

***The Difficult Credit Facilities Settlement Program:
An Introduction to Major Issues in the Development
of the Kuwaiti Economy***⁽¹⁾

Economic development is one of the major interests of economic policy makers in all countries. While the developing countries are trying to accelerate their economic growth rates, the developed countries are involved in enhancing theirs.

Our talk about major issues in the development of the Kuwaiti economy will necessarily lead us to the subject of economic development in Kuwait, from the viewpoint of both accelerating real growth rates and enhancing economic growth, including the maintenance of the economic achievements in the country. Due to the difficulty of discussing such issues, the realistic approach to discussing major issues in the development of the Kuwaiti economy requires us to explore the available potentials for the development of the economy, a matter that would take into account the basic features of the Kuwaiti economy. Although these features are numerous and interrelated, I would like to point out one of the discernible basic features, i.e. the direct dependence of the Kuwaiti economy on crude oil, whose revenues determine the volume of public expenditure, the major stimulus of domestic economic activity. Talking about various circumstances that govern oil revenues, the volume of exports or their prices, leads us, while talking about development issues, to think seriously of many subjects, among which is how to

⁽¹⁾ Delivered on March 4, 1987, at the Institute of Commercial Studies in Kuwait.

increase the degree of utilizing oil revenues and to concentrate on directing these resources towards precipitating basic changes in the sectoral structure of the gross national product (GNP), thereby amending the economy's behavioral characteristics.

As a capital-exporting country, Kuwait's economic reality provides an optimistic outlook about the financial sector which may contribute to the GDP as a sector nominated by many factors to play a supportive role to oil. In addition, the requirements of economic development in Kuwait and other relevant issues should prompt the economic management in the country to create an appropriate environment in which the financial sector in general, and the banking sector in particular, can play their roles in the development process.

No one can deny the important role played by the banking systems in different countries, particularly with the historical development of monetary theory and trends which have emerged over the past years about the growing role of money in realizing an economic equilibrium.

Monetary management in Kuwait, as a part of the economic management in the country, realizes the important role to be played in this respect. Though talking about this role will necessarily lead to the part that can be played by monetary policy in Kuwait to support the fiscal policies in developing the Kuwaiti economy, it is evident that monetary policies are not effective as such. Their effectiveness is realized through banks, and requires flexibility and response on the part of the banking system towards the different policies applied by the Central Bank. Further, it requires that confidence in banks must be maintained, in order to safeguard the momentum of the economy.

The Securities Market crisis in 1982 had adverse effects on the economy in general and on banks, which faced the problem of “difficult debts” in particular. This problem with its negative effects on the banking business and economic activity was the prime concern of the economic management in Kuwait, which addressed it with the implementation of the “Difficult Credit Facilities Settlement Program” as a radical solution to the debt crisis. Being the supervisor of the banking system, the Central Bank was entrusted with executing this program. Allow me here to elucidate the philosophy and dimensions of this program’s direct and indirect effects on both the banking system and the national economy. It receives particular importance as the implementation of this program represents, at this stage, a starting point for a comprehensive outlook regarding development, maintenance and promoting the performance rate of the banking and financial system as a main step towards the development of the Kuwaiti economy and the acceleration of its performance rates.

The Difficult Credit Facilities Settlement Program

Now allow me to talk about the difficult credit facilities settlement program, elaborating briefly the debt problem, its causes and the procedures adopted by the Central Bank to identify the problem, its size, the justifications for the program and settlement procedures. Further, I will illustrate the program’s philosophy, objectives and rules, including the Central Bank’s relationship with banks, relating to financial support.

1- The Debt Problem – Its Causes and the Control of its Effects:

The crisis of the securities market has had adverse effects on the economic environment for several reasons, including the decline in asset prices in the economy, particularly shares and real estate. Prices of these assets fell sharply, following their steep increases due to speculation in the two markets for shares and real estate. Equally, these prices were affected by swaps that, in turn, developed a wide credit market apart from the organized market. The sharp continuous decline in the prices of these assets adversely affected the financial positions of many individuals and companies. Further, it affected, due to another number of factors, the level of economic activity, which thereby led to a tangible decrease in performance rates. Which recorded negative results in many cases. As a result, many clients were unable to service their debts and satisfy their obligations to banks.

From the beginning, the government intervened to contain the crisis and curb its effects as much as possible by issuing a number of decisions and regulations, coupled with financial procedures to eliminate many interlinked financial problems, in a serious attempt to prevent this crisis from being aggravated and expanding into the Kuwaiti community.

2- The Central Bank's Procedures to Measure the Problem with a View to Solving It:

In 1984 the Central Bank adopted a number of measures to identify the real size of the debt problem and to consider its potential impact on the

banking and economic system. These measures led to some official instructions to banks in 1985 regarding the rules and principles of classifying credit facilities and calculating their provisions and real profits. These instructions aimed at identifying the size of the problem on technical bases that are to be observed by all banks, and following up the developments in these debts. For this purpose, the Central Bank prepared special forms to be filled out by banks periodically. From its ongoing study of data and statistics provided by banks in this respect, and from its scrutiny of these data through its bank inspection system, the Central Bank found that bank settlement of client debts is a major step towards the solution of the debt crisis and thereby the acceleration of economic activity in the country. Therefore, banks were allowed to have amicable settlements with their debtors in order to regulate these debts.

