Unemployment in Saudi Arabia

A serious issue for the Saudi youth

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Unemployment in Saudi Arabia

One of the wealthiest countries in the world yet its own citizens are not finding decent jobs to fill. Is it an issue of weak skill set or is it an issue of low quality jobs produced by the economy? More than 6 million foreigners are working in Saudi, mostly filling non-skilled jobs in construction, retail and other services. What are the implications of keeping a large portion of foreigners in the workforce? Do we need to improve the education level of Saudis or should we invite a better educated workforce from abroad? How could we improve the chances of finding decent jobs for Saudi nationals? Should we expand public sector hiring or wait for the private sector to act?

The typical image of a wealthy country with lots of oil and rich people is not necessarily true for all people in Saudi Arabia. Many Saudis have actually been suffering recently from high levels of unemployment and depressed wages. Saudi may have the largest oil reserves in the world, but it is also the most populated nation in the gulf. Many would be shocked to know that more than 4.3 million workers in Saudi earn an average wage of 213$ per month.

The private sector is dominated by foreign born employees, earning low wages despite the difficult work conditions they endure. Efforts to substitute foreign employees with nationals are proving to be challenging. Excessive dependence on foreign born-labour over a long period of time resulted in depressed wages and difficult working conditions for many employees. Many foreign born employees are viewed as temporary workers, while, no real effort is put in place to build more sustainable permanent status jobs.

On the other hand, large employment share of government jobs has created wages that are 6 times greater than private sector jobs. Working conditions are also significantly different for government jobs. Averaging government sector job requires around 30 hours a work weeks while private sector jobs average around 50 hours per week.

Despite high economic growth in recent years, unemployment continued its climb to alarming levels. Serious economic and social implications are at stake if policy makers do not enact measures to control unemployment. The government has shown unmatched determination to address the unemployment issue, under direct supervision by his highness King Abdulla bin Abdulaziz.

The Problem

According to the latest estimate by the Central Department for Statistics and Information (CDSI), overall unemployment stood at 10.5% in 2009 and more than 28.5% amongst females. Unemployment was also accompanied by low levels of participation among Saudi’s in the Labour force.
Unique aspects to the Saudi Labour Market

The most unique aspect to Saudi unemployment is that most unemployed persons are unemployed by choice. They can find jobs, but the jobs they find do not meet their expectations of pay and work conditions¹. Most of the unemployed are young first time job seekers, where unemployment is estimated to have reached 39%, ages 25 and below, according to the Central Department of Statistics & Information (CDSI).

First time job seekers are expected to fill low skill level jobs, which in Saudi are usually filled by foreign low-cost Labour. First time job seekers are faced by stiff competition from abroad, without any protection regulations. In some cases, government policies may unintentionally favour foreign Labour over local Labour, by keeping their wages low.

Saudi has a young population, where 48% of the population is below the age of 19 years. The Saudi work force is expected to double over the coming decade. Unless employment issues faced by this segment are resolved, the problem will likely worsen as the number of Labour market entrants grows.

Saudi Arabia and neighbouring GCC countries have the highest percentages of foreign born workforce in the world. Dependence on foreign labour started during the previous oil boom in the seventies, when development projects were faced by manpower shortages. The intention was to bring foreign Labourers, mostly Asians, as a temporary solution to complete the needed development projects. In practice, foreign Labourers never left the country, instead more and more were invited every year and the number of foreign born Labourers has been growing ever since. The following graph compares a number of OECD countries to Saudi Arabia, by percentage of foreign born in the workforce. This high percentage of foreign-born Labour (51%) certainly has its toll on the local Labour market.

Saudi and the GCC countries in general allow an almost free flow of foreign Labour through issuing work visa permits to private sector companies. Any private enterprise that is looking to hire foreign employees applies for work visa permits and gets a certain number of permits depending on the size of business. This situation has been going on since the seventies and because foreign labourers cost less they have been the preferred choice for private employers.

To the contrary of developed countries where foreign immigrants do not seem to affect unemployment\(^2\), in Saudi Arabia, the lower wages effect of immigrant workers is so significant that it makes jobs unappealing to Saudis.

Dependence on foreign Labour was not a problem until serious unemployment issues started to arise. Unemployment rose in recent years, despite healthy GDP growth. In the following pages we will discuss the root causes of this problem, the effectiveness of government policies in place and what can be done to improve current policies.

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Two different Labour markets in the same country

The high percentage of foreign Labour in Saudi has created two distinct Labour markets. One that is dominated by Saudis, mostly white collar jobs in government organizations or highly regulated industries, like oil & gas, financial services and utilities and another market that is dominated by foreigners, generally occupying low-skill jobs with difficult work conditions.

The increasing numbers of unemployed Saudis is causing them to accept jobs of the latter part of the Labour market. Now Saudis have to compete with the millions of unskilled foreign labour, consequently, accepting wages and work conditions that are much lower than other comparable countries.

As stated earlier, most cases of unemployment are by choice and the most cited reason is usually that pay is not worth the effort. This transition from two job markets that have different wage levels and work conditions to a more uniform one require policy intervention to ensure a smooth transition. Increasing pressures on the unemployed are forcing them to accept depressed wage levels and difficult work conditions, currently occupied by foreign-born Labour.
Economics of the Saudi Labour Market

Low and falling wages
To compare wage levels between different countries we will compare average wages relative to GDP per capita in different countries. This comparison should equalize any difference in GDP per capita levels across countries. The following graph compares average wages of private sector jobs in Saudi Arabia to average wages in different OECD countries. It is important to note that we will differentiate between private sector and Government sector wages.

