CHAPTER - I
INTRODUCTION

1.1 - Kuwait and Its Economic Significance

Kuwait, placed at the head of the Arabian Gulf close to the Shatt-el-Arab occupying significant geographical location, is a small Arab State of an area of about 17,818 sq.Km. (including 2,590 sq. Km. of Partitioned or Neutral Zone) of mostly desert\(^1\). It falls between the latitudes 28\(^\circ\) and 30\(^\circ\)N and between the longitudes 46\(^\circ\) and 48\(^\circ\) W. To the north and west, Kuwait shares a border of 240 km. (149 miles) with the Republic of Iraq, and to the south and south-west it neighbours with the Kingdom of Saudi Arabia along a border of 255 km. (155 miles). To the east it has a coastline of 290 km. along the Arabian Gulf and occupies a few natural harbours\(^2\). In addition, a number of islands in the Gulf extend the Kuwait's area of territorial waters to about 2,200 sq. miles. Of these,

\(^1\) Economic Intelligence Unit (EIU); Country Profile: Kuwait-1988-89, London, p.2.

\(^2\) The Ministry of Information, Kuwait; Facts & Figures, 1984, p.15.
Bubiyan, Failakha, Warba, Umm Al-Maradim, Umm An-Namil, Kubbar, Miskan and Qaru are worth mentioning. Failakha is most populated and beautiful while Bubiyan is largest but uninhabited. The climate and terrain are extreme and inhospitable. The country faces dry climate, relatively cold winters with low rainfall and the frequent sandstorms. Although, the evidences of human settlement in Kuwait are hardly traceable but the archaeological survey and the excavation carried out in its Failakha Island in 1937 unearthed that it were the Greeks who had created the history of establishment between around 400 and 100 B.C. But the early period of Islam is ascribed to A.D.633 with the victory of muslim General Khalid Ibn'l Waleed over Arab hostile to Islam and the Sasanian dynasty. However, the

history of modern Kuwait dates back to AD 1716 with the migration of a confederation of Anaiza tribe from north-central Arabia to the south coast of Kuwait Bay, predominantly called 'Ras al-Ajuza' (the cape of old woman). The present dynasty is descended from these settlers of Anaiza tribe. The record of the history unfolds that British had opened their relations with Kuwait in 1775 and the British desert mail from the Persian Gulf to Aleppo had been first despatched from Kuwait, the arrangement that continued until 1779. Its strategic importance was felt much acutely when Basra was first hit by plague and then captured by Persians in 1776. These twin events led to an exodus of people and the short lived transfer of the office of British East India Company gave an impetus to the development of Kuwait.

7. Ibid, p.263.
The geographical location of Kuwait made it a place of importance of the Arabian Peninsula and led it to be a significant trade centre for the desert caravans carrying various goods, traversing this region, to Europe through Aleppo. The region particularly the head of Arabian Gulf was considered to be the key to the world. Therefore, this led to the prevalence of a famous saying "Who would hold the key would rule the world". Hence the location of Kuwait gave it a strategic and economic significance as it turned out to be a focus of the attention of big powers of that time and, thus, later a bone of contention amongst them. The relations of Kuwait with Britain became stronger when both signed a treaty on January 23, 1899 whereby Great Britain assumed the responsibility of Kuwait's defense and foreign affairs. In return, the ruler of Kuwait pledged himself not to grant any concessions or cede his territory to anyone without British approval. This agreement was
updated in 1913\textsuperscript{10}. This resulted in making Kuwait a British Protectorate and a Political Agent was first appointed in 1904\textsuperscript{11}. Before the emergence of oil prospects, the entire region of West Asia geographically, strategically and economically was of immense importance mainly to the Ottomans, Germans, British and Russians but, the discovery of oil made it tremendously significant\textsuperscript{12}. The discovery of oil in Persia (Iran) in 1908 streamlined the prospects in the entire region and the subsequent explorations in Kuwait and other states made the entire region of more economic, political and strategic importance\textsuperscript{13}.

The relations between Kuwait and British had already set out which resulted in their associations but, the prospects of hydrocarbon resources in the

\textsuperscript{10}Lenckzowski, George; \textit{The Middle East in the World Affairs}, Cornell University, New York, 1980, p.661.

\textsuperscript{11}Op.Cit., Shaw, Ralph, p.17.


\textsuperscript{13}Shwadran, Benjamin; \textit{The Middle East, Oil and the Great Powers}, Israel University, Jerussalem, 1973, p.17.
region in the early part of this century helped them to be interdependent. The long drawn negotiations between the Emirs of Kuwait and the British Political Agents culminated in oil concession agreement which was signed between H.E. Sheikh Sir Ahmad and the representatives of Anglo-Persian Oil Company (British Petroleum) and Gulf Oil Corporation (American Company) through a joint venture Kuwait Oil Company (KOC) on December 1934. The first upstream of oil was witnessed in the Burgan region of Kuwait on February 24, 1938 which proved to be a boon for this small state. But the production of oil had to be halted for some time due to the outbreak of World-War II. Early in 1946 the ruler of Kuwait turned the silver valve wheel to start oil gushing into the bowels of the tankers and the first fruits of Kuwait's oil fields began to flow into the


15. Ibid, p.250.
commercial and industrial arteries of the world. The huge oil revenues have brought about tremendous upsurge in the economy and opened up innumerable avenues for economic development and absorption of manpower in more productive socio-economic activities.

