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# **Rentier States and Economic Regulation Infrastructure: Kuwait as a Case Study<sup>(\*)</sup>**

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## **Abstract**

**This paper aims at exploring the relationship between rentier states and the economic legal infrastructure in these countries. Kuwait was chosen as a case study and the legislative production process and the structure of the Kuwaiti parliament was analyzed from a law and economic perspective.**

**The economic structure in Kuwait was explored and then the rentier nature of the Kuwaiti economy was identified. Later on, the law and economic analysis of the economic regulations infrastructure was followed. This was done via implementing a number of law and economic theories.**

**The results revealed that the transaction costs associated with the legislative process in Kuwait is high due to the absence of regulatory framework that deals and acknowledge the formation of political parties. In addition, the constituencies structure exacerbated the situation by limiting the choices for the voters and it concentrated the fragmentation in the structure of the parliament members. This also accompanied with a new phenomenon that became known as “Services MP”. Further, the fact that the public sector dominates major economic activities had resulted with a very weak interest**

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groups that can demand for more efficient economic regulations. Moreover, the demand for economic regulations is very weak as 75% of the voters revealed that they have never asked their MPs to initiate economic regulation bills. After examining the bills that have been introduced by MPs the results showed that 91% of these bills were not related to the economy.

The final results revealed that the current structure of the parliament and election laws are economically inefficient as they increase the costs to produce legislations, and the economic structure, which is dominated by the public sector, hindered the development of any active interest groups that can boost the demand for economic regulation.

## Introduction

Economic regulations and institutions are an essential ingredient for achieving economic growth and prosperity. These regulations are a result of the economic structure and environment in any society. Without having a vibrant economic activities and a mature private sector the needed dynamics that will create such regulations will not function well and this will be reflected in the final outcome of these regulations. The structure of the legislator and the electoral laws are the framework for any legal production process. Therefore, the efficiency of these frameworks is an essential ingredient for having an effective legal infrastructure. This paper will try to examine both the economic structure/environment and the frameworks of the legal production process in Kuwait and see whether they are efficient and capable of introducing an effective and well established legal infrastructure.

The discovery of oil in Kuwait was in 1946 as the first shipment of oil was exported in that year.<sup>(2)</sup> Since then the revenue accelerated and the growth and the modernization of the Kuwaiti economy started. Further, the year 1961 is also a very important date for the economic evolution in Kuwait, as it became independent from the British Empire and took full control of all of its affairs.<sup>(3)</sup>

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(2) See Dr. Thari Al-Ajmi, *The Oil Industry and the Environment*, A Paper Submitted to the sixth Scientific Conference for Kuwaiti Economists in 2003, at p2.

(3) See Visited on the 1st of July 2001.



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This major economic development in Kuwait shifted the Kuwaiti economy from a, limited productive economy to an allocation economy. In other words, Kuwait became a rentier state as a result of the discovery of oil and the change it had on the economy. A Rentier economy can be defined as an economy “in which rent plays a major role, and in which the rent is external to the economy.”<sup>(4)</sup>

Building a modern and efficient legal infrastructure was essential ingredient for the modernization of the country. The Economic Regulations are an essential part of the needed legal infrastructure. However, a quick observation of the current economic regulations in Kuwait will show that the existing legislations are not well established and inefficient.

Before starting one must highlight that the concerned laws here are the so-called “economic regulations”. These laws can be defined as the laws that relates to the interference of the government in the market.<sup>(5)</sup>

The jurisprudence of law and legal theory mainly focuses on the general theoretical framework for the legislation as a whole. According to Bentham “The public good ought to be the object of the legislator...to know the true good of the community is what constitutes the science of legislation; are consists in finding the means to realize that good.”<sup>(6)</sup> On the other hand Law & Economics schools<sup>(7)</sup> try to apply economic theory to analyze the efficiency of the legislation formation process and substantive law. The later approach to law will be the followed one in this paper.

In this paper the researcher will try to give an economic, legal and political explanation for the failure to establish an efficient economic regulation infrastructure that is regarded to be essential to stimulate the economic growth in Kuwait. The structure of the parliament, the election

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(4) See Yates, at p13.

(5) See Richard A. Posner, *Theories of Economic Regulation, (1974) Working Paper No 41, Center for Economic Analysis of Human Behavior and Social Institutions.*, at p 1.

(6) See Jeremy Bentham, *The Theory of Legislation*, (Trubner, London, 1864) at p 1.

(7) There are three main schools that will be discussed later on in the paper, these include Chicago School, New-Heaven School and Institutional Economic School.

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laws, interest groups and the rentier nature of the economy will be the main focus of this paper.

Two main theories will be adopted in this paper, the first is the “Economic Regulation Theory” and the second is the “Public Choice Theory”. These two theories have their own analysis of the legislation formation from an economic perspective. Other theories will be incorporated in the paper whenever it is appropriate and relevant to do so. This paper will follow law & economic schools theories to analysis the legislative formation process in Kuwait. Its importance comes from the fact that this multidiscipline “Law & Economics” is totally new to the region and is rarely discussed or implemented in developing countries. Finally, for the rentier state the “rentier state theory” will be used to identify how the rentier nature of a state will ultimately impact the economic regulation infrastructure negativley.

## **Literature Review**

The written literature on Rentier state theory is wide and diverse in the sense that it covers economic, political economic and political science writings. Mahdavy (1970) article in 1970 could be seen as the start and the foundation of rentier state theory, as he investigate the economic environment and growth of the so-called rentier state and chooses Iran as a case study. Later on, Beblawi (1987) elaborated more on the notion of rentier state/economy and discussed in more details the main characteristics of such economies and the outcomes of such economies. These characteristics include, economic, social and political. Further, Luciani (1987) introduced a theoretical distinction between what he named allocation states, in reference to rentier economies, and productive states. Other scholars such as Jonathan Dijohn (2002) took the matter even further and investigated whether rentier economies would promote political violence and came to the conclusion that natural resource is not a factor by itself that promote conflict and wars although it could facilitate such conflicts once started. Moreover, Papyrakis and Gerlagh

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(2004) examined the relation between natural resources abundance and innovation and growth in rentier economies. On the other hand, Schwarz (2004) studies the link between states formation, reformation and deformation and external rent, rentier economies, in the Middle East. None of the conducted research on rentier state theory examined the relationship between rentier economies/states and the efficiency of economic regulations in these economies and whether the characteristics and features of rentier economies hinders the needed factors for having an efficient economic regulations. This paper aims at investigating this aspect and see whether there is a relation between the two. It should be noted that even in the law and economics literature this area is un-researched. Kuwait is the chosen case study for this paper.

### **Hypothesis of the Paper**

The current electoral laws in Kuwait are the main reason for the failure to have an efficient legislative formation process in general. In addition, these laws along with the absence of the active interest groups have exacerbated such failure especially in regard to the development of ‘economic regulations‘ in Kuwait. Furthermore, one of the negative consequences of being a rentier state is having inefficient “economic regulation” due to the dependence on external economies and domestic economy to stimulate growth.

### **Methodology & Applied Models**

In this part of the paper the research methods that are used and followed in order to achieve the above stated aim of the paper will be discussed.

Questionnaires are used in order to reach the desired results, this will include a questionnaires for eligible voters in Kuwait. The covered sample included 590 voters.

In order to apply the economic theory of regulation to the Kuwaiti legislative process the MPs’ will constitute the supply side in the equation as they are the body that is invested with the power to legislate. In

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addition to the fact that MPs supply legislations, the parliament supervision over the executive activities is another supplied service to the public and recently another service has become popularly supplied by the MPs' and that is the finalization of bended transactions of the voters of their constituencies in the executive branch. This third service will be discussed in more details later on in this paper.

The voters will present the demand side as they are the ones that are going to be subject to the legislation and usually will elect MPs' that promise to fulfill their "legislative needs". Finally, as stated above a new demand curve has emerged in recent years and that is the demand by voters form their MPs to finalize bended transactions processed by the executive branch, this new function will be discussed later on the paper. In other words voters prefer that their MPs finalize any unfinished work for that voter in the executive branch bureaucracies. For instance, voters that would like to be nominated for a scholarship to study abroad or to be promoted in these bureaucracies will not follow the established procedures in the executive branch rather they will go to their MP and ask them to finalize their needs and MPs do that by asking the government to finalize his voter needs as a special request.

The executive branch status in Kuwait can also be categorized as a supplier for legislations and in the same time a demander. The reason for that is the fact that the Kuwaiti constitution considers all cabinet ministers as ex officio members in the National Assembly. In addition, the executive has the right to ask the parliament to pass some laws so this constitutes another demand curve in the legislative formation process according to the economic theory of regulation.

## **Section 1: The Rentier Nature of the Kuwaiti Economy & The Weakness of the Private Sector.**

In this section the rentier nature of the Kuwaiti economy will be discussed and the main characteristics of the Kuwaiti economy that characterize it as a rentier economy will be highlighted.