Private Sector Wages
The following Graph compares Private sector wage levels to that of various OECD countries.

![Average Wages/GDP per capita](source OECD stats and MOL)

Wages in OECD countries averaged 111% of GDP per capita whereas Saudi private sector jobs are at a mere 22.9% of GDP per capita. Even if compared to minimum wage levels in OECD countries, which are around 36% of GDP per capita, private sector wages in Saudi are much

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3 Private sector wage data is based on the MOL annual report, citing an average monthly wage of SR1,353. It is not clear whether or not this figure includes other benefits or is just the basic salary.
lower. Meaning that, the minimum wage in OECD countries is relatively higher than average wages in the Saudi private sector.

Average wages within the private sector, where most new jobs are created, is among the lowest in the world, relative to GDP per capita. For foreign born workers in private sector jobs wages were even lower at 17% of GDP. Keeping in mind that these are average wages, low-wage earners are most certainly earning less than these figures. Foreign-born workers are placing significant downward pressures on wages and Labour productivity.

In fact, average wages are below the official level of minimum wage for Saudis, set by the Saudi Organization for Social Insurance (GOSI), which is around 467 US$ per month. This data clearly supports a case of depressed wages in Saudi private sector jobs.

A more worrying observation is that private sector wages have been on a downward trend in recent years, as illustrated by the red line in the graph below. An even steeper decline is (blue line) in wages for Saudis filling private sector jobs. Over the same period Private sector Saudization percentage have increased from 10% in 2004 to 13% in 2008. A logical explanation for this is that Saudis were initially induced into higher paying jobs, once such jobs became saturated; Saudis had to move to lower wage levels. As more Saudis join the private sector workforce their wages are likely to further deteriorate, approaching the mean.

Depressed wages are a result of the massive influx of foreign unskilled Labour into Saudi Arabia, consequently, diluting Labour productivity. According to the Ministry of Labour (MOL), nominal private sector wages have dropped by 0.1% between 2007 and 2008, while inflation hit 10% during the same period. Falling wages and increasing unemployment were not because of weak economic conditions. In fact 2008 was one of the best years for the Saudi economy, achieving record oil revenues of 281 billion dollars, but at the same time there were more than 1.75 million new visas issued for foreigners in 2007 alone.
Any economic gain witnessed is more than offset by a new influx of foreign Labour. Unless policy intervention could increase the level of wages earned in private sector jobs, no meaningful Saudization of jobs could be sustainable. Policy makers need to consider various measures to increase the level of wages to reach comparable levels to that of OECD countries.

**Government Sector Wages**

Wages levels of Government jobs are institutionally set and are often influenced by political considerations more than market dynamics. Oil prices and government revenues also play a role in determining the level of wages and the availability of public sector jobs. As higher oil revenues accumulate, the public sector is more inclined to increase wages, especially with high consumer price inflation seen in recent years. Similarly the number of job openings increases, yet this has not been enough to absorb new job market entrants.

As illustrated in the following chart, government sector wages are more than 3 times greater than average wages in private sector jobs.

**Average Wages/GDP per capita**

[Chart showing average wages/GDP per capita]

*Figure 4 Wages/GDP per capita (source OECD stats, MOL and Saudi Pension Fund SPF)*
sector jobs, reaching US$1,202 per month\textsuperscript{4}. In the past, wage inequality between public sector and private sector jobs was not an issue because only foreigners were occupying the private sector vacancies. Now, with increasing unemployment pressures and the inability to absorb new job market entrants in the public sector, private sector wages need to increase, before becoming a viable alternative for job seekers.

**Government Wages (Monthly)**

![Graph of Government Wages (Monthly)]

*Figure 5: Recalculated from SPF contributions*

**Work conditions**

The most basic measure of working conditions is the average weekly working hours for different jobs. Comparing average hours worked by employees in Saudi Arabia to those of OECD countries, we find that Saudi scores the highest. On Average, an employee in Saudi Arabia works almost 50 hours per week. This average includes government sector jobs that require only 30 working hours per week, so private sector jobs require working hours that are greater than the mean. Long working hours are reflective of the difficult work conditions experienced by private sector employees in Saudi Arabia, compared to OECD countries. Again, it is a rather substantiated claim made by unemployed Saudis, claiming that the offered jobs have difficult work conditions.

\textsuperscript{4} Recalculated from the Saudi Pension Fund Contributions 2008
Even clearer evidence, is the negative correlation between average hours worked and the Saudization percentage for different types of jobs. Saudization efforts are more successful in jobs that require less than 50 hours per week of work. Clearly, difficult work conditions are contributing to Saudis neglecting many of the available job vacancies. The following graph
compares average working hours per week to the Saudization percentage by job type. Shorter working hours are correlated with high Saudization rates.

**Participation rate**
Participation rates need to be segregated between Saudi’s and non Saudis, because immigrants are only allowed into Saudi for work reasons. The only exception is a small number of dependants that accompany expats in executive positions. Looking at the graph below, participation rates are clearly low among Saudi nationals.