The demographic picture of Kuwait of its pre-oil era is scanty due to the unavailability of statistics. Figures mentioned in this regard are mainly derived from personal estimates of European travellers and/or British Political Agents in Kuwait. According to such estimates, the population of Kuwait in 1831 was only 4000 which little over a century increased to 120,000 in 1947. There had never been a census conducted in Kuwait in the first half of this century. But the first census was conducted in 1957 which revealed that the population increased sharply as it was estimated at


of which 45 per cent were non-Kuwaitis. Though the size of population expanded rapidly due to the upsurge in oil revenues which consequently opened up new channels of absorption of foreign workforce but, the number of natives declined from 50.4 per cent in 1961 to 47.1 per cent in 1965. The real picture of total active manpower of the country is exhibited in the table - 1.1 which illustrates the shares held by the Kuwaitis and expatriates. It also reveals the distribution of active workforce among various productive sectors of the economy. It is discernible from the table that the number of native active workers increased by 25.4 per cent from 59634 in 1970 and further by 29.4 per cent to 87971 in 1975. It was the outcome of Kuwait's policy to encourage its indigenous manpower by providing many facilities including training. However, the total active manpower of Kuwait increased tremendously by 186 per cent in 1985 over its size of 1970 but, the size of indigenous

Table 1.1
ACTIVE MANPOWER OF KUWAIT BY NATIONALITY
ITS DISTRIBUTION AMONG VARIOUS SECTORS

<table>
<thead>
<tr>
<th>Sectors</th>
<th>1970</th>
<th>% in Total</th>
<th>1975</th>
<th>% in Total</th>
<th>1980</th>
<th>% in Total</th>
<th>1985</th>
<th>% in Total</th>
<th>1986</th>
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<td>6659</td>
<td>1.40</td>
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<td>14.40</td>
<td>32256</td>
<td>10.80</td>
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<td>20.10</td>
<td>122694</td>
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<td>39559</td>
<td>13.30</td>
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<td>12.10</td>
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<td>326729</td>
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<td>7271</td>
<td>2.40</td>
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<td>1.70</td>
<td>7466</td>
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<td>20347</td>
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<td>1.70</td>
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<td>78.10</td>
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<tr>
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<td>491509</td>
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<td>670385</td>
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Figure 1.1
Active Manpower of Kuwait by Nationality
labour force expanded by only 112 per cent during the same period. The share of Kuwaitis in the total manpower declined from 29.4 per cent in 1975 to 21.9 per cent in 1980 and only 18.8 per cent in 1985. The shortage of manpower not only in Kuwait but in the entire Gulf region has ever been aggravated since rapid development and colossal construction began at an accelerated pace after the upstream of oil and consequential influx of huge oil revenues. The oil sector which contributed a larger part of 65.7 per cent to GDP in 1971, 79.3 per cent in 1974 and more than 50 per cent in 1985 enabled Kuwait to hire foreign manpower in order to meet its growing requirements on all fronts. Mining and quarrying which employed slightly over 3 per cent of total workforce in 1970, has witnessed a decline and was recorded to only 1.4 per cent in 1985. Although, this sector does not employ a larger share of manpower but it indirectly provides opportunities of absorption in the other sectors of the economy. The construction, manufacturing, wholesale and
retail trades and transportation and storage sectors are the major absorbants of workforce. However, Kuwait through its five year plan 1985/86 to 1989/90 has aimed at raising the domestic contribution to the total labourforce from 22.6 per cent in 1984/85 to about 23.7 per cent in 1989/90. To achieve this, the plan focussed on raising the female participation in economic activities and on the educational and training systems. The table-1.1 and the figures 1.1 (a,b,c,d) give us the clear picture of the contribution of active manpower in various sectors of the economy. The Kuwaiti economy within a span of five decades has transformed from traditional modes of economic activities to the modern ones. Its dependence rests largely on the abundant hydrocarbon resources, particularly crude oil and associated natural gas of the country. The proven crude oil reserves of Kuwait were estimated at 94.53 billion barrels in 1988 which accounted 9.5 per cent of the total world oil reserves.

Figure 1.1 (a): Active Manpower of Kuwait by Sector

- Social services: 44.2%
- Manufacturing industries: 18.7%
- Construction: 14.4%
- Transport: 6.1%
- Mining and quarrying: 3.1%
- Agriculture & fisheries: 1.7%
- Financial institutions: 2.1%
- Electricity/gas/water: 3.1%

1970

Figure 1.1 (b): Active Manpower of Kuwait by Sector

- Social services: 53.7%
- Mining and quarrying: 1.8%
- Financial institutions: 2.2%
- Elect., Gas & water: 2.4%
- Agriculture & fisheries: 2.6%
- Transport, storage, commerce: 5.3%
- Manufacturing industries: 8.2%
- Construction: 10.8%

1975

Figure 1.1 (c): Active Manpower of Kuwait by Sector

- Social services: 45.5%
- Mining and quarrying: 1.4%
- Elect., Gas & water: 1.7%
- Agriculture & fisheries: 1.9%
- Financial institutions: 2.6%
- Transport, storage: 6.2%
- Manufacturing industries: 8.6%
- Construction: 20.1%
- Wholesale & retail: 12.1%

1980

Figure 1.1 (d): Active Manpower of Kuwait by Sector

- Social services: 49.4%
- Mining and quarrying: 1.1%
- Elect., Gas & water: 1.1%
- Agriculture & fisheries: 1.9%
- Financial institutions: 3.1%
- Transport, storage: 5.6%
- Manufacturing industries: 7.7%
- Construction: 18.6%
- Wholesale & retail: 11.5%