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The rentier state theory can be traced back to H. Mahdavy article in 1970.<sup>(8)</sup> In his article Mahdavy defines a rentier state as “those countries that receive on a regular basis substantial mounts of external rent. External rent are in turn defined as rentals paid by foreign individuals, concerns or governments to individuals, concerns or governments of a given country.”<sup>(9)</sup> Further, Beblawi elucidated on Mahdavi definition as he defines a rentier economy/state as “A rentier economy is thus an economy where the creation of wealth is centered around a small fraction of the society; the rest of the society is only engaged in the distribution and utilization of this wealth.”<sup>(10)</sup> The oil exporting countries are usually used as a crystal clear example of a rentier states. These countries are usually termed as hydrocarbon societies/states. The outcomes and the consequences of “hydrocarbon revenues” on these states macroeconomic performance can be traced to the writings of scholars in the 60’s and in specific to the so called “Dutch Disease” theory.<sup>(11)</sup>

The “Dutch Disease” writings aimed at analyzing the impact of the discovery of Gas in the Netherlands in 1960’s and 70’s and whether such discovery have impeded or promoted economic growth. The shocking fact was that the gas revenue acted as a hinder to the economic growth if compared with other similar economies that did not depend on natural resources.<sup>(12)</sup> The reasons behind this fact are disputed among scholars, some argued that such economies established environments that fostered corruption, rent-seeking, and bad decision.<sup>(13)</sup> On the other hand, Pauline Jones Luong argues that the underpinning reason behind such

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(8) See H. Mahdavy, *the Patterns and Problems of Economic Development in Rentier States: The Case of Iran*, in. M. Cook (ed) *Studies in the Economic History of the Middle East*, (Oxford University Press, Oxford, 1970)

(9) Ibid at p428.

(10) See Hazem Beblawi, *The Rentier State in the Arab World*, in *Hazem Beblawi and Giacomo Luciani (ed), The Rentier State*, (Routledge, London, 1987) at p51

(11) See Kiren Chaudhry, Terry Karl and Dirk Vandewalle, *Booms and Busts: Theorizing Institutional Formation and Change in Oil States*, *Review of International Political Economy*, 2001 at p165.

(12) This became known as the Curse of Natural Resources.

(13) See Elissaios Papyrakis & Reyer Gerlagh, *Natural resources, innovation, and growth*, Institute for Environmental Studies, Vrije Universiteit Publication {Unknown date of publication}, at p3. <http://degitx.cide.edu/Documentos/D05.pdf>

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phenomenon is that the state ownership rather than the reliance on natural resource that causes the curse. Loung adds that the majority of studies that have investigated these countries took place in a time that the state owned these natural resources via nationalization.<sup>(14)</sup>

### **Rentier State Theory**

As stated above this theory emerged in the early 70's as a result of emergence of hydrocarbon societies or states and this theory aims at examining the consequences of this phenomenon economically, politically, institutionally and socially. Mahdavy, Beblawi and Luciani can be seen as the pioneers of this theory.<sup>(15)</sup>

The main foundations of the rentier state/economy theory are as follow. Firstly, the economic growth of such states is “unimpressive” and usually such external rents impedes economic growth as noticed by Mahdavi in Iran<sup>(16)</sup> and the same result was found in the Netherlands as mentioned above and became known as “the Dutch Disease”. The main characteristics and outcomes of having a rentier economy varies. It includes the domination of the public sector<sup>(17)</sup> and the state participation in the domestic economy increases dramatically. Further, the level of taxation decreases dramatically as the state finance it activities from the nature gift of oil rather than from the public via taxation. Finally, because the “government” plays the key role in domestic economy the state budget expenditure tends to increase continuously as a result of the increase in the population.<sup>(18)</sup>

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(14) See Pauline Jones Luong, *Rethinking the Resource Curse: Ownership Structure and Institutional Capacity*, A Paper Submitted to the Conference on Globalization and self-determination, 2003 at p1. [http://www.yale.edu/ycias/globalization/Jones\\_Luong\\_-\\_TIGER\\_2003.pdf](http://www.yale.edu/ycias/globalization/Jones_Luong_-_TIGER_2003.pdf)

(15) It should be noted that this theory was found by Mahdavi and then developed by Beblawi and to an extent Luciani.

(16) See H. Mahdavy, *the Patterns and Problems of Economic Development in Rentier States: The Case of Iran*, in. M. Cook (ed) *Studies in the Economic History of the Middle East*, (Oxford University Press, Oxford, 1970) at p466.

(17) Some exceptions apply, e.g. Russia

(18) See Kiren Chaudhry, Terry Karl and Dirk Vandewalle, *Booms and Busts: Theorizing Institutional Formation and Change in Oil States*, *Review of International Political Economy*, 2001 at p165.

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Secondly, a rentier state usually depend almost totally on external rent, i.e. oil and gas, and can continue to survive without referring to the domestic economy via taxation. As a result such environment hinders political development and promotes corruption, violence<sup>(19)</sup> and allows the state to “bribe” the population via public service, e.g. free education, health, housing etc which in the end silence the population from demanding any political rights or participation.<sup>(20)</sup> In addition, according to Mehdavi a rentier economy hinders the needed reforms of socio-economic, e.g. land reform which will boost economic growth if were implemented and he cites the reforms that took place in Iran between the years 1961-4 as a result of “Political upheaval”.<sup>(21)</sup> In other words, because in a rentier state the political “environment” is restricted and the social culture is affected indirectly, see below, the needed institutions and participation of the public that could encourage the needed reforms that will trigger economic growth eventually is minimized which will affect the economic growth of these states.

Thirdly, the social network and environment is also according to Beblawi is affected as a result of having this kind of economy. A “rentier mentality” emerges according to Beblawi in a rentier state and this mentality affects the classical or ordinary economic behavior of individuals in regard to the “work-reward causation” and instead of seeing wealth creation a result of classical production cycle that include bearing the risk of failure “for a rentier, reward becomes a windfall gain, an isolated fact, situational or accidental as against conventional outlook where reward is integrated in a process as the end result of a long, systematic and organized production circuit.”<sup>(22)</sup>

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(19) See Jonathan Dijohn, *Mineral Resource Abundance and Violent Political Conflict: A Critical Assessment of the Rentier State Model*, Working Paper No 20 (2002) Crisis States Programme, LSE, at p1

(20) See Kiren Chaudhry, Terry Karl and Dirk Vandewalle, *Booms and Busts: Theorizing Institutional Formation and Change in Oil States*, *Review of International Political Economy*, 2001, at p166.

(21) See H. Mahdavy, *the Patterns and Problems of Economic Development in Rentier States: The Case of Iran*, in. M. Cook (ed) *Studies in the Economic History of the Middle East*, (Oxford University Press, Oxford, 1970) at p434.

(22) Hazem Beblawi, *The Rentier State in the Arab World*, in Hazem Beblawi and Giacomo Luciani (ed), *The Rentier State*, (Routledge, London, 1987) at p52.

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The rentier mentality can be seen in different forms and ways especially in the Gulf Cooperation Council, GCC, countries.<sup>(23)</sup> This can be seen by the fact that the citizenship itself became a financial asset. For example, the *kafil*, guarantor, system requires that each expatriate to have a guarantor who must be a national and this resulted in the emergence of trade in work permissions. The nationals received tremendous profits for just guarantying an expatriate or a number of expatriates. In addition, in Kuwait the government usually allocate shares for all residents in public companies via nationality document and as a result the selling of these documents became so popular, this illustrate how the citizens and the rentier mentality and behaviour of the society is influenced as a result of this rentier state.<sup>(24)</sup>

It should be noted that when Beblawi states that “citizenship becomes a source of economic benefit” which is a main characteristic of rentier economy he is influenced by the GCC environment and this is not applicable to all “rentier economies”, for instance, Venezuela.

Finally, the rentier state theory predicts the emergence of certain institutional formation in a rentier state and the level of efficiency in these institutions. The importance of the so called “good governance” of institutions in states has been widely raised recently in the proper development policies in developing countries.<sup>(25)</sup> Therefore, the efficiency and the nature of institutions in rentier states became the subject of a number of studies.<sup>(26)</sup> The Rentier State Theory predicts that the

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(23) Gulf Cooperation Council includes Kuwait, Bahrain, Saudia Arabia, Qatar, UAE and Oman

(24) Ibid p56.

(25) See Ha-Hoon Chang, *Institutional Development in Developing Countries in a Historical Perspective- Lessons from Developed Countries in Earlier Times*, (November 2001) A Paper submitted to the European Association of Evolutionary Political Economy Annual Meeting, at p 1.

(26) For example, see Kiren Aziz Chaudhry, *The Price of Wealth: Economies and Institutions in the Middle East*, 1997, Terry Karl, *The Paradox of Plenty: Oil Booms and Petro-States*, 1997 and Dirk Vandewalle, *Libya Since Independence: Oil and State-Building*, 1998.