![Participation Rate %](image)

**Figure 8: CDSI and OECD stats**

One reason for such low levels of participation could be the young demographics of the country. However, low participation rates may also be a result of low opportunity cost of being unemployed. Given what we know about wages and work conditions, Saudis are probably not participating in the work force because of low wages and difficult work conditions. If active job seekers are not finding suitable jobs, the non-participating population will certainly be discouraged from participating in the work force. If wages increase and work conditions improve we should experience a rise in participation rates as the cost of being unemployed increases.
The cost of not having a job is currently too low to matter. If we could increase the wages offered in the labour market we can encourage higher Labour participation for both males and females.

**Low female participation**

The graph below shows that Saudi female participation rate is among the lowest in the world. In addition to the previously stated reasons, female participation is also influenced by cultural barriers that require a long time to overcome, which are slowly changing over time.

![Women Participation %](chart)

Figure 9: (CDSI and OECD stats)

Another cause for this low participation rate could be the lower wages paid to females compared to males. In 2008, private sector Saudi female wages were only 66% of wages paid to Saudi males. This is probably linked to women’s rights and the broader values of society, rather than Labour market specific issues. Nevertheless, because females earn less they are less likely to participate in the labour market.

**Low productivity**

The best proxy measure of productivity is the wages paid to employees, if wages are determined by market forces. From what we know about private sector wages, labour productivity is relatively lower than other comparable countries. This has two reasons. First low levels of education among foreign born workforce, as illustrated in the graph below.
Second, low levels of capital formation in the economy as a whole. As a percentage of GDP, gross capital formation has remained stagnant in recent years, at below 20%, despite high economic growth. This rate of capital formation is lower than rates attained in other emerging markets during high growth periods. Gross fixed capital formation to GDP rates in China, for example, were above 35% in the 1990’s and India has followed suite more recently. Both Japan in the 1960’s and South Korea in the 1970’s attained rates above 30%\(^5\). The graph below shows capital formation as a percentage of GDP stood at below 20% in 2008.

\[\text{Figure 10: (CDSI)}\]

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\(^5\) Source: Banque Saudi Fransi, Saudi Economics, January 2010
Figure 11: Capital Formation (SAMA Report)

Consequences of low levels of productivity

Low and falling levels of productivity, implies that we are creating more low-wage jobs that cannot be filled by Saudi’s. Government’s effort to keep foreign-born labour wages low widens the gap between wages earned by foreign Labour and the minimum wage levels required by an unemployed Saudi. Keeping in mind that most unemployed Saudis hold high school education or less⁶, basic low-wage jobs are the most relevant jobs to this segment. Historically, government policies have always assumed that all low-wage jobs will be occupied by foreign Labour, but this may not be the case in the future. Recent demographic trends, associated with the growing young population, made it crucial to absorb part of the Saudi work force in basic low-wage jobs.

As long as the free flow of foreign Labour is allowed, productivity of a Labourer will always be based on Labour productivity in his country of origin. Businesses do not need to improve productivity as long as they can hire more Labour from abroad.

As mentioned earlier, unemployment amongst Saudis is due to low level of wages, not the lack of jobs. So unless productivity levels improve and subsequently wages increase, jobs will not be appealing to the unemployed Saudis. If we assume that we will always have Saudis working in the unskilled segment, which is fair to assume for any mature economy. Wage levels earned by the low-wage earners would have to increase for all workers before any sustainable replacement of foreign workers by Saudis can happen. As long as foreign workers cost less, business owners have an incentive to hire foreign Labour.

The lack of capital investments by businesses is also because of the same reason. Business owners are not incentivized to invest in capital and efficiency because the cost of Labour is so low. Unless we allow wages to rise, businesses will not move to more capital intensive practices. The lack of capital investment by Saudi companies creates businesses that do not match the countries resources (labour intensive businesses in a country that has shortage of labour). This issue could have serious consequences for the economy over the long-run. The incentive to invest in capital is closely related to the cost of labour. Given the choice, business will always elect to hire more low-cost Labour over incurring capital investments.

Social implications

One of the most serious results of unemployment is its effect on the physiological state of the unemployed. Low self esteem, depression, which leads to weak family ties and isolation from the community. Keeping in mind that 89% of the unemployed are below the age of 29, vulnerability to psychological complication is greater at this young age. Job market entrants are most vulnerable to radical beliefs and may be prone to recruiters of terror movements. Growing

⁶ CDSI 2008 Labor Force Survey
unemployment issues will also have negative implications on crime rates if not addressed properly. Providing jobs and decent living is the best way to engage the youth into the civic society.

The low participation rate of women in the workforce also limits the development opportunities for mothers. By participating in the workforce a mother would better understand job market requirements and raise her children accordingly. We currently have more than 520 thousand domestic helpers in Saudi homes, mostly Asians, whom are actively participating in raising Saudi children. By reducing our dependence on domestic helpers we could encourage stronger ties between mothers and children.

Having a large portion of the population as temporary immigrant workers also creates socio-political threats. Many of the immigrant’s population in Saudi have lived here for a long time and consider Saudi to be their home country. It will be foolish to assume that all immigrants will peacefully return to their home countries once the need for their services has ended. Given the long period of their lives spent within the country they will most likely demand to be given permanent residency status or full citizenship rights.