1985
which stand at 991.5 billion barrels\textsuperscript{20}. At the present rate of the crude oil production of 1.39 million barrels per day, Kuwait's reserves can last for about 185 years which is the longest life span of any country's reserves\textsuperscript{21}. Kuwait's natural gas reserves are estimated at 35 trillion cubic feet (about one per cent of world reserves) but are mainly in the form of associated gas\textsuperscript{22}. The hydrocarbon sector is the backbone of the Kuwaiti economy as it contributes about 38 per cent to GDP and 86.6 per cent to the total value of country's exports. The structure of international trade explains the major developments in Kuwait's trade and financial relationship with the outer world. The short lived stability in oil prices is reflected from the growth of Kuwait's petroleum exports. It helps in balancing the trade in favour of the country. The merchandise trade balance shows that the balance of trade recorded a


\textsuperscript{21} \textit{Ibid}, p.19.

surplus of KD 532 million in 1988\textsuperscript{23}. The value of total exports of Kuwaiti origin accounts 35.5\% per cent to GDP whereas the total import of the country have a chunk of 26.4\% per cent of GDP. This reflects the country's future prospects to expand its economy by absorbing surplus funds. The distribution of GDP between the oil and non-oil sectors reveals that the non-oil sector, which also includes fertilizers and chemicals, contributed less than 50\% per cent to GDP until 1985 baring the years 1982-83. But its share since then surpassed the oil sector's contribution as is exhibited in the table. It shows a shifting in the dependence of the economy that had begun to move from oil sector to non-oil sector. However, the hydrocarbon sector is still the key determinant of the levels of development of other sectors of the economy. The rate of fluctuations in the contribution of hydrocarbon sector to GDP influences the progress of the economy as a whole. The Kuwaiti economy is considered to be a

\textsuperscript{23} Central Bank of Kuwait; Economic Report-1988, p.76.
stable one with regard to its vast hydrocarbon resources and surplus funds which can pull ahead the country affluently for a long period. The affluence of the country can also be measured in terms of its GNP per capita income which was estimated at $13,890 in 1986\textsuperscript{24}. This put Kuwait among the top 6 nations of the world.

Kuwait, due to its important strategic location in the Gulf has made its place in the regional and international spheres as well. It has the privilege of being one of the five founding members of OPEC which was formed in September, 1960. Though it does not directly influence the world oil market but has some leverage in the determination of the levels of production, prices and the distribution of oil. Through OPEC, Kuwait plays an influential role in balancing the world oil supply and demand. It was the first country to adopt strict oil conservation policy and achieve 100\%

\textsuperscript{24} The World Bank; World Development Report, Oxford University Press, 1988, p.223.
per cent participation in the operations of oil Companies. Its vast oil reserves have put Kuwait in the list of top oil producing and exporting nations which scintillates its future prospects and prolongs the dependence on its hydrocarbon resources.

Kuwait became an independent state on the termination of the treaty of 1899 on June 19, 1961 and began to enjoy in a fashion of free economy. Therefrom the Sheikh of Kuwait took the new title of "Emir" and the state was admitted as a new member of League of Arab Nations. The country is being since then ruled by the constitutional monarchy which is hereditarily descending in Kuwait with an alternatively take over as Emir from one of the two lines of Al-Sabah family. Saudi Arabia, Kuwait and Libya on January 3, 1968 founded the Organization of Arab Petroleum Exporting Countries (OAPEC) in retaliation of not having equal participation and legitimacy with the Majors in the determination of oil

prices. The decision of OAPEC members of oil embargo against Israel and its friendly nations in 1973, due to the Arab-Israel conflict, had proved the power of Arab oil producers' unity. Thus, the process of evolution of economic cooperation and integration in West Asian region set out on equal footing of other regional groupings of developing and developed countries and this founded the genesis of future integration and interdependence.

Kuwait, apart from being one of the founding members of OPEC and OAPEC, has also got the credit of taking initiative to create the Gulf Co-operation Council (GCC) in February 1981. It was a step towards the establishment of unity among the Arab Gulf States.


and the security in the Gulf region. The GCC states represent ethnic, cultural and lingual affinity. They have historical, geographical, political and economic homogeneity. Kuwait has prompted modest attempt towards their unity. Though, the GCC is not exclusively an economic association but is perhaps the most promising effort to establish the economic cooperation among developing nations in the present time. However, in many agreements GCC has been successful in binding its member states in the circles of defense, foreign affairs, education, and energy, but after its Economic Agreement (EA) is after all the most significant achievement thereby the Arab Gulf states have established a comprehensive economic ties including free trade, common market, common oil and energy policy, and a coordinated policy of oil based on industrialization, common aid policy, and many other development of human and other resources in order to safeguard domestic industrial sector. The framework

of cooperation is dynamic as to explore the development potentials of the GCC member states through coordination of investment on various complementary activities. Kuwait is an active participant in many dialogues and conferences that are convened around the world. On the whole, Kuwait's regional relations have improved. It has always supported Egypt and Palestine for their legitimate rights against Israel. After the Arab-Israel war in 1973, Kuwait with other Arab oil rich states extended bilateral aid to Egypt and Syria for rebuilding their shattered economies.\(^{30}\)

