nationals expected to enter the labor force (see Box 2).[10] These policies have many common features. Most importantly, labor market policies are formulated within a broader framework of government expenditure containment and structural reforms aimed at increasing the economies' resilience to adverse oil market developments and enhancing efficiency by creating a more conducive environment for private sector activity.[11] With the recognition that in the period ahead, the responsibility for economic growth and job creation primarily rests with the private sector, policies are being defined in the GCC countries to facilitate the employment of nationals and increase labor market flexibility.

The policy instruments to achieve the employment objective have included measures that affect the quantity, price, and quality of labor. Measures influencing the quantity of labor include quotas and targets on employment of nationals and the regulation of the foreign labor force through administrative means. The relative prices of national and foreign labor are being influenced by government wage policy, direct wage subsidies to private sector, and fees and charges on foreign labor. At the same time, the quality of national labor is being upgraded by proper education and training. Moreover, measures are being implemented to increase market efficiency by facilitating labor mobility in the private sector.

a. *Selective employment policy*

In almost all GCC countries, the traditional liberal employment policy in the government sector is gradually being replaced by a more selective recruitment policy to reduce overstaffing, which has emerged as a major problem in many government departments and organizations. Moreover, many vacancies in the government sector remain unfilled, qualifications for new recruits are being tightened, and early retirements and dismissals for inadequate performance are becoming more common. Labor shedding—always a socially sensitive issue—has also become a policy option in some countries. In Oman, as part of a broader policy, the government has launched an ambitious retrenchment program to retire some one-fourth of Omani civil servants over the 1996–98 period, and the number of expatriate civil servants was reduced by 7 percent in 1996 alone. Efforts are also being made to place expectations regarding future employment opportunities on a more realistic footing. Several GCC countries have formally announced that job openings in the public sector are likely to remain very limited and that job seekers should look toward the private sector. In Bahrain, the government has indicated that under

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[10]In Kuwait, government estimates suggest a net flow of about 10,000 of job applicants a year during the next five years. The number of young Bahrainis entering the workforce in the coming years is officially estimated in the range of 4,500–6,500 a year. In Oman, the number of graduates seeking employment is officially projected at 17,400 a year during 1991–2000. Saudi Arabia's Sixth Development Plan estimates the total number of young Saudis entering the labor market at some 660,000 over 1995–2000.

[11]El-Erian and Sassanpour (1997) discuss the evolving nature of macroeconomic challenges and strategies in the GCC countries.

Box 2. GCC Countries: Labor Market Reform Programs

Bahrain. *The Bahranization program* established in 1988 was the earliest formal labor market strategy launched by the GCC area to create employment opportunities for nationals The current program seeks to provide 6,000 additional jobs a year for Bahrainis by requesting firms to increase employment of nationals by 5 percent a year until one-half of their labor force are Bahrainis. At the same time, the Human Resource Development Support Program introduced in 1994 seeks to promote the employment of Bahrainis in the private sector by offering financial incentives to small- and mid-sized firms in the manufacturing sector that employs at least 30 percent Bahrainis and meet certain other criteria.

Kuwait. The *Five Year Plan (1996–2000),* currently under consideration by the National Assembly, targets to creation of 10,000 jobs a year for Kuwaitis during the next five years raise the share of nationals in the labor force to 25 percent. Policies to achieve these objectives include raising the cost of expatriate labor, limiting employment of nonnationals in certain businesses and activities, and upgrading the skill levels of nationals.

Oman. The current *Five Year Plan (1996–2000)* sets labor market policies with the aim of providing 17,400 new jobs a year and increasing the proportion of national labor in the total labor force from 36 percent to 42 percent. Moreover, *National Vocational Qualification Program* launched by the government in 1995, and financed taxes on expatriate workers, aims to improve the skill levels of Omani nationals.

Qatar. Unemployment is virtually nonexistent in Qatar and there is no formal labor market strategy.

