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RE-ASSESSMENT OF GRANT ELEMENT IN KUWAITI DE- VELOPMENT AID: AN INTER- NATIONAL CONTRASTIVE APPROACH

Key Words

*Development Aids;
Grant Element; Kuwaiti
Fund; Aid Donors;
Concessional Loans.*

Abstract

This paper provides a statistical reassessment of the grant element in the Kuwaiti development loans over the past four decades. As a replacement for the conventional discount rate that is used by the Kuwaiti Fund for Economic Development as well as other donor institutions to estimate the grant element factor in development assistances, the present article utilizes the series of actual international rates of interest, which had existed over the period of 1962 - 2000, to re-estimate the annual Kuwaiti grant element during that period of time. This assessment measures the Kuwaiti grant element in comparison with a probable opportunity cost-grant element given that recipients have free access to international funds. The paper also compares the Kuwaiti grant element with grant elements provided by international aid association (IDA) of the World Bank to a selected list of 52 recipient countries. It is found that borrowers with low income are more likely to receive a higher grant element from IDA compared with KFED. Yet, compared to numerous IDA funds, the Kuwaiti loans have some immeasurable advantages to borrowers that cannot be incorporated in the grant element formula.

- Submitted February 2004, accepted July 2004.

- Acknowledgments: The author gratefully acknowledges the Research Administration at Kuwait University for its financial support of this research by Grant number IC01/01. The author also extends his special gratitude to the two anonymous referees for their valuable comments and worthy suggestions that helped to improve the present paper. Haifa Almatouq, MBA, deserves exceptional appreciation for her great assistance in this research.

Introduction

A common feature of almost all official development assistances, whether provided by developed or developing nations, involve, a certain degree of soft terms that are not found in commercial loans. These features which reflect financial terms of a commitment (i.e., interest rate, maturity and grace period) are called the grant element (GE). A grant element measures the concessionality of a loan, in the form of the present value of an interest rate below the market rate over the life of a loan (DAC, 1992 & OECD Web Site, 2001).⁽¹⁾

Conventionally, the market rate is taken as a constant factor of 10 percent in most development aid statistics. Thus, the grant element is nil for a loan carrying an interest rate of 10 percent; it is 100 percent for a grant; and it lies between these two limits for a soft loan. If the face value of a loan is multiplied by its grant element, the result is referred to as the grant equivalent of that loan (Concessionality Level) (DAC, OECD, 1992).

The following equation is used in measuring the grant element for each loan:

$$GE = \{1 - (r/d)\} \{e^{-dg} - e^{-dt} / d(t - g)\} \quad (1)$$

Where (e) is the natural log base, (r) is the rate of interest, (d) is the discount rate, (g) is the grace period and (t) is the maturity.

In addition to the 10% conventional discount rate that is commonly used by the development donor institutions to estimate the grant element, this paper utilizes the series of actual international rates of interest (IRI) to re-estimate the annual GE in the development loans provided by the Kuwaiti Fund for Arab Economic Development (KFAED) during the period of 1962 - 2000. This new measure assumes that all recipients of Kuwaiti development assistances have free access to international funds.

The paper also compares the average GE of loans provided by KFAED to a selected list of 53 recipient countries to the GE incorporated in highly

(1) For example the Development Assistance Committee (DAC) of the OECD defines the grant element in the official development assistances (ODA) as "a mathematical assessment of the financial terms of a transaction or set of transactions. It is the difference between the face value of a loan and the present value (calculated at a rate of discount of 10 per cent) of the service payments the borrower will make over the lifetime of the loan, expressed as a percentage of the face value. Three factors determine the grant element: interest rate (per cent per annum); grace period, i.e. the interval from commitment date to the date of the first payment of amortization; maturity, i.e. the interval from commitment date to the date of the last payment of amortization", DAC Statistical Reporting Directives, Organization for Economic Co-Operation and Development (OECD), Development Assistance Committee, www1.oecd.org/dac.

preferential development loans provided by the International Development Association (IDA) of the World Bank to the same countries.

