

# **Labor Market Challenges and Policies in the Gulf Cooperation Council Countries**

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## Executive Summary

- The rapid growth of the GCC economies over the past three decades required large inflows of foreign labor. Expatriate workers currently comprise over one-half of the labor force in all GCC countries and as much as 90 percent in some countries.
- The labor markets in the GCC countries are segmented along several dimensions: between public and private sectors, between nationals and nonnationals, and between skilled and unskilled labor. Market segmentation reflects a number of factors, perhaps most importantly the more attractive wages and benefits as well as job security and social status offered by the public sector to nationals. It also arises from the mismatch between the qualifications of new entrants to the labor market and the requirements of the private sector. The segmentation of the labor market is such that in some GCC countries, as much as 90 percent of the national labor force is employed in the public sector with expatriate workers comprising a comparably high ratio in the private sector.
- In most GCC countries, unemployment among nationals is a relatively recent phenomenon and still of a largely frictional and voluntary nature. In the period ahead, however, the labor market conditions are expected to tighten in view of a rapidly growing number of nationals entering the labor force at the time when governments can no longer act as employers of first and last resorts because of budgetary considerations as well as for efficiency reasons.
- Policymakers in the GCC countries recognize these pressing challenges and have embarked on formulating labor market strategies to create employment opportunities for nationals within a broader framework of fiscal consolidation and structural reforms. The policy instruments to achieve the employment objectives have included an array of measures affecting the quantity (quotas and employment targets), price (wage subsidies to private sector, government wage restraint, and fees and charges on foreign labor), as well as the quality (education and training) of labor.
- Employment quotas and administrative measures may create jobs for nationals in the short run, but such measures offer no permanent solution and could even be counterproductive in the long run. An effective strategy to reduce labor-market segmentation and improve market efficiency would require a mix of measures aimed at increasing the market responsiveness of incomes and employment policies, minimizing distortions created by government benefit packages, and matching the skill profile of the national labor force with the present and future requirements of the private sector.
- The labor market policies in the GCC countries have broader regional implications. Workers' remittances originating from the GCC countries are a major source of foreign exchange earnings and an important source of financing private sector consumption and investment in a number of labor-surplus MENA countries.

## **I. Introduction**

A distinguishing feature of the GCC countries is the significant proportion of expatriate workers in the labor force and the segmentation of their labor markets. Better educated nationals traditionally have been attracted to the government sector because of higher wages and generous benefits; early retirement with pension; and job security and social status associated with government employment. Private sector activity is heavily dependent on expatriate labor, which is readily available on the basis of fixed term, job-specific contracts under the sponsorship of nationals. Wages of expatriate workers are substantially lower than those for nationals at similar skill levels, and there are no significant nonwage benefits in the private sector. The segmentation of the labor market is such that in some GCC countries as much as 90 percent of the national labor force is employed in the public sector with expatriate workers comprising a comparably high ratio in the private sector.

The labor market conditions in the GCC countries are expected to tighten in the coming years, with a rapidly growing number of young, educated nationals entering the labor force at a time when the governments can no longer act as employers of first and last resort. There are budgetary considerations in some countries and all countries are stressing the need to foster private sector activity and employment for efficiency reasons. Indeed, labor market issues are clearly recognized as constituting pressing challenges for policymakers in the period ahead. Accordingly, the GCC governments have already embarked on formulating labor market strategies to create employment opportunities for nationals within a broader framework of fiscal consolidation and structural economic reforms.

Policy instruments available to the GCC policymakers cover a broad spectrum, ranging from market solutions at one extreme to mandatory and administrative policies at the other extreme. The key challenge is to develop an effective strategy to increase the efficiency of the labor market and reduce its segmentation by relying more on market forces and less on mandatory employment policies, which could prove counterproductive in the long run and would raise labor costs.

This paper is organized as follows. Section II establishes the conceptual setting and provides the background. Section III describes the present structure of the labor market in the GCC countries. The evolving labor market challenges and policies in the GCC countries are discussed in Section IV. Section V discusses the impact of labor market policies pursued by the GCC countries on the other countries in the MENA region. Concluding remarks are summarized in Section VI.

## **II. Economic Structure and Linkages in the GCC Countries**

Employment is largely influenced by the pace of economic activity and the labor-intensity and efficiency of production processes. The endowment and the price of labor relative to other inputs (capital, natural resources, and land) determine the optimum mix

between labor and other inputs. Some inputs are internationally mobile (capital, natural resources, and labor); others are nontradable (land). As such, labor market issues in the GCC countries would need to be viewed in the context of factor endowments and relative prices, and in relation to evolving economic growth, structure and linkages. A number of features and developments stand out:

- The GCC countries have a long tradition of liberal and open economic policies and maintain no restrictions on movements of goods, capital, and labor across their national boundaries. Consistent with their resource constraints, the countries have become major exporters of natural resources and capital, and major importers of merchandise goods and labor.

- The oil and gas sectors dominate the GCC economies: oil GDP has a direct relation to oil production and prices, and non-oil GDP is greatly influenced by government expenditure, which itself is a function of oil revenue. Indeed, government expenditure policies have supported economic activity in the past, and the budget has been used as a vehicle to distribute the oil-export proceeds—either explicitly (e.g., employment, wages, and benefits) or implicitly (free or below-cost provision of utilities, health, and education services).

