

GCC Economic Review

Empowering human capital

Labor market policy has over the past year once again moved to the center stage of economic policy-making in the Gulf. This change is largely attributable to the reality that a period of relatively rapid economic growth in the region has not translated into substantial increases in the employment of nationals, although education and training has for years been an important spending priority for the GCC governments.

- **Efficient labor markets are critical for the full utilization of human capital resources in an economy.** The ability of labor market to place people into employment depends on a wide range of institutional and regulatory factors. Most fundamentally, however, proper mechanisms are needed to pool and disseminate information about job-seekers and vacancies. Labor exchanges – virtual or real – play a matching function between the two while ideally identifying areas where remedial action is needed in terms of retraining or other support.
- **The GCC labor markets are characterized by a number of unique idiosyncrasies.** The regional employment levels are internationally low, partly because of limited labor market participation by women. The nationals tend to have a strong bias in favor of public sector employment whereas the private sector is dominated by low-cost expatriate employees.
- **Recent labor market initiatives in the region have been characterized by redoubled efforts to boost the employment of nationals.** The failure of the pre-2008 boom to meaningfully translate faster growth into greater relative employment of nationals has spawned new initiatives designed to incentivize companies to boost national employment. Education remains a key priority area for government spending.
- **Attitudes will need to change at the corporate level, likely in part with government support.** Successful nationalization is conditional on more regional private sector companies changing their default *modus operandi* from 'import the employer you need' to 'develop the talent you require.' Significant progress in this is dependent on a major change in attitudes. Given the limited resources of many companies, the government may need to facilitate the process where appropriate and reward companies that properly engage and develop their national employees.

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The challenge of labor market reform

The labor market is fundamentally like any other market – a pooling and clearing mechanism for the available supply and demand. Its efficiency depends on its ability to compile the relevant information and match the two sides with each other. Since labor is one of three factors of production (along with capital and land), the success with which the available potential labor resources are channeled into productive purposes has profound implications for economic development. An employed individual is a productive asset, all the more so if the qualifications, aptitudes, and skills of the person closely match a given employment opportunity. An unemployed person is an economic liability: a missed opportunity from the perspective of production and a cost, whether in terms of unemployment benefits or other claim on resources. The ability of an economy to grow sustainably is hence clearly linked to its ability to mobilize its human capital and minimize the underutilization of productive resources.

The functions of a labor market

Supply of labor	Clearing mechanism	Demand for labor
Pool	Timely and transparent matching of supply and demand	Pool
Inform	<ul style="list-style-type: none"> Job centers 	Transmit information
Enhance (education, training)	<ul style="list-style-type: none"> Web portals 	Assess and refine needs
(Re-)activate (boost employment)		Provide short-term solutions

Determining the demand and supply of labor

The demand for labor, as opposed to goods or services, is derivative demand. Labor is needed not in its own right but as input in production. Employment is therefore determined by the demand for these final outputs. But it is also critically influenced by other factors such as the organization of production.

While the supply of labor, or the labor force, should be close to the number of able-bodied adults of working age (usually defined as 16-65 years) in an economy, it seldom is. Many people choose not to work because of studies, family obligations, or other factors. Some people do not seek employment if they assume that the search will be unsuccessful. Consequently, many countries apply a much more restrictive definition that includes only people in actual employment and active jobseekers in receipt of unemployment benefits. Where unemployment benefits are limited in duration, the long-term unemployed are no longer counted as job-seekers.

A number of factors can affect a person's ability to work:

- Possessing the appropriate skills and experience for a given job
- Possessing an appropriate track record. Employers may shun a person due to long periods of unemployment or frequent job changes
- Possessing the material and physical means to reach a particular workplace
- Enjoying the consent of one's family and being able to meet commitments such as childcare, schooling, etc. both financially and in terms of time
- A person's ability to work beyond a certain age can be restricted by regulations or attitudes
- Market regulations can result in rigidities in terms of working hours or the costs of hiring and firing that make employers more selective and cautious than they otherwise might wish to be
- A labor market may have non-regulatory institutional rigidities caused by trade unions, guilds, and other comparable organizations that control the supply of labor
- Asymmetric information. The ability of a company to evaluate a job-seeker's capabilities is always limited. This may result in inefficient choices

Also willingness to work tends to be influenced by several considerations:

- Is a job perceived to be appropriate in terms of a person's aspirations and expectations or broader cultural attitudes? Many labor markets are segregated and particular jobs or sectors associated with specific groups (immigrants, expatriates, particular ethnicities, a specific gender, etc.)
- Does the available compensation meet a person's reservation wage, which can be aspirational or based on concrete financial need, or both?
- Does a job materially improve a person's financial standing and compensate for the cost of time and money associated with taking it? Is the person in an unemployment trap? Alternatively, a person may prefer to stay in education/training or opt for retirement, especially if the financial implications of doing so are not materially different from those of working
- Is a person motivated to take a job? For instance, long-term unemployed often lose their willingness to return to the labor market due to the perceived stigma of unemployment

Matching demand and supply

The matching function of labor markets in the most basic terms involves the pooling of information. A common response to the rise of unemployment in many countries has been the creation of labor exchanges as formal clearing mechanisms. They are designed to centralize information about unemployed individuals and job vacancies alike, so that the two can be matched with minimal delay and inefficiency. They may serve the additional purpose of registering job

seekers for unemployment benefits and helping disburse them. Without such centralization, the dissemination of information about job seekers and vacancies can be very inefficient and cause considerable economic costs for individuals, companies, and the broader economy alike. Search time and costs are an important source of unemployment.

But another very important aspect of efficient labor markets is corrective policy. The fact that a person is willing to work does not necessarily mean that he is deemed appropriate for a given employment opportunity. In any labor market, joblessness and vacancies tend to coexist. Beyond merely frictional unemployment, caused by people looking for new jobs, this can be due to a mismatch of skills or a locational discrepancy – the job opening is in area A, the unemployed person in area B. Active labor market policies in many countries have deliberately sought to address these types of mismatches. Various initiatives can seek to upgrade skill sets to better match the evolving needs of the economy or to enable people to move. In some cases, incentives are created for employers to relocate jobs into areas with high unemployment. Such steps are of critical importance in managing the transitional costs associated with structural changes in an economy.

The challenge of unemployment

Unemployment is technically defined as the difference between the people in the labor force and people actually working. To the extent that becoming a registered job-seeker is a matter of choice, the size of the pool of the unemployed is to an extent determined by the personal choices of jobless people. People may be more likely to register as job-seekers if they see concrete advantages associated with such a decision. These could include access to unemployment benefits or training. Similarly, a person is probably more likely to register if his perceived probability of gaining employment increases.

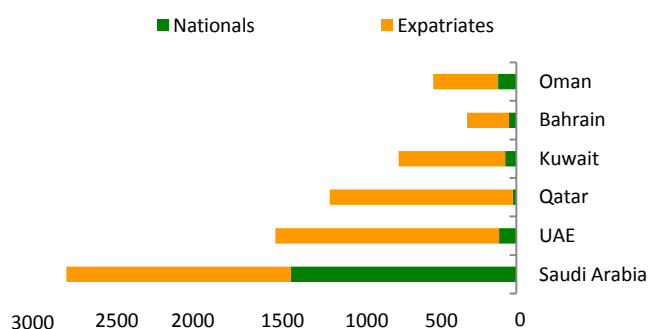
There are many different types of unemployment. All economies have a degree of *frictional* unemployment caused by people changing jobs. Similarly, *cyclical* unemployment is to an extent an unavoidable consequence of business cycles as hiring and firing reflect the level of economic activity. Especially in countries with flexible labor markets – with limited costs of hiring and firing – the cyclical variations can be quite significant. But economies can also have *structural* unemployment. This arises when people lose their jobs as a result of particular economic activities becoming uncompetitive. The unemployed are then unlikely to find comparable employment elsewhere. Typical instances of structural unemployment include relative changes in the sizes of major sectors. For instance industrialization tends to drain people from agriculture while the rise of services often happens in connection with a degree of de-industrialization. Innovation and changing input costs can undermine particular sectors while favoring others.

Characteristics of the GCC labor markets

In spite of the persistent challenges faced by the regional labor markets, the GCC countries have an internationally strong track record of generating jobs. Much of the non-oil sector in these economies is highly labor intensive, although this has tended to benefit the citizens of these countries only to a fairly limited degree. The IMF estimates that while the GCC countries created a total of 7mn new employment opportunities over the past decade, fewer than 2mn of them went to nationals. In general, a one percent increase in the non-oil GDP in the region is associated with 0.75-1.77% increase in employment depending on the country. By contrast, the corresponding proportion for nationals is 0.45-1.53%.¹

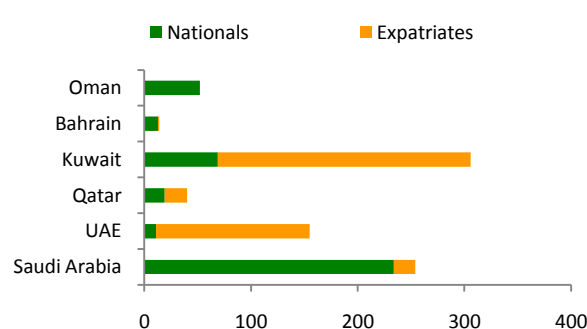
The GCC economies are characterized by a number of important differences in terms of their population base, relative level of prosperity, the scale of their hydrocarbons endowments, and the degree of diversification of their economies. Nonetheless, the regional labor markets display a number of important communalities which have proven remarkably resistant in spite of various policy initiatives to address them.