The results of this study are beneficial to both KFAED and borrowers as they indicate the concessionality competitiveness of the Kuwaiti development loans in conformity with international benchmarks.

Kuwaiti Development Aid Portrait

Kuwait is the pioneer development aid donor among underdeveloped countries. Twelve years before the early Seventies quadruple rise in crude oil prices, the Kuwaiti Fund for Arab Economic Development (KFAED) was established as the state agency for the provision of loans, grants and technical assistances to Arab development projects.

The early inception of KFAED, which came shortly after the countrys independence in 1961, is seen by some writers as a move to obtain political support for the nations sovereignty that was threatened by the then revived Iraqi old claim to the country (EI-Najar, 1971 and Field, 1976).

However, the entry of Kuwait into the then limited list of foreign aid donors had a great importance because of its ability to understand the conditions and needs of other underdeveloped countries. This ability is attributable to the fact that Kuwait

itself is an underdeveloped state that suffers, like the rest of developing countries, from deficiencies in vital infrastructure and major necessities. In addition, unlike most developed donors who aspire to attain access to recipients markets and/or natural resources, Kuwait does not have strategic economic interests in recipient countries. In numerous cases, recipients were obliged by OECD donors to tie their credits to purchase of products, and services from donors' suppliers (Abu-Alhassan, 1995). The advantage of the Kuwaiti aid is not confined to such benefit as KFAED provides grants to finance technoeconomic feasibility studies, in addition to technical support and assistance when needed.

Following the Seventies sharp increase in the states oil-based revenues, the scope of the KFAEDs activity was extended to the rest of developing countries. Hence, the funds capital was raised from 200 million to 1 billion Kuwaiti Dinars (KD). Subsequent to the second sharp rise in the crude oil prices of the early 1980s, the Fund's authorized capital was doubled to 2 billion KD. Over the past four decades, the number of loans extended by the Fund increased to 600 loans covering 97 beneficiary countries, with a total value of about 3.1 billion KD (KFAED Annual Reports, 1999/2000 & 2000/2001).

Over the past four decades, the maturity of loans extended by the KFAED ranged from 12 to 55 years, the grace period from three to six years, and interest rates from 0.5 percent to 7.0 percent.⁽²⁾ The terms of these loans reflect a conventional GE ranging from about 16 percent to 86 percent. On average, these terms have a maturity period of 22 years, a grace period of 4 years, and a mean interest rate of 3.5 percent. These terms incorporate an average grant element of about 44 percent.⁽³⁾

With regards to the GE in Kuwait's development loans, over the period covered by the present paper, the highest weighted conventional GE of 85.86 was recorded in 1973 to an agricultural project in Yemen, while the lowest GE of 16.3 was recorded in 1975 to a banking project in Morocco.

Concerning countries, Comoros obtained the lowest interest rate of 1.1%, the longest maturity of 37 years and 4 months, and the second highest grace period of 8 years and 4 months, while Sierra Leone got the highest grace period of 9 years and 2 months. In general, countries from Africa and Asia with the lowest GDP per capita obtained the most

advantageous terms of borrowing. Among the list of these low-income countries, the 4 Arab countries with the lowest per capita income, namely, Yemen, Mauritania, Somalia and Eritrea were the only Arab nations that had received the Funds highest grant elements.

Yet, a considerable part of the differences among annual conventional GE values is primarily attributed to the weight of loans extended to either specific projects or specific countries with preferential treatment. According to the pronounced policy of the Kuwaiti Fund, the extent of each loan's GE is determined in light of the economic conditions of the recipient country and the particular circumstances of each project (KFAED Publications, 2000).

Table (1) reports the amount of the Funds loans in million of KD as well as the maximum & minimum values of annual grant elements from 1962 to 2000. Similarly, figure (1) plots the pattern of the movements in the maximum and minimum GEs over the sample period. Also figure (2) plots the trend of the average amount of loans and the average ceiling of the grant element over the four decades covered by the study.