- High oil prices in the 1970s and the early 1980s were associated with periods of rapid economic growth combined with large fiscal and external current account surpluses.<sup>1</sup> This allowed the GCC countries to embark on ambitious investment programs to build up their physical and social infrastructure and diversify their production base. Initially, the emphasis was on construction and industrial development, but the rapid development of infrastructure and industries required the support of, and contributed to the development of, a host of service industries. Rapidly increasing population and per capita income levels also spurred the development of domestic household services. Additionally, economic diversification ushered the development of financial services and non-oil trade activity. Even the capital and resource intensive development of the oil and gas sectors required substantial support from service industries. For these reasons, the service sectors began to emerge as the main contributor to non-oil economic activity and as the principal source of new demand for labor (Chart 1). The shift in sectoral emphasis also implied a change in the composition of labor toward lower skill levels.

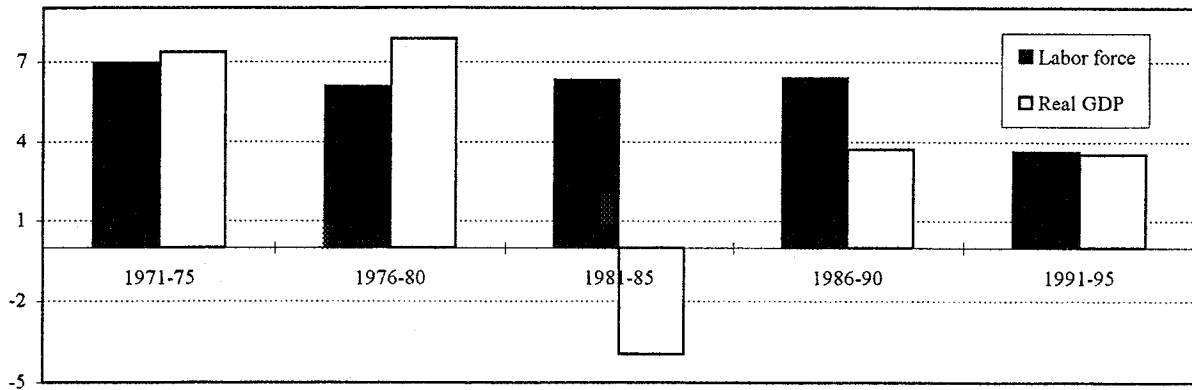
- With the continued erosion of oil prices through the second half of the 1980s, economic conditions weakened, and large internal and external financial imbalances emerged, prompting the authorities to implement adjustment policies primarily involving substantial cuts in expenditure. From the mid-1990s, the GCC countries intensified and broadened their efforts to reduce their fiscal imbalances and promote private sector growth and employment creation. The expenditure rationalization policies had to consider not only

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<sup>1</sup>Sassanpour (1996) reviews the different phases in economic development in the GCC countries since the early 1980s.

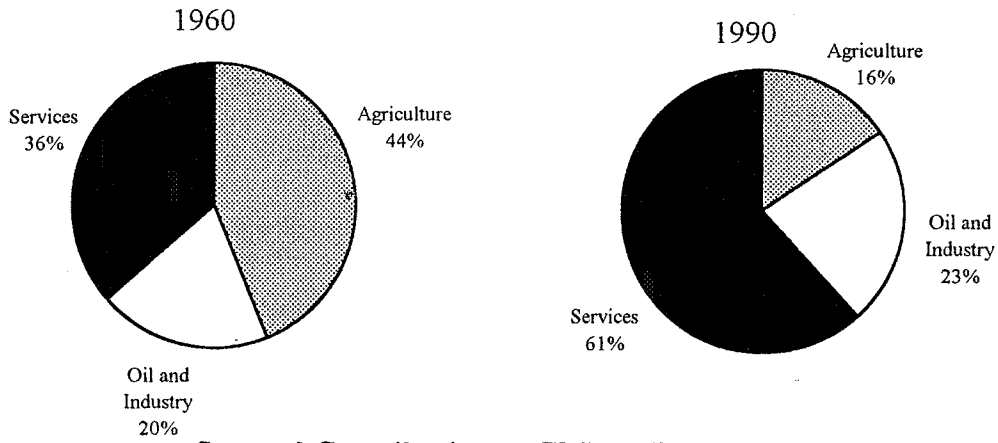
**Chart 1. Employment and Economic Growth in GCC Countries, 1971-95**