We must also remember the social implications on families of foreign Labourers that have to survive without a father or a mother, who is working abroad. In some estimates, the state of Kerala, India, has more than one million single mothers, often called the Gulf widows. It is not fair for such a large number of families to be missing an important part of the family for work reasons. By depending less on foreign unskilled Labour we give the widowed families a better chance to live their lives together.
A dualistic job market model\textsuperscript{7}

To better understand the economics of the Saudi Labour market we could explain the market dynamics by assuming a dualistic Labour market. We have two different segments of the Labour market, one that has institutionally set wages (government and related organizations); and another segment that represents private sector firms.

For the first segment, because wages and working hours are institutionally set, they are not market driven and do not react to current market conditions. Government sector jobs generally have higher wages and better work conditions, and are therefore in high demand. In recent years, applicants to government vacancies have poured in by the thousands whenever an opening is announced. In economic terms, government sector jobs face a flat curve of Labour supply, where wages do not change for any level of Labour demanded.

On the other hand, private sector jobs are more market driven, and are therefore more reactive to market conditions. Wages are set based on the supply and demand of Labour at any given output level. The intersection of the curves, equilibrium, is set below the level of wages earned for government jobs. Private sector wages are influenced by government sector wages, but are not directly related, because government employment is limited by the number of job openings.

Due to the scarcity of government job openings, more and more Saudis are turning to the private sector to find jobs. Over the five years between 2004 and 2008, the number of Saudis in private sector jobs increased by 70%, from 485 thousand in 2004 to 829 thousand employees in 2008. Over the same period, government sector jobs only increased by 14% (from 695 thousand to 794 thousand). In fact, 2008 saw for the first time ever that the private sector employed more

\textsuperscript{*} Model is based on a framework used by Dimitri G. Demekas and Zenon G. Kontolemis, in Government Employment and Wages and Labor Market Performance, IMF working paper, April 1999.
Saudis than the government sector. With no doubt, private sector employment is creating more job opportunities for Saudi youth. The problem, however, is in the wage inequality between the two segments of the Labour market.

Notwithstanding differences in job security (effectively a job for life), as well as better work conditions (only working 30 hours per week) and opportunities to do part time jobs after working hours, in government jobs. If all additional non-wage benefits are calculated, wage inequality would be even greater.

![Monthly Wages (Real)](image)

**Figure 12: MOL and Saudi Pension Fund (calculated based on 9% pension allowance)**

Recent government decisions to increase public sector wages four times over the last four years are probably easing inflationary pressures faced by government employees, but are widening the inequality gap between the two segments of the Saudi job market. Wages were increased 15% towards the end of 2005 then 5% in 2007, 2008 and 2009. High oil revenues are surely contributing to the flexibility in increasing wages and easing inflationary pressures on employees.

The problem with such decisions is that they lift the expectations of a Saudi employee in terms of earned wages, while not offering enough jobs at the same wage level. The value function of being unemployed and focusing entirely on finding a government job increases.

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8 Excluding Aramco, Saudi Airlines and independent government organizations like SIDF, CMA and others. Data is not available for such organizations. (MOL)
In other countries, a rise in government wages would also result in higher wages earned in private sector jobs. In Saudi Arabia, the situation is different because private employers have easy access to other Labour markets abroad, thus wages are not affected similarly.

This analysis leads to some key questions around the policies that shape the Saudi Labour Market.

Is our objective, as a country, to maximize output or improve our living standards?
I think this is a defining question. We can deliver greater economic output by importing labour from abroad, but the living standards of many Saudis will also deteriorate. In the past inviting labour from abroad was not an issue because the local population was fully employed, but with current unemployment rates we need to reconsider our priorities.

How do we address rising inequality between government and private sector wages?
First we need to focus on means to lift private sector wages, because they seem to be far lower than the mean, relative to wages earned in similar countries to Saudi. They are 23% of GDP per capita, whereas average OECD wages are 111% of GDP per capita.

Should we promote a government dominated economy or a private sector one?
The privatization choice is actually clearly stated by many government officials on various occasions. Promoting private enterprises could come with many improvements in levels of efficiency and utilization of resources.

What is a fair wage level for employees?
Especially in the private sector where wages are almost completely set by market forces and labour unions are non-existent. The government has a role to play in ensuring wage levels meet its target living standards while ensuring sufficient employment levels for Saudis and the foreign-born.
"In the Gulf States wages are higher in the public than in the private sector as a consequence of liberal admission policies that have driven private sector wages down; as a result, national workers prefer to remain unemployed rather than accept jobs in the private sector. This problem has been compounded by a recruitment system involving local “sponsors” or *khafeels*, who have profited handsomely from bringing in more workers regardless of their employment prospects. Swelling the labour market with migrant workers and thereby lowering wages may have benefited consumers and reduced the cost of public subsidies, but its long-term consequence is dependence and greater difficulty in providing jobs for local workers"

**International Labour Conference, 92nd Session, 2004**
ILO, Geneva
**Government Policies in place**
The ninth development plan (five years 2010 to 2014) approved by the Saudi ministerial council calls for the employment of 1.12 million Saudis, 73% of them in private sector jobs. All of these jobs are newly created jobs during the coming 5 years. This objective requires a lot of involvement by policy makers to reform the Saudi job market, before any sustainable placements can happen. Intervention can be in the form of Labour market spending, visa issuance limits or other tailored policies.

