

WORKING FOR THE FUTURE OF SAUDI ARABIA: LABOR MARKET REFORM

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Abstract: The Kingdom of Saudi Arabia has a persistent human capital problem which manifests itself in high unemployment and a low share of nationals in the labor force. The Saudi government has long tried to address this with little success. The plans for diversification of the economy increased the vigor of reforms and obtained some tangible results. Nonetheless, for the future success of reforms, the government needs to change the country's social contract along with citizens' mindset. Without political reform, such a complete fundamental change does not seem realistic. Nevertheless, there are interim goals that would mitigate the concerns for the economy's future.

Introduction

While the global clean energy transition progresses, the Kingdom of Saudi Arabia (KSA) is still struggling to make the necessary reforms to prepare its economy for the post-oil world. The most important realm for these reforms is in the labor market, focusing on improving human resources in the kingdom. The recent reforms aimed at diversifying the economy sparked a lively debate on the future of the country's labor market. The Kingdom faces several challenges to accomplish the transformations it needs to make to survive in the post-oil world. In particular, the inefficiencies associated with human resources in the country present the toughest challenge to the rulers. There is huge youth unemployment and a skill mismatch between workers and firms. The quality of public education is one of the lowest in the world which raises citizens who are underprepared for the labor market. This leads to a very high share of foreign nationals in the labor market.¹ The Saudization policies tried to address this by imposing quotas on hiring nationals, a usual tactic used in resource-rich countries. Although these policies have increased the share of Saudi nationals in the labor force in the private sector from 9% to 22%, they produced unintended consequences harmful to the economy such as decreasing the total employment and volume of exports. These policies did not address the underlying problems related to the skill mismatch between workers and firms.

The Vision 2030 strategy framework has addressed these underlying problems successfully and increased the vigor of reforms. Although Saudi policymakers are determined to fundamentally change the country's economic conditions under this framework, there are serious roadblocks in the way of a significant transformation. The ambitious goals set by the government are not likely to be reached anytime soon. Likewise, the absence of political reforms would preclude this paradigmatic shift in the country's social contract. Nevertheless, the government is in a unique position to implement a gradual reform agenda to create a more diversified portfolio of jobs and change cultural attitudes toward the labor market. Although there are mixed results so far in these two tracks, the government's determination to push for serious reform will be very critical for the country's stability in the post-oil world.

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This article first describes the country's human resource problem and evaluates the policies directed to this problem. The following section discusses the recent attempts to reform human resources under the strategic framework of Vision 2030. Finally, the paper ends by analyzing political bottlenecks facing the human capital reform and discussing future scenarios using two indicators to judge the reforms' relevancy.

The Human Resource Problem

The Kingdom of Saudi Arabia with its vast oil reserves has long been at the center stage of a world highly dependent on oil. Today, however, with the impending rise of the post-oil world, the country struggles to adapt to the new conditions. There is one surprising factor that complicates things: the legacy of abundant oil. The discovery of oil changed the country from a subsistence economy in the beginning of the twentieth century to today's prosperous economy. Yet, researchers claim that it has also created a rentier state where the dominance of rent-based economic activities leads to a change of mentality among citizens, known as a "rentier mentality."² Earning income through rent instead of work breaks the link between effort and reward and corrupts the work ethic. KSA along with other Gulf countries are considered as the primary examples where "rentier mentality" is exhibited.

Several factors contribute to this outcome in the KSA. First, oil has shaped the country's social contract whereby Saudi citizens previously enjoyed no tax on economic activities along with important subsidies. This suppressed their political demands and gave legitimacy to the Al-Saud family. Secondly, given the prosperity from oil wealth, productive economic activities were less attractive for Saudi citizens. This led to an economy that was highly dependent on oil where the petroleum sector accounts for roughly 64% of budget revenues, 25% of GDP, and 77% of export earnings.³