*(Average annual changes in percent)*



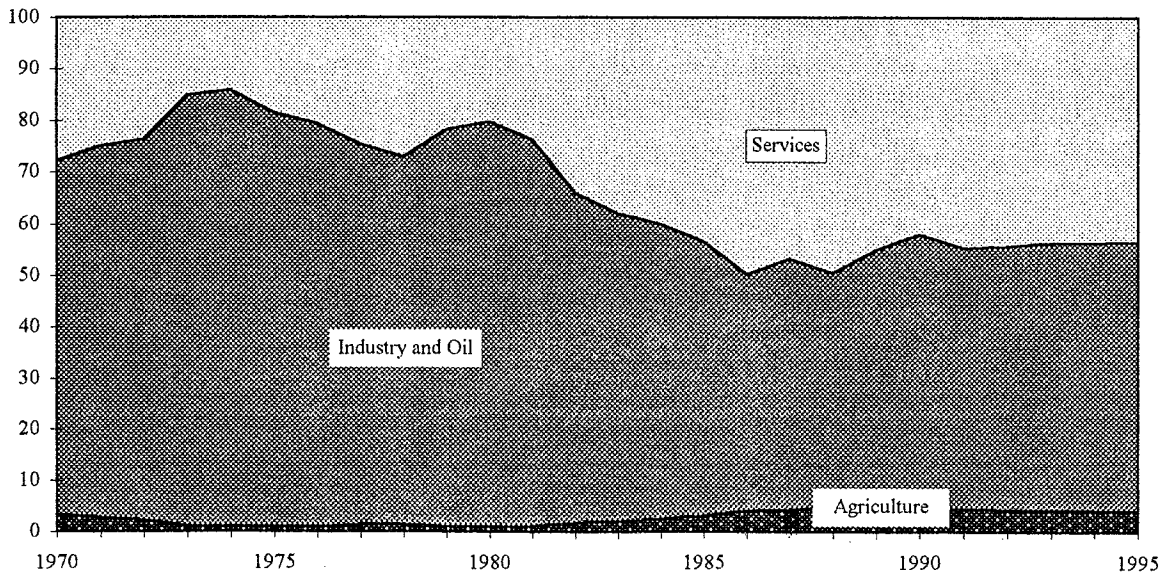
**Distribution of Labor by Sector in 1960 and 1990**

*(In percent of total)*



**Sectoral Contribution to GDP, 1970-95**

*(In percent of total)*



Sources: World Bank, World Development Indicators, 1997; UNDP, Human Development Report, 1997; and IMF staff calculations.

the relative efficiency of expenditures, but also the social dimension of expenditures, with specific reference to employment, wages, and benefits in the public sector.

- Given the limited resource base of the GCC countries, economic growth required large imports of materials and labor. In view of similar resource endowments and constraints, there was little scope for trade in goods and services between the GCC countries, but the established cultural and political relations with the other countries in the MENA region led to greater economic integration, essentially through labor market linkages.<sup>2</sup> Changes in the pace and composition of economic activity were reflected in the inflow of foreign labor. By some estimates, the foreign labor force grew, from a low base, by about 20 percent a year during the boom years, 1975–80, before moderating to 7 percent during 1980–85, and further to 3 percent annually in the next decade as economic growth consolidated (see Al-Qudsi, 1996). Expatriate workers currently comprise about 55 percent of the labor force in Bahrain, 65–70 percent in Oman and Saudi Arabia, and 85–90 percent in Kuwait, Qatar, and the United Arab Emirates (see Nur, 1995).<sup>3</sup>

Taken together, these factors have contributed to the current setting in the labor market and are defining the broad parameters for labor market issues and policies in the period ahead. In summary, an uncertain oil market outlook has underscored the importance of prudent macroeconomic policies and improved resource allocation to insulate the economies and support the growth of non-oil sector. Budgetary and efficiency considerations have also required a reassessment of government expenditure policies, including those on wages and employment. At the same time, the consolidation of economic growth and shifts in the structure of production in favor of services have moderated the demand for labor, possibly with a bias against higher skill levels. The link between economic growth and employment generation probably has also weakened over the years due to efficiency gains, industrial development based on capital-intensive technologies, and structural shifts in the nature of dependency on expatriate labor.<sup>4</sup> As a result, the demand for foreign labor appears to have become less sensitive to fluctuations in overall economic activity.<sup>5</sup> Given the GCC countries' open economic systems, the prices of foreign labor, capital, and natural resources are largely determined by international market conditions, but the price of domestic labor is, to a large extent, a policy variable and a social choice. This relative input price mix has created a bias against the use of national labor in the GCC countries.

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<sup>2</sup>Issues and challenges in economic integration between the MENA countries are discussed in Section V. See also Shafik (1996).

<sup>3</sup>No firm data are available on the geographical origin of the foreign labor force. Workers from the labor-surplus countries in the MENA region (i.e., Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic, Sudan, and the Republic of Yemen) and Palestinians initially dominated the GCC foreign labor force, but over the years, and particularly since the early 1990s, the number of Asian workers (mostly from the Indian subcontinent and the Philippines) has increased significantly.

<sup>4</sup>Al-Qudsi (1997) argues that in earlier periods, the demand for labor was related more closely to investment activities (e.g., building infrastructure), but recently, consumption activities (e.g., household services) appear to be contributing more to labor demand.

<sup>5</sup>Feiler (1991) and Al-Qudsi (1997) also stress the same point.

### III. Labor Market Structure

#### A. Growth and Structure of Population and Labor Force

Over the past three decades, the GCC countries as a group have recorded one of the highest rates of population growth in the world<sup>6</sup> (averaging 5 percent a year during 1970–95), reflecting the high rate of indigenous population growth as well as the large influx of expatriate workers. The rapid rate of growth of the national population (averaging 3 ½ percent a year in recent years) is attributable to the high fertility rates in the GCC countries (more than twice the world average) and significant advances in the areas of health and education, which have drastically reduced infant mortality rates (by a factor of 5 since 1970) and raised life expectancy (by some 20 years since 1970). The growth of indigenous labor force has been also influenced by the population's young age profile (40 percent below the age of 15) and the low participation rate of nationals in the labor market (Table 1).