**Active Labour Market Spending**
Active Labour market spending was only introduced in Saudi through the establishment of the Human-resources Development Fund (HDF), incorporated in 2001. In recent years more government funding was diverted to HDF as they became a lot more effective with the newly launched programs. The programs can be categorized into two categories, linking job seekers to job openings and subsidizing on-job training for Saudis placed in private sector jobs.

Prominent businessmen were appointed on the board of directors at HDF to ensure a good level of involvement by the private sector. HDF programs have been effective, over the last 2 years as more than 100 thousand first time job seekers were placed in private sector jobs. Allocated funds totalled around 1 billion US$ over the same period, mostly collected from different private sector fees.

Most funds were spent on the training subsidy program, meant to subsidize wages for first time Saudi job seekers. This program was highly effective and addressed the area where Saudi’s need the most support, especially candidates with basic or irrelevant education backgrounds. Up to 50% of monthly wages and 75% of training costs are covered by this program for the first two years of employment.

If HDF continues at the same pace we could certainly see a positive impact on unemployment. The question however, is how maintainable are these jobs after the first two years are over and the subsidies are lifted? this question is yet to be answered. Subsidies have a good impact on the short-term but are never a long-term solution. On-job training is certainly a good investment to make but may not be enough to change the structural deficiencies of the Saudi Labour market.

**The Sponsorship policy**
this is policy whereby every expat needs to be sponsored by a specific employer and is only allowed into the country if he has a sponsor. After arriving he could only work for that sponsor, a written consent is needed before an employee can transfer to work for a different sponsor. This policy stalls any effort to build a dynamic Labour market, because employers can abuse their powers and dictate employment terms. Effects of such abuse translate in 1) lower wages paid to foreign employees 2) businesses prefer foreign employees due to the sponsorship powers that can be exerted over them (stronger control), especially compared to Saudi employees who are free to seek employment elsewhere.
Limits on issuance of work visas for foreigners
An obvious solution to the massive influx of foreign Labourers is to curb the issuance of work visa permits. This policy was actually enacted between 2004 and mid 2007 by the Ministry of Labour. Between 2004 and 2005 work permit issuance was cut by 31%. Reactions to this policy were outrageous. The business community used all means possible to fight this policy, lobbying with regulators, threatening to close-down business and move to neighbouring countries, media fights and outcry campaigns. Then in mid 2007 worldwide food price inflation started picking-up and the curb on permits was blamed to be a contributing factor of inflation, and eventually the curbs had to be loosened.

Limiting job mobility
The curb policy failed because job mobility was not allowed and wages remained low. The problem with limiting the issuance of work permits is that it created a lot of inefficiencies, without allowing the needed flexibility for market forces to adjust. Because foreign employees were not allowed to shift jobs without the consent of the previous employer, employees were not delivering their potential productivity because they had to work for the same employer even if they could find a better offer elsewhere. This limits the potential for a foreign born employee wanting to earn a higher wage. Incentives to improve productivity become weak and the economy loses because resources are not utilized to their potential. The implication of this mobility constraint is that most foreign employees have depressed wages because they cannot move on to a better job offer.

The same thing happened with employers, they could not hire the best talent because their current employers would not release them. Businesses suffered from sub-par productivity levels because they could not attract the right employees.

Even worse, some employers would allow their employees to work elsewhere for a monthly fee, effectively collecting unlawful taxes from foreign Labour in exchange for allowing them to stay in the country. Especially in times when limits on new work permit are tight, demand for low-cost Labour increases and this type of employers benefit.

Limits on work visa permits could have eventually brought wages higher, if job mobility was allowed.

Lower wages earned by foreigners
It is understandable that many foreign Labour will settle for a lower wage than what a Saudi would require. However, if we want to build a uniform job market, wages need to be equal to the employer. Differences in wage expectations need to be captured by the government in the form of residency fees, not by business owners. Businesses that live off low wages paid to foreigners should not be incentivized, because they are inviting more competition to Saudi labour and reaping the differences in living standards. The wide gap in standards of living between Saudi Arabia and Asian Countries, where most foreign born employees are from creates an imbalance.
This issue is an issue of priorities to the country, what is more important? Hiring young Saudi’s or building low cost businesses. I assume that for any country, ensuring a decent living for the wider population of nationals is the number one priority. Moreover, building businesses around low-cost Labour cannot be sustainable unless the intention is to eventually grant them citizenships, which I do not think is intended. As shown in the graph below foreign Labourers invited into the country have low levels of education, much lower than Saudis.

![Figure 13: Education levels (Saudi vs Expats)](image)

Quick fact: Wages paid to domestic helpers and private drivers in Saudi homes alone, surpasses all wages paid to Saudi employees of Sabic, Saudi Electricity Company and the Saudi Telecom Company combined. The reason is simple, we have around 877 thousands foreigners working in Saudi homes, whereas, Saudis working in these companies are less than 100 thousand employees. The low wages paid to foreign labor are usually overlooked because they are marginal when looked at per individual. Looking at the overall picture, foreigners make it up in the number of employed.