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efficiency of institutions in such states tend to be corrupted, because its centralized, managed by a small number of people and the absence of political freedom results in having poor governance and supervision. Further, the fact that in a rentier state nepotism and “clientelism” are the main characteristics of these states/economies tends to undermine the efficiency of the institutions in these states which reflects on the economic growth of these states.<sup>(27)</sup> In other words, the rolling elite in a rentier state tend to prefer certain group in the society, to buy its loyalty, and the way it prefer such group is through nepotism and preferable treatment.<sup>(28)</sup>

In sum, the rentier state theory tends to describe the main characteristics of rentier states/economies and in the same time predicts the outcomes and the phenomenon’s associated with such economy. And in the next section the Kuwaiti economy will be analyzed and examined in order to look at whether it can be called a rentier economy and whether the predictions presented by the rentier state theory is noticeable in Kuwait.

### **Is the Kuwaiti Economy a Rentier Economy?**

The main characteristics presented by Beblawi in his seminal Article “ the Rentier State in the Arab World” will be applied to the Kuwaiti economy<sup>(29)</sup> along with the World Bank Classification of a mineral economy.<sup>(30)</sup>

From the definition introduced by Beblawi on what is a rentier economy one can infer the main features that if available then an economy can be categorized as a “rentier economy”. The three main

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(27) See Matthias Basedau, *Context Matters-Rethinking the Resource Curse in Sub-Saharan Africa*, Working Paper in the German Overseas Institute (DUI), 2005, p 12.

(28) This will be discussed in more details below when the Kuwaiti economy and political environment is analyzed.

(29) Hazem Beblawi, *The Rentier State in the Arab World*, in Hazem Beblawi and Giacomo Luciani (ed), *The Rentier State*, (Routledge, London, 1987) at p 52-55.

(30) Jonathan Dijohn, *Mineral Resource Abundance and Violent Political Conflict: A Critical Assessment of the Rentier State Model*, Working Paper No 20 (2002) Crisis States Programme, LSE, at p 2.

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features of a rentier economy according to the above stated definition are as follow.

The first feature is that the creation of wealth is centered around a small fraction, i.e. governments and this is the situation in Kuwait as all oil corporation are owned by the government, e.g. the government revenue derived from the oil sector in 2003 was 77.2%.<sup>(31)</sup> (Table 1 in Annex 1)

The second feature is that majority of the society engage in the distribution of this wealth(employed by the government).<sup>(32)</sup> A quick look on the Kuwaiti economy will show that this feature is presented in Kuwait. For instance the percentage of Kuwaitis working in the public sector, which mainly allocate this wealth via public services in 2003 was 93%.<sup>(33)</sup> This clearly shows that the majority of the society is involved in the distribution of the wealth.

The third feature is that the majority of the society are involved in the utilization of this wealth (oil). In order to examine this feature the best method is to show that the majority of the government expenditure goes to the public via services, subsidies and salaries and as a result the majority of the society is involved in utilization of this wealth. In the year 2003/04 35% of the total expenditure of the government was in the form of salaries and 24.5% in the form of services (health, education and housing) and goods (Table 2 In Annex 1).<sup>(34)</sup>

The fourth feature in a rentier economy is that the state usually implements a very low tax regime and do not depend on taxation as a form of public finance. In Kuwait in the year 2003/04 total revenue from taxation (which is mainly indirect taxation) was only 1.9% of the total

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(31) . See IMF Country Report No. 05/231, Kuwait: 2005 Article IV Consultation-Staff Report; Staff Statement; and Public Information Notice on the Executive Discussion, p. 27.

(32) Hazem Beblawi, *The Rentier State in the Arab World*, in Hazem Beblawi and Giacomo Luciani (ed), *The Rentier State*, (Routledge, London, 1987) at p55.

(33) See visited on the 25th of August 2005.

(34) See IMF Country Report No. 05/231, Kuwait: 2005 Article IV Consultation-Staff Report; Staff Statement; and Public Information Notice on the Executive Discussion, p. 25.

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government revenue.<sup>(35)</sup> In fact Kuwait has the lowest tax regime in the Middle East.<sup>(36)</sup>

The fifth feature that shows that Kuwait is a rentier state is the fact that the government is the main player and that the private sector plays a minimal role. For example, the public sector contribution percentage of the total GDP between the years 1995-2001 was around 70%.<sup>(37)</sup>

#### The World Bank Classification of Mineral Economies

According to Dijohn, many rentier state theorists classify states as rentier based on the World Bank of states as mineral economies classification.<sup>(38)</sup> Kuwait economy depends on natural resources, oil, in addition, it managed to create a parallel external source of rent generated from external investments, hence it fits the World Bank Criteria of what constitutes a mineral economy.<sup>(39)</sup>

## **Section 2: An Economic Analysis of the Kuwaiti Legislative Process & The Impact of Rentier Economy**

Economic regulations and sound legal environment is an essential ingredient for economic development in any country and especially in developing countries. The majority of Kuwait Private Sector participants argue continuously that the current laws are outdated and needs updating in order to stimulate economic growth and activities and to attract foreign investment. According to the United Nations Conference on Trade and Development (UNCTAD) Foreign Investment most suitable countries Kuwait was ranked 28<sup>th</sup>, however, when it comes to actual recipient of FDI Kuwait is ranked 136 out of 140 countries.<sup>(40)</sup> This shocking fact raise a simple question why is this the situation in

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(35) See visited on the 25th of August 2005.

(36) See Ahmed Jalali-Naini, *The Structure and Volatility of Fiscal Revenue in MENA Countries*, WorldBank Working Papers, 2000, p46.

(37) See Figure 3 in the previous Section.

(38) See Jonathan Dijohn, *Mineral Resource Abundance and Violent Political Conflict: A Critical Assessment of the Rentier State Model*, Working Paper No 20 (2002) Crisis States Programme, LSE

(39) See Table 1& 2 in Annex 1.

(40) See IMF Country Report No 05/234, Kuwait Selected Issues and Statistical Appendix, at p15.

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Kuwait? This section tries to answer the question by looking at two potential reasons behind such fact. The first reason is the fact that the legislative production process in Kuwait is inefficient when it comes to producing economic regulations. The second reason is the fact that Kuwait is a Rentier State and this is a main reason behind this shocking fact.

This section will explore existing theories of law and economics, with particular attention to Stigler's economic theory of regulation, to provide a theoretical foundation for analyzing the legislative production process in Kuwait. Special attention is placed on the production of "economic legislation" and the role of interest groups and civil society in the process.

### **According to James Madison,**

*Those who hold, and those who are without property have ever formed distinct interests in society. Those who are creditors, and those who are debtors follow under a like discrimination. A landed interest, a manufacturing interest, a mercantile interest, with many lesser interests grow up of a necessity in civilized nations, and divided themselves into different classes actuated by different sentiments and views. The regulation of these various and interfering interests forms the principal task of the modern legislation.<sup>(41)</sup>*

This statement summarizes the role of law in economic dynamics while encompassing the formula for legislative production. The dynamics of competition among competing interests are what produce laws. This understanding of the purpose and production cycle of the law serves as a road-map for the ensuing analysis of the Kuwaiti legislative process.

### **Law and Economics Theories**

Law and economics have been a separate discipline for the last five decades, but their roots can be traced all the way to the writings of Adam

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(41) See Mark Litchman, *Economics: The basis of law*. (1927) *American Law Review*, 61:357.

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Smith and Jeremy Bentham. Law and economics can be defined as the “application of economic theory (primarily microeconomics and the basic concept of welfare economics) to examine the formation, structure, process, and economics impact of law and legal institutions on the economy.”<sup>(42)</sup>

The underlying relation between law and economics can be summarized as follows: Any change in a society’s legal relations (e.g., shifting property rights from the public to the private sector via privatization) will eventually have a tremendous effect on the country’s economy. The following chart<sup>(43)</sup> should clarify the linkage between law and economics.

### **Law and/or Working Rules Incentive Structure Institutional Behavior Economic Performance**

- Law and economics scholars continue to address four main issues:
- Explaining the law and its institutional developments and whether these developments have followed an efficient logical sequence (a branch of law and economics that is mainly concerned with the development of common law and that can be directly linked to University of Chicago “ideology” as discussed below).
  - Changing the law in order to promote efficiency.
  - Impact of the law on the distribution of wealth and allocation of scarce resources.
  - Legal and political decision-making process (usually called the *legal-economic nexus*<sup>(44)</sup>).

This section is concerned with the last above issue and does not cover the rest of main branches except whenever such discussion is inevitable.

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(42) See Robin Paul Malloy and Christopher K. Braun (eds), *Law and Economics: New and Critical Perspectives*, (Peter Lang Publication, 1995) p 65.

(43) See Nicholas Mercuro and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism*, (Princeton University Press, 1999) p 23.

(44) Ibid.

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A number of schools and theories emerged in the area of law and economics. I will now summarize the main (not all) schools and theories, emphasizing the theory that will apply to the situation in Kuwait.