The degree of labor market participation in the GCC countries (35 percent) is lower than that of other countries at the same stage of economic development and with similar per capita income levels. This reflects a combination of demographic, economic, social, and cultural factors. First, a relatively large proportion of the population is below working age. Second, there are incentives to delay entry into the labor force and continue education at least through university: education is free; a university degree significantly increases the chances of securing a government job or other highly paid jobs; and there is a social premium associated with university education. Third, a low retirement age in the public sector—typically about 45 years with 20 years of service—allows early exit from the labor force (although many retirees establish private businesses and remain active). Finally, the female participation rate in the GCC countries is low despite the growing number of educated and qualified women; at about 30 percent, Kuwait has the highest female participation rate among the GCC countries and even that is low by international standards.

Adult literacy rates in the GCC countries have improved significantly over the past three decades in response to large investments in education and the countries' compulsory education policies. Adult literacy rates in most GCC countries is about 80 percent because of high literacy rates among the younger adults, and the GCC average of 64 percent is higher than the MENA average of 55 percent. Moreover, the traditional gender imbalance in literacy rates in favor of men is narrowing because of similar enrollment ratios between males and females at primary and secondary education levels, and the larger share of women in local universities. In several GCC countries, women university students significantly outnumber men reflecting, among other things, the higher drop out rates among men, the greater opportunities for men in the local job markets and military, and the

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<sup>6</sup>The GCC has a total population of some 27 million, ranging from 0.6 million in Qatar to about 19 million in Saudi Arabia. On average, nonnationals comprise about one-half of the population. With the exception of Oman, the GCC population is highly concentrated in urban centers.

**Table 1. GCC Countries: Population, Labor Force, and Social Indicators**

(1995 or most recent year)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	U.A.E.	GCC
GNP per capita (U.S. dollars)	7,840	17,390	4,820	11,600	7,040	17,400	8,592
<b>Demographic indicators</b>							
Population (millions)	0.58	1.66	2.20	0.64	18.98	2.46	26.52
Aged 0-14 (percent of total)	35	35	46	30	44	29	41
Aged 15 and over (percent of total)	65	65	54	70	56	71	59
Population growth (percent, 1993-95 average)	3.6	5.4	5.1	6.4	4.1	5.7	4.4
Population gender ratio (men:women)	57:43	56:44	53:47	63:37	55:45	63:37	56:44
Age dependency ratio 1/	0.6	0.6	1.0	0.5	0.9	0.5	0.8
Urban population (percent of total)	90	97	13	92	79	84	75
<b>Labor force indicators</b>							
Total labor force (millions)	0.25	0.82	0.55	0.33	6.26	1.14	9.35
Male (percent of total)	82	73	85	88	88	89	86
Female (percent of total)	18	27	15	12	12	11	14
Labor force growth (percent, 1993-95 average)	2.3	-1.6	5.2	3.9	3.3	3.9	3.0
Participation rate (percent)	44	49	25	52	33	46	35
<b>Social indicators</b>							
<b>School enrollment (percent)</b>							
Primary (1992)	111	...	85	90	75	110	79
Secondary (1992)	99	...	55	84	45	49	54
Tertiary (1992)	20	...	5	29	14	11	13
Adult literacy rate (percent, 1990)	85	79	35	79	63	79	64
Population per physician (1990)	760	...	...	667	749	1208	...
Access to safe water (percent of population, 1993)	100	...	...	100	93	98	...
Life expectancy at birth (years)	72	76	70	72	70	75	71
Infant mortality rate (per 1,000 live births)	19	11	18	18	21	16	19

Sources: World Bank, *Social Indicators of Development*, 1997; and UNDP, *Human Development Report*, 1997.

1/ Population under the age of 15 and over the age of 65 as a share of the total working-age population.



higher number of men studying abroad. Past investments in education have tended to favor primary, secondary, and tertiary education at the expense of technical and vocational training.<sup>7</sup>

The service sectors employ over one-half of the total labor force in almost all GCC countries for reasons discussed earlier (Chart 1). Employment in the industrial sector has reflected the GCC countries' different strategies toward diversifying their economic base. In some GCC countries (Saudi Arabia and Qatar), economic diversification has stressed the development of industries based on their hydrocarbon resources. Oman has also promoted the development of its non-oil industrial base. Policy emphasis in Kuwait has been on downstream diversification in the oil sector through assets acquisitions abroad. In the other GCC countries, the development of the industrial sector has been overshadowed by more dominant service sectors (transit trade in the United Arab Emirates and offshore banking in Bahrain). Reflecting these strategies, over the years industrial employment as a share of total labor force has increased in Oman, Qatar, and Saudi Arabia, but declined in the other three GCC countries. With the exception of Oman and to a lesser extent Saudi Arabia, the share of the agricultural sector in total employment is very small reflecting the GCC countries' limited potential in food production and the rapid urbanization of the population.