**Unfair competition for Saudi employees**

Even if we assume identical cost and productivity levels between Saudis and foreigners, an employer would favour a foreign worker over a Saudi one just because of the sponsorship powers that can be exerted. A foreign worker has to work as hard as he can or he would face the risk of being sent back to his country by his employer. This has created a situation where a Saudi worker is at a disadvantage and may have to accept a lower wage level just to make up for the lesser control an employer has over him.

The solution to this problem could be to give foreign workers more rights. Employees should own the right to manage their course, meaning no employer should have the right to deport an
employee from the country, as long as he has a valid offer to work elsewhere. Similarly, the right to move to a different employer should also be kept with the employee, without consent from his previous employer. Equal treatment is not just fair to foreigners, but also to the Saudi labour who are competing for the same jobs as foreigners. If the employer is given more power or leverage over a certain type of employee, it is in a way subsidizing the cost of that type of employee to him.

**Forced Saudization of Specific Occupations**

To encourage Saudization, from time to time the MOL issues directives to Saudize specific occupations, that can only be filled by Saudis. This form of Saudization was implemented on Gold shops, Airport Taxi drivers, Receptionists, HR managers and many others. At initial implementation phases of such directives, they tend to have a positive effect on the employment of Saudis. Eventually the enforceability of such directives becomes difficult to maintain and eventually benefits fade away. Higher cost of Saudi employees, difficult enforceability measures and lack of trained Saudis are reasons for failure when forcefully Saudizing specific jobs.

**Minimum wage**

The only form of minimum wage policy in Saudi Arabia, is the limit placed by the General Organisation for Social Insurance (GOSI) which requires a minimum registered wage of 400$ per month for Saudi employees.

In practice, minimum wage policy is weak or nonexistent, because it is not enforced on foreign born workers. How could a minimum wage policy stand if only enforced on a certain type of employees? As a matter of fact, it may discourage business from hiring Saudis, because, by law, they have to pay them higher than average wages, whereas foreigners are allowed to work for less. As mentioned earlier, average wages in private sector jobs are below the minimum wage set for Saudis. A minimum wage policy has to protect Saudi’s and non-Saudis alike, for it to be effective.

Even if enforced, the minimum wage level is still too low to matter, set at 25% of GDP per capita. Average OECD countries usually set minimum wage at 35% of GDP per capita. Wages earned by many Saudi’s, doing basic jobs, is below what is internationally accepted as a minimum wage relative to GDP.

An effective minimum wage policy set at 35% of GDP per capita, similar to OECD countries, will likely eliminate a large number of low productivity jobs that can be replaced by additional capital investments and better efficiencies. Another issue to consider in setting the minimum wage is that we might be over paying the foreign born employee who might settle for a lower wage in absence of such policy. This surplus is a net loss to the economy since it will, most likely, be transferred out as remittances. A fee scheme could be adopted to ensure that this surplus is captured within the economy as government fees.
Training of Saudis
Different forms of training institutions exist in Saudi, both private and publicly funded institutions. The most dominant institution is the publicly funded Technical & Vocational Training Corporation (TVTC), publicly funded. In 2007, more than 167 thousand candidates applied for seats at TVTC but only 58% were accepted, due to capacity constraints. Among females, even more constraints were prevalent, as only 10% of applicants were accepted. Recent government budgets have increased allocated funds towards vocational training, yet investment cycles will likely take some time before results materialize. Although the emergence of privately funded institutions was relatively more recent, they have grown significantly in recent years. Going forward, private training institutions should benefit from a larger share of active Labour market spending being directed towards training.

Additional Facts

Female participation in the workforce
Most female employment is concentrated in education and healthcare, accounting for 88% of female employment. Jobs in these sectors are culturally accepted to be filled by females because genders are segregated in both schools and to some extent hospitals. Government policies to promote a wider participation of women in the workforce are often faced by cultural barriers. Several government-lead initiatives were recently launched to promote hiring females in the retail sector, namely women’s clothing, but faced stiff resistance. Initiatives should also consider areas where male Saudis have succeeded, like administrative jobs. Of course cultural sensitivities ought to be considered, but should not stop women from filling such jobs. Ideas like, women’s only office building may need to be introduced, as a way to promote women’s

Opportunity!!
Upon a closer look at the Education levels of unemployed females, we find that females generally hold higher levels of education. Within unemployed females, 78% hold university degrees, whereas only 17% of unemployed men hold university degrees. A possible explanation for this is the limited job types they can occupy. A wider variety of possible job types, if opened, may encourage a better utilization of this valuable resource. Unemployed females constitute a greater potential to the economy.

Even more importantly, is the currently non-participating female population. More than 365 thousands university graduates are staying in homes as housewives. Saudi has one of the lowest rates of female labour participation in the world at 12%, compared to 57.5% in OECD countries. The lowest participation rate within OECD countries was recorded in Turkey at 24%, still double that of Saudi. Higher female participation appears to be another high potential goal for the Saudi economy. Starting from a low base and good education levels indicate a good possibility to increase economic output by attracting them into the workforce.
participation in office work. Administration jobs are generally more productive, therefore, may sustain higher wage levels and attract greater participation.

**Figure 14**: Unemployed Females by Education (CDSI) 2009

**Figure 15**: Non-Participating Female Population (CDSI)
Inequality and income distribution

As more and more Saudis join the private sector, a serious inequality issue is on the rise. The continuous fall in average wages for Saudis working in private sector jobs (as seen figure 3 above) is a clear indicator of this trend. This is a serious issue to consider in light of the government’s plan to move towards a private sector dominated economy. A successful privatization plan needs to create jobs that ensure a decent living for employees working for the private sector.

