

## ***The Impact of the Iraqi Invasion on the Kuwaiti Banking and Financial System: Lessons Learned from a Financial Crisis***

In their reference to historical outlines of economic development, Robert Baldwin and Gerald Meier cited the British historian Lewis B. Namier: “Thus the past is on top of us and with us all the time; and there is only one way of mastering it even remotely in any one sector: by knowing how these things have come to be, which helps to understand their nature, character, and their correlation, or lack of correlation, to the present realities of life”.<sup>(1)</sup> Baldwin and Meier found this true of the historical processes governing economic development. It is just as true for Kuwait’s recent experience of invasion and liberation. For Kuwait, controlling the impact of the Iraqi occupation on the banking and financial sector required an accurate assessment of the repercussions of the invasion. The experience of meeting the crisis has affirmed the correlation between the development of Kuwait’s banking and financial sector and the realities of Kuwait’s economic circumstances, before and during the occupation. Thus, I can find in this statement an appropriate beginning for a historical and analytical demonstration of the lessons learned by the Kuwaiti banking and financial system from the financial crisis caused by the Iraqi invasion of Kuwait on August 2, 1990.

This article focuses on the crucial lessons learned from that financial crisis, with emphasis on the efforts exerted by the Central Bank of Kuwait (CBK) during the period of the Iraqi occupation, and the period following the liberation of Kuwait on February 26, 1991. The time has come to bring these lessons into focus through an in-depth analysis of the consequences and impact of this financial crisis on the Kuwaiti banking and financial system. Therefore, this article has been arranged to comprise four complementary parts. The first covers the background of the main economic and monetary conditions prevailing during the period prior to the invasion. The second and third parts deal with the CBK’s efforts during the occupation, and developments after the liberation. The final part draws the crucial lessons learned from the financial crisis. We hope these lessons will provoke further attention to how the State of Kuwait responded to the impact of this vicious crisis on the Kuwaiti banking and financial sector.

### ***First: The Period Prior to the Invasion***

To appreciate the full impact of the Iraqi invasion on the banking and financial sector, it is necessary to understand the background to the main economic and monetary conditions of the time. In this period Kuwait was following clear policies to improve the performance of the domestic economy, both short and long term, and developing an economic plan for its future strategy during the period 1990/91-1994/95. The Iraqi invasion

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<sup>(1)</sup> Meier, G.M., and Baldwin, R.E., Economic Development (New York: John Wiley, 1957), page 139.

curtailed the intensive efforts that were aimed at the achievement of these goals.

To understand the performance of the Kuwaiti economy before the invasion, the following points may be helpful:

1. During the five years ending in 1989, the oil sector accounted for an average of 45% of overall GDP, 90% of export proceeds, and 88% of total government revenues. This distinct dominance of the oil sector over the economy explains the emphasis given to supporting and enhancing the non-oil sectors, especially the banking and financial sector.
2. The Kuwaiti economy has always depended heavily upon imports. As a result, domestic inflation has been subject to international price and exchange rate fluctuations. The consumer price index increased by only 1.5% and 3.3% in 1988 and 1989 respectively.
3. Since 1985, when the Five-Year Plan for the period 1985/86-1989/90 was launched, the Kuwaiti authorities have given priority to confronting Kuwait's structural problems, such as the population and labour force imbalances, and to expanding the productive base of the non-oil sectors in order to diversify sources of the national income.
4. Starting from the fiscal year 1981/82, the State general budget began to record deficits ranging, before the Iraqi invasion, from a minimum of KD 106.1<sup>(2)</sup> million in fiscal 1981/82 and a maximum of KD 1,302.3 million in fiscal 1986/87. The invasion increased this deficit to KD 7,368.2 and KD 5,528.8 million in the two fiscal years 1990/91 and 1991/1992 respectively.
5. The performance of Kuwaiti banks and other financial institutions during the pre-invasion period was characterized by significant progress in eliminating the effects of the difficult debt problem, in order to focus on their normal role in the economy, i.e., receiving funds from depositors, rendering various banking services, financing different economic activities, playing an intermediary role in transactions with the outside world, and managing others' funds.

