

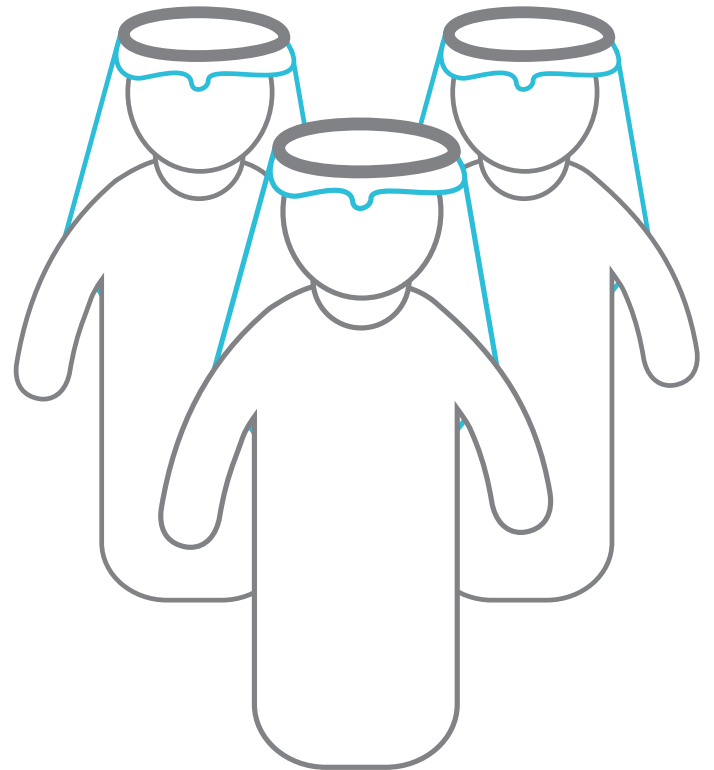


United Arab Emirates



The Government Summit
Thought Leadership Series

Taking a More Sophisticated Approach to GCC Labour Market Policy



In collaboration with
McKinsey&Company

February 2013

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A Global Challenge

Over the past few years, youth unemployment has risen to the top of the global agenda for policy makers. A troubled global economy has led to rising youth unemployment, which in turn has had economic, political and social implications in many countries. In the Middle East youth unemployment has been a major factor contributing to the Arab Spring.

Worldwide, young people are three times more likely than their parents to be out of work. In some European countries, including Greece and Spain, more than half of young people are unemployed. Across the Organization for Economic Co-operation and Development (OECD) countries, more than one in eight of all 15- to 24-year-olds are not in employment, education, or training. Around the world, the International Labour Organization estimates that 75 million young people are unemployed. Including estimates of underemployed youth would potentially triple this number. This represents not just a gigantic pool of untapped talent; it is also a source of social unrest and individual despair.

Paradoxically, there is a critical skills shortage at the same time. Across nine countries sampled in a recent McKinsey survey, only 43 percent of employers surveyed agreed that they could find enough skilled entry-level workers. This problem is not likely to be a temporary blip; in fact, it will probably get much worse. The McKinsey Global Institute estimates that by 2020 there will be a global shortfall of 85 million high- and middle-skilled workers.

If young people who have worked hard to graduate from school and university cannot secure decent jobs and the sense of respect that comes with them, society will have to be prepared for outbreaks of anger or even violence. The evidence is in the protests that have recently occurred in the Arab World, but also in Chile, Greece, Italy, South Africa, Spain, and the United States (to name but a few countries). The gap between the haves and the have-nots in the OECD is at a 30-year high, with income among the top 10 percent nine times higher than that of the bottom 10 percent.

Understanding The Regional Context

Over the past few months, we have run a series of surveys across the GCC to better understand youth employment. We wanted to understand both employment and unemployment – who is in work, who is not, and what factors make a difference.