Job creation in the private sector, 2000-2010 ('000)



Source: International Monetary Fund

Job creation in the public sector, 2000-2010 ('000)



Source: International Monetary Fund

Relatively low employment

Overall employment levels in the GCC countries tend to be low by international standards. For instance the 2009 Labor Force Survey of the UAE found that people in employment made up 53% of the total population of the country. The share of those not willing to work was 19.9% while job-seekers accounted for 2.3% of the total. In Saudi Arabia, the aggregate level of employment has tended to be just below 50%. Qatar, by contrast, boasts a much higher rate of 74.6% (March 2011). A number of factors account for low employment levels but chief among them are the role of gender and informal (unregistered) employment.

¹ Samya Beidas-Strom, Tobias Rasmussen, David O. Robinson *et al.*, *Gulf Cooperation Council Countries: Enhancing Economic Outcomes in an Uncertain Global Economy*, International Monetary Fund, Washington, D.C, 2011.

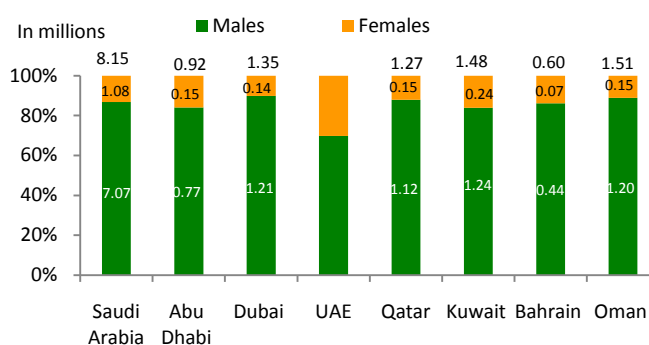
Key labor market indicators in the GCC

	Labor force participation	Employment to population	Unemployment	Youth unemployment
Bahrain	-	54.2%	3.7	-
Kuwait	52.9%	-	7.7 (Kuwaiti Nationals)	1.04%
Oman	-	37.55%	15% (est.)	-
Qatar	87.7	87.4	0.3	1.2
Saudi Arabia	49.9	47.2	5.4	29.9
UAE	72.6	69.7	4	12.1

Source: "Statistical Update on Arab States and Territories and North African Countries," ILO Department of Statistics, May 2011; CIA World Factbook.

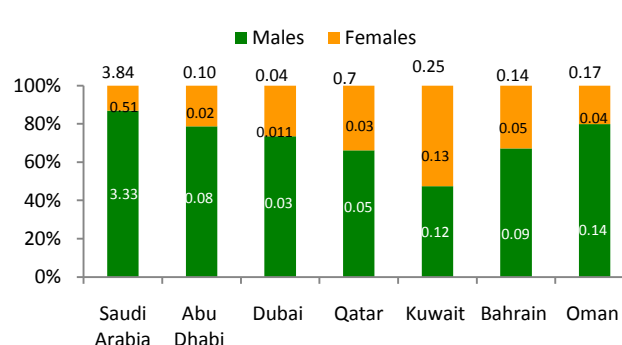
Gender. Due to cultural reasons and the persistent norm of large families, labor force participation by women tends to be significantly lower than that of men across the GCC region. Access to means of transportation can be a challenge, constraining the ability of women to work outside of home. Childcare responsibilities tend to depress female participation rates, most notably above the age of 30. Childcare facilities outside the extended family network are limited. As a result of these factors, the presence of women in the labor force tends to be largely confined to a small number of mainly public sector professions in sectors such as education and healthcare.

Female participation in the overall labor force



Source: Bahrain Labor Market Regulatory Authority, Kuwait Central Statistics Office, Oman Ministry of the National Economy, Qatar Statistics Authority, Saudi Arabian Ministry of Labor, SAMA, UAE National Bureau of Statistics, Dubai Statistics Center, Abu Dhabi Statistics Centre

Females in the national labor force



Source: Bahrain Labor Market Regulatory Authority, Kuwait Central Statistics Office, Oman Ministry of the National Economy, Qatar Statistics Authority, Saudi Arabia Ministry of Labor, SAMA, Dubai Statistics Center, Abu Dhabi Statistics Centre, UAE National Bureau of Statistics

Nonetheless, the standing of women across the region is far from uniform. Especially in the Gulf coast countries with large expatriate populations, the overall proportion of women in the labor force is marginal, seldom more than 10%. However, the standing of women in the national labor force can be far greater, especially in Kuwait and Qatar.

The official Ministry of Labor data for 2010 shows that Saudi women made up 16.5% of the total Saudi national labor force and only 8.2% of the overall aggregate total including expatriates. However, the national female participation

rate has increased from only 5.2% in 1992. The 2009 National Labor Force Survey of the UAE indicated that while 62.5% of male citizens in the country were economically active, the corresponding figure for women was only 27.5%. In Qatar, men made up 87.6% of the economically active population of 1.28mn in 2011 whereas only 158,200 women were counted in the labor force. However, their proportion of the 77,400 economically active Qatari nationals was a significantly higher 35.3%. Nonetheless, economically inactive Qatari women numbered 52,900, as compared to 28,700 men. 34.1% of Qatari women were economically active, as compared to 63.6% of men. The overall employment rate in the country was 74.6% in 2011 but the figure for men was 86.8%, while that for women stood at 37.4%.

The MasterCard Worldwide Index of Women's Advancement in 2012 found that only 24.9 Saudi women were active in the labor force for every 100 men. The corresponding figure in Oman was 35.4, in Bahrain 45.3, and in the UAE 46.9. Kuwait and Qatar were the only regional economies with indicators in excess of 50 at 52.7 and 54.3, respectively. By contrast, the corresponding indicator for instance for China was 84.3. The role of women is particularly marginal in the private sector. In Saudi Arabia, women made up only 2.1% of the total private sector labor force in 2010. They are similarly underrepresented among small business owners with the highest figure recorded in Oman: 38.9 for every 100 men. This compared to 32.0 in Bahrain, 31.5 in the UAE, 26.7 in Qatar, and 22.9 in Kuwait.

The low levels of female employment stand in an increasingly stark contrast to the dominance of women at institutions of tertiary education. Women outnumber men at advanced educational institutions across the GCC region. The dominance is most obvious in Qatar where 558.7 women are enrolled for every 100 men. The corresponding ratio in Bahrain is 273.1, followed by 243.1 in Kuwait, 181.6 in the UAE, and 156.8 in Oman. The discrepancy is smallest but still significant in Saudi Arabia at 109.5.

These patterns are increasingly reflected also in the labor force. For instance, economically active Saudi women tend to have higher qualifications than their male peers. More than nine in ten working Saudi women have a secondary qualification or a university degree while the corresponding figure for men is 60%. In the UAE, the employment rate among women with higher educational qualifications is 62.0% while it is only 18.5% for women with secondary educational qualifications and less than 5% for all lower qualifications. Nonetheless, 43.3% of Emirati women with a university degree were unemployed in 2008 as opposed to only 6.8% of men. In Kuwait, 61% of women over 25 have a diploma or a higher degree, as compared to 39% for men. At the same time, women make up 46% of the Kuwaiti workforce, up from 35% in 2000.

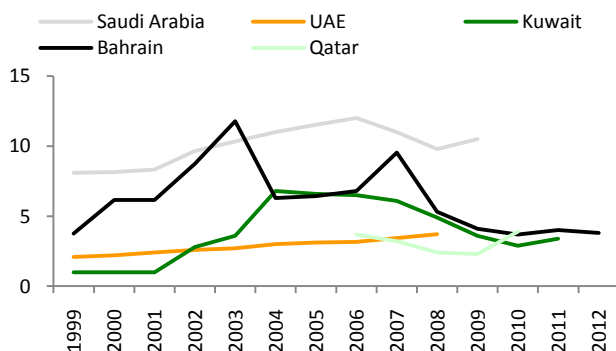
Informal employment. The ability of the formal sector to absorb new labor market entrants has been limited for a whole host reasons ranging from skill mismatches to business cycle variations, most notably the adverse effects of the

long period of low oil prices in the 1980s and 1990s. One of the consequences of this has been an increase in informal employment, typically people operating their own businesses without formal registration. The scale of such activity is difficult to determine because the mechanisms for monitoring it either do not exist (for instance pension contributions may not be payable by very small companies) or are circumvented. Nonetheless, the informal sector is estimated to have accounted for as much as 18.4% of Saudi Arabia's GDP as of 2000. The corresponding figure for the UAE was put at an even higher 18.4%.² In Bahrain, 118,549 of the total number of 130,130 employees in 2007 were registered at the Pension Fund Commission or the General Insurance Organization, the two insurance entities catering to public and private sector employees, respectively. The 'unregistered' component hence reached 8.9% of total employment as estimated by the Labor Market Regulatory Authority. An informal labor market exists also among the expatriate population, including illegal immigrants.