Saudi Arabia. The *Sixth Development Plan (1995–2000)* sets to create 319,500 jobs and reduce the number of non-Saudi workers by an average of 1.5 percent a year through a combination of incentives and target, including financial support to firms committed to training nationals; minimum targets for employment of Saudis; restrictions on employment of skilled and semiskilled workers; and a national information campaign. In April 1995, all private sector establishments with more than 20 employees were required to increase their Saudi workforce by no less than 5 percent annually and to ban hiring non-Saudis in certain job categories.

United Arab Emirates. There are no formal plans covering the federation, but the *Dubai Strategic Development Plan (1996–2000)* aims to increase the share of nationals in the Emirate's labor force from 7 percent to 10 percent by raising labor force participation and facilitating the employment of nationals in the private sector. The government supports vocational and technical training and chambers of commerce internship programs for nationals.

the current plan (1996–2000), the private sector would account for 80 percent of new job creations.

b. ***Wage restraint***

Fiscal consolidation in several GCC countries has required exercising wage restraint in order to contain the large government wage bill. In Kuwait, wages have been frozen for some time, and wage increases awarded in 1996 to government employees in Qatar and the United Arab Emirates were the first such adjustments in many years. Although the government wage structure is being adjusted upward less frequently and more moderately, annual salary increments are being paid almost automatically and nonwage benefits and allowances have increased in some cases.

c. ***Quotas on employment of nationals***

Quotas or targets on employment of nationals have been in existence in most GCC countries for many years, but rarely enforced until recently. In most cases, quotas specify a minimum number or ratio of nationals to be employed in private sector establishments, and in some cases eligibility for securing government contracts is linked to such a requirement. In Kuwait, private sector industrial establishments are required to have nationals representing at least 25 percent of their total employment (Industrial Law No. 6 of 1965). Consideration is also being given in Kuwait to award government contracts only to those domestic firms in which 40 percent of the labor force is composed of nationals, earning a combined salary of no less than 40 percent of the firm's total wage bill. In Saudi Arabia, the number of nationals employed in private establishments should not be less than 75 percent of the work force and their wages not less than 51 percent of the total wage bill (Article 45 of the Labor and Workman Law of 1969). In Bahrain, new establishments employing 10 or more workers are required to have 20 percent Bahrainis in their work force. In Oman, a ministerial decree in 1994 set sectoral targets on employment of nationals for firms with more than four workers. In the United Arab Emirates, there are indicative targets on the share of nationals employed in the banking sector.

d. ***Regulation of foreign labor through work permits***

Some GCC countries have placed limits on issuing work permits to regulate employment in certain sectors and even in some occupations. Such measures are intended to regulate the market in certain low-skill activities (e.g., construction and farming) where surplus labor has emerged; and to encourage employment of nationals in areas of higher skill (e.g., banking, insurance, legal, and other services) by keeping wages high. In Kuwait, work permits issued to foreign workers are confined to selected activities in the private sector (1994 Amendment 107 to the Labor Law). Saudi Arabia has similar sector-specific restrictions on issuing work permits. In Oman, there are annual overall and regional ceilings on the number of new foreign workers. Compliance with the terms and conditions of work permits is also being enforced more tightly in most GCC countries. In the United

Arab Emirates, under a general government amnesty program, some 150,000 foreign workers without proper work authorization left the country by the end of 1996. In mid-1997, the government of Bahrain requested foreign workers without valid work permits to leave the country within a period of three months. A similar amnesty program was also announced by the Saudi Arabian government in July 1997.

e. *Direct subsidies*

In some GCC countries, cash benefits and wage subsidies are being offered to private sector establishments to encourage them to employ more nationals. In Bahrain, the government provides payments of up to BD 1,000 a year to midsize private manufacturing firms, which maintain 30 percent of the Bahraini workforce. In Kuwait, consideration is being given to provide social allowances from the government budget to all nationals working in the private sector in order to increase the attractiveness of private sector employment.