Due to the openness of the banking and financial units to the outside world, the CBK started long before the invasion to seek adjustments that would enable them to face vigorous competition resulting from the existing and expected international economic blocs occurring in different parts of the world. It is important to say here that the total volume of Kuwaiti bank assets exceeded KD 12 billion at the end of May 1990, and that foreign assets constituted 25.5% of this total. The value of foreign

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<sup>(2)</sup> One KD equals 3.5235 U. S. dollars.

assets had reached KD 3,061 million by the end of May 1990, against KD 1,644.4 million for foreign liabilities.

### ***Second: The Period of the Occupation***

During this period the CBK played its role in exile and exerted massive efforts in more than one direction, with its attention given to three main areas of responsibility. These were its organization of Kuwaiti banks abroad, providing support to help them meet their financial obligations to foreign banks and to prepare a comprehensive plan to revive the banking and financial sector after the liberation of Kuwait.

#### ***1. Reorganizing Kuwaiti Banks Abroad:***

The CBK issued directives from its temporary operations base in exile for the management of Kuwaiti banks and the protection of their financial assets. As many bank officials as possible were kept in constant communication, and missing information and bank records were reassembled through cooperative contact with foreign banks. Authorized signatures of the pre-invasion period were restricted to certain chairmen and their deputies.

During the occupation, the vaults of the CBK had been looted of gold, coins and currency notes of the KD Third Issue; the CBK, after determining quickly the looted currency notes, abrogated them as legal tender through an Amiri decree. The CBK prepared the new KD Fourth Issue, which became ready in December 1990. This move to prevent the occupiers from benefiting from Kuwait's national currency was complemented by an earlier measure, a request that Kuwaiti assets abroad be frozen. This measure helped in protecting Kuwait's assets abroad.

#### ***2. Extending Support to Kuwaiti Banks:***

The limitation on authorized signatures enabled certain Kuwaiti bank transactions to continue, with confidence in bank security. The reorganization of bank officials and the reconstruction of bank records further extended stability during the crisis. Other measures by which the CBK helped the Kuwaiti banks to honor their obligations included the drawing up of schedules for the settlement of transactions and for interest payments on bank liabilities. As Kuwaiti banks reassumed control over their affairs in given areas, the CBK asked the concerned monetary authorities to lift the freeze on Kuwaiti assets.

It was important for the longer term to sustain confidence in Kuwait's banking system, anticipating the re-establishment of the banking and financial sector after liberation. GCC (Gulf Cooperation Council) monetary authorities extended their support by continuing to exchange Kuwaiti dinars, thus aiding Kuwaitis in exile.

### ***3. Preparing a Plan for the Post-liberation Period:***

From the earliest days of the occupation, the CBK anticipated liberation and planned for the rapid re-establishment of the banking and financial sector and its vital components, namely restored confidence in the Kuwaiti currency, stable exchange rates, inflation control, and domestic and international confidence in the banking system. The CBK established short- and long-term plans for the maintenance of the banking and financial system during the occupation and its restoration immediately upon liberation.

The long-term plan for rebuilding the financial sector involved maintaining contact with bank officers in different countries, so as to be able to mobilize them upon liberation. The CBK maintained contact within Kuwait itself during the occupation; it drew up instructions and procedures to be implemented by banks immediately upon their return to Kuwait. These instructions involved the release of customers' accounts and the conversions of KD into foreign currency.

The banks were instructed to set their accounts at their August 1, 1990 levels, and to pay interest on savings and fixed deposit accounts for the entire period of the occupation.

The CBK prepared to assess economic conditions and determine the initial KD exchange rate, designate banking functions to be temporarily suspended, and limits to be set on others during the inevitable transition period immediately following liberation. In this respect, the phased settlement of international obligations already referred to served as preparation for domestic operations after liberation.