The challenge of unemployment

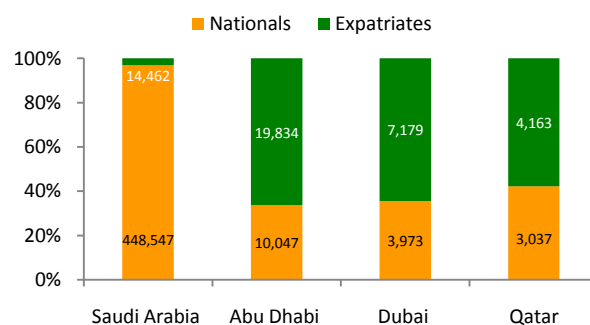
Even though the headline rates of unemployment in the GCC countries may not be exceptional by global standards, unemployment is a persistent problem in parts of the region, especially among nationals. Of course resident expatriates usually come to the region on work visas and their unemployment tends to be largely transitional.

Unemployment



Source: Saudi Arabian Ministry of Labor, SAMA, UAE National Bureau of Statistics, International Labor Organization, Qatar Statistics Authority

Nationality breakdown of the unemployed



Source: Saudi Arabian Ministry of Labor, SAMA, Abu Dhabi Statistics Centre, Dubai Statistics Center, Qatar Statistics Authority

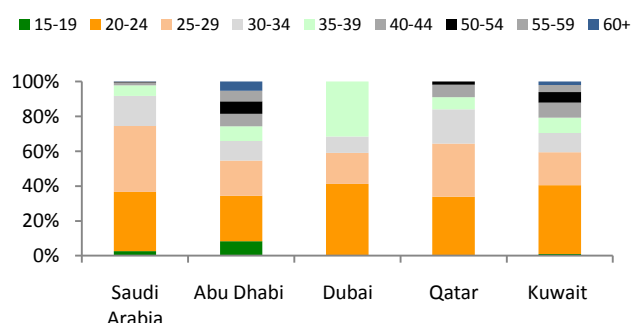
A significant proportion of joblessness in the GCC is structural as highlighted by the fact that the overall rate has in many cases not meaningfully responded to economic growth. For instance in the UAE, although the economy went through a spectacular boom in the years preceding the global crisis, unemployment among Emirati nationals in 2009 still remained a relatively high 14%. Saudi national unemployment in 2009 stood at 10.5%, while the total number of the unemployed reached 615,249 in 2012 (according to the Central Department of Statistics and

² Friedrich Schneider, "Size and Measurement of the Informal Economy in 110 Countries around the World," paper presented at a workshop of the Australian National Tax Centre, ANU, Canberra, Australia, July 17, 2002.

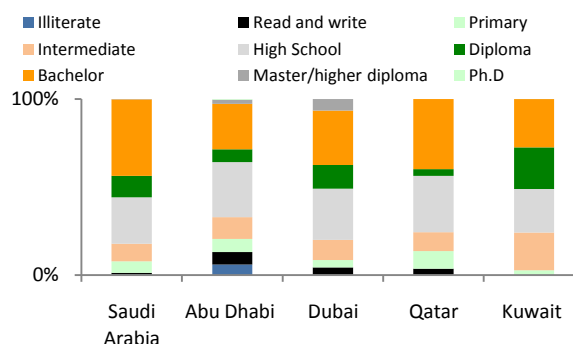
Information). The economic cost of unemployment was recently put by the Saudi Ministry of Labor at SAR5.5bn a year. Consistent with the labor market mismatches, available data on unemployment duration suggests that much of the joblessness is relatively long term. For instance in Kuwait, 27.4% of all job-seekers in April 2011 had been out of work for less than six months. By contrast, 53.9% had been jobless for over a year.

Quite beyond the headline unemployment rates, the problem of joblessness is particularly acute among certain sub-segments of the population. In particular, it tends to disproportionately afflict the region's rapidly growing young population. For instance in Saudi Arabia, unemployment among the 15-19 age group according to the latest data (2012) is 27.3%. Among the 20-24 category, it has reached some 28.0%. Even the proportion among 25-29-year-olds is around 14.3%. In the UAE, youth unemployment is three times the overall unemployment rate: 12.1% vs. 4.0%. In Kuwait, 36.3% of all the unemployed were 20-24 years old in April 2011. 17.4% of them were 25-29 and 10.1% 30-34 years of age.

Breakdown of unemployment by age group



Unemployment by education



N.B. The breakdown of UAE unemployment by age is as follows: 15-19: 36.1%, 20-24: 11.2%, 25-34: 3.9%, 35-44: 2.0%, 45-54: 1.5%, 55-64: 2.2%, 65+: 4.2%

Source: Kuwait Central Statistics Office, Qatar Statistics Authority, Saudi Arabia Central Department of Statistics and Information, Dubai Statistics Center, Abu Dhabi Statistics Centre

Source: Kuwait Central Statistics Office, Qatar Statistics Authority, Saudi Arabia Central Department of Statistics and Information, Dubai Statistics Center, Abu Dhabi Statistics Centre

Similarly, female unemployment in the region is consistently higher than that of men. The 2010 figure for Saudi women was 28.4% as compared to 6.9% for Saudi men. Women are estimated to constitute at least 75% of job seekers in the Kingdom. This problem represents significant underutilization of human capital. According to one recent estimate, quoted by Booz & Co., 78.3% of unemployed women in Saudi Arabia have university degrees while the same is true for only 24% of men.³ Among UAE nationals, female unemployment of 28.1% compares to male unemployment of 7.8%. Among Qatari women, unemployment in 2011 reached 8.0% as compared to 1.7% for men. In Kuwait, women made up 77.0% of the total number of unemployed in April 2011.

³ Richard Shediak, Karim Sabbagh, Ghassan Barrage, and Mona AlMunajjed, *Women's Employment in Saudi Arabia: A Major Challenge*, Booz & Company, 2010.

In spite of the considerable communalities across the region, Bahrain and Qatar appear to have made significant headway in containing their unemployment problem in recent years. Qatari unemployment as recently as 2001 stood at 11.6%. A period of robust growth, with a concomitant increase in public sector payrolls, has brought unemployment to well below 5%. In Bahrain, unemployment peaked at 16% at the beginning of the decade and stood at 12% in 2002. The government has tackled the challenge through more active labor market policies and the headline rate had come down to 3.7% in March 2010. As a key reform, Bahrain in 2006 introduced a national Unemployment Insurance System while job creation has in part revolved around focused programs with specific targets in certain market segments.

Dominance of public sector employment

A heavy reliance on the public sector as an engine of job creation is one of the most notable legacies of the 1970s oil boom when the expansion of public services and government-funded economic activity benefited from a major fiscal windfall. Public sector job creation subsequently evolved into an important counter-cyclical tool as well an instrument of wealth distribution. To this day, public sector salary increases have played a prominent role in responses to inflationary pressures and economic downturns alike. Due to this heavy reliance on the public sector for job creation among nationals, any reduction in the ability on the part of the government to create jobs risks translating into unemployment.

These trends have resulted in a widespread preference among nationals for public sector employment whereas they have a much more marginal presence in the private sector. In Saudi Arabia, 92.0% of public sector employment in 2011 was made up of nationals who occupied a total of 919,108 positions. By contrast, their share of the private sector labor force in 2010 was only 10.4% with nationals holding a total of 724,655 positions. In the UAE, Emirati nationals occupy only 43,000 of the 2.2mn private sector jobs in the country whereas the public sector employs 495,000 Emiratis. In Qatar, the private sector labor force in 2010 numbered 952,653. Only 6,279 of them (0.7%) were Qatari nationals whereas their share of the 101,565 government jobs was 55,170 (54.3%). Kuwaiti nationals made up just under three-quarters (73.1%) of the total public sector employment of 313,500 as of June 2011. While the total Kuwaiti labor force in 2011 was 2.2mn, only 31,700 nationals worked in the private sector as of 2008, although the number is subsequently estimated to have risen to 80,000.

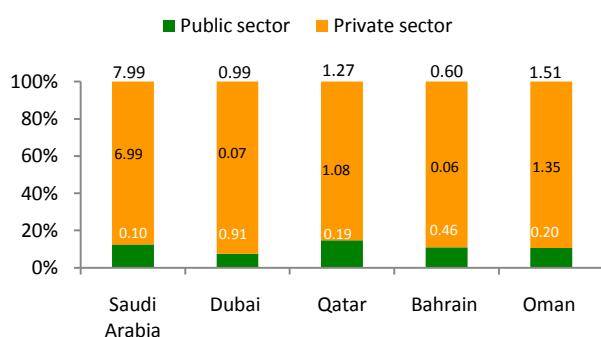
The preference for public sector employment is in part due to more attractive compensation and working hours. For instance in Saudi Arabia, the minimum public sector wage was increased to SAR3,000 a month as of May 2011. This was more than twice the average private sector salary of SAR1,293 in 2010 even allowing for a 32% YoY increase. In the UAE, private sector working hours are up to 30% above those required in the public sector. While federal government working hours average 40.8 a week, the private sector average is 52.8. Similarly, only 6.8% of all the jobs paying in excess of AED18,000 a month are in the

private sector. This state of affairs clearly involves a degree of crowding out as the public sector can more easily attract qualified candidates than the private sector.

