Rent Distribution and Labor Market Reforms in the UAE
by Steffen Hertog

Public sector employment is the centrepiece of the GCC distributional bargain. Together with Qatar, the United Arab Emirates (UAE) provides the most extensive guarantee of public employment in the GCC, and within the UAE, Abu Dhabi constitutes the most extreme example of government as employer of first and last resort. The UAE in general, and Abu Dhabi in particular, therefore make for an instructive case study of a) the economic outcomes and distortions that rent distribution through public employment generates and b) the political economy constraints that GCC governments need to consider if they want to move towards employing nationals in the private sector.

The UAE labor markets are deeply segmented; low-wage expatriates dominate private employment, while most nationals are employed in the public sector. The main factors that create this segmentation and prevent productive private employment of nationals are the much higher wages and better working conditions available in government jobs, combined with the easy availability of cheap foreign labor with limited labor rights in the private market. Unless the differentials in wages and labor rights between public and private employment as well as Emiratis and expatriates are overcome, private job creation will remain deficient.

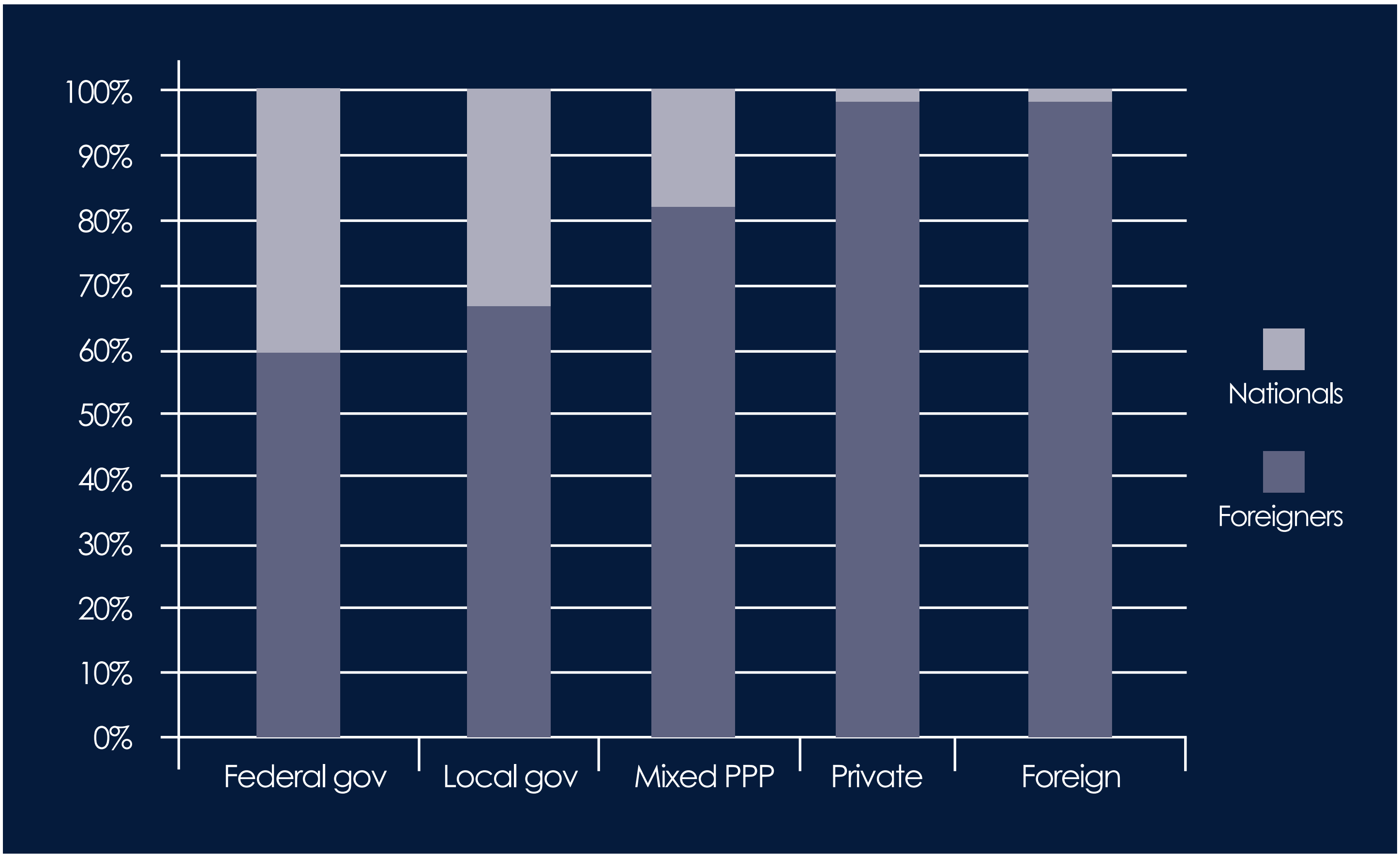
Closing these gaps will, however, require a rethinking of the distributional bargain on which GCC political economies are based.