The real measure of economic progress is the growth in number of middle income households, which in Saudi’s case, limited to government sector employees and other highly regulated sectors like banks, telecom and utilities. The rest of the private sector, which hires the majority of the labour force, does not provide decent jobs as seen earlier. Going forward, middle income jobs cannot be limited to a small number of industries. We can build decent jobs in many other industries if the right incentives are in place.

Statistics published by the General Organization for Social Insurance, reveal a wide inequality gap. The majority of subscribers (53%) fall in the below SR1,000 per month bracket, while 4.4% of subscribers earn SR10,000 or above. Moreover, the top 4.4% of subscribers earn a total sum that is greater than the sum of 53% of subscribers. This clearly indicates a concentration of income in the top income bracket, while the majority of subscribers fall in the lowest income bracket. With increasing unemployment pressures Saudi’s are being forced into the lower end of the income brackets, where they have direct competition from foreign labour.

Remittances by Expats

In 2008 remittances by foreign workers abroad totalled 21 billion Dollars, up 33% from 2007. This figure makes Saudi only second to the United States, in worldwide outward remittances. Remittances were 4.5% of GDP in Saudi Arabia whereas they were marginal in the US at 0.3%. That is the direct drain to the economy, but if we calculate the indirect losses we could find them to be even more significant. High propensity to save and transfer abroad, by foreign born labor, is a pressing matter to consider.

A possible explanation for this large share of wages being transferred abroad is that foreign-born labour, in Saudi, are treated as temporary workers and not as permanent residences. Possible solutions to this problem could be to grant the foreign-born labor additional rights like easier property ownership rights, loosening of sponsorship regulations, accepting cultural and religious differences etc. Unless the worker feels accepted as a resident, he will not try to integrate into the society and eventually consume more within the country rather than send the funds abroad.

Remittances abroad reached 21 billion $ in 2008
Multiplier effect
An important consequence for such high percentage of wages sent abroad is the loss of recirculation of funds back into the economy. Creating jobs should stimulate spending thru higher consumption by wage earners, but this is not happening with foreign blue coaler workers in Saudi. Home country Economies accepting such remittances are benefiting more from wages earned inside Saudi Arabia, than the Saudi economy itself.

Wages earned by Saudi employees will almost certainly get circulated back into the economy, whereas foreign employees spend a smaller share of their wages locally. It is estimated that every Dollar earned by a Saudi employee has an economic multiplier of 2.5 whereas a foreign employee has a multiplier of only 0.8 times his earned wage\(^9\).

Going back to expat remittances abroad of 21 billion $ and using the multiplier effect, we find that by adjusting for the spending multiplier difference, we could generate an additional 36 billion dollars in economic activity. In other words, the private sector would benefit an additional 36 billion dollar in business if foreign laborers are substituted for Saudis.

For example, the recent surge in government spending on infrastructure will not deliver its potential impact, because most construction jobs are filled by foreign-born unskilled laborers. Consequently, wages earned by foreign-born workers do not translate into higher consumption. A private sector that is dominated by foreign labor dilutes the trickledown effect that is usually associated with such high levels of government spending.

Recommendations for improving the effectiveness of current policies

Possible improvements for the current government policies fall under four objectives, as follows:

Improving the overall productivity of employees

Limit the influx of unskilled foreign Labour because they will unlikely help improve productivity. A gradual downsizing of unskilled foreign Labour employed could be planned and enforced over a long time span. Nevertheless, increasing productivity should not stop private employers from hiring good talent.

Many of the current policies try to influence behaviour by placing obstacles in front of businesses without giving an alternative. Instead of dictating change through directives, we could provide incentives that lead to change.

To improve productivity, policy makers need to provide incentives for creating jobs in more capital intensive businesses. We need to influence the investment decisions of business owners to build businesses that depend less on cheap labour and more on capital and skilled labour.

Policies should seek to increase the cost of unskilled labour and subsidise the cost of the skilled. The Government could increase the residency fees collected from foreign-born workers (Iqama Renewal Fees). The magnitude of such increase should adjust for the difference in minimum wage between Saudi and countries where most foreign-born Labour originates from. Setting a fixed flat fee will not affect the skilled segment of the labour force because it will be marginal, compared to their total pay, but it will have an impact on the unskilled.

Proceeds from such fee could also help train Saudi nationals through the HDF programs. This could help bridge the gap between wages demanded by Saudis and wages accepted by the foreign-born workforce.

Along with that, a meaningful minimum wage policy should be introduced that can make-up the difference in additional costs to foreigners and help protect the disadvantaged Saudis that earn low wages.

This might mean higher Labour cost to employers in the beginning, but it will also mean higher productivity. As businesses adapt to higher Labour costs, efficiency and utilisations should improve. Businesses will invest in better technologies to increase Labour productivity, to better utilize Labour resources.

Better utilization of available resources

- Creating a uniform job market where both Saudis and immigrants are treated equally.
- Removing all constraints associated with the Sponsorship Policy.
- Initiatives to promote female workforce participation in different types of jobs. Efforts to unlock the female potential are currently constrained by cultural barriers.
• Further government support for Saudis enrolment in vocational training to fulfil Labour market demand.
• Improve information flows between job seekers and employers.