### **Public Choice Theory**

The failure of legislation and public agencies to achieve the public good led many thinkers to theoretically explain such failure. Proponents of the public choice theory believe that the behavior of individuals in the *market*, which is based on the rational of maximizing one's own welfare concept, is not different from the behavior of individuals in the *political process*. Therefore, voters and interest groups try to exploit this process in order to maximize their utility and self-interest, and politicians act as entrepreneurs who offer such benefits in exchange for voting power to ensure reelection. In other words, the exchange process that takes place in the market to spark production also applies to the political system.

Nevertheless, there are some differences between the "conventional" market and the "political" market. The first is the fact that in a conventional market, participants are not coerced in any way except insofar as they must fulfill their obligation, which they entered into voluntarily, and as long as the transaction does not give rise to any externalities, third parties will not be affected or involved. Conversely, in the political market, the finalization of a transaction coerces others, including those who opposed it bear some of its costs, e.g., raising taxes on a certain class of individuals.

This problem can be overcome at least theoretically by adopting a unanimous decision-making process, which in practice is inefficient and very costly. A second difference is the fact that individuals in the conventional market express their preferences via the price mechanism: the more they are willing to pay for a product, the higher their preference for the product is. The political market involves no such criteria that determine preferences and there is only "yes or no" when it comes to voting, hence, this system does not express the *intensity* of the voters' preference reflected in the extent of demand.<sup>(45)</sup>

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(45) See Anthony I. Ogus, *Regulation: Legal Form and Economic Theory*, (Hart Publishing, 2004) pp 59-60

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Finally, policies and legislations in the policy market usually take the form of package products that ensure the needed majority: thus, although any particular package will involve costs, such costs are crucial to ensure the smooth passage of the legislation. However, in the conventional market, products are usually specific and not sold in a package.<sup>(46)</sup>

A number of sub-theories, which will not be discussed in this paper, emerged under the umbrella of public choice theory: (1) axiomatic social choice theory, (2) conventional public choice theories of bureaucracies, legislatures, and the state, and (3) catallaxy, the public choice theory of contraction.<sup>(47)</sup>

Proponents of public choice theory refuse the organic political science concept of state, and they reject the belief that government officials (e.g., legislators and bureaucrats) act for the common good or the public interest.

Public choice theory has two main branches: the *homo economicus* branch and the catallaxy branch.<sup>(48)</sup>

The *homo economicus* branch of public choice theory proposes that legislators and politicians usually make decisions that maximize their self-interest. When it comes to political processes, the public choice theory analyzes the political outcomes of such self-interested decisions by introducing the concept of “rational ignorance.” According to Nicholas Mercuro and Steven Medema;

“In the simplest of terms, rational ignorance holds that given majority rule, voters have little reason to invest the time, money, or energy required to cast a well-informed vote because they know that their individual vote has only the slightest chance to be decisive. Given the high probability that the outcome of an election will be unaffected by

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(46) See Anthony I. Ogus, *Regulation: Legal Form and Economic Theory*, (Hart Publishing, 2004) pp 57-60.

(47) See Robin Paul Malloy and Christopher K. Braun (eds), *Law and Economics: New and Critical Perspectives*, (Peter Lang Publication, 1995). p 85.

(48) Ibid.

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whether a voter makes an informed choice or simply chooses on the basis of existing knowledge, it is sensible (rational) for voters to remain uninformed on many issues-that is, it is rational to be ignorant.”<sup>(49)</sup>

Such negative involvement of voters is compounded by the fact that politicians try to focus on short-term strategies in order to ensure re-election. These two factors lead to inefficiency in political outcomes. The *homo economicus* branch try to explain the negative outcomes of bureaucracy by saying that bureaucrats tend to maximize their own, not the social, welfare. This branch further believes that legislators lack incentive to supervise the performance of the government because (1) there is no recognizable standard of performance for bureaus and (2) there is no source of neutral information as most information on bureau performance comes from the bureaus themselves.<sup>(50)</sup>

The second (catallaxy) branch, presented mainly by Hayek, holds that any market intervention, even if based on social justice, is an arbitrary intervention in terms of market mechanisms and dynamics. Therefore, there is no room for policy makers to affect the market mechanism by introducing laws and regulations.<sup>(51)</sup>

It should be noted that in public choice theory, the ideological pattern of the government is irrelevant to substantive legislation outcomes. The law’s shape is determined by the nature of involved interest groups and outcomes for such groups are determined by the constitutional framework.<sup>(52)</sup>

Jonathan R. Macey writes that the internal organizational structure of Congress is “consistent with public choice theory, Congress organizational rules are designed to further the rational self-interest of the legislators themselves.”<sup>(53)</sup> In other words, “the restricted access to

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(49) Ibid, p 89.

(50) Ibid.

(51) See Choudhury M.A., *Markets as a system of social contracts*. (1996).*International Journal of Social Economics*, 23:21, 1996.

(52) See Jonathan R. Macey, Public choice: The theory of the firm and the theory of market exchange.(1988)*Cornell Law Review*, 74:48-49

(53) Ibid, pp 54-55.

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the agenda, caused by the committee system, serves as a mechanism to prevent ex post renegeing.” The committee system tackles the “non-simultaneity-of-performance” problem as it ensures that log-rolling that are non-binding agreements by its nature become to an extent binding via the committee system as the committees have the power to affect the process of finalizing a bill.

### **Public Interest Theory**

The public interest theory can be traced back to the writings of Baumol and Pigou. The essence of this theory is that systematic failure is an original market ingredient and that laws are made to correct these failures and increase the economic welfare. This approach is similar to the traditional lawyer’s view of legislation as being in the public interest.<sup>(54)</sup>

This theory emerged in a time when the market was assumed to be inequitable and inefficient to the point that even government intervention could not rectify such inefficiencies. Public demand for rectifying market inefficiencies led to regulations. This theory has since then been reformulated by the idea that regulatory agencies are created for bona fide purposes but simply mismanaged, and such mismanagement requires these agencies to become more experienced.<sup>(55)</sup>

The problem of the public interest theory is that it does not convey any actual linkage or understanding of how the public interest is usually translated into legislative action. For example, Adam Smith Invisible Hand theory holds that when individuals try to promote their interest, they eventually maximize the allocation of resources. In the public interest theory there is nothing similar to such explanation. According to Posner,

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(54) See Richard Posner, *Economics, politics and the reading of statutes and the constitution*. (1982) 49 *University of Chicago Law Review*, p 265

(55) See Richard Posner, *Theories of economics regulation*. (1974) *Bell Journal of Economics and Management Science*, 5:337

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There is also no comparable articulation of how a public perception as to what legislative policies or arrangements would maximize public welfare is translated into legislative action. It is not enough to say that a voter will vote for the candidate who promises to carry out the policies that the voter perceives to be in the public interest; other policies might benefit the particular voter more. Policies that benefited 51% of the voters might impose much greater costs on the other 49%, in which event the majority would be confronted with a conflict between principle and interest- and no body of theory or to evidence suggests that they would be likely to vote the former.<sup>(56)</sup>

### **Theory of Economic Regulation**

In his seminal article “The Theory of Economic Regulation,” Stigler introduced a new theory that analyzes the process of legislation by applying modern economic theory. The essence of the theory is not new, but its application to regulation is new. Noll (1989) called Stigler’s 1971 article “the watershed event.”<sup>(57)</sup>

According to Stigler, economic groups aim to use public resources to improve and empower their status. Such interest constitutes the *demand* for regulations that will fulfill their aim while the political process that responds to these groups demands constitutes the *supply* side in the equation. Public resources and the state constitute a major power that can act as a threat to the industries (e.g., nationalization) and at the same time can act as a facilitator of trade and promoter of economic growth (e.g., subsidies and tax policies). The main or central theme of Stigler’s theory is that regulations can be sought by an industry or imposed on an industry and that, as a rule, industries seek regulations for their own benefit, although there are some exceptions such as the heavy taxation policies on the whiskey and playing card industries.

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(56) Ibid, p 342.

(57) See Sam Peltzman, *George Stigler’s contribution to the economic analysis of regulation*. (1993) *Journal of Political Economy*, 101:824.

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The state has a feature that is not shared with any of its citizens and that is the power to coerce. Only the state can oblige people to pay money; taxation, it is also the only entity that can restrict the movement of resources without the consent of the concerned people or firms. Industries usually seek four main policies from the state.<sup>(58)</sup> The first is direct subsidy. The second is the introduction of controls over new entrants to the industry. The third is any policy that encourages complements and restrains substitutes (e.g., the butter industry will seek a policy to restrain the margarine industry as well as a policy to subsidize the butter industry). Finally, industries seek policies that introduce price fixing in order to maintain their profits and protect themselves from competition based on price wars.<sup>(59)</sup>

Industries that seek political power and subsidies will go to the sellers, which are political parties. The party or the organization of a party eventually incurs operation costs, which include competing in the elections: “Elections are to the political process what merchandizing is to the process of producing commodity, only an essential final step.”<sup>(60)</sup> Industries that seek a regulation must be prepared to pay for it in two different forms: the first is resources (e.g., financing the campaigns) and the second consists of votes to the selling parties. If the buyer is a large industry, then the costs are usually higher because large industries usually seek regulations and programs that cost the society more and hence raise more opposition from affected groups.<sup>(61)</sup> Furthermore, the “smallest industries are precluded from the political process unless they have a geographical advantage, e.g., geographical concentration.”<sup>(62)</sup>

To summarize, then, according to Posner “legislation is a good demanded and supplied much as other goods, so that legislative

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(58) See George Stigler, *The theory of economic regulation*. (1971), *The Bell Journal of Economics and Management Science*, 2:3

(59) *Ibid*, p 4.