## **B. Institutional and Legal Framework of the Labor Market**

The legal framework and institutional regulations governing the labor markets in the GCC countries have many common features. There is no minimum wage legislation and no tradition of collective bargaining in public or private sectors.<sup>8</sup> Moreover, in some GCC countries, there are still no legal provisions in the existing labor laws to allow the establishment of social security or pension schemes in the private sector. Other legal provisions, however, protect the right of workers, and there are laws against child labor and against discrimination on the basis of race, religion, and gender.

In several GCC countries, the right of every citizen to work is formalized by legislation; in some countries, short of guaranteed employment, this had served as the basis for absorbing nationals in the government sector. Regulations and conditions governing down-sizing and staff retrenchment are practiced less widely, particularly in the government sector where job security for nationals is a key feature. In the private sector, the difficulty of dismissing a national increases the attractiveness of hiring an expatriate worker on a fixed-term contract.

The employment of expatriate workers in the GCC countries is based on renewable sponsorship visas and work permits. Visas and job-specific work permits are issued once the sponsor demonstrates the need and guarantees employment for the duration of the

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<sup>7</sup>With the exception of Bahrain, enrollment in technical schools is insignificant (2–6 percent of total enrollment in secondary education), compared with 20 percent in some other MENA countries (e.g., Egypt and Jordan).

<sup>8</sup>In Oman, there are legal minimum monthly salaries for Omani workers at different skill levels.

contract. Sponsorships are either transferable only subject to restrictive terms and conditions, or not transferable at all. In many cases, the expatriate workers would have to leave the country and stay abroad for a minimum period of time before being considered for another position. Generally, there are no strict numerical quotas for hiring foreign workers—either by activity, nationality, or qualifications—but some GCC countries have limited the issue of visa to specific sectors or the number of workers sponsored by small businesses. The terms and conditions of employment, including compensation packages, are typically agreed bilaterally and specified in binding contracts. In some GCC countries, there are indicative sector-specific wage guidelines for hiring expatriates, but for all practical purposes, wages are based on market conditions and are broadly uniform across the GCC countries. Expatriate workers have recourse to local legal channels in the event of contract dispute on the same basis as nationals.

### **C. Labor Market Segmentation**

The labor markets in the GCC countries are segmented along several dimensions: between public and private sectors, between nationals and nonnationals, and between skilled and unskilled labor. The extent of market segmentation is such that in some GCC countries (e.g., Kuwait and the United Arab Emirates), over 90 percent of nationals in the labor force are employed by the public sector. The segmentation of the labor market reflects a number of factors. Perhaps most importantly among them is the significant disparity in wage and nonwage benefits between the public and private sectors even for comparable skills, and between nationals and nonnationals employed in the same sector. Nationals and nonnationals of similar qualifications typically follow different career ladders, and certain positions are reserved for nationals even in the private sector. There are also marked dissimilarities in educational background, training, and qualifications between the national and nonnational labor.

Direct comparisons between private and public sector wages are difficult because of very dissimilar market structures between the two sectors and the lack of relevant data. It is hardly disputed, however, that wages in the government sector in most GCC countries are substantially higher than those in the private sector for comparable job content and skills. Moreover, in many cases, government workers receive guaranteed annual salary increments, and promotion through the public sector grade structure is virtually guaranteed for nationals in some countries. Even within the government sector, nationals command higher wages for similar grades, enter employment at higher levels, and move up the ladder faster. Wages for expatriate workers in the private and public sectors seem to be much more comparable across skill levels. The GCC countries' open border policies with regard to foreign labor have ensured the availability of a sufficient supply of labor at competitive wages at all skill levels.

In addition to high wages, the GCC nationals employed in the public sector benefit from generous family, housing, and transportation allowances, which together provide a significant income supplement. In some countries (e.g., Saudi Arabia), there are also incentives to continue training and education while on the job. Moreover, many

government institutions provide highly subsidized housing loans to national employees. Benefit packages in the private sector are generally less attractive, particularly at lower skill levels. Typical employment contracts in the private sector provide no family allowances and there are no provisions for formal training. Housing allowances or free accommodation are usually provided to unskilled expatriate labor, and in some cases, modest transportation allowances supplement the basic pay.

Pension benefits in the public sector—in some countries (e.g., Qatar and the United Arab Emirates) without contributions from employees during the years of service—and early retirement (sometimes after 20 years of service) are among the other chief attractions of government jobs. Bahrain, Oman, and Saudi Arabia have pension systems covering their nationals working in the private sector, but there is no social security coverage in the other GCC countries. For expatriate workers, end-of-service compensation is usually in the form of gratuity payments linked to years of service. Paid leaves are longer in the government sector, and shorter working hours allow many government employees to conduct private businesses after working hours. There are also important nonpecuniary benefits associated with government employment such as job security and social status.

The component of benefits provided to nationals in the government sector, which could be measured in monetary terms in many cases equals or even exceeds the basic salary, and all benefits put together significantly increase the reservation wages of nationals (i.e., the minimum wage for which they would be willing to work). The reservation wages of expatriate workers—reflecting their expected earnings in their home country, adjusted for the obligation to remit family support and save for investment on return home—are low and relatively even across labor-exporting countries, particularly those in Asia. Moreover, the shift in the geographical origin of expatriate labor over the past decade in favor of Asian workers appears to have effectively lowered the average cost of employing foreign workers. Additionally, free or highly subsidized availability of many services (e.g., utilities, education, and health services) in the host countries may have induced the expatriate workers to accept even lower wages in the GCC countries.