The long-term plan also included the preparation of studies on several other important matters, such as the following:

- A. Determining the number of branches that each bank would operate during the transitional post-liberation period.
- B. Stopping the activities of the exchange companies during the transition period, and determining the conditions they would have to meet in order to be allowed to resume their activities, including the settlement of all outstanding transactions with their correspondents abroad. These transactions involved transfers to their customers that had not been completed due to the invasion.
- C. Determining the procedures to be followed after liberation regarding the exchange of the new currency notes (Issue Four) for the old ones.
- D. Drafting the regulations for cash withdrawals from customers' accounts at local banks, and for conversions of Kuwaiti dinars into foreign currency. These regulations were to be followed during a

short-term period after liberation, for the purposes of limiting pressures on local banks and on the Kuwaiti dinar.

- E. Following-up on Kuwaiti banks with respect to the liquidation of their foreign assets, in order to assist them with the liquidity pressures that they would face after the liberation.
- F. Discussing different views on ways to treat the local banks' collection of debts from their customers whose financial positions were negatively affected by the invasion.

### ***Third: The Period Since the Liberation***

After the liberation of Kuwait came the immense task of rebuilding the war-shattered Kuwaiti economy, which had sustained damage to its infrastructure and the destruction of its production and development capacity. The oil sector, for example, was hindered by the fires in over 700 oil wells, and subsequently the stoppage of oil-production and export, the main source of the country's income. Another example can be found in the banking and financial system, which underwent complete cessation of activities, yielding the threat of monetary instability, lost confidence in the national currency and a rise in the increasing rate of domestic inflation.

The CBK was responsible for reviving the activities and the role of the banking and financial sector. To restore banking activities to normal levels again, the CBK provided input on many fronts, principally the preparation of this sector to resume its normal activities, and the search for the most effective way to handle the expected rush on customers' deposits at local banks.

Local banks were able, in record time, to quickly resume basic banking facilities, meeting the challenges imposed on them as a result of the Iraqi invasion. These challenges can be explained by the exceptional working conditions immediately after the liberation: a lack of technical manpower and of basic services such as electricity, the breakdown of computer systems and equipment, the lack of accounting records and systems and the deficiency in the domestic and international communications network. Nevertheless, local banks were ready to exchange the Third Issue currency notes for those of the new Fourth Issue as of March 24, 1991.<sup>(3)</sup>

From the CBK's point of view, there were several issues that were critical to monetary management and the CBK's objectives, especially the following:

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(3) The date when Kuwaiti banks resumed their normal activities.

- A. the smooth and effective resumption of withdrawals from customers' accounts at local banks, and ultimately of money conversions from the Kuwaiti dinar to foreign currency;
- B. the confidence in the Kuwaiti dinar;
- C. the reduction, followed by stability, in the general level of domestic prices;
- D. the difficult debt problem.

***1. Withdrawals from Customers' Accounts:***

The full extent of this problem cannot be seen without actual figures showing both the extent of the withdrawals and the immense challenge created for the CBK. Monthly data on withdrawals and deposits at local banks immediately after the liberation reveal the following astonishing facts:

- A. Withdrawals increased sharply during the first three months after the liberation, to reach a peak in May 1991 (Table 1), with a value of KD 1,102.9 million (85% of which were in KD, and the rest in foreign currency). The CBK was able to reverse this increasing trend during the following two months (June and July 1991). The CBK emphasized on many occasions its support for the relative stability of the Kuwaiti dinar, and achieved this stability through the KD exchange rate system and the interest rate on KD deposits, which enjoyed favorable margins over corresponding deposit rates on major currencies, together with certain temporary controls on withdrawals and conversions due to technical and logistical considerations. These controls did not cover transfers needed for legitimate economic activity, and exceptions were made for humanitarian reasons.