Even though the compensation available in public sector jobs is typically better than in the private sector, many positions are not particularly challenging from the perspective of human capital development. TCO Management Consulting recently found that only 42.8% of Emirate employees at a government agency were employed in core, as opposed to support, functions. Only 20% of core positions were staffed by nationals. Hence the financial investment made by the government in job creation for nationals risk yielding a limited economic return.

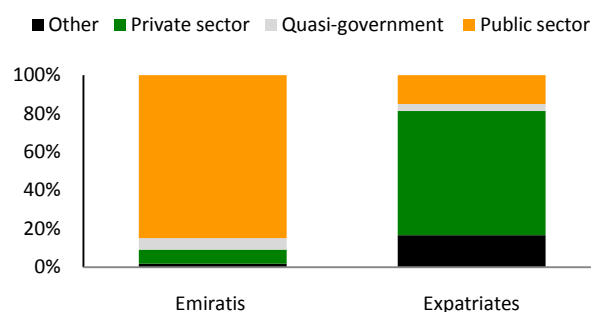
At the same time, public sector jobs in a number of instances involve an element of underemployment as people are placed in positions where their skills are not fully utilized and where overstaffing results in low levels of productivity. Most data suggest that this remains an endemic problem in the GCC. Booz & Co. recently estimated the average labor productivity (defined as the value of the output per employee) in GCC government service positions was USD27,910 in 2005. This was clearly below the average GDP contribution per employee (USD41,600) and well below sectors such as mining, quarrying, and energy (USD1,557,090) or banking, insurance, and real estate (USD146,200). On the other hand, it was far ahead of low value add expatriate dominated sectors such as trade, restaurants, and hotels (USD13,430) and construction (USD9,360). These numbers suggest that if more national employment is channeled to the private sector, potentially significant productivity increases become possible in the public sector, resulting in better timeliness and service quality.

Employment by sector



Source: Bahrain Labor Market Regulatory Authority, Kuwait Central Statistics Office, Oman Ministry of the National Economy, Qatar Statistics Authority, Saudi Arabian Ministry of Labor, SAMA, Dubai Statistics Center

Sectoral breakdown of employment in the UAE



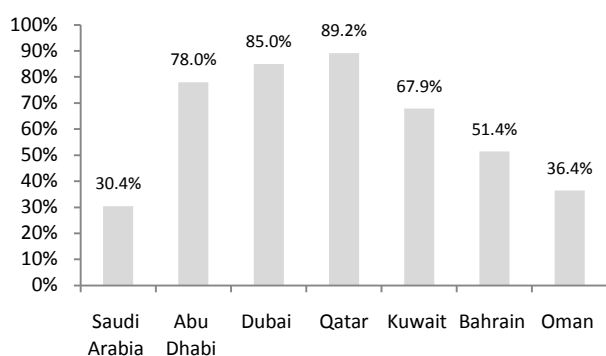
Source: "Harnessing the Full Potential of Emirati Human Capital," A TCO Management Consulting White Paper' 2012

Reliance on expatriate labor

One of the factors transforming the demographic profile of the GCC economies in recent decades has been a massive influx of expatriates. The robust economic expansion in the oil-fueled 1970s resulted in rapidly growing demand for new skills and workers. The ability of the national labor markets to respond to these

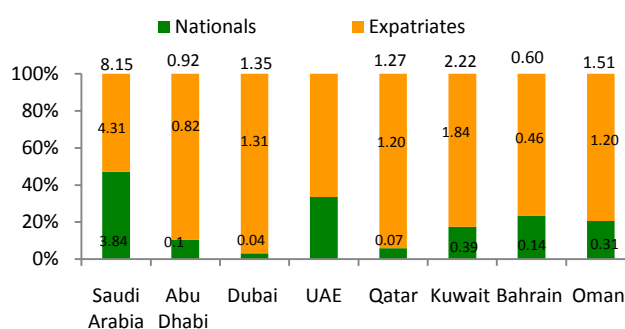
pressures was limited by insufficient numbers and the capacity of the national education systems. The consequence was a growing reliance on imported labor. This, in combination with the simultaneous dominance of nationals in the public sector, in turn engendered perceptions, attitudes, and organizational solution that have made this skewed labor market development extremely resistant to change. The bias of economic diversification towards construction and the rising service sector during the past decade meant that the new job opportunities continued to translate disproportionately into expatriate employment.

Expatriates as a percentage of the total population



Source: Saudi Arabia Central Department of Statistics and Information, SAMA, Abu Dhabi Statistics Centre, Dubai Statistics Center, Qatar Statistics Authority, Kuwait Central Statistics Office, Bahrain Labor Market Regulatory Authority, Oman Ministry of National Economy

Employment by nationality



N.B. Kuwaiti figures are for the total labor force

Source: Bahrain Labor Market Regulatory Authority, Kuwait Central Statistics Office, Oman Ministry of the National Economy, Qatar Statistics Authority, Saudi Arabian Ministry of Labor, SAMA, Dubai Statistics Center, Abu Dhabi Statistics Centre

By and large, the more labor-intensive a private sector activity, the greater its dependence on expatriate labor tends to be. These are typically sectors where the average compensation and productivity levels alike are internationally low. In essence, the large-scale imports of low-cost manual labor have created a low-cost, low-efficiency equilibrium. Although boosting efficiency would be good for growth, doing so would potentially undermine the model and involve short-term disruptions which are frequently taken as an argument against policy changes. For instance following the launch of the *Nitaqat* program, the Saudi Ministry of Labor found that 50% of all companies in the Kingdom were in the red or yellow categories with an extremely heavy reliance of expatriates. Some suggested that as many as 30% of SMEs could be hit by the efforts to transform the model.

This dependence on imported labor is particularly great in some of the Gulf coast economies which have deliberately sought to overcome the limitations of their narrow population base through an influx of expatriates. The economically active population of Qatar was 1.3mn in 2010 whereas the total number of Qatari nationals is only some 159,000. Qataris account for 5.9% of the national labor force. Less than 20% of the UAE resident population are nationals. Kuwaitis make up 1.2mn of the 3.6mn estimated total population of the country. By contrast, regional economies with relatively less reliance on expatriates include Saudi Arabia and the less oil-rich Bahrain and Oman. Even in Saudi Arabia, the expatriate share of the overall population rose from some 27% until about 2004 to some 31% as of 2010. In Bahrain, the share of Bahrainis in total employment of

594,900 as of 1Q11 was 27.3%. Nationals made up 85.8% of the public sector labor pool of 55,900. While their share of private sector employment was a much more modest 20.5%, this figure is nonetheless among the highest in the region.

Apart from their effect on the structure of the GCC labor markets, expatriate employees also create a macroeconomic challenge due to the large scale of remittances. For instance in Saudi Arabia, remittances by expatriate workers currently total some SAR100bn a year. Total remittances by GCC expatriates exceeded USD269bn in 2006-2010 according to Arab Monetary Fund estimates. The share of Saudi Arabia was USD112.2bn. Kuwait was the second largest source of remittances at USD50.7bn, followed by the UAE at USD49.3bn and Qatar at USD29.5bn.

Discrepancy between attitudes and needs

The willingness and ability of nationals to meet the needs of the regional labor market is influenced by a number of factors, some of which are more amenable to change than others. These include considerations of prestige but also religious and cultural factors may mean that certain activities are viewed as less appropriate or attractive. For instance, nationals are often unable or unwilling to work at hotels or restaurants that serve alcohol in some of the coastal countries. TCO Management Consulting recently found that although the overall pool of private sector jobs in the UAE stands at 2.2mn, only some 1.2mn would be unequivocally open to nationals.

A great deal of survey evidence suggests that excessive reservation wages remain a challenge especially for private sector employment. For instance, TCO management Consulting found that Emirati college graduates typically expect a monthly compensation of AED17,000-20,000 for entry-level positions, whereas private sector employers are seldom willing to pay more than AED10,000.

An additional complication is created by the persistence of historical patterns. Private sector employers are often accustomed to importing the skills they require in a way that allows them to select the desired numbers and qualifications. In some sectors, such as construction, employers have been able to rely on workers with flexible hours. The model is seen as having delivered value, which has limited the incentives to seek alternatives. Nationals, by contrast, are often seen as a less attractive due to higher reservation wages and less flexible working hours. Moreover, expatriates are seen to require little initial investment, since they can be pre-screened. In addition, they can be docile, partly because of their reliance on work visas and a local sponsor. These factors may make them less likely to leave even if they do not feel they are treated appropriately.

Past efforts at boosting the employment of nationals may have contributed to these asymmetries. Most regional economies used to have fairly rigid minimum quotas for national with for instance Saudi Arabia implementing a blanket Saudiization quota of 30% with some exceptions. There is ample anecdotal evidence to suggest that where the employment of nationals is based on

mandatory quotas, many companies do it merely as a way of avoiding penalties. Their willingness or ability to actively engage and integrate the national workforce is frequently limited or altogether absent. For the nationals, the lack of development opportunities and career prospects inevitably means reduced motivation and loyalty. The fact that some then leave to seek other opportunities in turn means that they are often viewed as less reliable.