(60) *Ibid* p12

(61) For a critique of Stigler’s theory, see the Richard Posner article “*Theories of economic regulation*”

(62) *Ibid*, p 12.

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protection flows to those groups that derive the greatest value for it, regardless of overall social welfare.”<sup>(63)</sup>

## **Political Environment and Legislative Process in Kuwait**

In this section an overview of the Political environment and the legislative process in Kuwait will be introduced to familiarize the reader with the back-ground which is essential for the understanding of the economic analysis of the legislative process which in the end will be an indication of the current evolution of the Economic Regulation infrastructure and the efficiency of this process.

Kuwait formed its constitution on the basis of a contract or agreement-*Le Pacte*-between the people and the ruler. A committee elected by the people was charged with drafting the constitution, which the ruler, Amir, signed without amendment. This recalls how the French constitution was formed in 1830 and how the Magna Charta was formed in England in 1215.<sup>(64)</sup> The political system in Kuwait is constitutional monarchy.<sup>(65)</sup>

The Constitution in Kuwait adopted the Orleanist monarchy system.<sup>(66)</sup> Therefore, the head of state the, Amir, enjoys great powers, e.g., he has the right to dissolve the parliament and appoints the Prime Minister.<sup>(67)</sup>

The legislature in Kuwait is the National Assembly and the Amir according to Article 51 in the Constitution. The Parliament consists of 50 members who are elected from 25 constituencies, 2 members coming from each constituency (Table 3 In Annex 1).<sup>(68)</sup>

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(63) See Jonathan R. Macey, Public choice: *The theory of the firm and the theory of market exchange*. (1988)*Cornell Law Review*, 74:46.

(64) See Professor Othman Al-Saleh, *Al-nitham al-distori wa al-mos'asat al-seyasyah fi al-kuwait*, (Kuwait University Publication, Kuwait, 1994) p 204.

(65) See. Visited 27 June 2005.

(66) See Professor Othman Abdel-Malek, *Al-nitham al-distori wa al-mos'asat al-seyasyah fi al-kuwait*, (Kuwait University Publication, Kuwait, 1994) p 237.

(67) See Article 102, 56 & 58 of the Kuwaiti Constitution.

(68) See Law No. 99/1980 as it restructured the election map by introducing 25 constituencies instead of 10.

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There are some restrictions on who is eligible to vote or run as a candidate in Kuwait. Voters must be 21 years old, military and police personnel are not allowed to vote. The justification for this restriction is that such personnel should not be involved in the political arena in order to maintain their impartiality when it comes to law enforcement. Finally, it should be noted that until May 2005,<sup>(69)</sup> women were not allowed to either vote or run as a candidate. Therefore, all elected parliaments did not involve female participation and, along with the age restriction, reduced the number of “eligible” voters and candidates substantially. According to one study, approximately 15% of the total population was eligible to vote in 2003.<sup>(70)</sup>

It should be noted that the law in Kuwait does not recognize the formation of political parties; therefore, all candidates run independently.<sup>(71)</sup> Furthermore, civil societies are heavily restricted by Law No. 24/1962, and there are only 55 civil societies with a total membership of 44,000. These include professional societies such as the Law Society, Accountants Society, and Engineering Society. The largest societies are the cooperative ones, which provide mainly food and household instruments. These societies, composed of area residents, aim at providing cheap and reliable supplies for residents, and they control 80% of the food market.<sup>(72)</sup> However, a number of associations and unions have been established in Kuwait such as Car Dealers Union and other many unions but the effectiveness of these unions and associations in the political market is marginal and rarely exist.

### **Analysis of the Current Supply and Demand Curves in the Legislative Production Process**

After giving a general overview of the political environment in Kuwait this section will apply the law and economics theories to assess

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(69) This was a result of around four decades of struggling to gain this right.

(70) See the United Nations Development Program (UNDP) at. Visited on 4 July 2005.

(71) However, there are some political movements such as the Islamic Constitutional Movement and the National Democratic Assembly.

(72) See the UNDP Program on Governance in the Arabic Region at Visited on 5 July 2005.

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the efficiency of the legislative process in Kuwait. The analysis of the efficiency of the legislative process and the current supply and demand for economic regulation will be the used criteria to determine the efficiency of the economic legal infrastructure in Kuwait.

This section identifies the current supply and demand curves in the legislative process by analyzing the empirical results gathered in the conducted field research along with primary resources. The questionnaire used for this research covered 590 eligible voters and excluded females, despite their eligibility after the 2005 amendment that granted them their full political rights, because they had not participated in any elections thus far. The next election is slated for 2007. This analysis also covers the Bills initiatives by the National Assembly members in the last three years to establish a trend of current supply and demand by identifying their nature, i.e., economic or social.

Before analyzing the field research results, it is important to define and explain some terms that are going to be used in the analysis. The first term is what is known in Kuwait as “Services MPs”, this is a description for those MPs that exploit their position in the parliament offer their voters their services to interfere in the executive branch bureaucracies to finalize voters needs in these entities. The following example should clarify this notion, in Kuwait the government offer free treatment in western countries, e.g. London and Paris provided that the treatment is not available in the health industry in Kuwait. In other words to be sent abroad, along with another family member, and enjoy a paid treatment and living expenses in London for instance, the treatment of the person illness should not be available in Kuwait. Voters usually demand from their MPs to talk to the responsible member in the government in order to grant such service despite the fact that the voter can be treated in Kuwait. People try to exploit this offered service, despite the fact that they do not qualify according to the stated rules, to get a free paid holiday in London in summer time. And some MPs specialize in offering such services for the voters and therefore became known as Services MPs.

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The first thing that can be inferred from this phenomenon is that it is not the MP duty to engage in such activities, he is suppose to legislate and supervise and not offer such services. The second thing that emerges as a result of this phenomenon is that this category of MPs must maintain a good relation with the executive branch to ensure that all their voters needs are finalized even though they are against the law. As a result this MP becomes controlled by the government and cannot say or do anything that is contrary to the executive branch wishes. This will eventually undermine the main functions of this category of MPs. Finally, this category of MPs usually do not have political programs that they wish to implement and they are not expected by their voters to come-up with solutions or supervise the executive branch effectively because the whole reason behind their success is not their political programs or the promises for change that they offer for their voters rather it is their services that qualify them to become MPs. In the end this will hinder the effectiveness and the main purpose of the parliament in general as the more MPs that join this category the worse the parliament will get and eventually it will fail to fulfill its main duties.

Now the problem is that despite the fact that this function is not the responsibility of MPs voters became convinced that MPs should fulfill this “alien” function. The questionnaire results revealed that 47% of voters believe that the MP has a duty to finalize and facilitate transactions<sup>(73)</sup> pending in the executive branch for their voters, e.g. securing a promotion, special health benefits etc. (Figure 1 In Annex 2).

This result demonstrates that members of parliament are supplying an additional service that is aimed at ensuring their reelection. This goes along with Jonathan Macey’s analysis that legislators act as entrepreneurs as they adopt new issues in order to create groups that will benefit them in the political process.<sup>(74)</sup> This is further demonstrated in the

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(73) Transactions here refer to public services offered by the executive branch, e.g. scholarship and health service as in many cases these services is not granted automatically to the public as certain criteria’s that needs to be fulfilled and MP’s usually interfere to ensure that their voters who have not fulfilled these criteria’s gets this service as a way of exception.

(74) See Jonathan R. Macey, Public choice: *The theory of the firm and the theory of market exchange*. (1988) *Cornell Law Review*, 74:46.

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increased number of transactions that the executive branch finalizes for MPs, e.g., in the year 2003, the Ministry of Interior Affairs alone dealt with 10,140 transactions introduced by MPs.<sup>(75)</sup>

The questionnaire results also show that 52% of respondents have given MPs a total of 438 transactions to finalize, and 2% stated that they have given a “lot of transactions” to MP’s to finalize and this 2% cannot be quantified, but this response would definitely increase the number of 438 requests and finally 46% stated that they never gave their MP any transaction to finalize (Figure 2 In Annex 2).

This clearly illustrates that becoming a “services MP” will guarantee, to an extent, reelection; therefore, more and more MPs are heading in this direction. This will eventually affect the main functions of MPs, which are legislating, including economic regulations, and supervising executive branch activities.