Market segmentation also arises from the mismatch between the qualifications of new entrants to the labor market and the requirements of the private sector even at the upper end of the market and at higher skill levels.<sup>9</sup> Consequently, highly specialized technical positions as well as low-skilled menial jobs are filled by expatriate workers, whereas nationals tend to gravitate toward administrative positions.

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<sup>9</sup>According to the Economic and Social Commission for Western Asia (1995), 38 percent of graduates from universities in the GCC countries completed studies related to social and Islamic studies, 34 percent in education (mostly women), but only 11 percent in business administration, and 18 percent in technical fields where private sector requirements are greatest.

#### **D. Employment Conditions and Prospects**

The lack of sufficient flexibility in the labor markets has been manifested in longer search periods and the growing evidence of tighter employment conditions for nationals. The scant information available on the unemployment situation in the GCC countries varies significantly across countries in terms of coverage, measurement, and currentness. At one extreme, open unemployment is believed to be almost nonexistent in Qatar. At the other extreme, the unemployment rate in Bahrain is reportedly in the range of 12–15 percent. The unemployment rates in the other GCC countries fall between these two extremes, with the rate in Oman being toward the upper end and the rates in the remaining GCC countries lying at the lower end of this spectrum. There is also strong evidence suggesting overstaffing in the public sector, contributing to underemployment of the national labor force.

Unemployment among nationals is still largely of a frictional and voluntary nature in most GCC countries. Those registered as unemployed include recent university graduates seeking government employment; job holders searching better paying jobs; and cultural factors and family ties limiting labor mobility, particularly among women. Nevertheless, in some GCC countries, unemployment is emerging as a more immediate economic and social concern, and virtually all GCC countries are facing the challenge of creating opportunities for productive employment for their nationals.

In those GCC countries where unemployment is a relatively recent phenomenon, the evolving supply-demand dynamics of the labor market suggest further tightening. (See Box 1, which provides an illustrative scenario of the evolving labor supply and demand conditions in the GCC countries.) More specifically, the rapidly growing supply of labor—reflecting both the high population growth and the rising participation rates—is outpacing the demand for labor, which is moderating due to slower economic activity and shifts in the structure of production. The situation is further complicated by the growing mismatch between the educational and technical qualifications of the new entrants and the skill requirements of the market. On the demand side, governments—the major employment outlets in the past—can no longer act as employers of first and last resort for efficiency reasons and because of the need to trim the high government wage bill (Chart 2). Also, given the traditionally strong link between public spending and domestic economic activity in the GCC countries, government expenditure restraint is affecting labor demand indirectly. At the same time, the private sector has not been able to pick up the slack because of labor market rigidities.

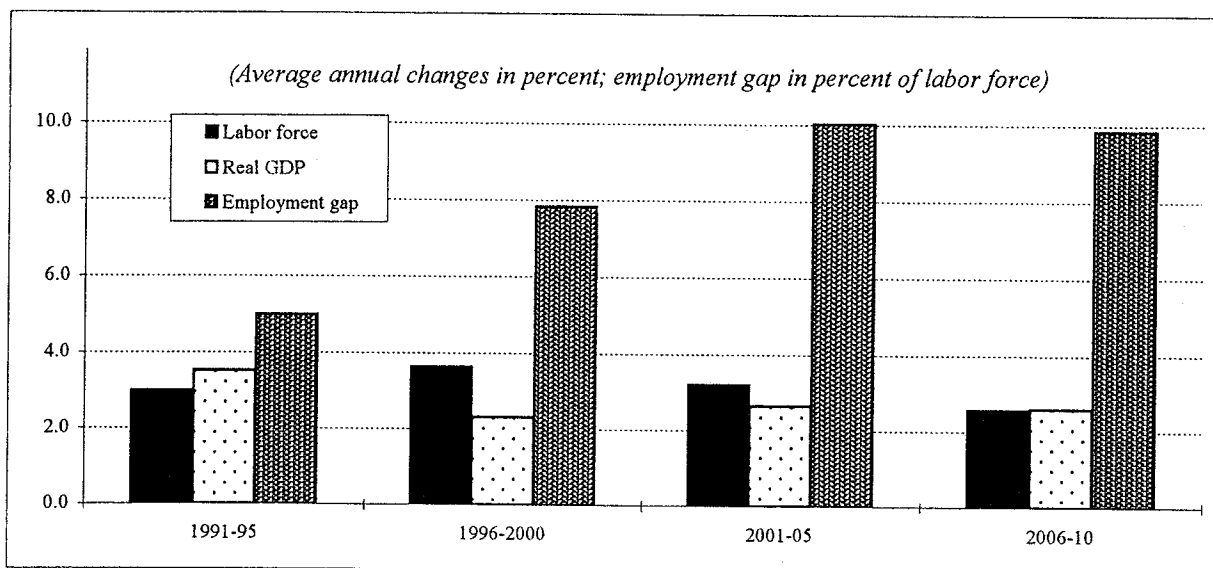
### **IV. Labor Market Challenges and Policies**