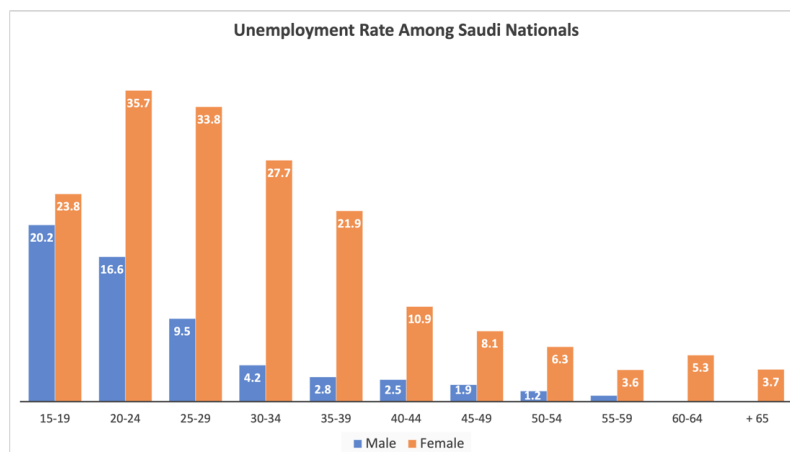


Figure 1: Unemployment Rate for Different Age and Gender Groups

Source Labor Market Q2 2021, General Authority for Statistics

One of the most severe adverse effects of the rentier mentality is manifested in the human resource problem, which forms a vicious circle. Before the oil boom in the 1970s, there was not enough labor or human capital to build the economy with the oil revenues leading the government to allow firms to hire foreign. As such, wealthy citizens benefited from the cheap labor and those Saudis who needed jobs were mostly hired in the public sector as a mechanism for the oil wealth's redistribution. Only recently, this strategy was aborted due to the realization that population growth exceeded the growth in oil revenues, making this strategy no longer feasible.⁴

After the 2010's, the government has changed its strategy to focus more on job creation for citizens and increasing the country's human capital. This did not change the fundamentals of the labor market where private-sector jobs are dominated by foreign labor. Surveys show that firms do not want to hire Saudi nationals due to their higher wage expectations and lower skills.⁵ The high level of spending on higher education has also not manifested in the labor market, judging from an 18% unemployment rate amongst bachelor-holders. The Harvard EPoD report summarizes this as a mismatch between the skills acquired by students and those demanded by potential employers.⁶

Labor Market Reform Attempts Before Vision 2030

The Saudi state started a big push for Saudization of the labor market with the launch of the "Nitaqat" ("phases" in Arabic) program in 2011. While there were also policies to increase Saudi participation in the labor force before this program, such as determining Saudization goals and increasing the fee for recruiting expatriates, none of these were comparable to the scope of the *Nitaqat* program and often not enforced strictly. With this program, the government put quotas for Saudi nationals depending on the sector and size of the enterprise. Those enterprises below these quotes could not sponsor additional visas for foreigners and the visas for their existing foreign workers were not renewed. In short, *Nitaqat* was designed to be implemented gradually to increase the share of Saudi nationals depending on the sector.

The program was unique in terms of its size and scope, and certainly had a great impact on the trajectory of the Saudi economy. It created jobs for Saudi nationals and successfully increased the Saudi national share of the labor force in the private sector from 9% to 22%.⁷ But it came with

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an expensive cost. Peck (2017) suggests that the policy caused the closure of many firms and decreased the surviving firms' total employment.⁸ Moreover, it also increased 'ghost Saudization' whereby Saudi nationals were paid without working in order to fulfill quotas.⁹ Even though the government recently reinforced the program's application,¹⁰ this had an important negative effect on the mentality of Saudi nationals whereby they could earn money solely by virtue of their citizenship. It had also decreased two critical revenue sources: it lowered the rent occupancy and fees for sponsorship. All of these point out the fact that the share of foreigners is a symptom of a bigger failure in human capital. Addressing the symptoms before treating the underlying causes could create other unforeseen problems as demonstrated by this case.