This departure by MPs from their constitutional duties can be also shown by a number of additional indicators. The first is the fact that 75% of the participants in the questionnaire stated that they have never asked their MPs to introduce “economic legislation” (Figure 3 In Annex 2).

This illustrates that the demand curve for economic legislation is very low. Therefore, if the economic theory of price and Stigler’s economic theory of regulation is applied, then this low demand eventually leads to a low supply. As a result, this low demand affected the supply curve negatively, and thus few economic bills are being passed by the Parliament. This low supply curve can be illustrated by considering Bills initiatives as an indicator of the current supply curve. After Examining 325 initiatives introduced by MPs in the last three years results shows that only 30 of these initiatives can be classified as “economic-related initiatives.”<sup>(76)</sup> This accounts for only 9% of the total initiatives introduced by MPs (Figure 4 In Annex 2).

This low demand/supply curve is mainly the result of the absence of “economic interest groups.” The reasons behind such absence of such

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(75) An Interview with senior personnel in the Ministry.

(76) This includes any initiative related to the operation of the economy.

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groups are discussed in the following section, but the general reason is simple: There is no active civil society for the above-mentioned reasons (i.e., legal restrictions and the absence of a culture of civil society). In addition, the economic structure and the rentier nature of the economy determines that the public sector is the dominating sector and this fact waives any chance of having an active interest group that can represent the private sector. Moreover, the structure of constituencies contributes to the absence of “economic interest group” and also the absence of political parties contributes to such absence as will be explained below.

To summarize, then, Stigler says that “the essential commodity being transacted in the political market is a transfer of wealth, with constituents on the demand side and their political representatives on the supply side. Viewed in this way, the market here as elsewhere, will distribute more of the good to those whose effective demand is highest.”<sup>(77)</sup> For Stigler, the question of which group will have the highest effective demand translates very quickly into a question of numbers. Application of this analysis makes it obvious that services and the social service demand curve is very high in the political market in Kuwait while the economic legislation demand is very low. This, along with the following discussion, explains to an extent the failure of economic legislation to arise.

### **An Economic Analysis of the Structure of the National Assembly and Election Laws**

Now that we have seen the current supply and demand for economic legislations, it is essential to examine the structure of Parliament and the electoral laws and how they are related to the inefficient legislation process in Kuwait. The main issues to be discussed are how the absence of political parties affects the transaction costs in the legislative process and the current structure of constituencies, which boosts the demand for “services” and affects the demand for economic legislation negatively.

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(77) See Sam Peltzman, *Toward a more General Theory of Regulation*, (1976) National Bureau of Economic Research., Working Paper Series No 133, at p3.

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As mentioned earlier, the law prohibits the formation of political parties. As a result, there are 50 independent MPs despite the fact that some of these MPs come from the same political movement-no political movement enjoys a majority or even a quasi-majority. In other words, Kuwait National Assembly is a fragmented institution in terms of the structure of its members. This negatively affects the legislative process because legislation, according to Posner and Stigler, is a product and therefore is subject to the costs of production and exchange that exist in any conventional market. The resources needed to produce a piece of legislation can be divided into two main resources: *direct* and *indirect* factors of production.

The first, direct resources, consist of the consent of the other MPs in the National Assembly, the needed majority; the second, indirect resource is the voters' support of the proposed legislation. Without the availability of these two main resources, legislations cannot be produced in Parliament. MPs who cannot guarantee the needed majority will not bother initiating the bill because economically their action would be inefficient since they know the end result. The same situation occurs in conventional markets when entrepreneurs cannot be assured that the needed resources, e.g., capital and labor, are available and so do not start the production process. This is because entrepreneurs are rational maximizers of their wealth and therefore do not waste time and energy in a lost cause. The same applies to MPs insofar as they are considered to be rational maximizers according to the public choice theory: MPs will not initiate an economic bill because they know in advance that it will not gain the needed majority. The absence of political parties and the fragmentation of the National Assembly makes the needed majority very costly if one considers the associated transaction costs in the legislative process, which are discussed below. On the other hand, the indirect resources mentioned earlier consist of the voters' support of such legislation. Without the actual support of voters for the introduction of economic legislation, MPs-as rational maximizers of their wealth-will not bother because of the high associated costs of gaining the needed majority and the low or even negative benefit they personally receive. However, if we apply the "rational ignorance" analysis, then voter support will not be a

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problem unless the proposed legislation directly affects them, e.g., introducing an income tax framework for residents in Kuwait.

In addition to these needed resources, one must consider the costs associated with the production of legislation. According to R. H. Coase, all exchanges have a cost other than the price. These costs include bargaining costs, supervision costs, and enforceability costs in the case of default. Collectively these are known as “transaction costs.”<sup>(78)</sup>

In the legislation production process, bargaining costs are a main associated costs because a majority is needed and therefore every proposed legislation goes through an intense bargaining process, mainly involving compromises and future promises of supporting other bill initiatives. This practice is known as *log-rolling*, which essentially involves the promise by a group of MPs to support proposal A if the other group of MPs will support proposal B.

It can be seen in the decision-making cost that as the number of individuals increases in the decision making process the costlier it is to reach a decision(see figure 5 In Annex 2).

Now that we have discussed the needed resources and associated costs for the production of legislation it is essential to examine the situation in Kuwait. According to the Kuwaiti constitution, a simple majority is needed in order to pass a piece of legislation.<sup>(79)</sup>

The bargaining costs in the Kuwaiti legislation process are very high. This presents an obstacle for the enactment of laws in general and economic legislation in particular, this obstacle is mainly due to the lack of an existing form that regulates the formation of political parties. Hence there are 50 independent MPs in addition to the unelected ministers, who are considered to be *ex-officio* members of the Assembly.<sup>(80)</sup> Passing a

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(78) See R.H. Coase, *The Firm, The Market and the Law*, (Chicago University Press, USA, 1990) p 23.

(79) Exceptions apply, e.g., changes to the constitution needs a special (two thirds) majority and the consent of the Amir.

(80) See Article 80 of the Kuwaiti Constitution: “the national assembly shall be composed of fifty members elected directly by universal suffrage and secret ballot in accordance with the provisions prescribed by the electoral law. Ministers who are not elected members of the national assembly shall be considered ex-officio members thereof.”

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piece of legislation requires the presence of at least a 51% majority. Negotiation and bargaining are necessarily intense because MPs cannot rely on a law's passing on the strength of a political party's endorsement. If a group or a political party enjoys a majority, then only internal discussions are required, as with Parliament in England where the Labor Party enjoys a relaxing majority (356 of 646 seats).<sup>(81)</sup> One can argue that what takes place in the Parliament in Kuwait is similar to the "internal discussions" that every party has to go through. However, this is not true because in any political party, the discussion takes place among a homogeneous group of people, which facilitates and lowers the costs of "discussion." In the Kuwaiti Parliament, bargaining and discussion occur in a heterogeneous group, which increases the costs dramatically.

This is demonstrated by the "legislative production outcome." Table 2 shows that the bill initiatives presented by the Executive Branch are usually passed in an average of 1.275 times in each parliamentary session. On the other hand, bill initiatives introduced by MPs are passed in an average of 0.1932 times in each parliamentary session. (Table 4 In Annex 1)

These facts culminate in one conclusion: Because members of the Executive Branch are *ex-officio* members of the National Assembly, the only political party in the country is the Executive Branch because it includes approximately 15 members in the parliament. According to Article 56 in Kuwait Constitution, the Executive Branch members should not constitute more than one third of the National Assembly members. Furthermore, the Constitution states in Article 128 that the dissenting members in the Council of Ministers must follow the decision taken by the majority unless they resign. This Article deals mainly with the consolidation aspect in the Council of Ministers. As a result, bills that are introduced by the Executive Branch are much more likely to be passed into laws, mainly because they cost less to transact since MPs have to secure the consent of at least 25 MPs whereas the Executive Branch needs the consent of only 10 MPs for a majority.

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(81) See, visited 10 July 2005.

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The absence of a legal framework that political parties can operate within is understandable from an economic perspective. The Executive Branch is the only de facto political party in Kuwait and thus enjoys a monopoly in the political arena; any monopoly will rationally create barriers to entry, and this is exactly what the Executive Branch has done by opposing any attempt to introduce a bill that would regulate the formation of political parties.

The foregoing analysis sheds light on the inefficiency of the legislative process in Kuwait and how the *inter alia* absence of political parties has substantially increased the transaction costs associated with the enactment of laws.

### **The Impact of Rentier Economy on Economic Regulations**

The rentier nature of the Kuwaiti economy can be seen as an additional element that contributes in the absence of efficient economic regulations and this is due to the following reasons. Firstly, rentier state theory, as discussed above, states that because of the lack of proper taxation program democratic representation is hindered and minimized. This can be seen in Kuwait by looking at the political formation prohibition, the civil society restrictions imposed by the government and the restriction on the media. As a result of this restricted political environment having an active and dynamic civil society is not possible in Kuwait which in the end contributes negatively on the needed demand curve for “economic regulations” by hindering the formation of interest groups. For example, there are no active consumer protection societies that can force and demand a modern and efficient regulation that protect the interest of their members.