3- The Settlement Program - Its Issuance Justifications, Procedures, Aims and Rules:

Since the friendly approach to debt settlement between banks and their debtors did not yield the desired positive results and as leaving the case in suspension was not in favour of banks nor their debtors, but could lead to confusion in the national economy, the Central Bank deemed it necessary to set a method for solving the debt crisis, with rules and principles allowing for the problem's dimensions and reality. On this basis "the Difficult Credit Facilities Program" was issued, obligating Kuwaiti banks and their debtors to commence immediately the settlement of difficult debts in accordance with the rules contained in the program.

This program defined difficult credit facilities that are subject to settlement as “non-performing credit facilities extended to residents who have a deficit in their financial positions.” It showed in detail the rules of settlement, taking into account all means of its success. The most significant feature of this program lies in the fair settlement of difficult credit facilities by the joint participation of both creditor and debtor, ensuring the soundness of the economic institutions and the citizen’s dignity. On the one hand, the settlement shall be made according to the financial position and cash flow of the debtor, who must be allowed reasonable housing and income that will maintain a dignified living for himself and his family. In this, the program has stressed an important social aspect by relieving the debtor from the anxiety and stress of debt. Further, it allowed the debtor to exercise his normal business activity. The program also allowed the settlement of all or part of the debt through the creditor bank’s participation in the capital of the debtor company. The debtor’s ability to repay could also be augmented through granting new credit facilities based on the needs of his economically viable enterprise. From this it can be realized that the real concept of settlement does not mean the liquidation of financial positions; rather it signifies the importance of stressing the economic aspects of settlement.

Moreover, the program specified clearly the stages of debt settlement between the creditor banks and their debtors. The first stage begins when the creditor bank advises its debtors of settlement procedures and invites them to be shown how to complete the required forms. The debtor shall be notified of the legal liabilities incurred upon him for providing inaccurate or misleading financial information. The second stage of settlement begins when the debtor supplies the bank with his financial position, in the light of the latest financial statements of debt-

ors and their guarantors, if any. The banks at this stage make sure that the evaluation of different assets is made in accordance with the rules set by the program. In the third and final stage, final settlements are made and authenticated at the Ministry of Justice after the relevant procedures are carried out by the banks, taking into account the rights of other parties in the settlement. I would like to mention in this respect that banks have made much progress in the first and second stages. Further, they have completed a considerable portion of the third stage and the program implementation is progressing normally on the right specified course.

The program shows in detail the settlement particulars distinguishing between debtors who have cash flows and others who do not. It also distinguishes between guaranteed and non-guaranteed facilities. As for those who have no cash flow, a non-interest bearing 10-year loan equivalent to the value of all collateral assets will be created. Regarding non-guaranteed facilities, a non-interest bearing instrument of deferred payment, payable by the debtor and maturing 10 years after finalizing the settlement, shall also be created. Debtors who have cash flows shall have their debts rescheduled for 15 years, as the bank shall create a loan equivalent to the guaranteed debts at an annual interest rate not exceeding 7%, and a deferred payment instrument equivalent to the non-guaranteed debts. This instrument shall be due on the date when the rescheduled part of the debt is repaid.

The program provides that the banks shall not liquidate the collateral assets without the Central Bank's prior approval. It is evident that these rules are intended to protect the asset value from being negatively affected. They also take into account the possible rise in asset value dur-

ing this period, which gives the creditor banks an opportunity, later on, to receive the major amount of the debt and also gives the debtors an opportunity to benefit from the rise in the value of their collateral assets.

Furthermore, the program has clearly discussed the supervision of settlement under provisions stipulating the formation of a committee of members of the Board of Directors of the Central Bank of Kuwait to supervise the settlement process, and the formation of another committee representing all Kuwaiti banks to co-ordinate and exchange information regarding debtors. Further. The Central Bank instructions provide that banks should form in-house work teams specialized in performing these settlements.

4- The CBK Relationship with Banks - Financial Support and Its Regulations:

Since it was expected that a part of settlements would be made in the form of non-interest bearing deferred payment instruments and in the form of low-interest-rate loans as mentioned above, such a situation may have adverse effects on banks' financial positions if their operating profits are not sufficient to build up the required provisions. For this reason, the program contains a number of rules and regulations regarding CBK financial support to banks, to help these banks realise operating profits sufficient for building up part of the provisions and distributing annual dividends at appropriate rates.

With regard to supporting the Kuwaiti banks, it can be noted that the program has stressed the State's commitment, through the CBK, to maintain the soundness of the Kuwaiti banks' financial positions, in-

cluding the sanctity of the shareholders' equity, as declared on 31.12.1985, besides the State's commitment to guarantee the rights of depositors with these banks.

The State's commitment to maintain the soundness of the banking system through clear financial support is an important factor that has enhanced the stability of the country's economic and financial position. Therefore, an analytical look at the "Difficult Credit Facilities Settlement Program" with its various procedures confirms that this program was not only set to solve the debt problem, but also as an economic working plan to cope with the nature of the current economic stage.

Finally, the Central Bank of Kuwait, taking into consideration the significant benefit that may be drawn from the problem experienced by the Kuwaiti economy, endeavours to develop its supervisory instruments and to use necessary new instruments that suit the circumstances of the Kuwaiti economy to prevent the recurrence of any problem and to ward off any adverse effects on the banking system in particular, and the national economy in general. In this regard, the Central Bank endeavours to develop and rationalize the banks' lending policy and urges them to channel their credit facilities into productive sectors in the economy and to apply necessary effective measures in respect of ensuring bank liquidity and credit-worthiness. Basic considerations are also taken to develop the financial market to transfer savings into investment outlets and to have wider diversification of savings channels in the economy. We see that the achievement of all the above-stated is essential for the development of the Kuwaiti economy.