f. *Raising the cost of foreign labor*

Most GCC countries have imposed various fees and charges on expatriate workers and their families. Almost all countries have fees for issuing and renewing visas and work permits for foreign workers; in some recent cases (e.g., Saudi Arabia), these fees have been raised substantially. Kuwait has imposed a flat fee on hiring domestic servants. In Oman, the fee for issuing a work permit is set at 7 percent of the annual salary of the foreign worker and the proceeds are earmarked for training nationals. In addition to raising the cost of foreign labor, such fees and charges act to defray part of the administrative cost of processing and issuing entry visas and work permits, and have been viewed as a form of taxation of foreign labor for the use of free or highly subsidized public goods in the host countries. In some countries, the expatriate workers make nominal payments for using government health services and in the United Arab Emirates and Qatar, foreigners are subject to higher electricity and water tariff rates. Nevertheless, in all GCC countries, foreign workers continue to be exempt from income taxes and other direct taxes on the same terms as nationals.

g. *Education and vocational training*

All GCC countries recognize the central role of education and training in their labor replacement policies. Part of the skill deficiencies of nationals is being addressed by vocational training and by on-the-job and in-house training. In Oman, a national program on vocational training is being managed by the private sector and financed through taxes on the private sector, as mentioned earlier. Saudi Arabia's Five-Year Development Plan sets out specific targets for general and higher education, and for technical and vocational training as a part of its human capital development objectives. In the United Arab Emirates, school curricula have been revised to focus on vocational training, and local governments and chambers of commerce are providing training and internships financed from their own resources.

h. *Increasing labor mobility*

In parallel with measures aimed at facilitating the absorption of nationals in the labor market, some GCC countries have taken steps to increase market efficiency by increasing the mobility of expatriate workers between jobs in the private sector. Regulations in Saudi Arabia allow transfer of sponsorships subject to certain conditions. In 1995, Oman allowed expatriate workers to move between sponsors, subject to the approval of the original sponsor, without first leaving the country as had been the requirement earlier. Similarly, in early 1997, the United Arab Emirates permitted transfer of sponsorships between employers after one year of service subject to approval of the employee as well as the new and the original sponsors. Moreover, expatriate workers in selected trades and professions in the United Arab Emirates were allowed to hold a part-time job or a full-time job with another employer for a period of up to six months.

B. Parameters of a Labor Market Strategy

Policymakers in the GCC countries recognize the importance of sustained economic growth for generating employment opportunities. Growth and development strategies are being formulated consistent with the countries' comparative advantages and resource constraints, and policies correctly stress the role of the private sector as the principal source of employment creation in the future. Linkages between the labor market and private sector activity run in both directions: a more efficient labor market would contribute to economic growth, which would in turn support job creation. As such, broadening the role of the private sector would also need to consider policies that would involve transfer of responsibility between the private and public sectors, including those related to deregulation and privatization.

Labor market measures already adopted or being considered in the GCC countries range from market-based strategies (e.g., wage and employment restraint, increasing labor mobility) to mandatory and administrative policies (e.g., quotas on employment of nationals, market regulation through work permits). In between there is a mix of other measures (e.g., taxation of foreign labor, direct employment subsidies) intended to achieve the same objectives. An effective strategy to reduce labor market segmentation and improve market efficiency would need to consider: (1) determining wages and benefits on the basis of market conditions; (2) minimizing market distortions; (3) limiting mandatory employment policies; and (4) improving human capital. A menu of mutually consistent and reinforcing options to achieve these objectives would include the following.

- *Terminating the de facto or de jure policy of guaranteed government employment to nationals.* A commitment to provide gainful employment opportunities for nationals, as legislated in most GCC countries, should not be interpreted as a policy of guaranteed government employment. Reducing total government employment in a phased manner through attrition, elimination of vacancies, and trimming redundant workers would send a clear signal that the government can no longer be viewed as a source of permanent employment. Over time, this would reshape the expectations of nationals, alter their educational objectives and priorities, and together with measures to reduce relative wage and benefit disparities, encourage them to seek employment in the private sector.

- *Reducing disparities in incentives between public and private sectors.* In principle, wages in all sectors and activities should reflect market conditions and the scarcity value of the labor, and the incentives associated with allowances and benefit packages should be neutral across sectors. As nominal wage cuts are likely to prove difficult, correcting the misaligned wage structure would mean, in practice, allowing public sector wages to erode gradually in real terms over time. Moreover, in some countries, the existence of minimum wages for nationals has increased the incentive for hiring nonnationals. This disincentive could be eliminated by removing the minimum wage requirement for nationals or, as the second best solution, by extending its coverage to nonnationals.