The CBK was successful in reducing withdrawals substantially to a minimum of KD 173.4 million in July 1991, and thus controls were eased in that month by increasing the maximum limit on withdrawals and transfers allowed for each customer from his accounts in local banks from four thousand dinars to six thousand. Later, on August 3, 1991, these controls were lifted completely and necessary precautions were taken by the CBK to meet any possible large capital outflows. It is worth mentioning here that fewer deposit withdrawals from banks and transfers to foreign currencies occurred than had been anticipated according to various possible scenarios.

**Table (1)**  
**Monthly Withdrawals and Deposits at Local Banks**  
**Immediately After the Liberation <sup>(1)</sup>**

(Million Dinars)

Description		1991 <sup>(2)</sup>					
		March	April	May	June	July	Total
<b>Withdrawals</b>	In KD	48.7	194.9	934.9	206.0	131.7	1,516.2
	In FC	4.1	75.6	168.0	66.5	41.7	355.9
	Total	52.8	270.5	1,102.9	272.6	173.4	1,872.2
<b>Deposits</b>	In KD	41.0	196.5	183.6	127.9	97.9	646.9
	In FC	0.1	2.5	16.7	24.4	8.7	52.4
	Total	41.1	199.0	200.3	152.3	106.6	699.3
<b>Withdrawals (-) Deposits</b>	In KD	-7.7	1.6	-751.4	-78.2	-33.8	-869.5
	In FC	-4.1	-73.1	-151.3	-42.1	-33.0	-303.6
	Total	-11.8	-71.5	-902.6	-120.3	-66.7	-1,172.9

(1) Including the Kuwait Finance House, and figures are rounded.

(2) One KD equals 3.4642, 3.4321, 3.4567, 3.4032 and 3.4238 U. S. dollars during these five months respectively.

B. Deposits at local banks ranged between KD 41.1 million in March 1991 and KD 200.3 million (92% of which were in Kuwaiti dinars) in May 1991, reflecting confidence in the banking and financial system, and reducing the severity of withdrawals, as the difference between

withdrawals and deposits was reduced from KD -902.6 million in May 1991 to only KD -66.7 million in July 1991.

To further encourage deposits at local banks and promote the credibility of the banking system as a whole, the CBK instructed local banks after the liberation to reset the balances of all customers' accounts to what they had been on August 1, 1990, before the invasion, and to pay interest on savings and fixed deposit accounts for the whole period of the Iraqi occupation of Kuwait.

## **2. *Confidence in the Kuwaiti Dinar:***

Monetary policy instruments differ in their effectiveness according to the different economic and monetary circumstances within which they work. The KD exchange rate system is designed to provide Kuwait with economic and monetary stability consistent with the country's dependence on oil, which is priced in U.S. dollars. Also crucial to the exchange rate policy is the need for imports to satisfy the major portion of domestic aggregate demand within Kuwait's free trade and payments system (there are no restrictions on currency transfers). The other main factor is the openness of the Kuwaiti economy in areas of trading and investing abroad, which necessitates regulating the flow of capital to and from the domestic economy, in addition to limiting speculation on the Kuwaiti dinar.

The present KD exchange rate system has been in force since March 18, 1975. It involves a linkage with a special basket of currencies, and was quite effective in maintaining stability before the invasion, and played a vital role immediately after the liberation in restoring the confidence in and stability of the Kuwaiti economy in general, and the banking and the financial sector in particular. The need for confidence and stability stemmed from the anticipated rush on customers' accounts at local banks, and the expected money conversions from the Kuwaiti dinar into foreign currency.

