountability and better performance. Instituting HR policies, performing internal audit, better risk management, reforming administrations would curb corruption and ensure good governance and better delivery of services.

### **Civil Society and NGO’s can play a Significant Role**

Civil society can be better organized to voice scrutiny on delivery of services to citizen. Currently, NGO’s are underfunded, under-empowered, and weakly regulated. Yet some have done well to fill the huge void left by the state especially in areas such as arts, youth developments, and monitoring of public agencies.

There are new forms of funding permitted by law, such as the Minister of Finance Act No. 58 of 2007 issuing regulations to Law No. 46 of 2006 concerning Zakat and public shareholding and closed companies contribution in the state budget. The law includes educational services, health, social solidarity, media and others. Allowing the private sector that is qualified with its economic experiences to achieve a leap in the areas of community service through the institutions of civil society could be beneficial. For instance, Bayt Abdullah Children’s Hospice provides multi-professional, specialist, pediatric palliative care and support to children with life limiting or life threatening illnesses who are resident in Kuwait, and their families.

The poor performance of public institutions arising due to lack of competitiveness can lead to increased systemic risks. The need for functioning institutions to have more depth can’t be over emphasized. More than implementation, policy planning remains weak due to lack of ownership. In order to promote good policy making, a suitable research community/think tank is required to analyze problems at the grassroots level and suggest possible localized solutions that work. Currently, the policies lack depth, pluralism and institutional character. Policies conflict and weak accountability are the most important indications. Strong research alliances with excellence centers and local credible organizations to build institutional depth

should be promoted. The beginning of which should be through developing research human resources.

Obstacle to the effectiveness of functioning institutions and its human cadres could be due to dependency and procrastination through foreign consulting firms. International consultancies have failed to improve national capacity building due to conflict of interest. Further, multiple studies and various mutually exclusive recommendations could lead to procrastination in decision-making and weak accountability. Institutions did not pay attention to the need to build human capacity to absorb knowledge brought by advisers and international development institutions.

Other approaches should be developed to support institutions in order to build capacity and achieve depth and independency in these institutions. Technical support programs by strong national institutions and universities programs (research and training) for public organizations could be other options; as well as partnership programs between private and public sectors, all this could lead to efficient institutional community in Kuwait. Also, usage of consultants and international institutions should be re-assessed as they haven't been beneficial considering our progress made so far based on their recommendations.

#### **b. Meritocratic Human Resource Policies**

Kuwaitization through compulsory labor ratios and not creating jobs in the private sector was a priority in the state's policies. National employment rates in the private sector companies have not been matched with the expansion of the private sector and hence job creation has been meagre. Further, the local labor fund undermined the alignment of interest between corporations and their staff.

For private sector to play a greater role in job creation they should be offered greater opportunities in the economy. To bridge the private and public sectors, greater emphasis on partnership projects (PPP) could be laid in government contracts. Such projects typically have long tenure and thus have inherent legal and technical complexity, as well as social implications. Therefore it requires human resources depth particularly in management field among the state's institutions and a higher degree of accountability.

To bring talent forth, meritocracy in civil service should be ensured; for the youth fair and equal opportunity in the private sector should be provided. Presently, in the current state human resources policies in state institutions are far from meritocratic. As a result, Kuwait is losing talent to competitive markets like UAE (Dubai) and Qatar.

Thrust on SMEs to act as engines of growth in job creation has become more of a political slogan. More than capital provided by the state, the youth of the nation need equal opportunities across sectors to flourish. Institutions also lack capacity to absorb "purchased" knowledge and implement best practices.

In this regard, 'enabling youths' is a mentality, not a slogan. This mentality has to focus on motivating youths to absorb two vital values - knowledge and work; then direct our programs into that direction.

#### **c. Trust**

Innovation remains a metaphysical concept rather than a societal value that we understand its risks and requirements professionally. Institutions and leaders are not incentivized to take risk. Confusion between calculated risk taking and corruption has taken its toll in the form of delaying economic growth & development. Weak accountability and absence of proper KPI's

further permeates risk-averse culture among public institutions. Hence most of the innovation discourse is commercially driven. However, we feel that innovation should come down from being treated as an ‘abstract concept’ and transformed as a ‘value’ that is well embedded in accountability of institutions

### **Honest communication is a key to enhance Trust**

We have too many false slogans leading to confusion. For instance, consider these:

- What does empowerment of the youth mean?
- What does enabling the youth’s slogan mean?

Do they imply fast track promotions at the expense of experience? Does it mean adequate creation of jobs for its youth? Would it involve providing equal opportunities in public and private organizations?

Overlapping objectives and unclear motives could cause confusion in sloganeering campaigns. To tide over, a clear national metric for Kuwait youth is required. Private sector should entrust itself with the act of job creation while public sector should volunteer to provide equal opportunities for all in terms of employment, promotion and incentives. SMEs could contribute by opening new sectors for its youth through friendly government contracts for youth projects, majorly, with oil sector.

### **Conflicting policies banish trust**

For instance, the savings which the authorities intend to achieve by curbing fuel and electrical subsidies far exceeds the largesse spending by the state on wages and salaries. Therefore, it is difficult to promote such policies to the citizens or expect partnership will from them. Unfair allocation of burden between citizen and state is an obstacle facing the economic reforms charter. Successful partnership between the state and all related parties necessitate fair distribution of burdens. Overall, trust and not marketing is the prerequisite of any meaningful reform. Homogeneity of policies to achieve higher unified and clear message to all is a major requirement for proper implementation of these policies and their success.