An important step to improve human capital was taken with the expansion of government scholarships for studying abroad. The number of students who were sent abroad increased significantly with the introduction of King Abdullah Scholarships in 2004. In 2021, 130,000 students were funded which costs around \$2.4 billion, a significant portion of the education budget.¹¹ There is not much data on how the recipients of scholarships fared in the Saudi job market and whether their skills were utilized sufficiently. The anecdotal evidence suggests that they may be overqualified for many jobs and did not fundamentally change the job market. But the army of international graduates with its growing size has the potential to create important changes in the future.

New Approach to the Human Capital Problem

Under the rule of crown prince Muhammed bin Salman (MBS), Saudi Arabia has launched an ambitious plan, Vision 2030, for the economy's diversification and the transition to the post-oil world.¹² Vision 2030 strategy has demonstrated the Saudi state's determination to reform the labor market, and has substantially increased the speed of human capital reform.

The Kingdom of Saudi Arabia Vision 2030 strategy document identifies the key sectors for diversification of the economy and projects significant investments in these sectors.¹³ Certainly, an important factor for the success of these investments is the availability of skilled human capital. This document, therefore, sets out a new agenda for implementing economic and cultural reforms to decrease unemployment among women and young people and increase skilled labor.

In order to build skilled labor in the country, the National Labor Gateway (*Taqat*) was established to determine skills and knowledge required for different sectors and provide vocational training.

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Moreover, the “*Sajfi*” internship program for training Saudi students was made mandatory for all firms with 25 or more employees.¹⁴ More stringent policies were enacted under the framework of “*Nitaqat*” to ramp up Saudization rates.¹⁵ However, the new reforms being enacted to attract skilled foreigners deviate from the playbook of *Nitaqat*. This is indicating a new policy for changing the nature of foreign jobs from low-skilled jobs to high-skilled ones to attract foreign talent, a strategy echoing the Dubai model. In this direction, Premium Residency, or the so-called Saudi Green Card, enables entrepreneurs and high-skilled workers to get permanent residency without requiring a sponsor firm.¹⁶ Cultural reforms for allowing Western lifestyle are also partly aimed towards attracting foreign talent.¹⁷

Increasing female participation in the workforce is another strategic priority. The government implemented important policies for encouraging female employment under Vision 2030. One of the most popular reforms was lifting the driving ban for women.¹⁸ National Labor Gateway (*Taqat*) also created programs for subsidizing transportation and childcare for female workers. It has also started to provide training and mentorship during the job-seeking processes. As Figure 2 shows, there has been a strong increase in the female labor force participation rate over the last few years, hinting at the pace of the reforms.

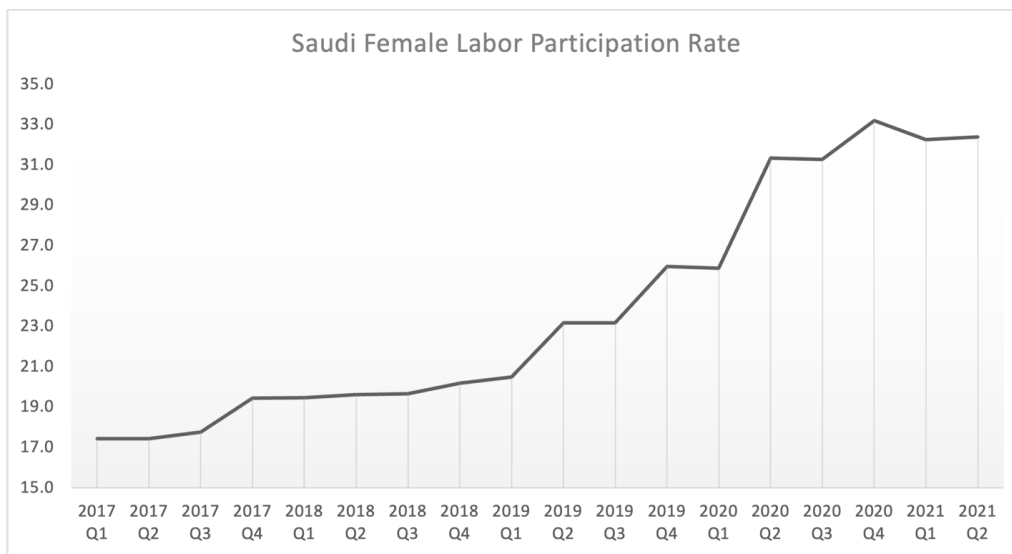


Figure 1: Female Labor Force Participation Rate for Saudi citizens (% of female population ages 15-64)