As regards nonwage benefits, it should be feasible socially—and justifiable economically—to reduce, restructure and better target various income supplements and allowances that are being provided to public sector employees. On a broader level, the real challenge is to separate social welfare policies manifested in benefit packages from strict wage policies. A bold and far-reaching approach—though administratively difficult—would involve replacing allowances currently provided only to nationals in government employment with a smaller social cash benefit package payable to all nationals employed in the public and private sectors. This would eliminate a major incentive associated with government employment and should not burden the budget excessively at this stage, given the relatively small share of nationals working in the private sector. Moreover, direct income transfers of this nature would allow a restructuring and eventual phase out of other subsidies and transfers provided to nationals.

A major disincentive for working in the private sector could be corrected by introducing an unemployment insurance scheme and a pension system funded by contributions from employers and employees.[12] Ideally, the coverage of pension benefits would need to be extended to expatriate workers in order to remove the disincentive of hiring higher-cost nationals. Other considerations would include narrowing the gap between the public and private sectors with regard to working hours, paid leave, and other related benefits.

- *Phasing out mandatory employment quotas for nationals*. Establishing employment targets for nationals in relation to the total labor force or for specific sectors and activities would provide useful indicative guides for governments' labor replacement policies, but mandatory quotas could be counterproductive in the long run in the absence of downward flexibility of wages. Under a quota system, employers are likely to hire nationals at lower skill and pay levels to meet the prescribed targets, thus defeating the initial purpose of providing opportunities for the national labor at higher skill levels. Quotas are also likely to be resisted by private sector employers who lose employment

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[12]The pension system in Bahrain provides similar benefits to nationals working in the public and private sectors.

flexibility and may have to pay higher wages. This would contribute to underemployment of labor and by adversely impacting the firms' competitive position would tend to undermine the authorities' broader objective of promoting private sector activity. As a general rule, private sector employers should have sufficient flexibility to hire the most qualified labor—both national and expatriate—at market wages in order to maintain competitiveness.

- *Facilitating labor mobility across sectors and activities.* The existing system of hiring expatriate workers under the sponsorship of nationals, which is the practice in all GCC countries, has two major shortcomings: first, it creates rent-seeking opportunities, which could be easily exploited by potential sponsors; and second, it provides no or, in some cases, only limited scope for moving between sponsors and jobs. It is also not cost effective because in most cases, labor can only be hired from abroad at a higher initial installation cost when it would be more economical to tap the existing labor pool at home. Moreover, all other things equal, potential employers are likely to hire, train, and retain expatriate workers rather than nationals who could easily move to higher paying jobs after training. Allowing expatriate labor to move between sponsors and jobs—subject to compensation for initial installation costs and other arrangements agreed between sponsors—would increase the efficiency of the labor market by channeling labor to its most productive uses.

- *Requiring expatriate workers to pay for government services.* Imposing or raising fees and charges on expatriate labor would not, in itself, help the integration of the labor market. It also raises other issues and considerations: such fees may be absorbed by either the employer or the employee or both, and be reflected in higher final output prices and/or in reservation wages. Typically, the extent of disparity between the reservation wages of nationals and nonnationals in the GCC countries is such that higher fees and charges on expatriates could not close the gap to any significant extent without compromising the competitive position and the cost structure of the economy. Nevertheless, such fees and charges would act to internalize some of the costs associated with hiring expatriate labor. Reasonable fees and charges on expatriate labor could be justified—and indeed warranted—as partial compensation for free or heavily subsidized goods and services provided by the GCC governments to all residents, including expatriate workers. In the absence of other forms of direct taxation, the challenge is to strike the right balance between partial payments for government services and the impact of higher fees and charges on cost competitiveness of the economy.