(2) From 1962 to 1974, KFAED had kept its rate of interest at comparatively low levels (around 2-3 percent), then, only in 1975, the Fund extended loans to Malaysia with 5 percent interest and to Morocco with 7 percent interest.

(3) All figures are based on KFAED loans' data obtained directly from the KFAED official database.

Table 1
KFAED Loans in Million KD and Weighted
Average Lowest & Highest Grant Elements 1962 -2000

Year	Loans in M. KD	Lowest GE	Highest GE	Year	Loans in M. KD	Lowest GE	Highest GE
1962	11.87	31.3	61.68	1982	203.71	34.34	77.88
1963	5.80	34.62	49.43	1983	104.96	26.42	71.30
1964	17.71	27.57	38.46	1984	71.09	26.06	67.00
1965	1.76	31.69	31.75	1985	56.87	24.27	60.38
1966	9.86	29.97	48.79	1986	91.78	23.00	70.81
1967	11.27	27.82	45.00	1987	73.52	20.44	68.56
1968	4.59	28.29	48.77	1988	76.70	25.29	62.60
1969	7.00	42.40	42.40	1989	98.44	28.31	65.87
1970	9.80	28.07	61.86	1990 a	43.35	22.67	61.71
1971	5.99	27.57	85.31	1990 b	84.30	27.83	54.48
1972	14.57	24.89	85.08	1991	109.10	29.23	67.92
1973	17.22	35.75	85.86	1992	130.90	28.09	46.04
1974	40.36	33.03	85.19	1993	193.29	35.30	58.32
1975	86.65	16.31	73.87	1994	63.89	27.86	64.45
1976	87.49	30.42	83.25	1995	185.35	35.05	68.73
1977	102.01	27.96	67.16	1996	151.77	24.26	58.15
1978	43.07	27.25	65.20	1997	120.79	38.01	59.42
1979	92.96	32.39	77.69	1998	138.45	36.14	57.63
1980	68.85	19.43	77.44	1999	173.37	31.11	55.89
1981	174.02	30.92	77.97	2000	99.00	26.29	57.98

(a) The Funds loans prior to the 1990s Iraqi occupation of Kuwait.

(b) The Funds loans throughout the 1990s Iraqi occupation of Kuwait.

Source: Re-estimates based on initial actual conventional GE on loan basis taken from the official KFAED database, and then summed and averaged on annual basis using the loans amount as weight.

On average, according to table (1), the amount of loans rose almost 12 folds from its annual 8.7 million KD throughout the 1960s to 100 million KD for the period of the oil price rise which began with the quadruple increase of crude price in 1973, and was followed by the price hike of the Iran-

Iraq war in 1980, until its decline in 1983. Between 1984 and the Iraqi aggression of 1990, the average amount of loans declined to 73 million KD before its upsurge to 132 million KD all through the period subsequent to the Iraqi aggression up to the year 2000.⁽⁴⁾

(4) KFAED continued its financing operations from abroad throughout the 7 month- period of the Iraqi occupation of Kuwait (August 1990 - February 1991).