Enormously endowed with hydrocarbon natural resources, Kuwait is liberal enough in channelling economic assistance and financial aid to the poor countries of Third World. Economic aid is disbursed by Kuwait Fund for Arab Economic Development (KFAED) and the Kuwait based Arab Fund for Economic and Social Development (AFESD) for the development in the Third World countries. The aid dispensed from these

institutions between January 1962 and June 1982 amounted to KD 992 million ($ 3.436 billion at 1982 exchange rate). Kuwait’s aid ranged between 3 and 10 per cent of the country’s GDP and it was estimated at 3.88 per cent of the GNP in 1983 of which 57 per cent had gone to Arab States. Foreign aid is an important aspect of Kuwait’s international linkages as it has been channeled out on an average of 9.5 per cent of the country’s GNP since 1970. Besides, Kuwait also shares in many of the multilateral aid programmes of which International Monetary Fund (IMF), the World Bank (IBRD), the OPEC Special Fund, the Arab Bank for Economic Development in Africa (ABEDA), Islamic Development Bank (IDB), UN special fund, International Financial Corporation, and many more agencies of U.N. and others are worth mentioning. The motive behind this programme is not merely the goodwill of the country but

31. Ibid, p.44.

there are political and economic explanations as well. Since Kuwait is one of the wealthiest small states and endowed with abundant oil and gas resources, it faces problems arising out of surplus funds which it invests abroad to assist poor Arab states and other developing countries. After Kuwait's independence in June 1961, Iraq was the first recipient country to have $70 million on generous terms. This was extended by Kuwait on account of political grounds as to have claim her independence. Moreover, the fear of Soviet expansion in the region of West Asia, the conflict in the Horn of Africa, the coup d'état in South Yemen (PDR) and Afghanistan, and the outburst of Iranian revolution focussed further interests of Kuwait to extend aid to the poor countries such as Sudan, Yemen Arab Republic and Pakistan. Apart from these efforts, Kuwait maintains good relations with the rest of Third World too. Kuwait does not always expand all its surplus funds in the form of loans and aids but invests

33. Ibid, p.175.
abroad to provide a permanent stream of income. Owing to the skyrocketing of oil prices in 1970s and early 1980s and consequently the surplus revenues, Kuwait has amassed huge foreign reserves by investing abroad. Such funds amounted to about $72 billion in 1983\textsuperscript{34}.

1.2 - Structure of the Kuwaiti Economy

(a) Pre-oil Economy:

The economy witnessed a vast structural change since its reliance on the traditional Arab economic modes has shifted to the modern ones. Although, the explanation of pre-oil economy can not comprehensively be made due to the scarcity of detailed information and scanty statistics available; but for understanding it is evident that prior to the upstream of oil, the livelihood of Kuwaiti people was confined to the extent of pearling, fishing, boatbuilding and small trade, agriculture and herding. The pearling was the prospective business for the merchants but, in

\textsuperscript{34} Op.Cit., MERI Report, p.10.
contrary, a risky job for the divers since, in some instances, their lives were short. Upto the year 1930, the pearling industry employed about 15000 divers out of 60,000 population and engaged about 800 boats, and was reported to have earned about one million U.S. dollars. The other economic activity which provided the livelihood to the lower class people by the Kuwaiti economy was fishing on which their diet also rested. In this sector of the economy, the wages and salaries were low though the fishing banks and islands supplied Kuwait with more than 4000 kilo grams of various sorts of fish every day in the early part of this century. It is evident from the fact that more than 1000 people from coastal villages were directly employed in this activity since the efforts were made to develop it as a regular industry for export. The boat building was the third activity of the Kuwaiti economy in the pre-oil era. This is true to the fact that Kuwait had become the centre of boat building for the entire Gulf.


region since it began to export to the rest of the Gulf the boats of different sizes and types of imported woods. On an average, more than thirty people were engaged in the building of a single boat. In 1931, though it was not a commercial year, witnessed the production of 25 large pearling boats and 30 small fishing craft by the Kuwait’s shipyard\textsuperscript{37}. The Kuwaiti shipyard built the ships needed by the pearling and trading sectors.

In addition, Kuwait has always enjoyed its favourable geographical location in the context of the main trade routes between the East and the West. Moreover, its relative political stability made it an important trading centre. This enabled Kuwait to have attracted a number of merchant families from various Arabian tribes who migrated from all around the domain. Its well sheltered natural harbour and the proximity to the towns of Iraq and the Arabian Peninsula has adorned with the unique composition of Arabian races.

\textsuperscript{37} Ibid, p.23.
Its location, providing linkages between Persian and Arabian coasts of the Gulf, India and the Far East, and the Mediterranean and European ports, made it the best transit area for trade. The ships carried dates and grain to Kuwait and other ports of the Gulf, India and African Peninsula. The Indian ships carried woods, coffee, tea, spices, rice, iron, lead and cotton yarn. The Kuwaiti tradesmen benefitted from the cargo and passenger trade to and from India. The ruler of Kuwait had, thus, the permanent source of income by levying tax on caravans that traversed his territory for directing and protecting them. It is worth mentioning that in 1905 more than 30 per cent of Kuwait's foreign trade was with India whereas the contribution of United Kingdom was only about 14.6 per cent. Kuwait's trade with Persia (Iran) accounted for about 9.1 per cent composing of tobacco, barley and wheat whereas it was only 18 per cent each with France and Germany composing

38. Ibid, p.20.
of arms and sugarcane respectively. The trade has increased substantially over the years but unfortunately the unavailability of data and informations restrict its explanation in further details.