Skills mismatch

In spite of massive investments in education in recent years, the ability of the GCC economies to provide national employees with the skills demanded in the marketplace remains constrained. Indeed, the employment of expatriates for specific skilled positions remains an important aspect of the regional labor markets. In many cases, the sought-after skills are not limited to precise technical qualifications but include various soft skills, experience, and the ability to transmit international practices and standards. Local educational investments are hence not necessarily sufficient to fully level the playing field in the near term.

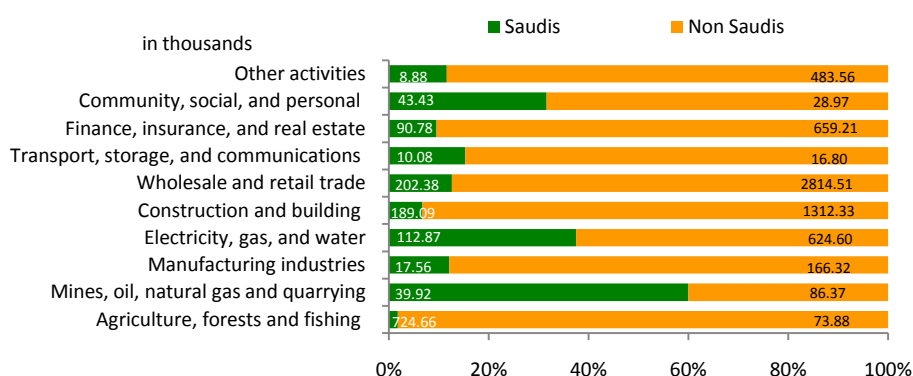
The regional shortage of highly skilled employees is reflected by the fact that for instance in Saudi Arabia, university degree holders made up only 0.2% of the total number of job-seekers in 2010. High-school graduates were the most important group accounting for 38.9% of the total. 25.9% of the total had an intermediate school certificate and 15.2% only a primary school certificate. In terms of age, 42.8% were 25-34 years of age, which suggests that a large number of people may lack the skills sought after by the labor market or struggle to compete against low-cost expatriate employees in the current environment.

Part of the challenge historically has come from the poor alignment of the education system with the needs of the labor market. For instance in the UAE, only 24.6% of university students study science and technology-related subjects. However, the proportion of business and economics is a reasonable 27.4%. In Saudi Arabia, the proportion of science and engineering students is 14.8% of the total number of students while the share of business and social sciences is 9.1%. The share of education is a remarkable 41.7%. A further 7.9% are enrolled in general faculties of arts and sciences where the breakdown by discipline is not provided. At the moment, there are still typically few mechanisms to remedy such mismatches.

Refocusing policy

While it has been a strategic priority for the Gulf governments for a long time, labor market policy has dramatically increased in salience during the past year or so in connection with a general shift toward a more inclusive growth paradigm. With the demographic momentum in the region showing little sign of waning, the ability of the GCC labor markets to effectively absorb the growing numbers of new entrants remains the central challenge. Up to 4.5mn GCC nationals are due to enter the labor force in 2010-2015, a figure that is close to the total current employment of nationals – some 5mn.⁴ The Saudi national population alone is growing by close to 450,000 a year. At the same time, the ability of the sectors historically preferred by the nationals to absorb new job seekers is limited.

Expatriates dominant in labor-intensive private sector activities



Source: Saudi Arabian Ministry of Labor, SAMA

Tackling entrenched patterns

International precedents suggest that entrenched patterns in labor markets cannot be overcome without significant regulatory intervention. Far-reaching reforms are necessary to enable the GCC labor markets effectively absorb the new entrants as it is unrealistic to expect that this will happen by virtue of economic growth alone. For instance, the above IMF estimates on linkages between growth and job creation suggest that Saudi Arabia would need 7.5% annual growth to halve unemployment over a five-year period. This still looks like an unlikely outcome in view of historical trends. Consequently, the key challenge for regional policy-makers is to reshape the regional labor markets in ways that are economically as undistruptive as possible.

⁴ Beidas-Strom, Rasmussen, Robinson et al., *Gulf Cooperation Council Countries: Enhancing Economic Outcomes in an Uncertain Global Economy*.

A central element of meeting the employment imperative comes from enhancing the ability of the private sector to absorb new job seekers. The targets involved in this transformation are unprecedented. In Saudi Arabia, the government's ninth five-year plan foresees the creation of 1.2mn new jobs in 2010-14, of which 92% is expected to go to Saudi nationals. Recent government initiatives have sought to boost these numbers much further. One statement put the objective at some 3mn job opportunities by 2015 and up to a total of 6mn by 2030 while other projections foresee 3.5mn jobs by 2025. This compared to the current total number of Saudis in paid employment of 3.8mn (2009). The overall national labor force stands at 4.3mn. The Omani Ministry of Labor is targeting 50% Omanization which would be a major quantum leap from the current estimate of 12.8% (March 2012).

In a major new policy departure, the Saudi government last year launched the *Nitaqat* program with the objective of boosting the private sector participation of Saudi employees from current 10% to 50% over three years. Instead of setting rigid quotas, as has been the case in the past, the program compares private sector companies on a number of indicators in terms of their Saudiization record. A flexible system placing companies into 230 categories based on their sector, sphere of activity, and size is designed to better account for the idiosyncrasies of particular sectors. Within each group the top 50% of companies are marked green or silver, the bottom 20% red.

Nitaqat creates rewards for companies with a strong history of employing nationals and imposes penalties on ones lagging behind. The middle category of yellow companies cannot extend employee visas beyond a sixth year while red companies cannot renew them at all. Green and silver companies, by contrast, can recruit expatriates locally from non-compliant companies provided the qualifying expatriates have been in the Kingdom for more than six years with at least two years of service for their current employer. A transfer is only possible after the expiry of a work permit. In practice, quotas vary significantly with for instance banks with more than 500 employees facing a minimum Saudiization target of 49% while corresponding figure for the media sector is a much lower 19%. Yellow companies faced a grace period of nine months in terms of complying with their national employment targets, red companies six months.

The *Nitaqat* program has engendered considerable controversy, including widespread suggestions that it will force large numbers of companies to cease operations as they will likely fail to employ sufficient numbers of nationals. After all, many private sector activities have to date depended almost exclusively on expatriate employees. On the other hand, the need to relatively quickly boost the numbers of national employees creates a risk of token jobs which offer no meaningful opportunities for career development. There is also a chance of beneficiaries of the policy abusing their privileged position, for instance by working less efficiently than they would in a genuinely competitive market environment.

In practice, the design of the *Nitaqat* program seeks to manage these types of risks, although ongoing monitoring will clearly be necessary. In order to avoid an excessive burden on small firms, companies with fewer than 10 employees do not come under the program provisions. Saudiization quotas are calculated over a period of 13 weeks in order to avoid companies manipulating the numbers through temporary employment. A Wage Protection System linked to the General Organization of Social Insurance (GOSI) seeks to ensure that appropriate wages are paid in connection with genuine jobs. Companies must ensure that the share of the wage bill paid to Saudis matches their relative numbers.

Along with the broader strategic priorities, there are more targeted programs focusing on particular sectors and ventures:

- The new Cadre Program serves the economic cities and guarantees a minimum of three job opportunities for those enrolled. In cases where vacancies are not found, the program offers monthly SAR4,000 stipend for job seekers. The first 750 participants in the program are due to graduate next year
- The Ministry of Labor hopes to see 28,000 Saudi job seekers as taxi drivers with a monthly salary of at least SAR5,000. Nationals currently account for some 15,000 of a total of 43,000 taxi drivers in the country
- Saudi Arabia is taking steps to ensure female staff in shops serving a female clientele. This reflects a broader commitment to “support economic empowerment of Saudi women” as articulated by the ninth five-year economic development plan.

The initial indications of the effectiveness of *Nitaqat* have been generally encouraging with the Saudi Ministry of Labor announcing in late May that it had found jobs for 195,000 men and 51,000 women under the auspices of the program. Another 35,000 was given as a realistic goal for the next few months.

Also in the UAE, The Ministry of Labor has quotas with concomitant penalties for increasing the numbers of nationals in some sectors, albeit with fewer parameters than *Nitaqat*. While good progress has been made in the banking sector, the progress in trade and insurance has been far more limited. For instance in insurance, companies have to pay some 0.01% of their net profit, something that many of them seem prepared to do. Recruitment in banking is expected to see 4% growth each year until 40-45% of staff are Emiratis, up from the current Emiratization level of some 33%. As an example of a more targeted approach, the Abu Dhabi Tawteen Council announced in January that 298,000 jobs would be created for UAE citizens by 2020 in seven industries including media, real estate, financial services, tourism, health care, and energy.

Nonetheless, considerable resistance to change persists. In the UAE, the head of the Emirates National Development Program (ENDP) in May called on the authorities to stop recruiting nationals to the public sector for at least three years. This highlights the widespread frustration that public sector employment remains

the default choice for many nationals. The ENDP seeks to encourage the employment of nationals across the spectrum of professions.

Creating more efficient markets

A key emphasis of the recent labor market policy initiatives in the region, especially in Saudi Arabia, has been on enhancing the operations of the labor market. In particular, the challenge of unemployment is being tackled in part by compiling better information about job-seekers and vacancies while communicating both more widely. Additional interventions are being considered to better match market demand and supply.