- *Financial incentives to private sector employers for hiring nationals.* As an inducement for hiring nationals, consideration is being given in some GCC countries to providing wage subsidies to private sector employers, typically on a declining scale to be phased out over a relatively short period of time. Such direct incentives aim to close the gap between the public and private sector wages without significantly increasing the wage cost of the employer, and to finance on-the-job training. Over time, it is argued, labor productivity gains would be matched by higher contributions from the employer toward wage payments, thus allowing a phase-out of government financial support. Direct wage subsidies may offer a strong and immediate incentive for hiring nationals—particularly if there are employment quotas in effect—but would be potentially costly and difficult to monitor. Moreover, it would not guarantee employment at the end of the subsidy period and is subject to misuse. From a practical point of view, it would probably be more efficient for the government to fund internships and on-the-job training organized and conducted by potential private sector employers without any direct linkages to salaries and employment.

- *Reorienting education and training programs*. Labor market policies would be reinforced by efforts enhancing human capital development through proper education and training programs geared to the future job requirements of the economy. Specifically, policies should stress vocational and technical training to respond to the skill demands of the private sector, and encourage creativity and productivity at all skill levels.[13] The experience of a number of dynamic and competitive economies in Asia shows that investment in education and training result in high private and social returns; invariably, highly competitive economies are supported by a cadre of trained and highly skilled workers. To be effective, national training programs require close coordination between the governments and employers in the private sector with respect to the goals, management, and financing of training (see World Bank, 1995).

- *Creating an information bank on job seekers*. In most GCC countries, government agencies (usually ministries of labor and civil service commissions) maintain a registry of national job seekers and attempt to match them with vacancies in the government sector. The private sector typically relies on market information network to advertise its vacancies and meet its labor demand. Other government agencies (usually ministries of interior and immigration authorities) maintain information on expatriate workers on the basis of visas, work permits, and sponsors. One of the problems contributing to the segmentation of the labor market is the insufficient information flow between the different markets. As such, the availability of up-to-date and complete information on job seekers and potential employers in the public and private sectors would be an important element of an efficient labor market clearing system. A national data bank could be created with the purpose of matching national job seekers with the available positions in the private sector.

V. Labor Market Policies of the GCC Countries in a Regional Context

The labor market provides the strongest economic link between the GCC and the other countries in the MENA region; in contrast to sizable flow of workers' remittances

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[13]Among the countries in the MENA region, Egypt and Morocco have had favorable experiences with vocational training programs that are providing a viable alternative to higher education and are meeting the economies' demand for technical workers. In Morocco, a payroll tax on employers is financing vocational training. See World Bank (1995).

(Chart 2), interregional trade and investment flows are less significant.[14] The GCC countries have significant natural resources and surplus of capital but scare labor resources. Most other MENA countries are labor rich but have limited natural resources and capital. In principle, such large disparities in resource base between the two groups of countries would offer significant potentials for economic integration and gains from trade. In practice, however, the degree of economic integration between the MENA countries has been modest because of differences in policies and the relative openness of the economies.[15] More specifically, the inward-looking policies pursued in the past by many labor-abundant MENA countries inhibited the development of competitive export industries at the time when the GCC countries with their open trading systems were establishing trade links with countries outside the region. For these reasons, economic integration within the MENA region took hold not through the more traditional trade links, but rather through labor movements, which were actively encouraged by the labor surplus countries and made possible by the open employment policies of the GCC countries.

The outflow of workers' remittances originating from the GCC countries is a major source of foreign exchange earnings in a number of labor-surplus MENA countries and an important source of financing private sector investment and consumption spending in these countries.[16] In addition to providing family support, workers' remittances have traditionally financed small-scale private investments (mostly in construction) in the recipient countries.

Employment opportunities in the GCC countries for labor from the other countries in the MENA region are becoming more limited. As indicated earlier, the pace of economic activity is leveling off in part due to the weakening growth impulse from the oil sector and initial impact of expenditure restraining policies being pursued by many GCC governments. More directly, as discussed earlier, labor substitution is taking place at two levels: (1) employment policies of the GCC countries are geared toward gradually replacing foreign labor with domestic labor; and (2) labor from Asia is increasingly replacing labor from the other countries in the MENA region. Workers from the MENA region are mostly employed in mid- to highly skilled technical and administrative positions—positions most likely to be replaced by nationals—but nationals are less likely to accept the less-skilled positions currently filled by Asian workers.