Two important facts illustrate the favorable outcome of the KD exchange rate system in maintaining confidence and stability:

- A. The average buying and selling rates of the U.S. dollar against the Kuwaiti dinar, according to the adopted basket of currencies and as declared by the CBK on March 24, 1991 (the first day of bank operations after the liberation), was 287.500 fils, against 287.490 fils on August 1, 1990, the day before the invasion. That an almost identical exchange rate existed between the U.S. dollar and the Kuwaiti dinar before and after the invasion was fundamental in giving the public a clear message of the intention to maintain confidence and stability by resuming the KD exchange rate system from where it had stood before the invasion.
- B. The KD exchange rate system continued immediately after the liberation to give relative stability to the KD against major currencies. Specifically, available monthly statistics on two periods before and after the invasion

(from January 1985 to July 1990, and from March 1991 to December 1996) reveal that fluctuations in the U.S. dollar exchange rate against the Kuwaiti dinar were very small compared with its fluctuations against other major currencies, as the highest rise and lowest decline of the dollar against the dinar were 3.3% and -5.3 in the first period, against only 2.2% and -1.5 in the second period respectively. But fluctuations of the dollar against other major currencies were at much higher rates, as shown in Table (2).

**Table (2)**  
**The U.S. Dollar Exchange Rate Against**  
**the KD and Major Currencies**

**(I) The First Period (January 1985 - July 1990)**

	<u>Highest Increase</u> <u>(%)</u>	<u>Lowest Decline</u> <u>(%)</u>
Sterling pound	8.98	-11.58
Deutsche mark	8.63	-8.96
Swiss franc	9.31	-10.03
French franc	9.08	-7.82
Italian lira	10.63	-6.62
Japanese yen	8.05	-8.21
<u>Kuwaiti dinar</u>	<u>3.31</u>	<u>-5.30</u>

**(II) The Second Period (March 1991 - December 1996)**

	<u>Highest Increase</u> <u>(%)</u>	<u>Lowest Decline</u> <u>(%)</u>
Sterling pound	16.16	-5.32
Deutsche mark	6.03	-6.86
Swiss franc	6.79	-8.01
French franc	5.85	-6.75
Italian lira	15.22	-6.07
Japanese yen	9.93	-8.38
<u>Kuwaiti dinar</u>	<u>2.17</u>	<u>-1.48</u>

**3. Monetary Stability and Domestic Prices:**

Within the framework of macroeconomic efforts to rebuild the productive capabilities of the Kuwaiti economy, stabilize the dinar (domestic currency) and rehabilitate the banking and financial sector, monetary policy was concerned with achieving and maintaining domestic price

stability. This concern stemmed from the fact that domestic inflation during this post-invasion period was essentially a combination of shortages in available goods and services due to damaged ports and storage facilities on one side, and high levels of aggregate demand, nourished by excessive domestic liquidity, on the other.

Demand for cash in the post-liberation period was quite noticeable; bank clearings at the CBK indicated a drop in the number of transactions from 211.5 thousands (with a value of KD 366.9 million) in July 1990 to only 62.1 thousands (with a value of KD 229.1 million) in September 1991. It was the responsibility of the CBK to limit the predictable increases in the rate of inflation, which were seen as a reflection of the imbalance between monetary demand and the supply capacity of the economy, in view of the damage to the ports and transport system, and the supply network. Maintaining stability in this broad sense was an essential contribution of monetary policy during the exceptional post-liberation period.

According to the domestic price indicator prepared by the CBK during that period, prices rose in April 1991 by 85% over their level before the invasion (the base period of May 1990), compared with less than two percent during 1989/90. Fortunately, in the two weeks ending on September 7, 1991, this price indicator showed an increase of only 12.8% over the pre-invasion base period, compared to 9% by the end of December 1991. Available annual data on the CPI (Consumer Price Index) show increases in domestic prices of -0.6%, 0.4%, 2.5% and 2.7% for the four years ending in 1995 respectively.

#### ***4. The Difficult Debt Problem:***

This problem received considerable attention from the CBK during the post-liberation period, stemming from the CBK's conviction about the negative effects which this problem could be expected to have on the ability of the banking and financial sector to perform its role of strengthening the performance of the domestic economic sectors.

