

## Economics

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# GCC Macro View

## Time For Fundamental Overhaul of Job Market

- While the grievances that in recent weeks have brought thousands of people onto the streets to protest against many regional governments, or to take up arms in Libya's case, vary greatly from country to country, one common theme underlying the unrest in most countries so far seems to be a lack of jobs.
- In the light of this, we would expect to see an even greater push by GCC countries to address the imbalances in their local labour markets.
- We do not believe it is the lack of jobs that's a problem in the GCC, but the unsuitability of these jobs for large portions of the local population that keeps them out of work. While it is important to ensure that the population has the appropriate skills to do the jobs available, this is a necessary but insufficient condition to improve labour market participation in the GCC. In our view, what is required in addition is a comprehensive overhaul of labour policies that would raise the standard of pay and working conditions for all workers, create a competitive and flexible private sector labour market, reduce the disincentives for employers to hire locals by raising the cost of foreign labour, and reduce the inherent advantages of working in the public sector vis-à-vis the private sector.
- Weaning their economies off cheap foreign labour is not going to be easy and will have a number of profound effects on the GCC economies, including on: (i) inflation; (ii) competitiveness; (iii) economic growth; and (iv) exchange rate regimes. However, we see this as the most viable option for improving labour participation in the GCC.
- The immediate response of a number of GCC countries to rising unrest has been to create more government jobs and introduce other measures, such as greater welfare payments, to raise standards of living. While such responses are necessary, in our view, to address immediate grievances and quell the potential for further unrest, they do not address the long-term challenges facing these countries, particularly given the demographic imbalances they face.

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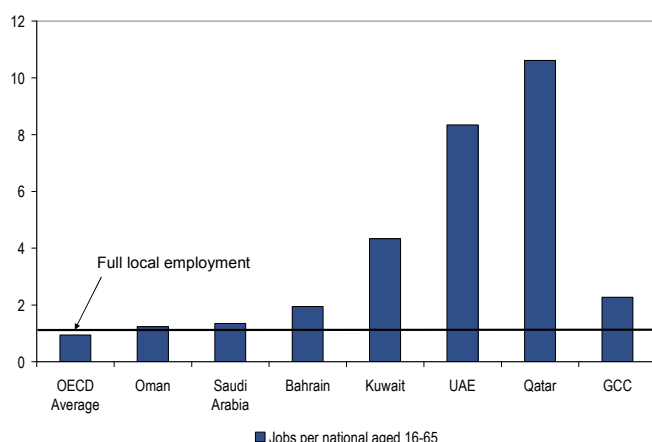
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# Time For Fundamental Overhaul of Job Market

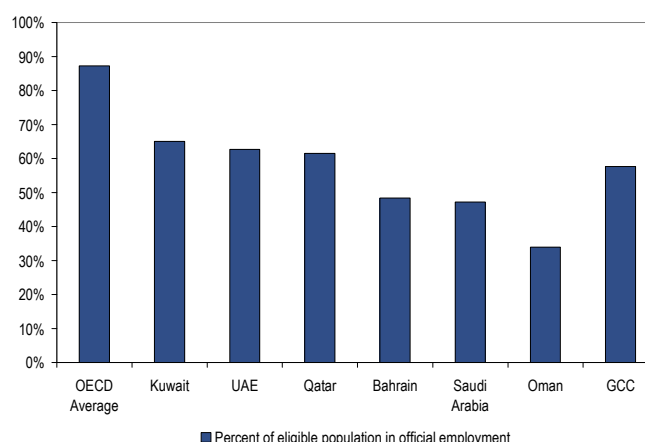
While the grievances that in recent weeks have brought thousands of people onto the streets to protest against many regional governments, or to take up arms in Libya's case, vary greatly from country to country, one common theme underlying the unrest in most countries so far seems to be a lack of jobs. The role that unemployment has played in sparking off events that ultimately led to regime change in Tunisia and Egypt has been widely discussed in the media and elsewhere. Jordanians and Omanis who have protested have not called for regime change, but for a better standard of living, complaining first and foremost about the lack of employment. Even in Bahrain, unequal job opportunities between the Shia and Sunni populations are at the heart of what is otherwise seen as a sectarian crisis. Countries with high unemployment rates could be regarded as possible candidates for future unrest.