Source Labor Market Q2 2021, General Authority for Statistics

Political Economy of the Labor Market Reform

Vision 2030 aims to change the foundations of the labor market and along with it the attitude of Saudi workers towards the job market. The Vision program encourages people to get the necessary skills and training for competitive private sector positions rather than seeking lucrative public sector positions. One of the important challenges to this lies in the reform of increasing the attractiveness of the private sector job market. Saudi nationals greatly prefer public sector jobs due to the higher wages and job security. The government plans to increase the private sector’s share in the economy and the labor

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market would entail reducing the relative advantage of the public sector against the private sector. For this purpose, sizeable funds were made available to finance entrepreneurship in the country. Along with that, the features of the job market which play a role in high unemployment, such as the generous unemployment benefits should be revised to increase employment in the private sector.¹⁹ The increase in taxes in 2020 is a signal of the things to come for this structural change although it is currently only restricted to value-added taxes (VAT) for now.²⁰

The kind of economic transformation imagined by Vision 2030 would imply a change from a rentier social contract to a real competitive liberal economy. The rentier social contract was based on giving to people while securing politics without representation. This new social contract is based on decreasing the rent previously given to people to convince them to get the necessary skills and work in the private sector. It is, of course, impossible to reset the social contract overnight, and there are many roadblocks on the way. The most important problem is the fact that the depth of the proposed labor market transformation requires a long period of time, making it impossible for these goals to be reached by 2030. Hertog shows that in an optimistic scenario for the private sector to have a reasonable share of the labor market comparable to the OECD average, it would take around 49 years.²¹ Similarly, the goal of a balanced budget without oil revenues would also linger for decades.

Secondly, the government needs job creation in a diversified portfolio of sectors in order to implement the labor market reforms. This would require the private sector to chip in and invest in the sectors that will be guided by the state's industrial policy as suggested by the Vision 2030 document. The country's business environment plays a vital role in the success of the diversification efforts. The rule of law and a predictable political environment are prerequisites for convincing critical entrepreneurs. There are still no indications of such reforms and the government's past record would not appear to be very helpful either. The 2017-2019 purge against princes, ministers, and businessmen remains a cautionary tale for the arbitrary nature of politics in the country.

There is a possibility of backlash from those who will be negatively affected by the reforms especially for people working in the public sector and those who do not have the skills to thrive in the new

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economy. But one can argue that the political capital of the current government may enable it to weather a potential backlash. MBS has more concentrated power compared to his predecessors, and is in a good position to enjoy popularity especially from younger demographics. Indeed, the successful implementation of strict nationalization policies despite its burden on the economic elites may serve as an example for the capacity of the ruling elite to implement reforms.

Supposing that the government overcomes all these challenges before the economic transformation, there is a question of whether it will lead to a wave of political transformation. The type of citizen described by the Vision to reach its ambitious goals corresponds to the middle-class citizen in developed countries: well-educated, professional, and thriving.²² As in the repeated story of a flourishing bourgeoisie demanding more political rights, the agents that would realize this economic transformation could demand more political rights. The political reforms initiated by Gulf countries such as Kuwait and Qatar are important examples that have the potential to spill over. The rulers in these countries are implementing reforms to share some of their powers at a controlled pace.²³ Even if these reforms do not currently extend beyond symbolic value, they could have important political consequences. There are still no indications of potential political reform in the KSA. Although there are very important political aspects of these major reforms, the Vision 2030 strategy document is highly concentrated on the economy and does not include any political reform agenda. The government's current attitude against dissidents does not suggest any real possibility of a political opening.²⁴

The lessons from other countries which have fundamentally transformed their economies also do not favor the view that the KSA's ambitious goals could soon materialize. There are significant differences between the successful transformation cases in Singapore, Taiwan, and China and the case of Vision 2030. Firstly, these countries did not have rich resources which could have caused a rentier mentality amongst their citizens in the first place. Secondly, prior to their growth story, their education system was still in good shape, which has been cited as one of their recipes for success.²⁵ Lastly, they had an effective bureaucracy that guided their industrial policy along with a large, disciplined state security apparatus. KSA does not have any of these.