Secondly, as illustrated above the domination of the public sector in rentier states is a main reason behind the absence of efficient legal economic infrastructure. The need to have an active “economic interest group” that can boost the demand for economic regulation is undermined and hindered due to the fact that these interest groups usually represent the private sector which in a rentier state is dismantled and

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paralyzed. In Kuwait the private sector is marginalized as its been shown in the first chapter and the public sector is the dominating sector which in the end resulted in a very low demand for economic regulation. For example, the private sector contribution to the Kuwait GDP is around 30% only. (Figure 6 In Annex 2).<sup>(82)</sup>

Thirdly, the fact that a rentier state depends on external economies for its survival and as a main supplier of its needed finance, unlike the normal situation as states usually depend on domestic economic activities, via taxation, for the growth and prosperity of the state and the absence of this environment affects the interest of the government to come-up with more efficient economic regulations. In other words, in a rentier state the government is independent, not totally, from domestic economy and depended on external economies and a result there is no direct interest for such state to incorporate efficient legal regulations because the domestic economy do not contribute to the survival of the government. In the case of Kuwait tax revenue is less than 2% (Table 5 In Annex 1)<sup>(83)</sup>

In addition, the government is the main if not the only employer for Kuwaitis, hence, the private sector role is minimal in terms of helping the government<sup>(84)</sup> and therefore having efficient legal regulations is not on the government top priority. Whereas on a non-rentier economy the government is very concerned or dependent on the domestic economy, therefore its interest is to have an efficient economic regulation as this will promote economic growth in the domestic economy which in the end will benefit the government as the profits and the production level increases which will reflect on the amount of revenue these government can collect to finance its public expenditure via taxation.

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(82) See IMF Country Report No. 05/234, Kuwait: Selected Issues and Statistical Appendix, p. 12

(83) See IMF Country Report No. 05/231, Kuwait: 2005 Article IV Consultation-Staff Report; Staff Statement; and Public Information Notice on the Executive Discussion, p. 27.

(84) See Abdel-Rasoul Mousa & Keith, Kuwait: The elite society the delusion and reality, (Dar Al-Saqi, Kuwait, 2000) at p76-79.

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## Major Remarks as to the Nature of the Legislative process in Kuwait

The legislative process in Kuwait is clearly inefficient for a number of reasons. The first and foremost is the absence of formal political parties, which has increased the transaction costs associated with passing any legislation. Furthermore, the restricted and inactive civil society and fragmented constituency in Kuwait has inhibited the formation of an effective interest group that can boost the demand curve for economic legislations.

These obstacles or reasons behind the inefficient legislative process in Kuwait, especially when it comes to economic regulations are generated by the fact that Kuwait is a Rentier State. This is due mainly to the fact that in a rentier economy the government/state is not dependent on domestic economy for generating revenue as the revenue is derived from external sources. As a result of this fact the interest in developing an efficient economic regulations that will promote domestic economic growth is marginal in a rentier state. In addition, the fact that the public sector is the dominating sector in a rentier economy means that the needed interest groups<sup>(85)</sup>, which usually emerge from the private sector,<sup>(86)</sup> will not exist or even if existed the environment will not cultivate such interest groups and help in their evolution. Finally, on top of the need to have a major role for the private sector in order to cultivate the needed interest groups having an active civil society is also essential for fostering the needed interest groups. As mentioned above interest groups are an essential component that is needed to boost the demand for economic regulations. And not having a dynamic civil society is also an indirect result of the rentier nature of the Kuwaiti economy. As according to rentier state theory corruption and anti-freedom measures usually exist as a result of rentier state.

The final result is that the negative outcomes and the environment that are usually associated with the rentier state are all contributing

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(85) The reference here is to “economic or market interest groups”.

(86) The private sector share in the GDP in Kuwait is less than 30%. See the previous chapter for more details.

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indirectly in the efficiency of the economic regulation infrastructure in such a state and that is for the reasons discussed above. In other words, the rentier economy is depriving the formation of the needed ingredients, which are mainly interest groups and an active civil society which are both not usually available in a rentier economy to have dynamic and efficient economic regulations.

## **Conclusion**

This paper tried to investigate whether one of the outcomes of rentier state theory could be the absence of efficient economic regulations in such states. It started by giving a general overview of the Kuwaiti economy as it was the chosen case study. Later on the rentier state theory was discussed and the main features of rentier economies were found in the Kuwaiti economy making Kuwait a rentier economy. Finally, the adopted methodology to assess the efficiency of the existing economic regulations was through looking at the legislative process and by applying mainly Stigler “Theory of economic regulation” and other law and economic theories.

It was shown through empirical results that in Kuwait there are no active “economic” interest groups, i.e. private sector and as a result this was reflected on the outcome of the legislative process. This outcome was divided mainly into two main parts the first is “social legislations” and the second was “economic legislations” and it was proven that the former was the main outcomes of the legislative process and the later was severely neglected. The paper further investigated the election laws and the parliament structure to show that as rentier state theorists articulated in the past that in a rentier economy/state nepotism and “clinetalism” prevails in its institutions and the parliament structure and election laws was formulated to fulfill this function. This was illustrated by the altered function of MPs, finalizing voters transactions. The absence of formal political parties increased the cost of legislating in Kuwait and the continuation of the current situation will be a major obstacle in the formation of economic legislations.

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It can be clearly said that in a rentier state the institutions and the economic structure tends to act as hinders for the emergence of an environment that can facilitate and introduce the needed dynamics to have an efficient economic regulations. The domination of the public sector in a rentier economy eliminate an important needed ingredient to have an active “economic interest groups” which can boost the demand side for economic regulations. Without having a mature private sector that can act and seek efficient economic regulations the legislative outcome will never be economically efficient as it carries with it a “rentier mentality”. In a non-rentier economy it is in the government interest to have efficient economic regulations so that the market can function efficiently and sustainable growth can be achieved. This is due to the fact that the government in a non-rentier economy is mainly financed by the private sector and as the population grows the need to have a sustainable growth in the economy becomes a crucial matter. Therefore, providing the needed “legal infrastructure” become a necessity and not an optional thing. Whereas in a rentier economy it is the opposite the private sector needs the public sector as it survives on the public sector expenditures mainly capitalist expenditure and not the opposite. Further, because the private sector is minimal in a rentier economy leaving the government with a monopoly in regard to planning the needed legislations outcome.

## Annex (1)

### List of Tables

**Table 1. Kuwaiti Government Revenue, 1999/2000 to 2004/2005**

	1999/2000	2000/01	2001/02	2002/03	Pref. 2003/04	Budget 2004/05
	<i>(in millions of Kuwaiti dinars)</i>					
Total revenue	7053	8.722	6630	7256	7966	3.167
Current revenue	7053	8.721	6.629	7229	7.929	3142
Oil and gas receipts	4795	6037	4525	5499	6150	2735
Investment income and transfer*	1976	2208	1386	1164	1161	0
Other current revenue	282	476	718	567	618	407
Tax revenue	97	93	110	135	187	150
Taxes on income and profits of non-oil companies	17	15	18	26	30	29
Taxes on property transfers	4	3	6	8	10	9
Customs duties	76	75	86	101	147	112
Excise taxes	185	383	608	432	431	257
Nontax revenue						
Capital revenue	0.2	1	26	37	25	
	<i>(in percent of total revenue)</i>					
Oil receipts	68.0	69.2	68.2	75.8	77.2	86.4
Investment income	28.0	25.3	20.9	16.0	14.6	0.0
Tax revenue	1.4	1.1	1.7	1.9	2.3	4.7
	<i>of which</i>					
Customs duties	1.1	0.9	1.3	1.4	1.8	3.5
Nontax revenue	2.6	4.4	9.2	6.0	5.4	8.1

\* Income from government's external assets; excluded from national budget and ex-post fiscal accounts.

**Table 2.** Summary of Fiscal Operations

Year	2000/01	2002/02	2003/04
<b>In percent of total revenue</b>			
Total revenue	100.0	100.0	100.0
Oil	69.2	68.3	75.8
Investment income and transfer of profits of public entities	25.3	20.9	16.0
Taxes	1.1	1.7	1.9
<i>In percent of total expenditures</i>			
Total expenditure	100.0	100.0	100.0
Wages and salaries	36.7	34.1	35.0
Subsidies and transfers	24.2	26.9	24.7
Goods and services	23.1	22.1	24.5
<i>In percent change</i>			
Total expenditure	12.0	2.0	11.5
Wages and salaries	5.0	4.0	4.4
Subsidies and transfers	8.2	24.7	-6.3
Goods and services	5.0	7.7	12.7

**Table 3. 2003 Kuwait Elections Data by Constituency\***

<b>Constituency Number</b>	<b>Voter Number</b>	<b>Number of Participants</b>	<b>Amount of Participation</b>
1	3629	3183	88%
2	2238	1806	81%
3	2471	2052	83%
4	3803	3225	85%
5	3487	2980	85%
6	3213	2640	82%
7	3150	2693	85%
8	7363	6005	82%
9	3323	2783	84%
10	6373	5172	81%
11	4531	3801	84%
12	4423	3594	81%
13	7260	6241	86%
14	4627	3526	76%
15	8033	6444	80%
16	6716	5312	79%
17	7161	5813	81%
18	5788	4829	83%
19	5399	4371	81%
20	6864	5662	82%
21	10764	7801	72%
22	7276	5840	80%
23	6606	4896	74%
24	7933	6318	80%
25	4284	3397	79%
Total	136715	110384	81%

\* See <http://www.majlesalommah.net/run.asp?id=364> Visited on 5 July 2005.