Besides fishing, Kuwaiti's relied upon its small agriculture and herding for the diets. But the scanty rainfall, dry climate and wide flanged desert confined it within the sphere of these activities. However, Kuwaiti's enjoyed its small vegetation and herds for their foods. But the thing changed soon since the pearl diving and sea faring industries, the bases of the Kuwait economy, were highly dependent on the state of world economy. The Great Depression and the cultured pearl of Japan dealt a blow to the pearl diving industry, and the trade blockade of Nejd against Kuwait reduced its sea faring trade with India and East-Africa. The boat building industry declined as a result of losses incurred by the earlier two industries. But

Kuwait could have no longer faced the economic bottlenecks, thank to the discovery of oil which changed its fate soon.

(b) Economy in the Oil Era:

The emergence of oil industry with the upstream of oil and its export at commercial scale put the pre-oil era to an end. Rising oil revenues brought about the transformation in the economy and resulted in increasing its per capita income and flourishing construction and other economic activities. The change in the price structure in 1971 and skyrocking of prices of oil since 1973-74 opened up new channels of progress. Although, the hydrocarbon resources, mainly oil, dominate the scene but the Kuwaiti economy, to a larger extent, depends on the other sectors as well. The Kuwaiti economy is composed of two major sectors, i.e., oil sector and non-oil sector which build up the Gross Domestic Product of the country.
i - Oil Sector :

The oil sector is considered the key determinant of the progress of Kuwaiti economy though its contribution to the Gross Domestic Product, despite upsurge in oil prices, has been varying since 1971 but, the dependence of the economy on it has ever remained almost constant. It is evident from the table-1.2 that the contribution of this sector has, however, declined from 65.7 per cent to the GDP and 94.3 per cent in the total export earnings of the country in 1971 to only 50.4 per cent and 93.6 per cent in 1985 respectively. The oil revenues held the highest share of 79.3 per cent in the GDP in 1974 which could no longer stagnate as shrunk to only 59 per cent in 1978. The fluctuations in the share of oil revenues to the GDP occurred as a result of increase in oil prices and the deceleration in the rate of oil production. The oil revenues increased initially due to the adjustment of exchange rate of dollar which resulted in the rise of oil prices. But the expanding government's participation in oil operations later manifested as
<table>
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<td>2001.58</td>
<td>35.9</td>
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</table>

3-Central Bank of Kuwait; *Quarterly Statistical Bulletin* Vol.16 No.3 July-September 1989.
the nationalization of oil industry and resulted in an immediate upsurge in oil prices. Though the oil conservation policy has been adopted in 1972 which caused a decline in oil production but it did not affect the oil prices and the revenues. On the contrary, it increased the posted prices and the royalties to the government. It helped in increasing participation and ultimately achieving the nationalization of KOC in the year 1975\textsuperscript{40}. However, the oil revenues and the contribution of oil sector to the GDP has varied thereafter. After the complete take-over of oil industry by the Kuwaiti government caused much of the fluctuation in the contribution of oil sector as an outcome of erratic oil revenues which could have not happen from prior planning. Moreover, some of the variations could be ascribed to the modest success of diversification of the policy\textsuperscript{41}. The share of oil sector representing 70.5 per cent in the GDP in 1975

\begin{footnotesize}
\textsuperscript{40} Op. Cit., Al-Sabah, p.54.

\end{footnotesize}
fell to 65.7 per cent in 1976, 61.2 per cent in 1977 and only 59 per cent in 1978. The abrupt increase in oil revenues as a result of sharp rise in oil prices altered the situation in 1979, raising the contribution of oil sector to GDP to 64.5 per cent and 65.7 per cent in 1979 and 1980 respectively. But the decline in oil revenues in the early 1980s caused a shrinkage in its share in GDP as it slashed to only 59 per cent in 1981 and 44.5 per cent in 1982. The ratio of oil export to the total export also dropped from 91.1 per cent in 1979 to only 80.5 per cent in 1982. Though, the contribution of oil sector to the GDP improved in the following years as it surged to 53.3 per cent in 1984 but again witnessed a decline as shrank to only 38.1 per cent in 1987. The ratio of petroleum exports in the total export of the country has remained fluctuating as it rose to 93.6 per cent in 1985 but dipped to 90 per cent in 1987. The obvious decline in the oil sector's contribution to the GDP and in the total export of Kuwait can not be considered as a real indicator of success in the diversification of the sources of income
since the decrease in these ratios occurred mainly because of the fall in oil revenues rather than the increase in other revenues accruing from other sectors of the economy. It reflects that Kuwait could not avoid and reduce its excessive dependence on oil sector in the past. However, the other sectors of the economy have also registered a positive growth in their ratios to the GDP after 1982. A clear picture of oil and non-oil sectors' contribution to GDP and the share of petroleum in the exports of the country is evident from the table and, the figures exhibit the trends on these lines.

ii - Non-Oil Sectors:

The non-oil sector comprising of agriculture and fisheries, manufacturing, electricity, gas & water, construction, wholesale & retail trades, transport & storage, financial institutions, insurance, and a few other sub sectors, combining with oil sector...

Figure 1.2
Oil Sector's Contribution in GDP and Total Export

![Graph showing the contribution of the oil sector in GDP and total export over the years.]  