The difficult debt problem was initiated by the stock market crash in the early 1980's. The Central Bank of Kuwait began setting the criteria for provisions required against difficult bank debts in 1985, in order to assess the volume of the problem. Later, the CBK introduced the Difficult Credit Facilities Settlement Program, which was implemented starting from the end of 1986. By the end of the first half of 1990 almost 90% of the program was finished.

The difficult debt problem was exacerbated by the Iraqi occupation of Kuwait in 1990, as these debts increased to KD 6,262 million, representing 47% of the aggregate balance sheet of local banks, and covering 10,423 debtors, whose debts had been purchased and managed against Debt Purchase Government Bonds. Thus, post-liberation cleaning up of local banks' balance sheets from the severe and prolonged difficult

debt problem has reflected positively on their performance, solvency and profitability, as well as their credit ratings according to international rating agencies.

#### ***Fourth: The Lessons Learned from the Crisis***

As background information on the effectiveness of these lessons, available statistics reveal that several banking indicators reflected positively the impact of Kuwait's post-liberation period monetary policy. These indicators included the following:

1. an increase in net profits of local banks to KD 129 million in 1995, representing a rise of 35.2% over the previous year, and showing the highest profits since 1984.
2. a rise in private deposits at local banks from KD 5,780.6 million immediately after the liberation (end of March 1991) to levels the minimum of which was KD 5,297.6 million at the end of August 1992, and the maximum of which was KD 7,089.2 million. More recently, private deposits at local banks at the end of October 1996 were KD 6,873.5 million, an increase of KD 1,092.9 million and 18.9% over their level of March 1991.
3. a high average capital adequacy ratio of local banks of 28% in 1995, against the minimum required ratio of 8% according to international standards.
4. relatively good credit ratings, which state and local banks have received lately from international ratings agencies.

Although these banking indicators are examples of the rapid and outstanding recovery of the Kuwaiti banks from the financial crisis inflicted on them by the Iraqi invasion, they do not represent the ultimate goals and aspirations of monetary policy in Kuwait. The future outlook of the CBK's monetary policy includes ways to further improve the performance of the banking and financial system, and increase its effectiveness in serving the national economy. Specifically, the CBK is seeking to achieve in coming years, with the aid of mergers and foreign participation, banking and financial units that are capable of producing outstanding performance, of meeting international standards and of providing excellent services and free competition, locally and abroad.

In the aftermath of the Iraqi invasion, Kuwait has won international commendation for the expert financial management skills it demonstrated from the time of the Iraqi occupation in 1990/91. With its country under foreign occupation, its productive sectors shut down, its domestic institutions inoperative, the Kuwaiti authorities in exile nevertheless managed and controlled the country's extensive financial holdings worldwide, stabilizing its dispersed financial institutions, and putting in place a post-liberation restructuring scheme. The lessons of the Iraqi invasion cover a wide range, including the value of analytical skills, cooperative communication, experienced and

dedicated personnel, clear lines of authority, well-understand procedures, and flexibility.

The first lesson learned from the Iraqi invasion was the value of having a strong, flexible, knowledgeably run institutional infrastructure already firmly in place before the crisis occurred. Like buildings in an earthquake, those institutions survive the greatest stresses, which have the strongest foundations. It would not be too much to say that the groundwork for Kuwait's successful financial management during the Iraqi occupation had been laid many years before. In a crisis, decisions must often be taken in a minimum of time and with a minimum of information, relying on the analytical wisdom of experienced authorities. Such analytical skills are acquired over time, within a well-organized system. Kuwait's monetary authorities operated in just such a milieu before the invasion; its soundness was proven in the crisis of 1990/91.

Specific characteristics of that effective system were shown to be of crucial value during the occupation. These involved the relationship between the CBK and the local banks. Clearly defined principles, based on a legal and administrative framework, have always governed the interaction between the CBK and the banks. In the years before the invasion, various functions and supervisory rules of the CBK were specified, and the obligations of the banking system were laid out.

