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GCC Labor Markets: Challenges and Policy Options

by Andras Bodor & Robert Holzmann[1]

Overcoming underlying distortions key to effective change

Countries of the Gulf Cooperation Council (GCC) exhibit notable differences but also key similarities. Among the most critical common features of their economic and political landscape are the labor market challenges that have given rise to many reform engagements reflecting three policy objectives: (1) providing jobs for young nationals in the private sector; (2) moving towards a diversified, high-skilled, and knowledge-based economy that pays high productivity based wages; and (3) rebalancing the demographic structure.

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There are several underlying economic and demographic changes driving the above objectives. Most importantly:

(a) the rising number of national entrants to the labor market that can no longer be employed by the government for fiscal and other reasons giving rise to unemployment, in particular among youth and females; (b) the finite hydrocarbon resources whose contribution to economic growth needs to be replaced over the medium- and long-term by growth which is knowledge and skills-driven, autonomous, and led by an innovative private sector; and (c) a demographic environment in which the national population makes up a decreasing share in total population and a small share in the private sector labor force.

Against this background all GCC countries are engaged in various policy reforms to nationalize the labor market while striving for a diversified economy. Perhaps best known in the region are the labor market policies initiated in the Kingdom of Saudi Arabia such as *Nitaqat* (with dynamic economic sector-specific and firm size-specific Saudi labor quotas in the private sector), *Hafiz* (a support-turned-activation program for unemployed Saudi youth), and *Taqat* Job Placement Centers (a public-private partnership to place Saudi jobseekers in private sector jobs). Policy measures to make expatriate workers more expensive (through fees and quotas) and national workers cheaper (through subsidies and better training) have been almost universal in the region.

Underlying distortions

These labor market policies often show quite limited labor market effects and broader economic effects. This is due to several key underlying distortions in the labor market and the economy. The two basic and most common distortions in GCC economies are namely the way hydrocarbon wealth is distributed and spent and the way foreign labor is admitted and managed.

Since the discovery of hydrocarbon resources, this wealth has been distributed to the population broadly through public sector employment, educational subsidies, and energy subsidies. These all create significant distortions in the labor market, skills acquisition market, and product markets, respectively. Public sector employment for nationals with compensation above productivity levels has solidified in these countries as a status quo 'social contract.' This generous provision of government jobs has resulted in bloated public sector employment with high salaries, generous perks, low work effort and high job security. These conditions make the public sector the benchmark for the private sector instead of the other way around. Consequently, private sector job creation and the hiring of nationals is rendered difficult, while queuing-up for public sector jobs becomes attractive. Second, the laudable focus on education for development is undermined by taking out any market-oriented steering mechanism for educational choices. Free education at all levels and no market sanction for wrong choices—also as skills retrofitting is free and government job queuing is prevalent—leads to educational selections and outcomes mismatched with market needs and diversification goals. Last but not least, energy in all its forms is provided to the population well below world market prices and untaxed leading to the highest subsidy levels in the world. The outcomes are huge distortions across all product markets with ramification for firms and jobs creation.

Overreliance on foreign labor

The reliance on foreign workers to kick start economic development with modern infrastructure, housing and critical services has served the GCC countries well in the past. However, the way expatriate workers are admitted and managed is increasingly an obstacle for economic development and national job creation, with three elements standing out: first, the hiring of labor at below market prices leads to major economic rents that are inverse to skill levels.

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As a result employers have incentives to maximize admission at lowest skill levels with negative consequences for the choice of production technologies. Second, the binding of the migrant to employers through visa and work permits limits labor mobility, and in turn competition between workers thereby dampening the incentives for skills development and productivity enhancement. Last but not least, the labor market distortions for expats carry over in reduced competitiveness and reduced private sector job opportunities for national workers.

The channels through which these distortions operate have been brought to light by (a) analytical studies that document firm dynamics (creation and destruction) that are significantly weaker than those of peer countries in America, Europe and Asia; (b) evidence of low labor mobility for nationals, for expats, and the jobs between them; but also by (c) specialized labor market surveys that signal a distance/disengagement of nationals from the labor market not seen elsewhere in the world.

To overcome the challenges, major changes in the way hydrocarbon wealth is distributed and foreign labor is admitted and managed is necessary. Such policy proposals exist in the form of replacing existing subsidies with a universal payment to all nationals (citizen income) and employer-initiated but government-led admission of foreign labor (quantities and skills) coupled with full mobility and equal treatment once in the country. It is against these benchmarks that new policy approaches need to be designed and evaluated.

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