Figure 1.3
Sectoral Contribution in GDP

![Graph showing the sectoral contribution in GDP over the years with bars representing Oil Sector and Non-Oil Sector.]
composes the structure of the Kuwaiti economy. The efforts of the Kuwaiti government with regard to diversify its heavy dependence on hydrocarbon sector and establish a viable alternative are discernible in the following analysis. The table - 1.3 and the figure-1.3 both glitter the major facts of this shifting. Within the non-oil sector as a whole, the relative shares of many aforementioned sectors have tended to be quite stable, eg; the revenues accruing from agriculture and fisheries rose from KD 3.17 million in 1971 to KD 6.47 million in 1975, KD 14.07 million in 1980 and KD 39.38 million in 1985. The revenues from electricity, gas and water have also gone up from KD 9.33 million in 1971 to KD 25.97 million in 1979 but thereafter this sector registered a negative growth. Financial institutions and Insurance sectors have also witnessed the growth rates as the revenues increased from KD 21.81 million and KD 1.49 million in 1971 to KD 221.60 million and KD 19.38 million in 1985 respectively. The major non-oil sectors i.e.; manufacturing, construction, wholesale & retail trades and transport & storage which registered
### Table 1.3

NON-OIL SECTOR'S CONTRIBUTION IN GDP  
(In Million Kuwaiti Dinars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Sector</th>
<th>Total</th>
<th>&amp; Fish</th>
<th>Industry</th>
<th>Gas &amp;</th>
<th>Suction</th>
<th>Trades &amp;</th>
<th>Inst. ance</th>
<th>[Water]</th>
<th>[Storage]</th>
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<td>3.17</td>
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<td>37.5</td>
<td>3.78</td>
<td>65.42</td>
<td>10.77</td>
<td>38.43</td>
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<td>37.8</td>
<td>4.72</td>
<td>77.81</td>
<td>11.77</td>
<td>44.42</td>
<td>112.70</td>
<td>41.75</td>
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<td>20.7</td>
<td>4.69</td>
<td>171.19</td>
<td>12.64</td>
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<td>140.40</td>
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<td>554.05</td>
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<td>274.91</td>
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<td>272.24</td>
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<td>1988</td>
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July-September 1981.  
October-December 1987.
positive growth rates. The manufacturing sector witnessed an upsurge in its revenues contributed to the GDP despite various handicaps involved in its development, such as the narrow marketing outlets, the lack of raw materials other than oil, storage facilities and the high cost of skilled manpower. Due to the incorporation of petrochemical industry, which contributes the larger part of the value-added of intermediaries enhanced the share of the manufacturing sector in GDP. Its revenues, as a result, increased from KD 54.19 million in 1971 to KD 197.49 million in 1975 and KD 378.18 million in 1985. However, the contribution of this sector to the GDP registered the highest growth rate as rocketed a high to KD 569.77 million in 1979 but declined thereafter. Its growth rate depends on the trends of domestic and foreign demands for Kuwaiti petrochemicals and manufactured goods. The construction after the oil sector price rise began at massive scale, therefore, it has also

achieved a rate of growth witnessing an increase from KD 33.28 million in 1971 to KD 73.67 million in 1975 and KD 197.98 million in 1985. The growth in revenues of this sector continued in an upward trend throughout the period barring slight variations meanwhile. The growing oil revenues opened up the new avenues of diversification of income which resulted in the flourishing construction of many sub sectors of the economy. The position of trade, a traditional occupation in Kuwait similar to other Gulf states, maintained its steady but unspectacular growth particularly in the early eighties. The revenues accruing from the wholesale and retail trades sector jumped from KD 90 million in 1971 to KD 211.30 million in 1975 and KD 714.81 million in 1982 thereafter declined to KD 499.60 million in 1985. Transport and storage sector has also maintained its level of growth as the revenues multiplied from KD 31.84 million to KD 291.35 million between 1971 and 1982 but thereafter reduced to KD 239.58 million in 1985. And the remaining sub sectors also marked a steady and continuous
improvement. The relative shares and overall growth rate of non-oil sectors as a whole have largely rested on the course of Iran-Iraq war. Disruption of Gulf shipping had a major effect which disturbed the oil exports and put enormous pressures on the non-oil sector.

1.3 - Oil Industry and Downstream Operations

The oil industry in Kuwait since its inception underwent a significant structural change over the entire span of time. The first and predominant feature of the change is reflected from the profit sharing formula which came into effect in 1952 whereby the interest of the government improved over the years and, accordingly, the profits were shared fifty-fifty between Kuwait and the operating companies. This resulted in a sharp increase in oil production and the


revenues to the Government of Kuwait. The huge expansion in production itself depended on the existence of vast oil reserves of the country. The oil industry witnessed a another notable change when Kuwait with other oil producing nations formed OPEC as a permanent organization with international status by an agreement concluded in September 1960. It was all as a consequence of slicing of oil prices by the operating majors twice in 1959 and again in 1960 by about 27 U.S. cents a barrel which caused a heavy loss of revenues estimated at $4,000 million during 1960s to the Middle East oil-exporting countries. Through OPEC, Kuwait began to expand its holding over the oil industry. This turned into the establishment of Kuwait National Petroleum Company (KNPC) in 1960, and the relinquishment of about half of the area under Concession Agreement which later came under KNPC's