Figure 1
High GE & Low GE 1962-2000

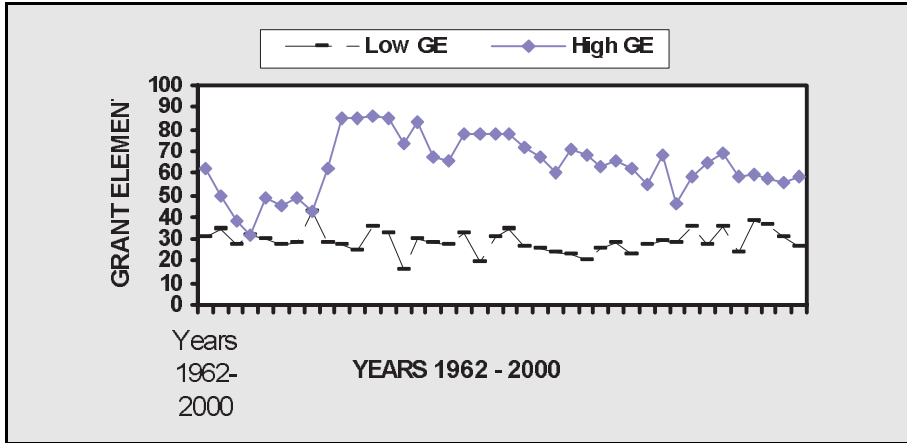
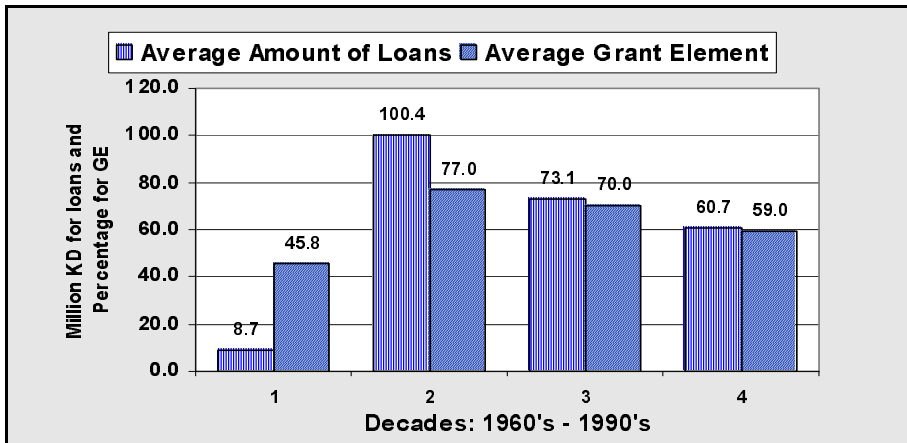


Figure 2
Average Returns & Standard Deviation for the 11-year period



Equally, throughout the first three decades, the trend of the GEs ceiling was quite similar to the trend of the loans amount as its average increased from 45.8 during the 1960s to nearly 77 during the 1970s before its decline to 70 during the 1980s. However,

subsequent to the Iraqi aggression in 1990 up to 2000, the GEs average ceiling declined to 59.⁽⁵⁾

The escalating divergence between the high and low GE of the Kuwaiti loans after 1970, as can be simply

(5) There are numerous sources of GE variance. To find out the most significant determinants of such variance, the author is working on a forthcoming study on factors affecting the GE level in the KFAED's loans over the period of 1962-2000.

noticed in figure (1), can be attributed to the climbing price of crude oil which enabled the fund to extend more loans with a large amount of higher grant element. It also can be attributed to the Fund's awareness during its first decade of activity of the need of diverse projects for different levels of GEs.

Conventional Versus Non-Conventional Grant Element

In this section we will evaluate the GE in all loans provided by the Kuwaiti Fund using the average international rate of interest (IRI) which prevailed during the 39 years covered by this study as a substitute for the conventional 10 percent discount rate, which is commonly used in measuring the grant element of development aid. The use of such a substitute is significant and informative because it estimates the opportunity cost of having these loans assuming that access to other World creditors is available to all borrowers of the Kuwaiti Fund; hence, it judges the Kuwaiti grant element in a real sense.

To prepare for the comparison between the conventional and non-conventional GE, we first recalculated the KFAED annual conventional GE

by estimating the weighted average GE for each year because the Fund's data do not provide GE levels on annual basis. Second, in the reassessment process, the grant element for each loan provided by the Fund in each year was re-estimated based on the IRI which symbolizes the dominant determinant factor of the GE level. Subsequently, these GEs were used to estimate a new non-conventional weighted average GE for each year. In the reassessment process, all other conditions of loans, such as loan maturity and grace period were kept equal.