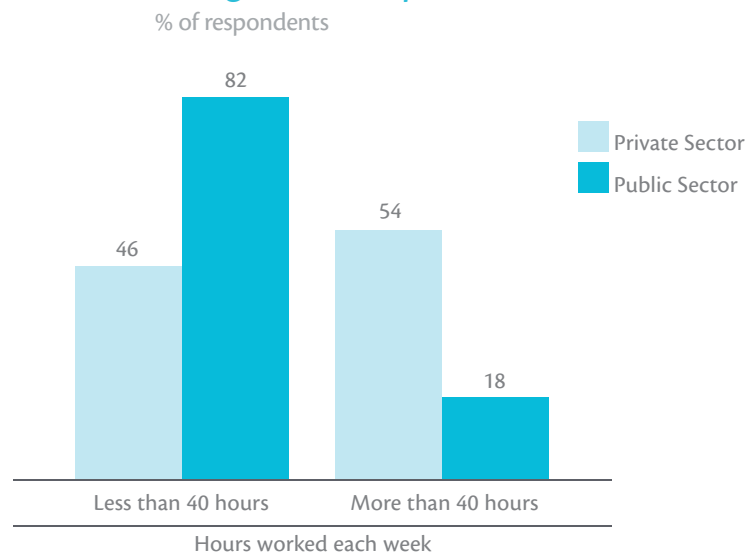
The picture that emerges is far more complex than the traditional broad brush used to paint the region's youth. The GCC countries are very different from each other – the challenges they face are different in both nature and intensity. There is also great variation within countries, with discrete segments of youth in each country facing different challenges. These results suggest that governments will need to adopt more complex and targeted labour policies, and will need to carefully adapt their interventions to match the different profiles of young people.

For instance, in the UAE, only 9% of UAE nationals responding to the survey were unemployed and looking for work – an exceptionally low level by regional standards. In this respect, the UAE is in an enviable position, compared to many other countries in the region. But the number masks significant differences. Men are twice as likely to be unemployed as women, and those under 25 are three times as likely to be unemployed as those over the age of 36.

Moreover, 61% of UAE nationals in work were employed directly by the government, a number likely to fall as the population grows. This will require some adjustment. For instance 18% of those working in government said they worked more than 40 hours a week, compared to 54% of those not working in government. Labour policies will need to help employers and employees adjust their expectations as a shift towards private sector employment occurs.

Exhibit 1

Working Hours are longer in UAE private sector



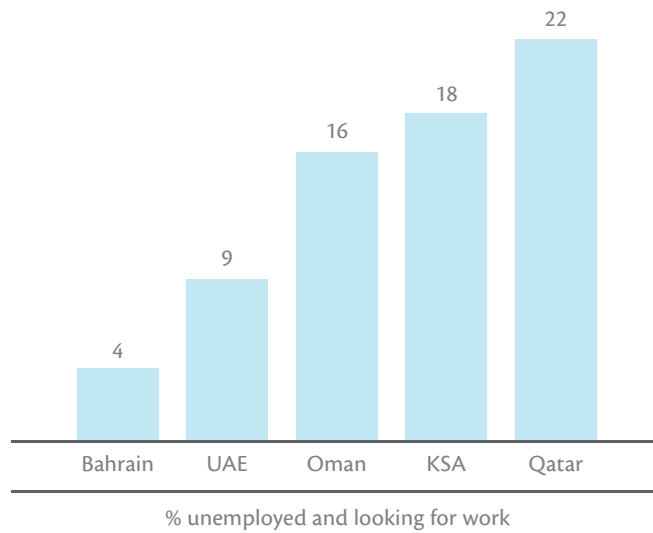
Source: Employment Survey, November 2012
McKinsey & Company

In Saudi Arabia, by contrast, our surveys showed twice the level of unemployment compared to the UAE (18%). This unemployed population is diverse. Highly educated women were a large segment of unemployed, while men, if they were unemployed, were likely to have a low level of education. Data from the government suggests significant variation in unemployment levels across the country.

Oman exhibited a similar unemployment profile to Saudi Arabia. Overall unemployment was 16%, but with much higher levels among the young (30%) and women (31%). By contrast, Bahrain had the lowest overall unemployment at just 4%.

