Without the discovery of oil, it is inconceivable that Kuwait could have existed as a modern sovereign state. Lacking any significant agriculture or water resources of its own, Kuwait survived into the twentieth century by dint of shrewd diplomatic manoeuvring and managed to feed its modest population by trading, fishing and pearling. The introduction of cultured pearls in Japan during the 1930s could very well have killed off any prospects for a Kuwaiti state independent of British interests, however, had it not been for the Anglo-Persian Oil Company’s discovery of oil in 1938. Even then, it was a close-run thing. Anglo-Persian (later British Petroleum) spent years wrangling over Kuwait in a turf battle with American oil companies that forced it to give an equal stake to Gulf Oil.\(^1\) Then, having won the concession, it was unwilling to explore for and develop oil because it already had huge reserves in nearby Iran and because the oil market was glutted. It took fifteen years for oil to be discovered, a further ten years for production to begin in 1948, and it was only after Mohammed Mossadeq’s nationalization of Iranian oil in 1951 that Kuwaiti oil production exceeded half a million barrels a day. Thereafter, development was rapid, with output doubling by 1954 and redoubling in 1962.\(^2\) By that time, Kuwait was important enough to be worth fighting for: British troops were rushed to the defence of the newly-independent state to deter Iraqi military threats in 1961.

Just as oil effectively underwrote Kuwait’s national identity in the post-colonial world, oil was also the basis for all of its economic activity during two decades of uninterrupted growth and a further decade in the doldrums of the 1980s. Kuwaiti national accounts data, following accepted international norms, show approximately 60 per cent of its Gross Domestic Product (GDP) at constant prices derived from oil during the 1980s. This substantially understates the influence
of oil in the economy. The only sectors entirely independent of the oil industry – agriculture and fishing – contributed less than 1 per cent of GDP throughout the 1980s. The trade sector included a thriving re-export trade, which was greatly reduced by the effects of the Iran–Iraq war, but even in its heyday this business contributed only 1 per cent of GDP. ³

In modern times, all other economic activity in Kuwait has been directly determined by the level of oil revenues generated by the government, and the transmission of those revenues through the public sector into the private sector of the economy. With the expansion of the country’s oil refineries in the late 1980s, the manufacturing sector trebled its output between 1984 and 1989 and increased its share of GDP by 9.5 percentage points to 14.3 per cent of GDP, all of which was directly attributable to the petroleum downstream, although measured as part of the non-oil sector. Construction and real estate contributed 11 per cent of GDP by the end of the 1980s, and were closely correlated to the level of direct government contracts as well as its purchases of land from the private sector (a traditional wealth transfer mechanism in Kuwait). Indeed, welfare and social expenditure by the government rose steadily, even during the relatively austere late 1980s, and accounted for 18.8 per cent of GDP in 1989, compared with 11.9 per cent in 1980.

A paradox of Kuwait’s economic management is that although oil has been fundamental to the state’s existence and survival, oil revenues have, to all intents and purposes, been regarded as current income rather than a wasting asset. In a twist to H. Hotelling’s classic natural resource theory, the state has chosen to generate excess oil revenue (by selling more oil than it needs to meet its expenses) and has then treated this financial surplus with the respect due to a precious capital asset. ⁴ Whereas other oil exporters either absorbed all their oil revenue or used financial surpluses only as temporary buffers to finance current account deficits in lean years, the Kuwaitis put a substantial portion of their surplus into a ‘Reserve Fund for Future Generations’ (RFFG).

This has resulted in a peculiar accounting system for government finance. Non-oil revenue accounts for only one-eighth of state revenues, the rest being derived directly from oil. ⁵ Income from the state’s substantial investments, which in years of low oil prices such as 1986–87 exceeded oil revenue, are not included in the government’s budget calculations. On the other hand, the RFFG receives an annual transfer of 10 per cent of state revenue, and this is included in the budget as an item of ‘expenditure’.