Attracting higher participation rates
The best way to increase participation rates is to improve productivity and average wages, *the substitution effect*. To fund higher wages, regulators can use proceeds of the higher residency fees, imposed on foreign labour, to support the hiring of Saudis on higher pay scales. Either through direct subsidies, similar to the HDF programs, already in place or create rebates on foreign labour fees based on the number of Saudis hired. The only exception is women participation which may require, in addition to higher wages, government support in braking cultural barriers.

Another needed area to improve is the difficult work conditions in private sector jobs. Work conditions need to be benchmarked to other similar countries and reviewed regularly. We can also link the minimum wage policy (mentioned above) to this issue, by calculating it on an hourly basis to offset differences in working hours per week.

Building a sustainable Labour market
More than half of the current Labour market participants are foreign-born. Therefore, it would be unrealistic to assume a stable Labour market without the foreign born employees, in the short-run. Policy makers need to consider measure to discourage the dependence on low productivity Labourers, over the long-run. At the same time, encourage attracting foreign-born talents filling high productivity jobs where considerable knowledge transfer could be achieved.

Expanding permanent residency status granted to highly skilled foreign born employees could also be utilized to maintain a higher skill level within the local workforce. In certain cases, even granting citizenships may be considered, in attracting scarce qualifications. This would help attract better talent to the country and most importantly spur consumption within the country instead of sending outflow remittances to be consumed abroad. If foreign born Labourers are here to stay, the local economy should at least benefit from the income generated within it.
**Expected outcomes of the mentioned recommendations**

Any reform is expected to have its impact on the market, for them to be effective. Given the magnitude of the problem we face, changes may be radical in some cases and not so radical in other cases. The objective of these changes is not just to solve the pressing unemployment issue; it should also build a more productive Saudi labour force. The following table summarizes the expected effects of these reforms on a selected list of industries.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food retail stores</td>
<td>Limited effect on supermarkets, but significant effects on convenience stores whom might be forced to reduce the number of outlets until higher utilisation is achieved or increase prices</td>
</tr>
<tr>
<td>Home servants (maids and drivers)</td>
<td>Significant effects, because many of them will ask for higher wages or chose to serve in other industries</td>
</tr>
<tr>
<td>Hospitality (restaurants and hotels)</td>
<td>Limited effects on large hotels, because 5 star hotels already pay international wages and smaller hotels do not employ a large number of labour. Small restaurants will be forced to either increase prices or reduce the number of outlets.</td>
</tr>
<tr>
<td>Contracting, Operations &amp; Maintenance</td>
<td>Government projects will not be effected because higher costs will be offset by additional fees collected from foreign labourers, but private projects will need to rationalize their investments</td>
</tr>
<tr>
<td>Professional services (electricians, carpenters and plumbers)</td>
<td>Higher cost, which will encourage the Saudis to participate in such jobs, but consumers will also have to rationalize their requirements</td>
</tr>
<tr>
<td>Heavy Industries</td>
<td>Limited effects, because labour cost is not a big part of their cost base</td>
</tr>
<tr>
<td>Light industries</td>
<td>Significant effect, many will have to move to more capital intensive industries</td>
</tr>
</tbody>
</table>

**Consumer price inflation**

One of the most feared outcomes of these reforms is its effects on inflation, yet a closer look at the components of cost of living measures in Saudi Arabia reveal a different reality. The following is a list of the basic components that go into measuring the cost of living in Saudi Arabia and the likely changes to each.

<table>
<thead>
<tr>
<th>Component</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food &amp; Beverages</td>
<td>Limited effects (most is imported)</td>
</tr>
<tr>
<td>Textiles, Apparels and Clothing</td>
<td>Limited effects (most is imported)</td>
</tr>
<tr>
<td>Category</td>
<td>Description</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Refurbishing, Rents and Fuel</td>
<td>Limited effects (not much labour involved)</td>
</tr>
<tr>
<td>Home Furniture</td>
<td>Limited effects (most is imported)</td>
</tr>
<tr>
<td>Healthcare</td>
<td>Limited effect on public sector facilities (the dominant player), significant effect on the private sector</td>
</tr>
<tr>
<td>Communications &amp; Transport</td>
<td>Limited effects (not much labour involved)</td>
</tr>
<tr>
<td>Education and Entertainment</td>
<td>Limited effect on public sector facilities (the dominant player), significant effect on the private sector</td>
</tr>
<tr>
<td>Other Goods and Services</td>
<td>Not clear</td>
</tr>
</tbody>
</table>

Source: independent research

**Living standards**

Most importantly, bridging the inequality gap and providing a decent living to citizens in the bottom of the pyramid. As seen above, many Saudis now face the choice of being unemployed or accepting wages that are significantly lower than citizens of a similar country to Saudi Arabia, in GDP per capita levels. The current situation favours the wealthy citizens by providing them cheap labour to run their businesses and serve their homes. This situation is fine as long as we can find enough decent jobs for all willing Saudis, if not we should revisit our priorities.

Higher costs to certain parts of the society should benefit others, so it is not all good or all bad. We need to set living standard targets for everyone in the pyramid and work accordingly. As long as we can meet the target living standards, we could tighten or relax our dependence on foreign labour.