**Table 4.** Average Legislation Outcomes in Each Parliamentary Session in the Sixth, Seventh, Eighth, and Ninth Parliamentary Terms (1985-1999)\*

	Sixth Term	Seventh Term	Eighth Term	Ninth Term	Total Average
Average no. of bills introduced by the Executive Branch in each Parliamentary session	0.25	2.18	0.92	1.75	1.275
Average no. of bills Introduced by MP(s) in each Parliamentary session	0.10	0.34	0.083	0.25	0.1932

\* See <http://www.majlesalommah.net/run.asp?id=77#> visited on 12 July 2005.

**Table 5. Kuwaiti Government Revenue, 1999/2000 to 2004/2005**

	1999/2000	2000/01	2001/02	2002/03	Pref. 2003/04	Budget 2004/05
	<i>(in millions of Kuwaiti dinars)</i>					
Total revenue	7053	8.722	6630	7256	7966	3.167
Current revenue	7053	8.721	6.629	7229	7.929	3142
Oil and gas receipts	4795	6037	4525	5499	6150	2735
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Excise taxes Nontax revenue	185	383	608	432	431	257
Capital revenue	0.2	1	26	37	25	
	<i>(in percent of total revenue)</i>					
Oil receipts	68.0	69.2	68.2	75.8	77.2	86.4
Investment income	28.0	25.3	20.9	16.0	14.6	0.0
Tax revenue	1.4	1.1	1.7	1.9	2.3	4.7
	<i>of which</i>					
Customs duties	1.1	0.9	1.3	1.4	1.8	3.5
Nontax revenue	2.6	4.4	9.2	6.0	5.4	8.1

\* Income from government's external assets; excluded from national budget and ex-post fiscal accounts.

From: Ministry of Finance; and Fund staff estimates.

## Annex 2

### List of Figures

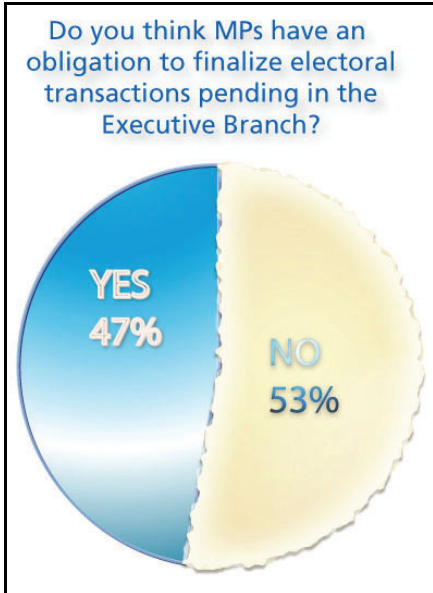


Figure 1

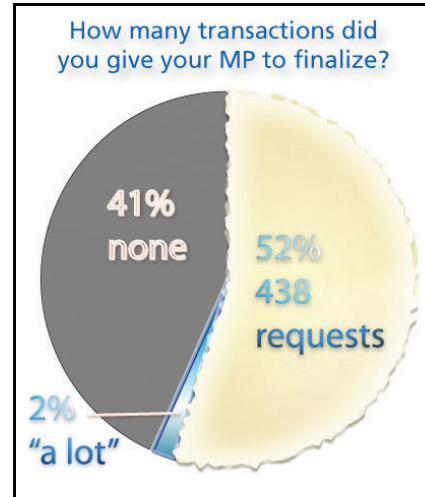


Figure 2

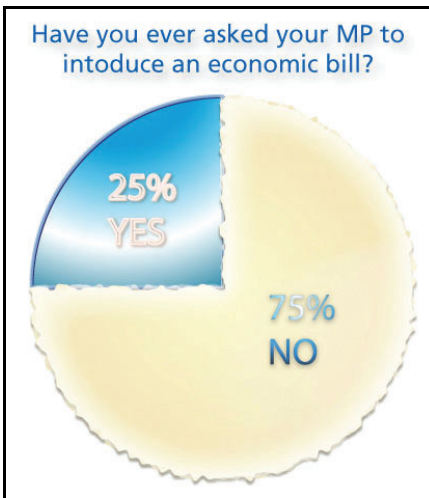


Figure 3

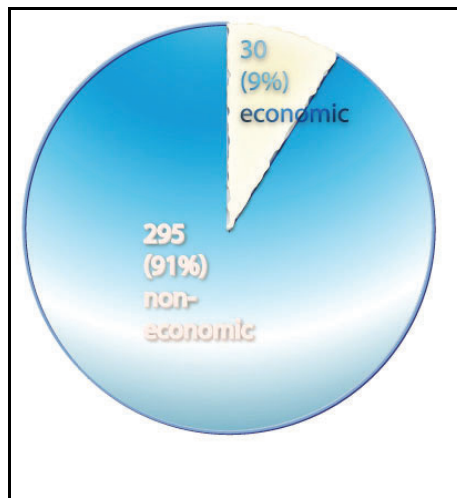


Figure 4

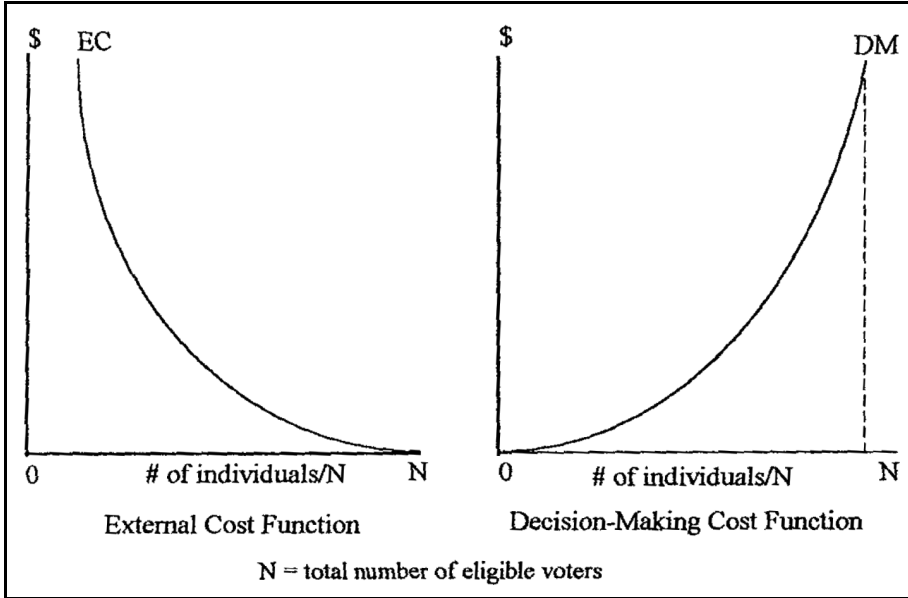


Figure 5

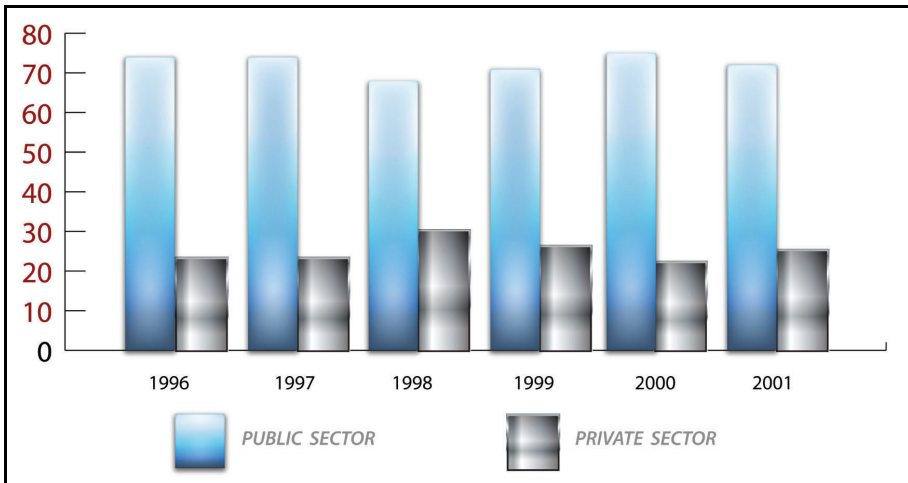


Figure 6

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