One of the most important new initiatives in this regard is the unemployment support program *Hafiz* which was introduced in Saudi Arabia last year. Under its provisions, the unemployed will receive a monthly allowance of SAR2,000 for a period of up to a year from the Human Resources Development Fund (HRDF). The number of beneficiaries rose from 500,000 to 800,000 in the first three months of the program and is expected to exceed 1mn. Total payments in the first year of the program are expected to reach SAR20-30bn.

A major goal of *Hafiz* is to turn the unemployed into active job seekers. Job placement centers (*Taqat*) have been set up to register and counsel candidates so as to better equip them to meet the needs of the market. A national network of 18 centers has been created and the Ministry of Labor this year announced plans for 50 new facilities for women. The internet-based Virtual Labor Market provides automated search engines as well as on-line training. *Hafiz* promotes training and requires job seekers to regularly update their CVs. Benefits will be scaled back and eventually terminated for violations of the program. Conditions include a failure to visit the program website at least weekly or a failure to attend training sessions and job interviews without a valid reason.

Beyond this, the Saudi Ministry of Labor is developing a Labor Market Observatory of 66 key market indicators in order to be able to better monitor market needs and dynamics and to respond to them in a timely manner. The Saudi National Manpower Tracking System is designed to produce a database of job seekers and universities in an attempt to highlight the market trends. In order to drive the process of labor market development in the future, there are plans to turn the HRDF into a dedicated Labor Agency.

Similar schemes exist elsewhere in the region. In the UAE, the ENDP was set up in 2005 to enable nationals to find jobs in the private sector. The organization in 2009 launched a blacklist of Emiratis who were not serious about getting a job. Those blacklisted will not receive any support from the program for a period of six months. The National Human Resource Development and Employment Authority (*Tanmia*) facilitates the process through specialized training and assistance with job placements.

Bahrain in 2006 introduced a pioneering national unemployment insurance system which ordinarily pays the recipients some 60% of their latest salary. The program is funded through 1% payroll contributions which are matched by the government and employers.

Aligning labor market policy with education

Education has long been recognized as an area of relative weakness in the GCC, although the picture has never been uniform across the region. Moreover, various initiatives in recent years have made significant headway in addressing the mismatch between skills and labor market needs. There have been a number of impressive new university and college projects, new schools, and curricula review. Nonetheless, international comparisons of educational standards still make for relatively unflattering reading for the region. For instance UNESCO's Education for All Development Index in its latest 2007 review placed the three GCC countries it ranks at just above the middle of the 128 jurisdictions reviewed. The UAE is ranked 52nd, Kuwait 53rd, and Bahrain 54th.

Even as education overall remains a key fiscal priority, vocational training in particular is increasingly recognized as an area requiring more attention. This likely to prove critical for substantially boosting the numbers of people placed in the labor market given the numerical dominance of jobs that require non-academic skills and qualifications anywhere in the world. For instance, while Saudi Arabia spends some 6.9% of its GDP on education, a figure ahead of the OECD average, spending on technical and vocational training is some 70% below the global benchmarks. Only 9% of Saudi youth today graduate with a vocational qualification as compared to an OECD average of 45%. The proportion in the other GCC countries is even lower with Bahrain the only exception as 24% upper secondary students were in vocation and technical training as of 2009. In response to these realities, the Saudi government is supporting public-private partnerships so as to increase the capacity of vocational training from 10,000 to 200,000 over the coming decade. At the same time, regional policy makers are taking steps to formally define competencies and develop a targeted plan for meeting them. For instance in the UAE, local colleges and the National Institute of Vocational education are tackling the task with the assistance of foreign colleges.

Apart from imparting formal knowledge and skills, education has other positive roles to play in enhancing labor market efficiency. In particular, general awareness of the labor market, and career planning can – and ought to – be effectively communicated as part of educational curricula. It is essential to ensure that all schools have access to professional career counselors and that career fairs are organized on a systematic, open-access basis. Starting the process early enables students to plan their careers based on informed assumptions.

Recent labor market initiatives in the GCC have paid unprecedented attention to these factors. For instance, the UAE Ministry of Education last year announced plans to appoint specialist career counselors in all government high schools in

Dubai and the Northern Emirates by 2015. UAE law is being revised to require school attendance past the age 14 until Grade 12. Linked to this, steps are needed to foster workplace exposure through education and internships. The increased use of the internet is boosting access to labor market information and organized career days are becoming more common across the region. In Saudi Arabia, more than 10,000 people, almost three-quarters of them women, had by April registered in the *Liqaat* program which is designed to more effectively bridge the gap between employers and job-seekers through a website and events such as career fairs and exhibitions.

Beyond labor market awareness building, the GCC region faces a number of specific needs in the area of education:

- **Remedial education and training.** The mismatches between the skills of job seekers and the needs of the labor market can in many cases be overcome or at least meaningfully mitigated through focused programs that are limited in duration and cost. Where concrete labor market needs exist, focused spending on relevant diploma and certificate programs can yield significant net returns while bringing more of the local population into the active labor force
- **Ongoing education.** In a rapidly changing global economic and technological environment, formal learning can quickly become outdated. Creating mechanisms for ongoing further education is important for skill updates, upgrades, and motivational reasons. The most competitive knowledge economies globally owe part of their prowess to their ability to enhance employee skills and encourage productivity on an ongoing basis
- **On-the-job training.** Some of the most valuable skills are acquired at work rather than at school. Moreover, many companies have procedures and cultures that are specific to them. Since especially the regional private sector has a long history of importing skills 'off the shelf,' on-the-job training tends to be relatively underdeveloped. Ultimately, however, it, more than anything, remains the necessary 'glue' that links raw human capital to the requirements of the workplace. After all, fresh graduates of educational institutions cannot be expected to fit in naturally at a workplace. In many countries this alignment is formalized under apprenticeship programs which are gaining growing attention also in the GCC

Changing relative prices

As much as policy can hope to address attitudes and overcome weaknesses in skills and qualifications, economic decisions are to a large extent based on purely financial considerations. The employment of nationals in the private sector has historically suffered because of far higher public sector salaries and the reality that private sector compensation in many cases is not sufficient to support a family. Employers have met their needs by importing low-cost expatriate labor with a minimal cost of living. The economic rationale of such jobs has come from

the relatively higher purchasing power of the workers' earnings in their home countries. Addressing these disparities is likely to be a necessary precondition for boosting national employment.

Expatriates. One of the key reasons for the private sector predilection for expatriates is the fact that they are less costly in terms of their salary, their willingness to work longer hours, and their finite labor contracts. The relative competitiveness of nationals can benefit from ongoing steps to boost the rights of expatriate workers while formalizing their working hours and compensation, something that is pushing up the costs associated with expatriate employment. Another part of the solution may well come from the rapid growth in Asia which is pushing up the local demand for labor as higher salaries erode the relative appeal of working in the Gulf. Also, attempts are underway to more effectively monitor illegal trade in work visas. A recent initiative in Qatar proposes the establishment of a trade union while scrapping the sponsorship system for foreign workers in favor of contracts between workers and employers.

Levies associated with expatriate employment have been another instrument for reducing the gap in relative labor costs. These can involve visa fees, ongoing charges, and contributions to the training and employment of nationals. The Saudi Ministry of Labor in April announced non-refundable monthly payments of SAR200 per employee to the HRDF for every foreign worker in excess of the number of Saudi employees. Bahrain used to levy monthly payments of BHD10 per expatriate employee, which were remitted to the *Tamkeen* fund in order to support the development of the national labor force. However, the policy was suspended last year.

Various initiatives are being mooted to raise the quality of expatriate workers. For instance the UAE is planning to curb the import of unskilled workers. This follows calls by the UAE Cabinet last year to put an end to the "unsystematic import of workforce." The objective is to boost private sector productivity through technology upgrades and a greater reliance on skilled workers.

Public sector. As much as public sector employment and salaries remain an important policy instrument in the region, new initiatives are likely to become necessary in terms of reducing the discrepancy in work conditions in the private and public sectors. Part of this will have to involve steps to boost the efficiency and accountability of public sector employment. Indeed, many government-owned companies and government-related entities already operate like private sector companies. However, it will almost certainly be necessary to more effectively control relative compensation as well.

A number of schemes seek to subsidize national private sector employees so as to reduce the wage gap vis-à-vis the public sector. In the UAE, the Khalifa Fund for Emiratization Empowerment was established to subsidize private sector compensation. In Saudi Arabia, the HRDF provides a subsidy in instances where a private company employs a Saudi for less than SAR3,000 a month in certain

fields. The risk with such initiatives is that they will further push up salary expectations thereby perpetuating the discrepancy.