As a result, over the years the banking sector had become accustomed to the impartial authority of the central bank, and to the procedures for operating and reporting required of them. There was continual communication and information-sharing among them, recognizing that understanding between the CBK and the banks under its supervision could not be based solely on the figures on the balance sheet.

Furthermore, this lesson learned from the Iraqi invasion about the necessity of having strong and efficient financial institutions explains the CBK's efforts after the liberation to achieve the following:

- A. enhancing the professional performance of the Kuwaiti banks. These efforts required the CBK to adopt new supervisory systems, among which were the regulations on maximum credit concentration, the required conditions for members of banks' boards of directors to obtain credit facilities from their banks, and the required experience that ought to be expected of members of banks' boards of directors, and of top executives of these banks;
- B. reforming the financial system base through the termination of financial companies which were not capable of continuing their activities by means of effective financial systems that were accepted locally and internationally. Also, the CBK requested able companies to strengthen their capital base, and to reform their internal control systems;
- C. expanding the diversified base of the banking and financial system through the establishment of new investment companies that can perform their activities according to Islamic principles, and the preparation of a new legislation pertaining to Islamic banking, currently in progress.

An effective working relationship among the banks was the second lesson of the Iraqi invasion of Kuwait. A close, well-established working relationship between the CBK and its constituent banks was evident in the dispatch with which the CBK restructured the Kuwaiti banks in order to secure their operations and enable them to continue to honor or settle foreign transactions. Directives governing the replacement of bank officers and the reorganization of authorized signatures were issued, adopted and communicated to international authorities. The decision to abrogate currency notes of the KD Third Issue as legal tender was handled as smoothly. These actions point to an efficient monetary authority, accustomed to lines of authority and cooperative operations.

The crisis of the invasion taught us, as a third lesson, that we were right in adhering to the principle of honoring all our commitments and obligations, no matter how costly and troublesome they might be. To get around these commitments and obligations by not honoring them would have caused us many problems, one of which would have been lost confidence in and respect for our banking system. This explains why the Kuwaiti banks were instructed to settle all their outstanding transactions with their counter-parties abroad, to set their customers' accounts at their August 1, 1990 levels, and to pay interest on savings and fixed deposit accounts for the entire period of the occupation.

Honoring our commitments and obligations without hesitation recalls a statement which I made in a speech in 1991: "As a central bank, God willing, we shall prove to all in Kuwait, as well as in the region and the world, that we are capable of overcoming all challenges put to us, and time shall testify to this."<sup>(4)</sup>

The need to be able to accurately assess a crisis situation was the fourth lesson garnered from the Iraqi invasion of Kuwait. In the sudden, precipitous crisis, Kuwait's monetary authorities were able to assess the danger accurately to take decisions and initiate effective action. They recognized the threat to the currency, to the credibility of the banking and financial sector, to national assets, and to the well-being of Kuwaitis in exile, and drew up plans for both the short and long run.

The fifth lesson the crisis taught us was to anticipate possible developments and events. Since time should be used most efficiently during any crisis, when considered measures and timely actions are needed, the CBK was faced with this task. For example, the CBK expected that during the period immediately following liberation there would be massive withdrawals from customers' accounts at local banks, and conversions from KD into foreign currency. The CBK developed practical views on possible scenarios with which to counter that challenge with flexibility, resulting in the gradual application of controls during a specific period of time, after which they would be eliminated.

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<sup>(4)</sup> "Crucial Tasks of the Central Bank of Kuwait During the Iraqi Invasion and After the Liberation of Kuwait", delivered on November 30, 1991, in Manama, Bahrain, on the occasion of the 17th Inter-Arab Cambist Association.

The importance of being in continual communication with other monetary and financial authorities was the sixth lesson. For example, the CBK consulted with the Ministry of Finance and the Kuwait Investment Authority, and with GCC (Gulf Cooperation Council) monetary authorities. It also communicated with the IMF, the World Bank and other international financial and monetary authorities. As the restructured Kuwaiti banks assumed control in various areas, the CBK communicated requests to the authorities in these areas to lift the freeze on Kuwaiti assets which had been implemented to prevent their looting by the Iraqi occupiers. Given the magnitude of these agreements, it is clear that a spirit of cooperation and trust existed between the Kuwaiti monetary authorities and those of the international community.