Figure 1. Plenty of jobs in the GCC



Source: National Statistical Sources, CIRA estimates

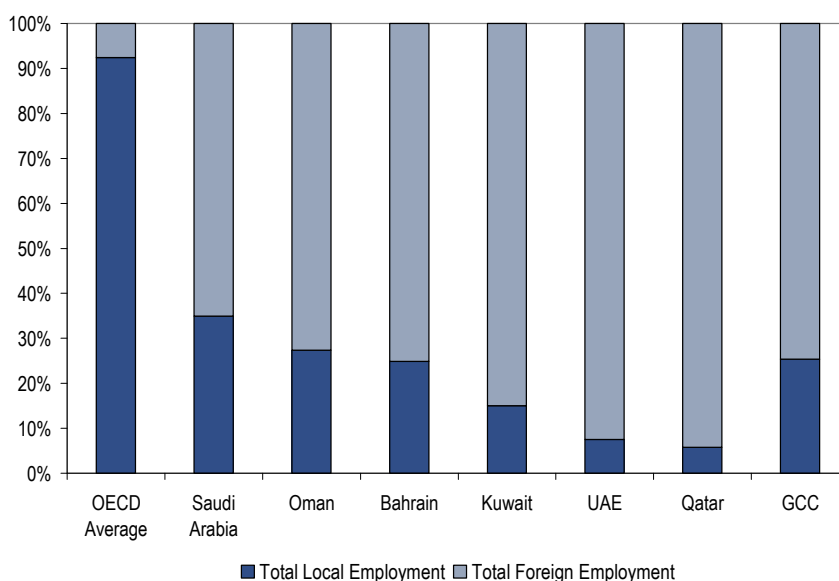
Figure 2. But labour participation rates are low



Source: National Statistical Sources, CIRA estimates

**But in the countries of the Gulf Cooperation Council (GCC), the question of employment is much more complex than the availability (or lack thereof) of jobs.** Official statistics show that there are many more jobs available in each of the six GCC countries than there are nationals of working age (Figure 1). Taken as a whole, there are twice as many jobs in the GCC than there are GCC nationals between the ages of 15 and 64, although this varies from country to country: there are just enough jobs in Oman for the entire working-age population, but over 10 jobs per person in Qatar. In principle, full employment should, in all cases, be the norm. However, less than 50% of Bahrainis, Saudis and Omanis of working age are actually officially employed, and this number is only just over 60% for the three other GCC countries (Figure 2). Compare this with the OECD average, where despite there being insufficient jobs for the number of nationals of working age, almost 90% of the population is in official employment.

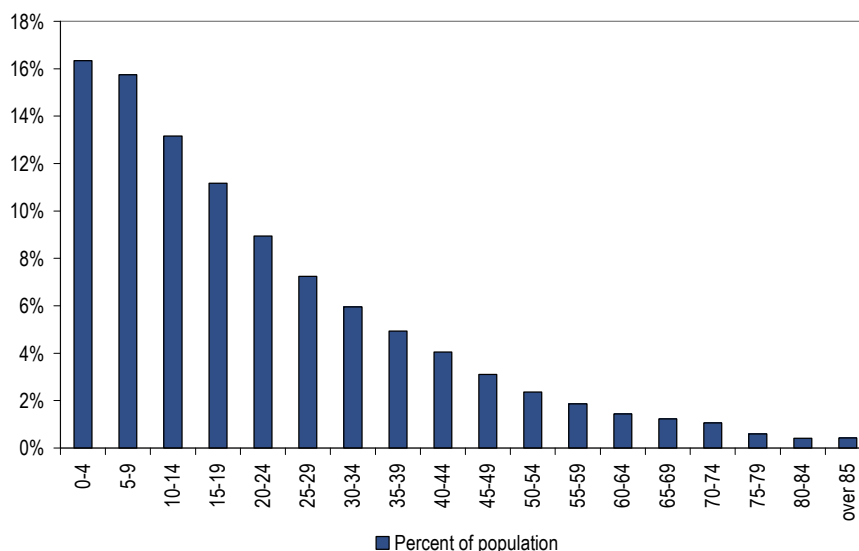
Figure 3. High proportion of foreign labour



Source: National Statistical Sources, Citi Investment Research and Analysis estimates

**The difference between the number of jobs available and those taken up by nationals reflects the high level of foreign labour in the GCC job market.** Foreign nationals make up the vast majority of the GCC labour force, around 70% on average, and over 90% in Qatar and the UAE (Figure 3). This gross imbalance is a function of a number of factors that are common to most countries within the GCC. Recent events show the extent to which this imbalance may lead to social frictions and potential political instability. What's more, the demographic profile of the GCC countries suggests that in the absence of a significant rise in labour participation rates across the GCC, joblessness will increase dramatically in the coming years. Figure 4 illustrates this fact for Saudi Arabia, whose population structure we believe is typical of the region. 56% of Saudis are under the age of 20.