As a more relevant benchmark could use the case of Dubai, an important hub for the Middle East which successfully attracts skilled human capital from the world. There is a real contrast between the case of

Saudi Arabia and Dubai. First, Dubai was the emirate with the smallest reserve of oil which helped Dubai to concentrate on diversifying the economy since the early stages of its development and on attracting high-skilled labor.²⁶ Secondly, the small size of the population was also helpful, not having a lot of conflict-prone rifts in the society, thus satisfying its citizen base with much ease. Lastly, there is a growing competition between the UAE and KSA which will also be amplified with Vision 2030's goal of creating trade and tourism hubs in Saudi Arabia.²⁷ Dubai looks much more favorable in this competition with its first comer advantage and better perceptions.

The Future Ahead

These ambitious targets for human capital reform may not be realistic given the aforementioned political-economic considerations. Nevertheless, more achievable goals of a gradual transformation can be achieved. There is a spectrum of possible scenarios that range from state failure to the dream transformation that would make Saudi Arabia a regional economic powerhouse. While we have argued that the dream transformation is not conceivable over the short and perhaps even mid-term that does not predetermine a doomsday scenario. The future, rather, lies in between these two ends of the spectrum.

Instead of discussing the unattainable goals, it is more reasonable to focus on metrics that would enable us to assess the success of the reforms. The number of jobs created for Saudi nationals and the change in citizens' rentier mentality could be two key indicators to assess the human capital reform. When we evaluate the numbers so far, there is around a 20% increase in the employment of Saudi females while the male employment did not change much.²⁸ While the increase in female employment could be considered as low-hanging fruit given the low initial levels, more importantly, it points to a cultural shift that has started to take place. The government has been actively pushing these cultural reforms through social engineering methods.²⁹ The cultural change surrounding the work ethics in the country will be very important for the success of human capital reform.

In the future, the critical variable for the success of reforms will be the price of oil, that is, how long Saudi Arabia can depend on a continuous inflow of oil revenues in this transition period. If the oil prices collapse permanently before the political reforms, the likelihood of serious reforms

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would decrease dramatically. That would exacerbate the issues concerning the kingdom's stability since the government would need to cut subsidies and increase taxes before a successful transformation of the labor market. If the government could have enough time before an imminent price crash, the investments could create more jobs for Saudi nationals and diversify the income sources. If the right emphasis on the reform of labor markets is prioritized over infeasible expensive projects, Vision 2030 can help tremendously for this purpose.

The development track is full of traps with self-perpetuating vicious cycles, as demonstrated by KSA's human capital problem. Accustomed to oil rents without tapping the country's human resources, the government faces an uphill battle to diversify its economy. Under the conditions of the post-oil world, the government will need to convince its citizens to contribute to the economic pie by working in efficient jobs. Effective persuasion requires the fine-tuning of incentives in a meritocratic way. There are many likely pitfalls the government could stumble into, including picking the winner in the economy.

Moreover, in the case of successful economic transformation, political demands may come next. As indicated in the famous slogan of "no taxation without representation," the new tax-paying citizens could demand more political rights. The ruling elite's openness to the new political-economic conditions would determine their faith in the reforms. Judging by the government's current approach, we can conclude that such a large-scale upheaval of the social contract is unlikely. But there are key reforms that concern the country's future in the post-oil world which are more attainable. There are signs that government is on the right track for achieving this. Still, the Kingdom should take care to prioritize more realistic interim goals over infeasible projects.

The depth of the proposed labor market transformation requires a long period of time, making it impossible for these goals to be reached by 2030

Endnotes

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