As a proxy for IRI, the long-term US Treasury Bond Yields (USTBY) between 1962 and 2000 were chosen, as they denote proper substitutes for IRI and have been extensively applied in empirical works.⁽⁶⁾ In official data, the U.S. Office of Management and Budget (OMB) uses interest rates on 30 Years Treasury Bonds as a proxy for discount in the cost-effectiveness, lease-purchase, internal government investment and asset sale analyses, while the discount rate for the U.S. Department of Energy (DOE) is based on long-term Treasury bond rates

(6) Annual Long-Term Treasury Yield Rates were obtained from the Dallas Federal Reserve Bank, US Interest Rate Data, www.dti.gov.za/econdb/euro/IntUSA.html; the IMF International Financial Statistical Yearbook of 1974, 1982, 1993, 1979 and 1998 and the US Treasury Department Website: www.ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield.

averaged over the previous 12 months.⁽⁷⁾

Throughout the first year of the Fund's activity, i.e., 1962, USTBY had averaged at 3.95. Subsequently, these yields steadily increased until their peak of 13.45 in 1981. Since then, they have declined and by the year 2000 reached the low of 5.94. The rise and fall of such proxy of borrowing prime rates points towards the improper use of the conventional constant discount rate of 10 per cent in measuring GE of development aids.

Table 2 reports the resultant annual weighted average conventional GE as well as annual weighted average non-conventional GE based on a proxy of the IRI, between 1962 and 2000.

Figure (3) plots the pattern of the conventional and non-conventional grant elements over the sample period.

From table (2) and figure (3), the sample can be divided into three different sub-periods, each with a distinct pattern of relationship between the two GEs.

1. The first sub-period began with the commencement of the KFAED

operations in 1962 until the quadruple increase in crude oil prices of October 1973, where the weighted average of conventional GE exceeded the weighted average of non-conventional one by a factor of two thirds, as the first stopped at 39.6 on average, while the latter stopped at 13.2 only. Such outsized disparity was mainly due to the soft international interest rates during those years.

2. The second sub-period consists of those years subsequent to the oil price rise until the eve of the August of the 1990 invasion of Kuwait, where both categories of GE were comparable as the weighted average of conventional GE was beyond the weighted average of non-conventional one by a mere 2.6 percent (45.4 for the first one and 44.2 for the second). This reflects the climb of the international rates of interest during those years. Along with the interest rates increase to about 13% in 1981 and 1982, the non-conventional GEs reached their maximum values of nearly 62.5 and 64, respectively.

(7) For the US government intensive use of interest on Long-Term Treasury Bond as proxy for discount rates see Zerbe Jr., Richard & Xi Han, David Layton, and Tom Leshine, A History of Discount Rates and Their Use by Government Agencies, October 2002, at www.faculty.washington.edu/zerbe/docs/discount_rates.

Also see Bazelon, Coleman and Kent Smetters, Discounting in the Long Term, *Loyola of Los Angeles Law Review*, Vol. 35, November 2001.

Table 2
KFAED Conventional GE
Versus Non-Conventional GE (1962 -2000)

Year	Loans in M. KD	IRI	Conv. GE	Non- Conv. GE	Year	Loans in M. KD	IRI	Conv. GE	Non- Conv. GE
1962	11.87	3.95	38.69	1.99	1982	203.71	12.76	52.00	63.65
1963	5.80	4.00	39.72	3.64	1983	104.96	11.18	41.78	47.65
1964	17.71	4.15	33.51	1.21	1984	71.09	12.39	44.28	54.99
1965	1.76	4.21	31.74	1.56	1985	56.87	10.79	42.74	46.59
1966	9.86	4.66	44.72	13.93	1986	91.78	7.79	49.28	38.86
1967	11.27	4.85	36.09	9.48	1987	73.52	8.59	45.57	38.96
1968	4.59	5.26	35.79	12.48	1988	76.70	8.96	46.22	40.41
1969	7.00	6.12	42.40	21.37	1989	98.44	8.45	44.04	37.74
1970	9.80	6.58	47.59	31.00	1990a	43.35	8.61	42.63	39.41
1971	5.99	5.74	33.76	14.43	1990b	84.30	8.61	47.74	41.71
1972	14.57	5.63	42.44	18.71	1991	109.10	8.14	47.05	37.89
1973	17.22	6.30	48.29	28.63	1992	130.90	7.67	41.99	26.45
1974	40.36	8.06	43.26	35.10	1993	193.29	6.59	44.18	21.17
1975	86.65	8.19	49.94	40.40	1994	63.89	7.37	44.59	32.65
1976	87.49	7.87	47.87	38.36	1995	185.35	6.88	44.36	27.98
1977	102.01	7.75	42.27	31.18	1996	151.77	6.70	44.39	25.40
1978	43.07	8.49	44.93	41.31	1997	120.79	6.61	53.66	33.20
1979	92.96	9.29	46.62	45.18	1998	138.45	5.58	45.08	17.83
1980	68.85	11.30	41.24	48.37	1999	173.37	5.87	46.70	20.36
1981	174.02	13.45	47.50	62.48	2000	99.00	5.94	49.12	28.50