Some mid-range policy options to address existing labor costs and labor rights gaps, such as a reform of the sponsorship system and a potential fee or subsidy system to narrow the private wage gap between locals and foreigners could be implemented at limited political cost. Politically more difficult policy options required to make nationals genuinely interested in private employment, such as long-term reforms of public employment, would however require large-scale compensatory policies like an unconditional 'citizens' income' paid out to all nationals.

Segmentation

Figure 1 illustrates Abu Dhabi's extremely biased employment patterns. Emiratis are driven away from the private labor market due to the easy availability of public sector jobs with higher wages and non-wage benefits. These benefits include higher job security, lower work effort, shorter working hours, all-round flexibility, and what many nationals perceive as a more congenial cultural environment—a recent national survey shows that only 2 percent of unemployed Emiratis list the private sector as preferred employer.[1]

Figure 1: Sectoral employment structure in Abu Dhabi by nationality



Source: Based on Employment, Wages and Hours of Work Survey 2008, UAE National Bureau of Statistics

The public sector

This imposes a huge cost on the Emirati economy. Guaranteed public sector employment has reduced the efficiency of the country's bureaucracy and, perhaps more significantly, means that a large share of potentially productive national employees is "parked" in unproductive government jobs. Their potential remains underused, and consequently UAE nationals play a marginal role in their own economy. In the face of continuing population growth and a decline in oil prices, public employment guarantees for nationals appear fiscally unsustainable in the long run. Moreover, while the dominant role of cheap foreign labor in the private sector has helped to keep costs down in the UAE economy, it has put the country on a low-productivity path in which companies invest little in training, technology upgrades or research. UAE total factor productivity has stagnated or fallen during most years since the 1980s.

The private sector

In the long run, most national employment will need to be generated in the private sector as in other advanced economies. Currently, however, forces of supply and demand are stacked against UAE nationals: Private sector demand for Emiratis is very weak at wage levels demanded by nationals, as employers can hire more experienced, much cheaper, and more easily exploited foreigners thanks to migration and sponsorship systems that allow large-scale importation and easy control of labor from other developing countries—a process which in turn creates additional low-effort rent-seeking opportunities for nationals as brokers on the labor market.

Wage and benefits gaps

There are critical gaps between average monthly earnings for privately employed foreigners, privately employed Emiratis and publicly employed Emiratis, with the latter earning by far the most.[2]

For sustainable Emiratization, the double segmentation within the Emirati labor market by wages as well as labor rights and conditions needs to be overcome. Past policies have not dealt with these structural challenges directly, but instead have attempted to directly impose Emirati employment on private business through quota rules and prohibitions. Like in the rest of the GCC, such policies have led to widespread evasion and 'phantom' employment.

There are a variety of options to close the gaps in wages and labor rights between the public sector and private sector, and between Emirati and expatriate employment.

Narrowing the private sector labor cost gap

The relatively easiest challenge is to narrow the cost gap between nationals and foreigners on the private market. One option would be a tax on foreign labor that could finance some benefits or subsidies for national employees. The sheer size of the migrant workforce means that even a modest lump sum tariff of $11 (Dh 40) per month per foreign employee could finance subsidies of some $2,200 (Dh 8,000) for all Emiratis currently working in the private sector which would close the wage gap in the semi-skilled and high semi-skilled categories.