Figure 4. Saudi Arabia's young population is typical of the region (2009 estimate)



Source: Saudi Central Department of Statistics and Information, Citi Investment Research and Analysis estimates

## Why are labour participation rates in the GCC so low?

### Few females in the labour force

In general, it is less common for women to work in the GCC than it is in OECD countries, meaning that aggregate labour participation rates (which include participation by both men and women) will inevitably be lower in the GCC. Participation rates among the male population are higher than those suggested above, but there are insufficient data to calculate these across the board. Evidence from Saudi Arabia, where female participation in the labour force is lowest, suggests that among the male population, participation rates are 82% among the male population, compared with 47% for the total. In Bahrain, male participation rates are 62%, compared with 49% when including women. These numbers are less alarming than the aggregate, but are still some way off the OECD average and the outlook is not encouraging, given the demographic profile.

### Not just any old job

Part of the difficulty in getting locals into jobs is that many of these are unattractive for the following reasons:

- **Cultural aversion to certain jobs.** Many GCC nationals would not consider doing a manual job (construction, maintenance, factory work etc.) or being in servitude to others (maids, drivers, cooks etc.). Indeed, most blue collar jobs are shunned by GCC nationals, resulting in a significant narrowing in suitable job opportunities.
- **Low pay and working conditions.** In many instances, a job may be suitable in principle, but salaries and conditions are not. This is because GCC nationals have to compete with foreign nationals, who often accept much lower salaries than their local counterparts. Foreign labourers are often able to share cheap accommodation, have often left their families back home, have fewer outgoings and are able to save money to remit to their families.

- **Why go private when you can go public?** Unlike in most advanced economies, public sector jobs in the GCC are better paid, less demanding, and offer greater job security. Faced with the choice between working in the public sector or the private sector, the majority of locals would prefer the former and may not even contemplate the latter. Given that public sector jobs are limited in number, GCC nationals often end up waiting for years for an opening, supported by their families, and not seeking jobs in the private sector in the meantime.

### **The private sector prefers to hire foreigners**

**Aside from the job preferences of the local population, private sector hirers are hesitant in hiring locals for the following reasons:**

- **Locals are more expensive:** In a number of GCC countries, locals are subject to a minimum wage and benefits that foreign workers are not, making it unattractive from a cost perspective to hire locally. Salary expectations of locals are generally higher, for the reasons outlined above.
- **Foreigners have higher incentives to perform:** Many foreign workers in the GCC are there without their families and are thus in the country for the sole purpose of working. Moreover, the sponsorship system, whereby a foreign worker's right to stay is dependent on his employer, gives that employer more leverage with respect to the foreign employee than is the case with nationals, who could ultimately get a job elsewhere.
- **Foreigners are easier to hire and fire.** Firing locals is often a difficult affair in GCC countries under current labour laws. This is not true of foreigners. Employers seeking flexibility in their cost structure may prefer to hire foreigners who they can lay off should business conditions require. Moreover, the difficulty in firing locals reduces their incentive to perform.

### **Skills mismatch**

**Assuming that locals had the desire to take up private sector jobs, and that employers were more minded to hire them, a further obstacle to greater employment of GCC nationals is their lack of appropriate skills for the jobs on offer.** Educational systems in the GCC have yet to catch up with the modern job market which has evolved rapidly over the past two decades. There is a mismatch between the skills required by the GCC economy and those acquired by the local population. According to the Saudi Central Department of Statistics and Information, only 17% of the male Saudi labour force has a university degree. Getting more locals into private sector jobs requires that the locals are equipped with the appropriate skills to do the jobs, which is currently not necessarily the case.