(a) The Funds loans prior to the 1990 Iraqi occupation of Kuwait.

(b) The Funds loans throughout the 1990 Iraqi occupation of Kuwait.

Source: The weighted average conventional KFAED grant elements were computed based on loans data taken from the official KFAED database, while weighted average non-conventional grant elements were computed based on returns on long-term US treasury bonds as a proxy of the international rates of borrowing.

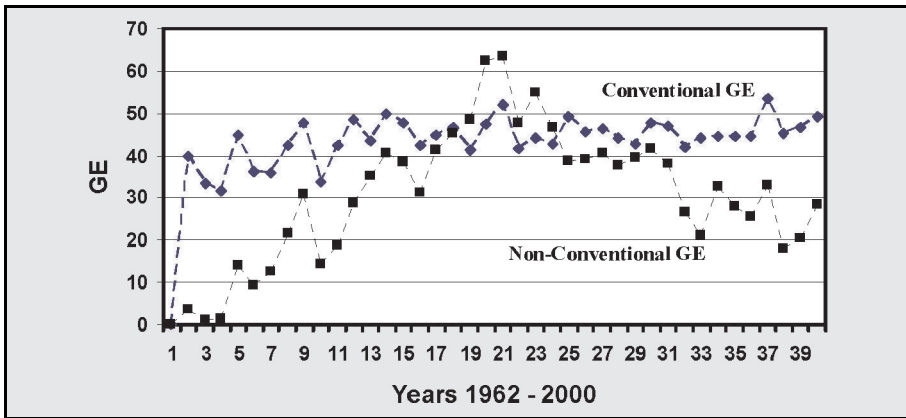
US 30 Year Constant Maturity Treasury Yields are based on data of the Dallas Federal Reserve Bank, US Interest Rate Data, www.dti.gov.za/econdb/euro/IntUSA.html; the IMF International Financial Statistical Yearbook of 1974, 1982, 1993, 1979 and 1998 and the US Treasury Department Website: www.ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield.

3. The third sub-period consists of years following the Iraqi aggression up to the year 2000, where the weighted average of conventional GE (46.3) exceeded the weighted average of the non-con-

ventional one (28.5) by 38.5 percent. This is mainly attributed to the ease in international interest rates during the 1990's.

However, over the sample period, the weighted average conventional

Figure 3
End Values of an Initial Investment of SR 1000 (Pre-Provision Income Basis)



GE was higher by almost 45% than the weighted average of the non-conventional one (44 versus 30.6 only).