Subsidies would be less fiscally expensive in the long run than creating surplus public jobs, which has been the favored solution of GCC governments to date, and would help push national talent towards productive employment.

There is one GCC country that has experimented with wage subsidies: Kuwait with its "*da'm al-'amala*" system, introduced in 2000. Although the system has been subject to some abuse, its overall results have been encouraging, resulting in private employment levels for nationals that are about three times higher than in the UAE, despite a comparably sized national population.

In addition to addressing the wage gap, labor policy should work towards closing the labor rights gap between nationals and foreigners in the private market. Partial reforms of the sponsorship system since 2011 have already somewhat improved foreigners' labor mobility.[3] Protection against dismissal as well as domestic labor mobility however remain much better for Emiratis, de-incentivizing employers against hiring them.

More selective public sector employment

Narrowing the cost and rights gaps will not be enough to attract many Emiratis into the private sector as long as a low-effort and secure government employment option is easily available, and the minority of nationals joining the private sector will arrive with unrealistic expectations about wages and work conditions. A more difficult but necessary long-term change will hence be reform to public sector employment.

To some extent, the gap in salaries and working conditions between the public and private sectors will have to be closed from the side of the public sector. In the long run, public sector hiring should be much more selective, and pay and promotions more performance-based.

It is clear that such tightening is politically sensitive; nationals will need to be compensated for relatively less secure and easily available public employment. As a first step, there should be a more decisive move towards modern social security arrangements, such as unemployment benefits, unemployment insurance and more comprehensive active labor market policies for nationals (including training subsidies, match-making and temporary job placements). Such mechanisms would make reduced job security less painful and daunting.

A new distributional bargain?

This would still mean giving a bit while taking away a lot more and might not be politically feasible. This is why GCC governments should consider a more fundamental reform of rent distribution: moving away from public sector employment as a distributional tool and instead providing comprehensive schemes of income support for nationals that are more fiscally sustainable, incentive-neutral and fairer than government employment.

One such policy would be an unconditional cash grant or 'citizens' income' provided to all nationals who are not public sector employees—who are, in other words, currently excluded from a key provision of the distributional bargain. Such a citizens' income would provide basic income security in case of unemployment, but would also decrease national reservation wages on the private labor market, as national employees could top up their private sector wages with the cash grants, which would not be means-tested.

It would therefore boost private sector nationalization outcomes without having to force employers to recruit nationals they are not interested in employing.

While “basic income” plans for tax-based economies have met scepticism as they require higher taxes and can create work disincentives, these arguments do not apply in the GCC context, where basic income is superior to the status quo both in fiscal and efficiency terms.

A citizens’ income of perhaps $1,200 to $2,500 per month could make other, more restrictive policies, such as a reduction in public sector recruitment, more politically acceptable. Simulations show that in the long run, such a scheme would be less expensive than the current practice of public sector over-employment. It would contribute to a leaner and better-functioning bureaucracy, give stronger work incentives to nationals, and would be transparent, fair, and easier to predict and plan than the current ad hoc regime of rent circulation. It would also make for a powerful political gesture of inclusion towards the citizenry, which is entitled to a share of the country’s wealth.

Even if labor market segmentation is particularly pronounced in the UAE, the country arguably has the best fundamentals in the region for reshaping its rent distribution system: Not only is it one of the systems with the largest fiscal resources relative to its population; it also has a more dynamic track record on labor reform than its affluent neighbors Qatar and Kuwait. It could become the region’s bellwether in developing a fairer and more inclusive wealth sharing and labor market regime.

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1 Labor Force 2009, UAE National Bureau of Statistics.

2 For more details refer to Employment, Wages and Hours of Work Survey 2008, UAE National Bureau of Statistics.

3 For more on the impact of these reforms, see Suresh Naidu, Yaw Nyarko and Shing-Yi Wang, *Worker Mobility in a Global Labor Market: Evidence from the United Arab Emirates* (The National Bureau of Economic Research: 2014).