### **What's being done to address the issue?**

#### **Arabisation**

**Arabisation policies are in place in most GCC countries.** The principle behind such policies is to compel business to ensure that a certain percentage of their labour force is comprised of locals, with financial and regulatory sanctions against the business if it fails to meet these arabisation targets. There are several problems with such policies, which have in any case failed to improve the labour participation rate among locals. Specifically, arabisation policies do nothing to make private sector jobs more attractive to locals, make locals more qualified to do them, and actually reduce the incentive of locals to

perform since employers are compelled to keep locals on staff regardless of performance. Moreover, they are unpopular with employers as they raise the costs of doing business and increase inefficiency. As a result, arabisation targets are seldom achieved and often ignored by both government and business throughout the GCC.

### Diversification

**The drive to diversify GCC economies away from their traditional dependence on oil & gas is in part motivated by the desire to reduce economic and fiscal vulnerability to volatile commodity prices, but also to create job opportunities.** The oil & gas sector is highly capital intensive and has by and large stabilised in size. This makes it an unsuitable industry to deal with the growing job requirements of the GCC population. Finance and tourism, on the other hand, are labour intensive and growing fields which, in principle, hold much promise for job creation. The diversification drive has, however, done little to improve job participation in the GCC. Like arabisation policies, diversification efforts do not make private sector jobs more attractive to locals (with the exception of the financial sector), make locals more qualified to do them, or make business more eager to hire them. Moreover, the number of jobs created cannot keep up with demographic trends. Diversification efforts have largely focused on areas where the GCC has a comparative advantage, mainly industries that benefit from abundant and cheap hydrocarbons feedstock and energy, such as petrochemicals and aluminium production. These are capital-intensive industries that do not create large-scale job opportunities.

### Education

**In our view, the most important and effective initiative being taken up by the GCC with respect to improving labour market participation is the drive to raise education standards.** In Saudi Arabia, at least 20 new universities have been established in the past six years alone, including the large King Abdullah Institute for Science and Technology (KAUST). Moreover, King Abdullah has reinstated a programme of overseas education for a select number of Saudi school leavers (around 5,000 per year), entirely funded by the state. Other initiatives in the region include the Qatar Foundation and Dubai's Knowledge Village, which seeks to create a local presence for quality foreign universities.

**There are, however, a number of challenges impeding the effectiveness of this drive in improving labour participation rates in the near term.** These include:

- The benefits of better education will be enjoyed by future generations, not by those locked out of the job market currently.
- While broadening the range of jobs nationals can do, better education does not broaden the range of jobs they are willing to do.
- The number of jobs currently attractive to GCC nationals is unlikely to address the jobs imbalance, even if they were filled entirely by able and qualified nationals.
- Problems will remain with respect to hiring and firing rigidities, cost differentials between local and foreign labour, and the preference of most individuals to work in the public sector regardless.

**In other words, closing the skills gap is a necessary but insufficient step in addressing the GCC's job imbalance.** The challenge remains to ensure that the breadth of jobs GCC nationals are willing to do widens, that the preference for public sector jobs over private sector jobs diminishes, and that measures are taken to address employers' concerns regarding the hiring of locals.

## **The missing link: dealing with high level of foreign labour**

### **Widening the appeal to locals of jobs in the private sector**

**While some jobs are likely to remain culturally unacceptable to many GCC nationals, there are a number of others that may be unattractive today, but that could be made more attractive to locals with some tweaking to national labour policies.** From department store sales clerks to small business accountants, many jobs are shunned by locals today because they do not pay enough, entail poor working conditions, are more demanding and less secure than government jobs. How to fix this?

- **Raise pay and work conditions.** This would make jobs that were hitherto unattractive to locals more acceptable. It is important to note that the suggestion here is not to raise minimum wages for locals alone: this has the perverse effect of making locals less attractive than foreigners to employers. Rather, what is required is to improve pay and conditions for all jobs to a level that makes it attractive for locals to do the job, while cutting off the alternative of cheaper foreign labour to employers.
- **Relax sponsorship systems.** One way to help achieve better pay and work conditions would be to improve the flexibility and competitiveness of the labour market. Currently, it is difficult for foreign workers to switch jobs in the GCC due to the fact that residency is dependent on the continued sponsorship of one's employer. Abolishing this system would help engender a sense of competition among employers to provide better pay and work conditions to attract quality employees. This would benefit foreign employees originally, but as salaries and standards rise, the effect would be to entice greater numbers of locals to the job market.
- **Tighter immigration control.** As long as there are no restrictions on immigration, the scarcity value of the local labour market is largely eroded and salaries will be bid down by cheap foreign labour. An immigration policy that balances the need of local business for qualified labour while taking into account the impact on local employment is needed across the GCC. Such restrictions are evident in most advanced economies for the purpose of protecting local employment. As the skills gap closes, the opportunity to tighten immigration policy increases.
- **Closing the gap between public and private sector.** The above measures will go some way to closing the gap in salaries and working conditions between public and private sector employees. However, public sector jobs will remain less demanding and more secure in the absence of an overhaul of public sector employment policies.