47. Ibid, p.53.
operations. The KNPC was initially involved in the marketing of refined petroleum products within the domestic market. The most remarkable changes were noticed in the seventies when the prices of oil began to rise since 1971 and brought about a vast change in the volume of oil production and the government revenues. However, there was no control over the operating practices of the oil majors who drilled where they liked and as much volume of oil as they wished. Thus, the high rate of oil production caused a decline in actual reserve to production ratio. As the daily production approached, this ratio declined further which caused the shortening of the life-span of oil reserves. It simultaneously affected the natural gas reserves since natural gas is found associated with oil and, thus, was wastefully flared rather than put to productive use by the operating companies. It led a hue and cry in Kuwait and the issue of gas utilization became a deep concern and was muted in the

parliament. The oil revenues to the government exchequer declined heavily, despite a continued rise in oil production, that reached its peak in 1972, as a result of devaluation of U.S. dollar. But the effect of the devaluation of dollar was offset by OPEC through its Tehran Agreement by fixing up the income tax rate at 55 per cent, consequently raised the posted prices by 40.5 per cent. The year 1972 marked a notable change in oil industry as the Kuwaiti government deliberately adopted the policy of oil conservation which consequently put an end to the wasteful production techniques practised by the companies. This not only checked the heavy exploitation of oil and wasteful faring of associated natural gas but also helped in raising oil prices and extending lifespan of oil and gas reserves of the country. The Kuwaiti oil wells have an installed capacity estimated at 2.9 million barrels per day, with a maximum


sustainable capacity of 2.5 million barrels per day\textsuperscript{51}. The life of Kuwait's oil reserves which are estimated at 94.53 billion barrels can be spanned for more than 185 years at the present rate of production of 1.397 million barrels per day\textsuperscript{52}. In December 1975, the oil industry witnessed memorable achievement of the government when it was completely taken over by terminating BP's and Gulf Oil's concessions\textsuperscript{53}. The oil revenues, despite a decline in oil production as a result of government's conservation policy, remained stable since diversification of export from crude oil to refined products took place.

(a) - Administrative set-up of Oil Industry:

The oil industry in Kuwait witnessed a propitious change in its administrative structure on 21 January, 1980 when the government set up Kuwait

\textsuperscript{51} Op.Cit., MERI Report, p.73.


Petroleum Corporation (KPC) under the Decree law No.6/1980. It was a step to perfectly regulate the oil operations and enhance its desirable profits. The government after having taken full control over the operations of oil industry, which had to be administered in a way that could be made favourable to the country, delegated KPC the responsibility of undertaking the activities of hydrocarbon industry, such as: exploration, refining and production of oil and gas; and the processing of oil and gas and their distribution and transformation. The KPC comprising KOC, KNPC, PIC, KOTC, KUFPEC and Kuwait Santa Fe Broun, undertakes upstream and downstream oil operations of the industry through its subsidiaries as follows:

i - Kuwait Oil Company (KOC) is responsible for exploration and production of oil and gas.

ii - Kuwait National Petroleum Company (KNPC) has been assigned the responsibility of refining of crude


oil and processing of natural gas; and the sales of refined petroleum products in the domestic and international markets. It supervises its five subsidiaries—KNPC (Far East), KNPC (Trade and transport), KNPC (Western hemisphere), KNPC (Liberia), and Kuwait Aviation Fuel Company.

iii - Kuwait Oil Tanker Company (KOTC) operates the tanker fleets and pipelines network and transports the Kuwaiti crude and refined oil, LNG, LPG, refined and petrochemical products to the consuming centres.

iv - Petrochemical Industries Company (PIC) is responsible for the production and sales of fertilizers and chemical products.

v - Kuwait Foreign Petroleum Exploration Company (KUFPEC) has been set-up to undertake exploration and upstream activities in the oil fields abroad, except in USA. It has also acquired equity in International Energy Development Corporation (IECD) to carry out exploration work in the third world.

vi - Kuwait Santa Fe Brown has been merged with Kuwait Santa Fe International of USA, and undertakes
oil operations almost at every port in the United States and integrates with many European networks.

The KPC, a public company with an annual budget averaging more than $10 million and a net profit estimated at $721 million in 1984-85, is one of the 10 largest companies in the world. It enjoys independent judicial entity under the supervision of the ministry of petroleum. Its structure and functioning can be understood by having a cursory look at the following chart.

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<th>Higher Petroleum Council</th>
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<td>(Chairman : Oil Minister)</td>
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<th>Exploration and Production</th>
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<td>KOTC - 100 %</td>
</tr>
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<td>AOC - 60 %</td>
<td>KOC - 100 %</td>
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<td>KOC - 100 %</td>
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<p>| Refining and Sales |</p>
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<td>KNPC - 100 %</td>
</tr>
<tr>
<td>KOC - 100 %</td>
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(b) Downstream Operations:

The downstream operations of oil industry which Kuwait undertakes encircles refining of crude oil, processing of oil and associated natural gas and the related activities, such as: transportation of oil, gas and petroleum products through marine transport and pipelines network. The growing concern for the rapidly declining levels of abundant oil reserves following the sharp rise in the rate of production after the price adjustment in 1971 made the Kuwaiti government to realize that their indigenous natural resource is finite and non-renewable. The increasing awareness about the future of the Kuwaiti economy, particularly due to the lack of human and physical resources other than hydrocarbon, left the government with only choice of reducing country's dependence on export of crude oil. At this juncture, the Kuwaiti government adopted the oil policy which aimed at the optimum utilization of its hydrocarbon resources through plans to shift from its almost entire and unavoidable dependence on crude
oil sales to industrialization and the export of refined products, liquified gas, chemical fertilizers and other petrochemical products. Thus, the oil industry through the downstream operations helps the Kuwaiti economy as the development bridge. The downstream operations provide the choice of profitable investment of the surplus capital to create domestic viable alternative, employment opportunities and reasonable standard of living through the optimum utilization of valuable depleting non-renewable indigenous natural resources. The choice of the government of going downstream seems to be an endeavour of building up the future of Kuwaiti people as the deposits of abundant hydrocarbon resources synchronized the industrial revolution. The downstream operations, therefore, not only diversified the economy but also provided new avenues in the country as well.