Monthly average wages of employees in the private in 2010 (SAR)			
	Saudi	Non-Saudi	Total
Administrative and business directors	7,186.39	7,123.4	7,180.05
Scientific, technical and human specialists	5,318.27	3,337.11	3,642.23
Scientific, technical, and human technicians	3,773.1	1,787.84	2,103.38
Clerical jobs	3,265.65	2,459.45	3,228.35
Sales jobs	2,229.17	1,379.37	1,648.36
Services jobs	2,234.61	795.65	915.33
Agricultural and animal husbandry poultry and fishing	6,388.89	704.73	816.41
Industrial and chemical processes and food industries	4,195.17	887.32	1,116.76
Auxiliary basic engineering jobs	3,059.71	840.64	900.48
Total labor force	3,476.76	1,040.48	1,293.01

Monthly average wages of employees in the government sector in 2010 (SAR)	
Employees general salary scale	
Grade	Average salary
1	3945
15	24750

Source: Saudi Arabian Ministry of Labor

Women. In parts of the region, employing women still involves substantial additional expense for the employer and potential employee alike. Companies may have to set up separate women's sections. Women often also face additional challenges with transportation. In order to address such limitations, for instance the Saudi Ministry of Labor has indicated plans to support women working from home. In addition, women may need greater flexibility about working hours and maternity leave, something that has been embodied in legislation in a number of countries around the world. In the past Saudiization rules sought to address these discrepancies by equating the employment of one woman to two men.

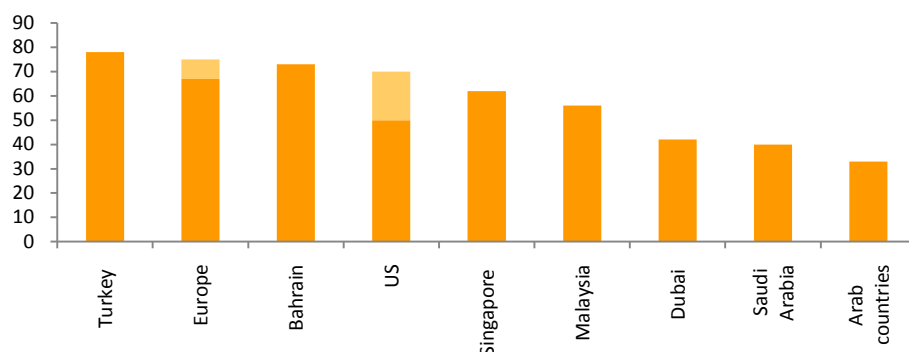
Encouraging entrepreneurship

One of the main structural challenges facing the GCC labor market is the historical dominance of oil and gas. While transformative in terms of wealth and living standards, and hence one factor behind the continued high population growth rates, hydrocarbons extraction is a highly capital- rather than labor-intensive industry. As much as it has supported overall growth and the governments' fiscal position, it has been unable to absorb the region's growing population. Overall, the sector employs less than 3% of the regional labor force. Although various economic diversification initiatives have begun to change the situation, the international experience consistently suggests that truly transformative change in this regard is conditional on supporting entrepreneurship to a point where small and medium-sized companies serve as the principal engine of job creation.

More problematically, the SME sector is in many cases heavily reliant of low-cost imported labor. For instance Bahrain is in fact considering plans to revamp its policy of pro-rata Bahrainization in industry and trade so as to mitigate the financial burdens associated with nationalization. In order the better align the

initiatives designed to support SMEs with broader employment objectives, new thinking is likely to be required on recruitment. While the need for more flexible treatment of small companies is obvious, a combination of public education and incentives may over time begin to change the picture.

SME contribution to employment



N.B. These data typically reflect jurisdiction-specific classification criteria for SMEs which differ somewhat, partly in reflection of the divergent price levels of countries. A range of estimates is provided for the EU and the US.

Source: Shandong University of Technology, European Commission, United States Census Bureau, Bahrain Economic Development Board, SME Dubai, Turkstat, NCB estimates

Optimizing the use of expatriate labor

Expatriate employment has for decades been an essential aspect of the GCC labor markets. Reducing reliance on it will inevitably be a gradual process as doing it too fast can only prove disruptive. Nor can the goal of the process ever be full nationalization. Any open economy anywhere in the world draws on a global pool of labor in key competencies. Indeed, the GCC themselves have encouraged labor mobility within the region and the model of integration is potentially applicable to other countries as well.

Successful nationalization policies will inevitably to a degree transform the role of expatriate employment, albeit with significant intra-regional differences, given that the population base of some of the coastal countries is to a large extent and deliberately composed of non-nationals. Regardless of the country, however, expatriates will continue to have important positive roles to play in the regional economy:

- **Facilitate knowledge transfer.** Many expatriates have been hired because of their specific skills and experience that are otherwise not readily available in the GCC. They can play a critical role in transmitting these skills and competencies to locals through on-the-job training. If anything, this process should be further encouraged and actively supported. This may in some cases need to involve the redrafting of contracts in ways that creates the appropriate incentives and overcomes the limitations posed by short-term tactical thinking

- **Flexible employment.** Expatriate employees are currently brought to the region one person and contract tenure at a time. Yet in many cases the relevant installment maybe different from the typical contract tenor. In some instances, outsourced employees can be used for the specific purpose of training and skills transfer. Some initiatives are now underway to encourage more temporary and flexible modes of employment. For instance in Saudi Arabia the new *Istiqdam* program is designed to provide expatriate employees through Labor Recruitment and Reassignment Companies on a flexible project basis
- **Specific competencies.** Many positions require skills and competencies that in short supply and need to be sourced from an international market. The competitiveness of the GCC economies will continue to require access to the necessary skills in such areas and they should be available with minimal limitations
- **Job creation by residents.** The region has a large semi-permanent expatriate resident population. These people in many cases constitute an important productive resource when properly mobilized. In particular, as increasingly suggested by analysts, some of the entrepreneurial talent they possess could be mobilized to encourage company creation, ideally with the consequence of more jobs for nationals

Where do we go from here?

The task confronting labor market policy makers in the GCC is enormous and in many ways unprecedented. Their success in absorbing new entrants into the regional labor will be critical for ensuring the sustained diversification of the regional economies. But beyond this, accumulating adequate collective savings for the eventual retirement of the current working age cohorts is also growing in urgency. Although rapid population growth should ensure a relatively youthful demographic profile, for instance the Economist Intelligence Unit recently projected that the share of over-65-year-olds in the GCC would increase fairly sharply from 19.5% of the overall population in 2009 to 28.8% in 2020. According to projections by Muhanna & Co., the regional dependency ratio (active employees per pensioner) can be expected to decline from 4.5 in 2006 to 2.3 in 2025 and 1.5 in 2050. There is a risk of benefits outgrowing contributions by the early 2020s and many funds could be depleted in less than half a century.

Human capital development remains a national priority

As much as a number of different factors still impede the employment of nationals in the Gulf region, survey data – as limited as it is – fairly consistently suggests that the most important constraint remains a lack of appropriate skills and the weaknesses of the educational system. In other words, companies struggle to source the talent they require among national workforce. While there clearly are stopgap measures to alleviate this constraint, there is no structural alternative to further developing the national education systems and training facilities. As much as education clearly has emerged as a leading spending priority, further steps are required to expand the numbers and, where appropriate, upgrade the skills of teaching professionals while providing appropriate compensation. Similarly, ongoing curricula reviews and remedial training are needed to ensure that the transmission of skills is appropriate from the perspective of the global competitiveness of the GCC countries.

Attitudes need to change

Overcoming entrenched patterns in the labor market – especially ones involving a cultural dimension, ethnicity, etc. – has almost everywhere been a challenging process. Particular patterns tend to persist because represent a market equilibrium. They are seen to work albeit not in ways that are ultimately sustainable or desirable from the social perspective. There are a number of international precedents of countries seeking to rectify long-standing labor market such imbalances, in some instances over a number of decades. The success of such efforts is often critically linked to effective communication. Quite apart from rationalizing the choices made, and thereby ensuring a degree of buy-in by the public, it is important to clearly demonstrate how in concrete terms the relevant policies can be implemented.

Given the number of entrenched patterns and attitudes in the GCC labor market, meaningfully accelerating change is likely to require a combination of the proverbial stick and carrot. Past experience suggests that purely quota-based moves risk being undermined by myopic thinking or lack of resources at companies. Such factors alone call for ongoing monitoring by the authorities. But policy may also have to recognize the financial and human resource limitations of many businesses and make investments in government-funded advice, consultancy, and training with a view to enabling companies to overcome their internal constraints. Much of such support can be provided on a fairly generic, large-scale basis as many skills, types of knowledge, and attitudes are not company specific. Although drawing on such resources may involve short-term disruptions, their existence will in turn make it easier for governments to penalize firms that refuse to utilize the resources made available to them.

A key objective of policy is to mould company thinking about the role of their staff. Employees need to be seen as partners and in many cases formally recognized as such through incentive schemes. The challenge cannot be simply to develop locals that match expatriates in their characteristics but to develop local hiring solutions that work better than the current model of labor imports so as to promote the necessary structural changes away from the current the low-cost, low-efficiency economic model. This is likely to be conditional on increased efficiency (to justify higher compensation) and successful retention. Company-level incentive structures can be designed to reward commitment and efficiency.

The default choice for GCC employers has to move from 'import the employer you need' to 'develop the talent you require.' As part of changing perceptions, accurate information and concrete precedents have an important role to play. Recent initiatives in Saudi Arabia publicize success stories with for instance a new campaign entitled "Your way to localization" highlighting examples of companies that have successfully boosted their employment of nationals. The Ministry of Labor operates an e-portal designed to enable private sector companies to share their experiences.