## Incentivising employers to hire locals

### **Arabisation quotas are ineffective and counterproductive, in our view.**

What is required is an overhaul of labour laws that would make it more attractive for local employers to hire local labour. These include:

- **Easier hire/fire rules.** Making firing a local easier (and on par with a foreign worker) would mean that employers would have fewer qualms about hiring a local. If business slows, or performance is unsatisfactory, employers would know that they can fire an employee. Moreover, this provides greater incentives to the employee to perform.
- **Fiscal incentives.** Ultimately, it may be necessary to provide fiscal incentives to hire local employees. Given the general lack of taxes in the region, it is likely that fiscal disincentives to hiring foreigners would be more effective, including hire fees and taxes on foreign labour. This would reduce the gap in cost of hiring locals versus foreigners, providing more incentives to employers to go local.

## Conclusion and implications

**Events of the past few weeks across the Arab world have highlighted the importance of jobs to social and political stability.** In the light of these events, we would expect to see an even greater push by GCC countries to address the imbalances in their local labour markets.

**In a nutshell, our argument on how GCC countries will most effectively address these imbalances is as follows.** We do not believe it is the lack of jobs that's a problem in the GCC, but the unsuitability of these jobs for large portions of the local population that keeps them out of work. While it is important to ensure that the population has the appropriate skills to do the jobs available, this is a necessary but insufficient condition to improve labour market participation in the GCC. What is required is a comprehensive overhaul of labour policies that would raise the standard of pay and working conditions for all workers, create a competitive and flexible private sector labour market, reduce the disincentives for employers to hire locals by raising the cost of foreign labour, and reduce the inherent advantages of working in the public sector vis-à-vis the private sector.

**Weaning their economies off cheap foreign labour is not going to be easy and could have a number of profound effects on the GCC economies:**

- **Inflation.** Raising salaries and working conditions across the board while reducing the supply of cheap foreign labour will have significant cost implications for businesses which will likely be passed onto consumers. Effectively, the cost of living in GCC countries may converge with other countries of comparable wealth, such as Scandinavia, where average salaries and the cost of living are both high.
- **Competitiveness.** Rising costs will have a *prima facie* negative impact on competitiveness in the GCC countries. However, the extent to which this is true varies from country to country. Most GCC countries' exports will remain dominated by hydrocarbon products, whose competitiveness will be unaffected by rising domestic costs. Perversely, it is the more diversified economies of the GCC, such as Dubai, that would be more affected, as they are dependent on the export of non-oil goods and services, and rely on their ability to attract foreign business for economic growth. That said, Dubai

suffers less from the labour market imbalances than most of its neighbours. Referring back to Figure 1, the UAE is job rich, with almost 9 jobs available for every national. The small local population will therefore be more easily absorbed in the local labour market without the need for the kind of aggressive labour market reforms described in this note.

- **Growth.** In the near term, rising costs and inflation would be a drag on growth as this would delay investment decisions. However, we believe there are clear long-term benefits. A large proportion of expat salaries are remitted to their homelands, with an associated negative impact on the balance of payments and non-oil sector growth. As salaries increase and local employment increases, this would support stronger domestic demand and an improvement in non-oil economic activity, providing an impetus to diversification in and of itself.
- **Currency pegs.** The impact on inflation competitiveness and growth would argue for a greater divergence between US and GCC economic cycles, and a greater need for monetary policy independence. The sustainability of the pegs in such circumstances would, in our view, once again come into question.

**The immediate response of a number of GCC countries to rising unrest has been to create more government jobs and introduce other measures, such as greater welfare payments, to raise standards of living.** While such responses are necessary, in our view, to address immediate grievances and quell the potential for further unrest, they do not address the long-term challenges facing these countries, particularly given the demographic imbalances they face. GCC countries have set off on the path of diversification and education to improve labour force participation, we believe what is required now is a more fundamental overhaul of labour policies.

## Appendix A-1

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