The success of oil industry depends on the sales of crude oil as well as refined products. The revenues

accrued to the government from the oil sector steadily increased manifolds despite a deceleration in the rate of crude oil production and variations in the prices. This happened due to the expansion in the export of refined products. The table T-1.4 illustrates that the share of crude oil in total export of petroleum nose dived from its peak 93.2 per cent in 1972 to only 49.1 per cent in 1985 whereas the share of refined products upsurged from its lowest level 6.8 per cent to 50.1 per cent over the same span of time. It is, however, clear from the table that the respective ratios of crude oil and refined products in the total volume of petroleum export remained almost steady but after the nationalization of oil industry fluctuations occurred remarkably. The exports of both crude oil and refined products at present hold almost equal shares in the total volume of petroleum export. The ratio of crude oil and refined products exports in the total crude oil production have also been altered tremendously. The export of crude oil slashed from 89 per cent in 1972 to only 44.7 per cent in 1982 but
Table 1.4

PETROLEUM EXPORT OF KUWAITI ORIGIN

<table>
<thead>
<tr>
<th>Year</th>
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<th>In Percentage Term</th>
<th>Percentage Share in Total Crude Oil Production</th>
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Figure 1.4

Petroleum Export of Kuwaiti Origin

[Chart showing Petroleum Export of Kuwaiti Origin from 1971 to 1987]
improved to 52.6 per cent in 1985 in the total volume of oil produced. The situation was reversed in the case of export of refined products which rocketed from high surface level of 6.4 per cent to 52.4 per cent in the same period. This reflects the optimization of oil and gas resources in the establishment of a viable alternative through the downstream oil operations. The expansion of the installed refining capacity from 437 thousand barrels per calendar day in 1971 to 720 thousand barrels in 1985 and the ratio of utilization of natural gas to its total production was also expanded from 35.3 per cent to 86.9 per cent over the same span of time. This mirrors the progress of downstream oil industries and the expansion of the economy's absorptive capacity as well. The petrochemical industry has also expanded to the extent of producing fertilizers and some other chemical products. The number of oil tanker fleets has increased to 30 putting the KOTC on the top position in the Arab world; and the pipelines' network expanded to
the total length of about 500 km. In addition, KPC's investments abroad have pushed it ahead in the front row of 10 largest companies of the world. The downstream operations of oil industry not only have a positive influence on the domestic economy and help change its face but also plays a dominant role in the economic integration within the region and in the wider sphere. Hence it provides the country with a source of interdependence and new avenues of development.

1.4 - Purpose and Scope of the Study

Notwithstanding limitations, the principal aim of the present study is to make a comprehensive assessment of the levels and developments in the field of downstream oil operations in Kuwait during the period 1975-1985. The period undertaken for research has its significance since the oil industry was completely taken over by the government in December 1975, retrospective to March of the same year, and a great structural change including a modification of administrative set-up of oil industry took place.
thenceforth. The power of decision making with regard to the determination of oil prices and the levels of production and distribution shifted from operating majors to the producing and exporting country's government.

Our objective is to investigate as to how far the Kuwaiti government has been succeeded in accomplishing its goals after having attained the power of decision making from the operating company KOC in 1975; and to what extent has it been successful in expanding and modernizing the pre-established infrastructure for downstream oil industries. It is the purpose of the study to make an assessment through the analysis of available data to find out how far the Kuwaiti oil policy has been proved instrumental in diversifying the total reliance of the economy on the export of its single non-renewable depleting source of energy. The present study pertaining to the developments of downstream oil industries is based on the following hypotheses:
1. The production of oil should be as such that it may cater with the revenues required for the development expenditure and the domestic demand.

2. The work at rapid pace is going on throughout the world to find a cheaper alternative source of energy since oil is depleting and non-renewable, it is desirable for the oil producing countries, as Kuwait, that they should utilize their hydrocarbon resources to develop their economies on firm footing and attain a sustainable economic growth.

3. It unfolds that the demand for oil is corelated with economic strides in the industrialized world and the prices are highly volatile, therefore, oil producers should devise their policies with regard to their export according to the prevailing circumstances.

    Therefore, the downstream operations in the field of energy seem to be the best choice in order to establish a viable alternative and accomplish a sustainable economic growth by utilizing the existing potentials of the country.
The scope of the study is to encompass the prime needs of the country and enable the people in general and the intelligentsia in particular to foresee the prospects of sectoral integration and economic expansion. It explores the new channels through which the trade of the country's main source of income may be expanded.

The study is divided into six chapters; each one dealing with an aspect related to the objectives. In chapter two a historical-cum-analytical assessment of the development of the oil industry has been undertaken. Chapter three deals with the downstream operations in its varied aspects. It also discusses plans, OAPEC & OPEC activities and policies related to it. In chapter iv, a detailed analysis of refining and transportation has been undertaken with a view to finding out its linkages with the overall infrastructural developments. Chapter v deals with the petrochemical industries in particular. It analyses various aspects related to it and, on the basis of its conclusions, makes certain suggestions. Finally, chapter
vi summarizes the main findings of the study.

Our analysis is based on the literature primarily available in English language. The statistics and data have been taken from various publications of the government of Kuwait such as the Ministry of Planning, Central Bank of Kuwait, and also international sources, i.e., World Bank, U.N., OPEC, OAPEC reports and bulletins, and many others.