#### **A. Current Policy Approach**

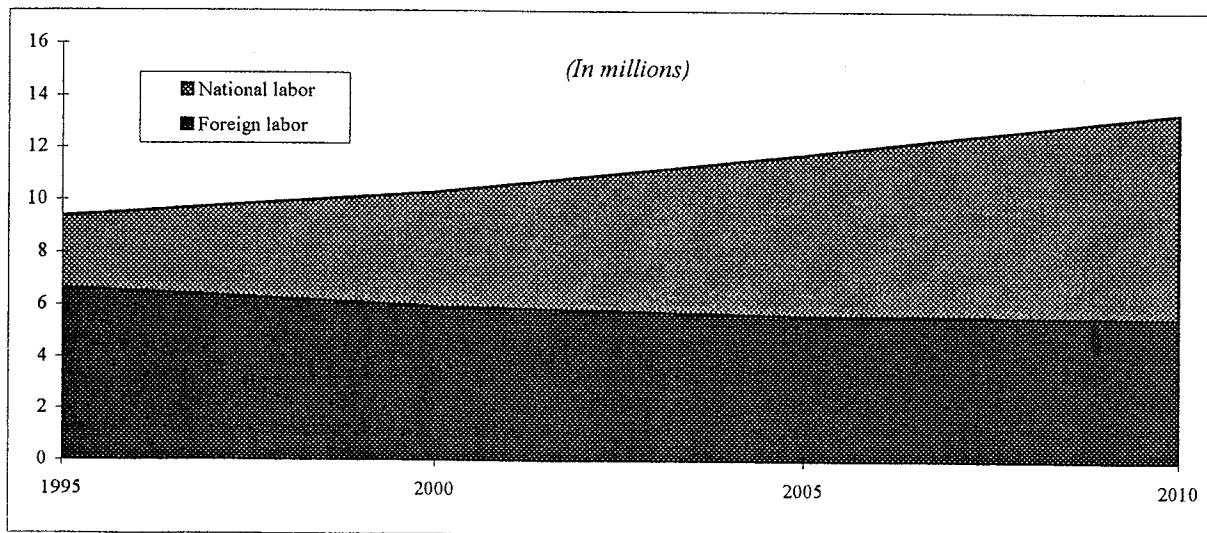
The prospects of tighter labor market conditions have already prompted a policy response in several GCC countries to facilitate the absorption of a large number of

### Box 1. Illustrative Labor Market Scenarios in GCC Countries, 1995–2010 1/

Illustrative scenarios based on simple labor demand and supply functions suggest tighter market conditions in the coming decade. Demand for labor would be affected by slower real GDP growth (2–3 percent a year) and moderate productivity gains. Supply of labor is projected on the basis of population growth, population age and gender profile, and small increases in labor participation rates. Net migration is assumed to be small. On this basis, the overall employment gap – defined as the ratio of the difference between supply and demand for labor to total labor force – would double to 10 percent in the first decade of the next century.