Kuwaiti Versus World Banks IDA Grant Element

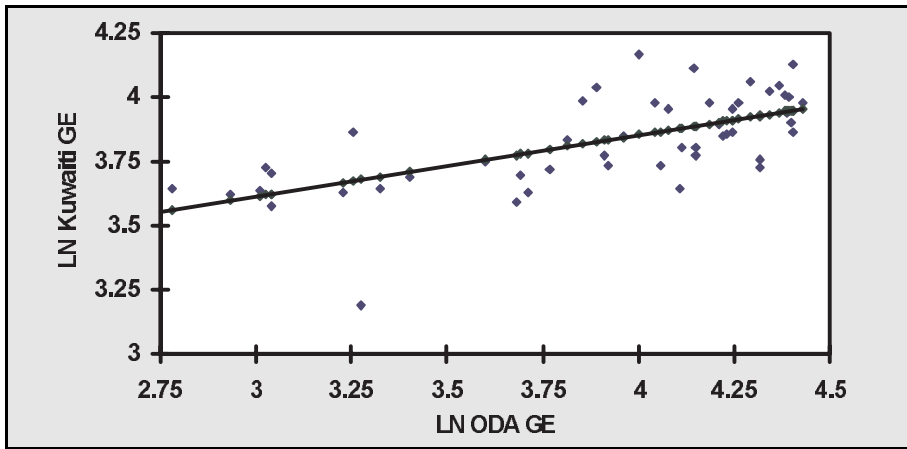
Next we compare the Kuwaiti weighted average GE incorporated in loans provided by the Fund between 1962 and 2000 to a selected list of 52 countries out of the Fund's 97 beneficiary recipients with the GE incorporated in loans provided by the International Development Association (IDA) of the World Bank to the same 52 countries. The IDA list of the same borrowing countries was also chosen from a set of 89 beneficiary countries, 39 of which are IDA borrowers, 3 are blend borrowers, i.e., borrowers that are also creditworthy for the International Bank for Reconstruction and Development IBRD, and 49 receive aid from other sources.

The data for GE of these loans were obtained from a recent study (Anagol, 2002).

The eligibility for IDA borrowing is governed by two basic criteria: a country's relative poverty (as measured by per capita income) and its lack of creditworthiness. The IDAs concessional loans have no interest charge, but a service charge of 0.75 percent on disbursed balances, maturities of 35 or 40 years with a 10-year grace period on repayment of principal. Hence, IDA offers one of the top leading GE in the World, and judging the Kuwaiti GE against it would undoubtedly signal the importance of the Kuwaiti GE on international basis (World Bank Website, 2002).

In this contrast, the Kuwaiti GE were found to be higher than those offered by the IDA in almost half of the cases in the previously mentioned list of countries. And by regressing the

Figure 4
Kuwait LN GEVS. IDALN GE Line Fit



Kuwaiti LN GE as a function of the IDA LN GE, the first was found to be positively related to the latter. The statistical linear relationship is presented by the following regression equation and figure (4).

$$\text{The Kuwaiti LN GE} = 2.89 + 0.24 \text{ IDA LN GE}$$

$$R \text{ Square} = 0.44$$

$$\text{Adjusted } R \text{ Square} = 0.42$$

$$\text{Standard Error} = 0.14$$

$$\text{Observations } 52$$

$$t \text{ Stat} = 6.15$$

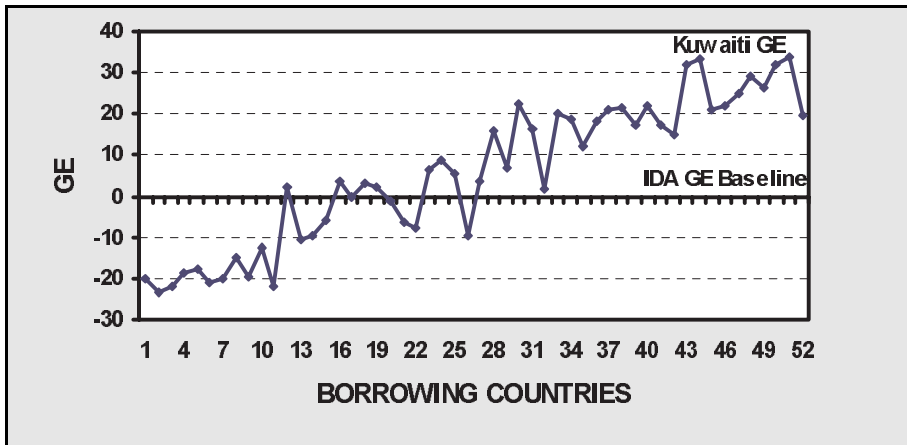
Such a positive association between the Kuwaiti country-based GE and the IDAs GE confirms the rationality of KFAEDs GE on international basis. The coefficient of determination (0.44) indicates that variations in the IDAs GE to the selected list of countries explain 44% of the variations in the dependent variable, i.e., the Ku-

waiti GE. Also, the t-statistic test shows that the slope term is significantly different from zero.