The prospects of reduced employment opportunities and a more moderate wage growth in the GCC countries suggest lower remittance flows that, in addition to a direct balance of payments impact, would affect investment and growth in the recipient countries.

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[14]The other countries in the MENA region accounted on average for 2–3 percent of total GCC merchandise trade during the period 1991–94. Moreover, only a few countries in the MENA region accounted for a significant share of trade with the GCC. See Sassanpour (1996).

[15]This issue is articulated by Shafik (1996).

[16]During 1992–95, workers' remittance averaged 13 percent of GDP in Egypt, 18 percent in Jordan, and 23 percent in the Republic of Yemen. In relation to total external current receipts, the shares were 24 percent in Egypt, 26 percent in Jordan, and 40 percent in the Republic of Yemen.

The challenge in the period ahead is to seize on opportunities being created to strengthen economic linkages within the MENA region through expansion of trade and investment.[17] Specifically, the ongoing economic and structural reforms in a number of MENA countries hold the promise of strengthening their trade links with the GCC countries. Moreover, in a number of countries in the MENA region, the simplification of investment laws and removal of barriers to the entry of private capital offers the GCC countries opportunities for increased investment.

VI. Concluding Remarks

Policymakers in the GCC countries have correctly identified labor market issues as one of the key policy challenges—not only in those countries where unemployment is more of an immediate economic and social concern, but also in countries where there is presently no apparent unemployment but where strains are emerging. Also important has been the recognition by GCC policymakers that labor market issues are closely linked to other structural policies related to economic efficiency and the division of responsibility between the public and private sectors. As such, policies to increase the flexibility of the labor market are being defined in the context of a broader framework also including fiscal consolidation and structural budget reforms, deregulation, and privatization. In the context of an uncertain oil market outlook, these policies are intended to increase the resilience of the GCC economies and help sustain non-oil sector growth based on private sector initiative. Indeed, the considerable downside risk in oil prices and the long gestation period for most structural reforms call for an early start at reforms.

Labor market issues in the GCC countries are largely of a long-term structural nature. Employment quotas on nationals, restrictions on foreign labor, and administrative directives 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. Correcting the segmentation of the labor market and creating employment opportunities for nationals would require a mix of measures aimed at increasing the market responsiveness of incomes and employment policies and minimizing the distortions created by government benefit packages. None of these measures would—or indeed should—substitute for human resource development, which aims to match the skill profile of the national labor with the present and future requirements of the private sector.

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[17]See IMF (1996) for a discussion of issues related to economic integration between the countries in the MENA region.

Appendix. Illustrative Labor Market Scenarios in GCC Countries, 1995–2010

Supply of Labor

The supply for labor is projected on the basis of the World Bank estimates of working age population (World Development Indicators CD-ROM, 1997) and staff estimates of labor participation rates by gender. Relative to the working age population, participation rates are assumed to remain constant for males, but increase slightly for females (see table below). Formally,

Labor supply = (working age population) x (participation rate of the working population)

	1996–2000	2001–2005	2006–2010
Participation rate (male)	92.0	92.1	92.1
Participation rate (female)	22.3	22.7	23.0

Labor Demand

The labor demand is projected separately for the oil and non-oil sectors based on sectoral real GDP growth (see table below) and output per worker. On the basis of 1995 data on employment in the oil and non-oil sectors, the base year output per worker is calculated. It is assumed that output per worker grows by 0.5 percent a year in the oil sector and by 0.7 percent a year in the non-oil sector during the projection period. The total demand for labor is the sum of labor demand in the oil and non-oil sectors. Formally,

Labor demand by sector = (real GDP) / (real output per worker)

	1996–2000	2001–2005	2006–2010
Real oil GDP growth	1.1	0.8	0.7
Real non-oil GDP growth	3.0	3.5	3.4

Employment Gap

The employment gap is defined as the difference between labor supply and labor demand divided by labor supply.

Demand for Foreign Labor

The demand for foreign labor is the residual between the total demand for labor (described above) and the supply of national labor, thus assuming that all new national entrants to the labor force find employment first. Using the 1995 data as a base, the projected increase in the national labor force reflects the increase in the total labor supply (described above) adjusted for net migration.

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