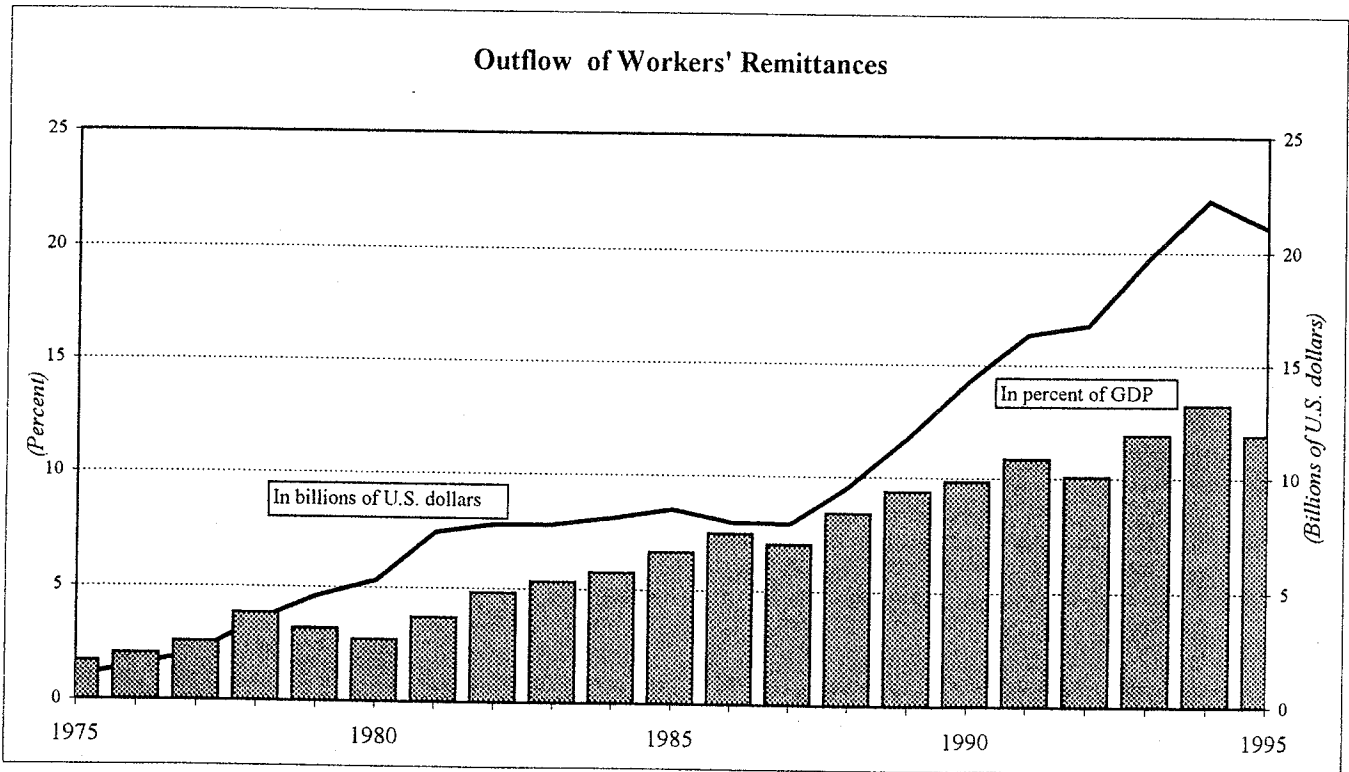
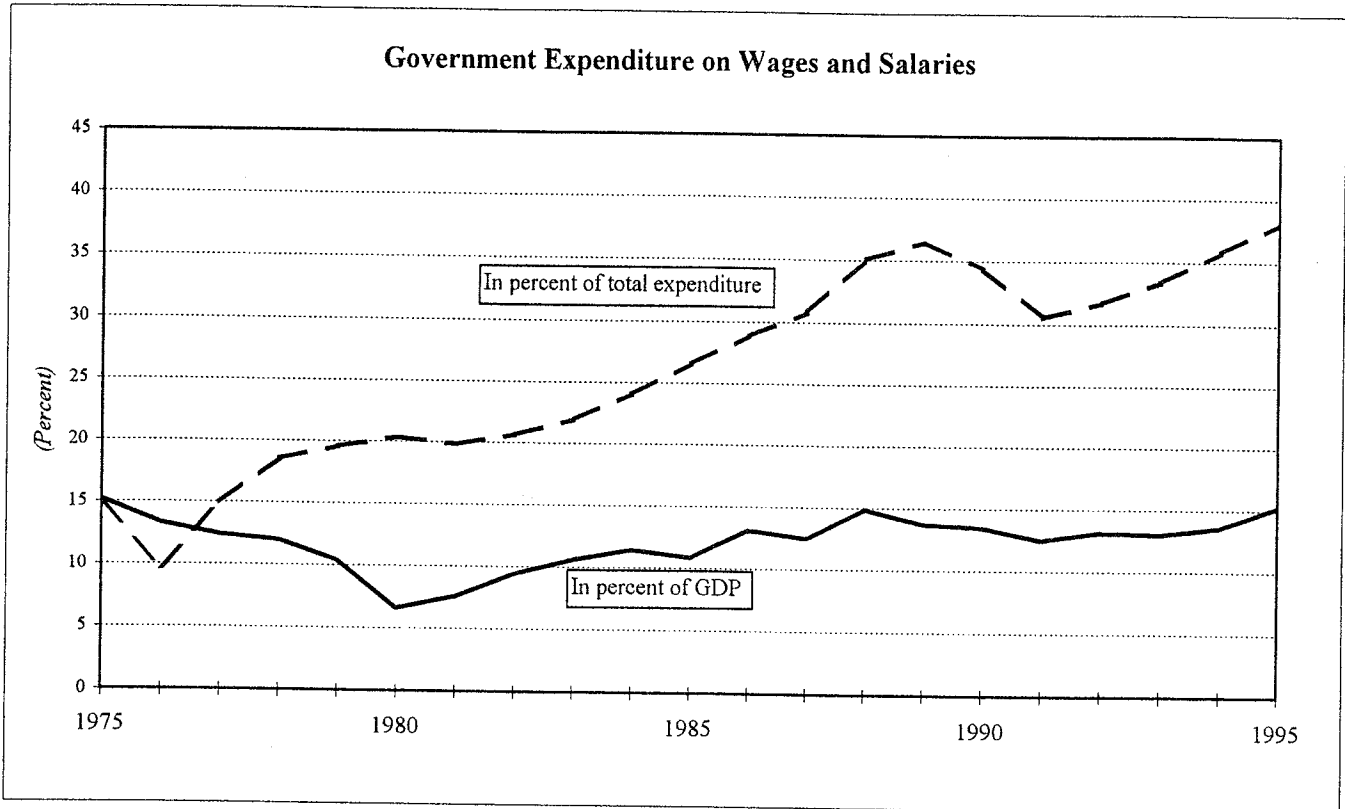


Employment opportunities for foreign labor could become more limited due to slower growth in overall employment and the labor substitution policies pursued by the GCC countries. Nevertheless, the GCC countries' reliance on foreign labor would still remain significant even if all new national entrants to the labor force find employment and foreign labor meets the residual demand.



1/ See appendix for details.

Chart 2. GCC Countries: Government Wages and Expatriate Remittances, 1975-95



Sources: IMF, *International Finance Statistics*; IMF, *World Economic Outlook*; and IMF staff calculations.