Recognizing the importance of plans and procedures for post-liberation restoration constitutes the seventh lesson. This planning would better enable the concerned authorities to direct the course of future events toward specific goals, and allow more control over unforeseen challenges. This task further demonstrated the analytical skill and institutional organization of the Kuwaiti monetary authorities, who recognized that phased limitations and phased operations must be built into their plans, to accommodate changing circumstances as reconstruction proceeded. Hence a “transition” period was designated, and the flexibility of the system was called upon to make the modifications in operations that would become necessary as time passed.

The eighth lesson, a substantial one, was to give priority and concern to stabilization policies; these policies were altogether necessary in light of the war-shattered economy and the disordered banking and financial sector which remained in the wake of the occupation. They involved the CBK’s tireless efforts to defend the stability of the Kuwaiti dinar after liberation.

We must admit that any noticeable decrease in the KD exchange rate, no matter how it could be justified on economic bases, would have created a general expectation that further decreases were possible and would be implemented soon. This lesson learned from the crisis would make us give priority to stabilization policies in general, and to those connected with the national currency in particular.

The way the CBK anticipated and reacted to the negative repercussions of the difficult debt problem on local banks’ activities constitutes the ninth lesson of the crisis. The severity of these expected repercussions explains the reason why this problem received so much attention from the CBK during the post-liberation period. One might say that the greatest achievement in solving this problem, according to the CBK’s views, was in handling it through two phases, the first of which was aimed at cleaning up local banks’ balance sheets from this severe and prolonged difficult debt problem, and the second of which was concerned with views on how to treat the local banks’ collection of debts from their customers whose financial positions had been negatively affected by the Iraqi invasion. Cleaning up the balance sheets, through Debt Purchase Government Bonds, was a necessary first step to allow these banks to properly perform their role in the national economy.

Apart from the negative impact of the crisis on the physical facilities of the banking and financial sector, that impact on monetary authority personnel and bank officers should also be assessed as the human element, the tenth of the lessons learned from

the crisis. The CBK maintained continuous contact with its officers in different countries, so as to be able to mobilize them upon liberation. It is proper during crises not to lose track of trained employees, since training new ones would be very costly time-and money-wise. As a matter of fact, some of these officers were working in exile for the CBK, which had a strong presence in exile. Needless to say, the monetary policy personnel who were working for the CBK in exile were put under severe pressure, and were on call for duty continuously. Here the crisis taught us the value of qualified persons, who can use their mettle to face problems and difficulties promptly, and in an assured and confident manner. These dedicated and experienced persons, as they lived the crisis, turned its agony into challenges, and its fearful situation into confidence and optimism.

It is clear that Kuwait's ability to withstand the massive shock to its banking and financial system posed by the Iraqi occupation was made possible by the maturity and soundness of the CBK, as well as the banking and financial institutions, operating within an economy which has for years been characterized by openness and interaction with the outside world. This openness appears in the absence of controls on the transfer of capital funds abroad, and in the fact that exchange rates on the KD have for years been linked to a basket of currencies, giving the Kuwaiti currency its enviable stability. The entire system is stabilized by the clearly-delineated supervision of the nation's banking and financial institutions by the CBK.

In conclusion, there are no guarantees against crisis, and Goldman Sachs Chairman E. Gerald Corrigan has said: "..... at the end of the day, it is that great intangible of the credibility of the central bank and its leaders that will be decisive".<sup>(5)</sup> Kuwait's monetary authorities have built and sustained such credibility through a massive crisis.

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<sup>(5)</sup> An address on: "Central Bank Management of Financial Crisis", delivered on October 25, 1995 in Shanghai, China.