In figure (5), which plots the Kuwaiti conventional GE versus the World Bank's IDA conventional GE, the latter is used as a base line to show the divergence of the Kuwaiti weighted average country-based GE from the IDAs GE for each country of the selected 52 borrowing nations.

The figure shows that the inferior Kuwaiti country-based GE is below the IDAs GE by slightly more than 20 points while the superior one exceeds the IDAs GE by more than 30 points. Also, there are about 8 countries with comparable GE values. The figure also indicates that over the available sample of countries, Kuwait has more cases of superior GEs than inferior cases.

Figure 5
The Kuwaiti GE Vs. IDA GE Baseline



Conclusion

Aside from the fact that Kuwaiti development loans are free of particular covenants associated with the World Bank and developed nations loans, such as tying credits to purchase of products and services from donors' suppliers, the conventional GE of the Kuwaiti development concessional loans has proved to be highly compatible with one of the World excellent GE levels. Further, the Kuwait GE has preserved a noticeable portion of its significance over the largest part of the time period considered by this paper when these GEs are reassessed based on the actual international in-

terest rates. However, such a reassessment assumes that all borrowers from Kuwait have free access to the Worldwide sources of development loans which is not always the case. On the other hand, due to the unprecedented rise in international interest rates between 1980 and 1985, the Kuwaiti non-conventional GEs had exceeded their corresponding conventional GEs. The study indicates the concessionality competitiveness of the Kuwaiti development loans in conformity with international benchmarks, thus providing useful guidance and information to both KFAED and borrowers.

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الملخص

إعادة تقدير عنصر المنحة في المساعدات الإنمائية الكويتية:

منهج مقارنة دولية

عباس علي المجرن

جامعة الكويت

تعرض الدراسة إعادة تقدير إحصائي لعنصر المنحة في قروض التنمية التي قدمتها الكويت على مدى العقود الأربعة الماضية. وبدلاً من استخدام معدل الخصم التقليدي الذي درج الصندوق الكويتي للتنمية، وكذلك المؤسسات المانحة الأخرى على استخدامه لتقدير عنصر المنحة في القروض التنموية، تعتمد الدراسة الحالية على سلسلة معدلات الفائدة الفعلية التي سادت في الأسواق الدولية خلال الفترة ١٩٦٢ - ٢٠٠٠، في إعادة حساب عنصر المنحة السنوي في القروض الكويتية. كما تقارن الدراسة بين عنصر المنحة الكويتي، وعنصر المنحة الذي تضمنته قروض مؤسسة التنمية الدولية التابعة للبنك الدولي إلى ٥٢ دولة مقترضة، حيث تبين أن بإمكان الدول الفقيرة الحصول على معاملة تفضيلية من البنك الدولي، تفوق ما يمكنها الحصول عليه من الكويت، إلا أن المعونات الكويتية تتضمن عناصر غير حسابية، قد تؤدي إلى تفوقها إذا ما وضعت في الحسبان.

Abbas A. Al-Mejren (Ph. D., University of Exeter, 1984) is associate professor in the Department of Economics at Kuwait University. His Research Interests Include Industrial Economics, Energy Economics, Microeconomics, Monetary and Fiscal Policies. He is also Expert in the Field of Economic and Technical Feasibility Studies. Dr. Al-Mejren is also a Professional Trainer in the Field of Efficiency, Productivity and Economic and Technical Feasibility Studies.