The experiences of a number of regional economies suggest that affirmative action can build on itself. If government action is used to produce positive precedents, certain jobs and sectors can with time come to be viewed as acceptable and desirable. The inroads made by nationals into taxi companies are a case in point. Retail trade is another area with huge potential. For instance in the UAE, the sector makes up 30% of the national GDP and employs large numbers of people without advanced qualifications. It has in recent years evolved into the second-highest sector for Emirati employment accounting for 17% of the total intake of private sector Emirate employees.

One challenge created by a more employee-centric labor market culture is that labor mobility will make it difficult for employers to reap the rewards for their investments. Companies need ways to manage the risks of losing employees they invest in heavily. While such movement is impossible to completely avoid in a free market, certain types of training may be provided in return for assurances

on staying in a job for a minimum period. More generally, companies clearly need to align their training agenda with their job retention policies.

Nationalization is not a zero-sum game

The evolving labor market policies of the Gulf countries have generated considerable anxiety among expatriates. For instance, a recent Hay Group survey on attitudes toward Saudi Arabia's *Nitaqat* program found that 42% of respondents were nervous that knowledge transfer to nationals would result in them being pushed out of employment altogether.

Nonetheless, labor market nationalization does not have to be a zero-sum game. The numbers alone suggest that nationalization need not involve substantial costs for expatriates, especially in growing economies. In Saudi Arabia, the total number of job-seekers, which is probably not much more than a million (if measured by the number of *Hafiz* participants), is relatively modest compared to the total number of expatriate employees which totals some 4.3mn. In many of the Gulf coast countries, the population base itself is predominantly composed of expatriates.

The international experience suggests that all developed labor markets are to varying degrees open and the recruitment for many positions happens on an international scale. Ultimately, an efficient allocation of labor fuels growth and creates employment opportunities that can go far beyond the national resources. Most advanced economies have significant populations of expatriate professionals, craftsmen, and unskilled laborers alike.

Learn from the international experience

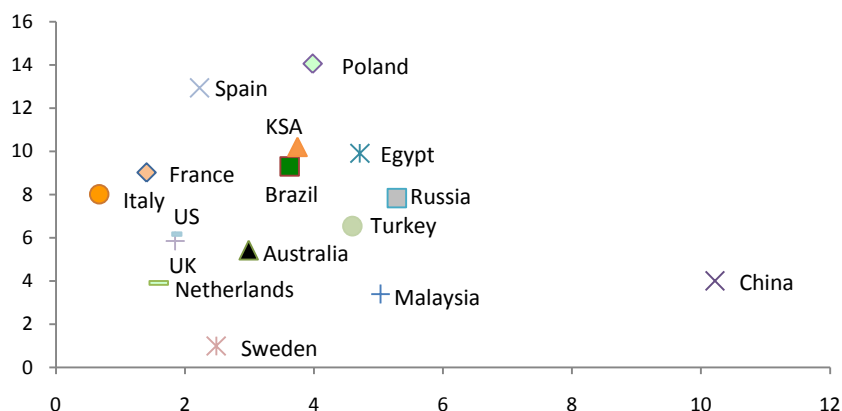
The track record of countries in implementing effective labor market policies varies a great deal and differentials in unemployment are not attributable to macroeconomic conditions alone. For instance Spain has a long history of double-digit unemployment whereas Sweden has successfully kept unemployment in the single digits. In practice, "Good economic performance does not necessarily translate into improved employment situations."⁵

As much as the emphasis of labor market policy must remain on the creation of new employment opportunities, such positions can seldom be permanent in a rapidly evolving market place. Any market economy naturally develops through – and indeed owes its creative energy to – a process that the Austrian-American economic Joseph Schumpeter once dubbed as 'creative destruction.' Innovation is critical to progress and new, superior ideas inevitably challenge and undermine older, less efficient solutions. At the most macro level the advanced economies have traveled through an evolutionary process from agricultural to industrial and

⁵ Claire Harasty, ed., *Successful employment and labour market policies in Europe and Asia and the Pacific*, Employment Strategy Papers, International Labour Office, Geneva, 2004/4.

eventually to service-based economies. Movements of labor between these sectors have invariably significantly boosted efficiency and growth.

Average GDP growth and unemployment, 2000-2011



Source: International Monetary Fund

The international experience highlights the importance of labor market flexibility as a precondition for sustainable growth. Economic policy should hence not seek to prevent market dislocations but, rather, to manage their consequences. As a recent IMF study put it, policy solutions should seek to “protect the worker and not the job.”⁶ Economic policy should seek to optimize the allocation of labor while enabling companies are able to adjust their organization without punitive costs. After all, when an employer is no longer needed, he risks becoming a burden for the company. In that situation, economic efficiency dictates that the company should be able dismiss the worker with relative speed and modest cost. The responsibility of labor market policy is to ensure that the laid-off employee is made aware of new opportunities and provided with additional skills if necessary. Social policy should be used to minimize the financial implications associated with job loss and new job search in a way that does not undermine the incentives to look for new employment.

In general, countries with inflexible labor markets – ones characterized by high costs of hiring and firing – tend to struggle to adjust to economic change. Rigid institutions, even if they seek to protect workers, also prevent the market mechanism from working efficiently. Companies that anticipate significant cost of money and time in the event of lay-offs are likely to be more cautious about hiring in the first place, sometimes relying on more flexible solutions such as outsourcing, often outside their home jurisdictions. Another consequence of rigid labor markets can be the preponderance of informal employment. This creates its own set of challenges in terms of a lack of access to government social services and pensions. At the same time, it can deprive the government from revenue sources, whether licensing fees or tax receipts.

⁶ *Regional Economic Outlook: Middle East and Central Asia*, The International Monetary Fund, Washington, D.C., April 2011.

The situation in the GCC remains uneven in the area of labor market flexibility. In the words of a recent assessment by Booz & Co.: “Although Gulf Cooperation Council (GCC) countries’ labor laws offer significant flexibility to employers, those regulations typically ignore part-time or temporary work arrangements, rendering such work contracts difficult, expensive, or impractical.”⁷ The result tends to be lower labor force participation and diminished corporate flexibility.

Beyond flexibility, successful labor markets appear to share a number of other important characteristics. The international experience is naturally not always directly transferable because of difference in the structure, maturity, and institutional/regulatory framework of economies. Yet a number of factors appear to be fairly consistently associated with effective labor market policies:

- Macroeconomic stability. This is important in terms of creating an attractive investment environment for growth. Well-run government finances also provide the resources to engage in short-term stimulus to shore up employment in the event of a cyclical downturn. In this regard the GCC countries are generally very well positioned by international standards
- Trade liberalization and measures to promote market competition have in many countries stimulated entrepreneurship and employment by boosting access and efficiency. The GCC countries are generally very open economies and for instance Saudi Arabia has deliberately used its WTO membership to boost competition. Nonetheless, significant differences persist across sectors in the region
- Active labor market policy. Capping unemployment benefits tends to incentivize people to look for work but the process can be much faster when government resources are channeled into proper counseling and retraining. These considerations are likely to be particularly important in the GCC
- Social dialogue. Ongoing discussion between the government, trade unions, and employers associations has been an effective way of promoting moderation and longer-term thinking on employment strategies in many European economies. While the institutional context in the GCC countries is very different, mechanisms that seek inputs from all the interested parties with a view to formulating clear, broadly anchored policy priorities have a better chance of success than ‘quick fixes’ that are routinely revamped. In the words of a recent assessment, “Cultural values and attitudes that foster consensus and cooperation among stakeholders can likewise spur economic and growth and help the labor market.”⁸

Perhaps the most important lesson of the international experience for the GCC is the strategic significance of active labor market policies. While passive policies such as unemployment benefits and early retirement provisions can be used to

⁷ Richard Shediak, Chucrallah Haddad, and Moncef Klouche, *The Case for Flexible Employment in GCC Countries*, Booz & Company Ideation Center, Abu Dhabi and Dubai, 2010.

⁸ Richard Shediak and Hatem Samman, *Meeting the Employment Challenge in the GCC: The Need for a Holistic Strategy*, Booz & Company Ideation Center, Abu Dhabi and Dubai, 2010.

control the supply of labor, overcoming persistent disconnects between the supply and demand side will almost always require a more proactive approach. Labor market policy in countries such as Denmark, the Netherlands, and Ireland has often claimed close to 5% of the government budget, several times that of countries that tend to rely on more passive policies. The share of active measures in some economies is more than a third of overall labor market spend. Such measures have generally been very successful in containing especially long-term unemployment. This in turn limits the economic costs associated with de-motivated job-seekers leaving the labor force altogether.

The experiences of the East European transition economies are particularly instructive as the post-communist transformation found them saddled with a largely obsolete economic structure dominated by uncompetitive heavy industry. On the other hand, sectors such as services were underdeveloped. The daunting challenge of massive structural unemployment was dealt with through a range of interventions including grants, preferential credits, and even subsidies to private sector companies creating jobs. Jobseekers were encouraged to set up their own companies where possible. Support services were provided by government-funded innovation and counseling centers. At the same time, active labor market measures prioritized vocational training, retraining, skills upgrades, and increased mobility. In some east European countries, government projects were used to generate employment opportunities, an area that clearly offers potential in the GCC as well thanks to the massive pipeline of infrastructure projects.



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