Exhibit 2

Survey based estimates of unemployment



Source: Employment Survey, November 2012
McKinsey & Company

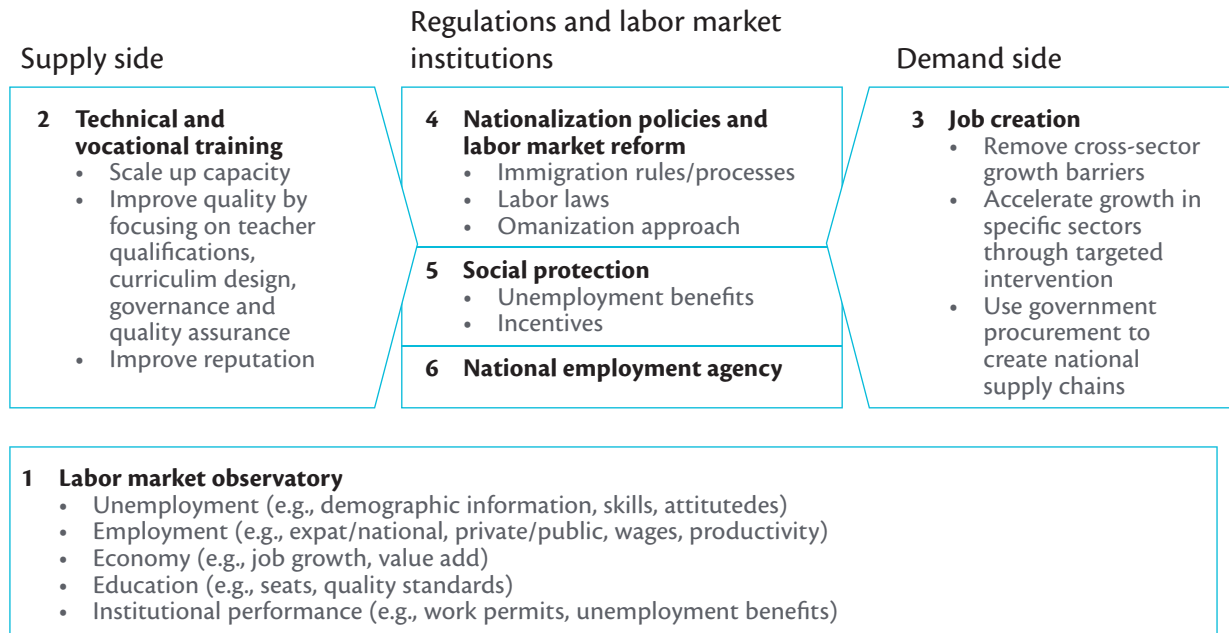
Other factors are of course more similar. The overall demographic profile is similar across the GCC, with a large and growing youth population. All of the GCC countries have a significant expatriate population who compete for jobs with nationals, particularly in the private sector and in lower-skill jobs. Government employment of the national population is high relative to benchmarks elsewhere in the world, and the private sector is still emerging as a major source of national employment.

So labour policy in the GCC will need to be based on three core truths about the fundamentals of each country.

- **First**, that the challenges each country faces are different – from unemployment, to productivity, to female participation, to mismatches between employer and employee expectations – and as a result, the broadly similar policy approaches of the past (Saudization, Bahrainization, Emiratization etc.) will need to be replaced by interventions specific to each labour market and developed on the basis of an understanding of its specific problems.

Exhibit 3

Building blocks of employment agenda



Source: McKinsey & Company

Broadly speaking, these interventions can be thought about in six groups. First, a labour market observatory provides precisely the data and intelligence required to create a sophisticated set of labour market interventions. Second, supply side interventions help youth build the skills (hard and soft) required for work. Third, job creation initiatives can stimulate growth in the economy. Fourth, nationalization policies, particularly in the GCC, can help create a level playing field between nationals and expatriates. Fifth, social protection provides temporary protection for those out of work. And finally, a National Employment Agency provides the critical matchmaking role to ensure that individuals get the support most appropriate to their needs.

Most GCC countries have already put in place elements of these interventions. For instance, Saudi Arabia's Nitaqat system has put in place stronger and more differentiated incentives for employers to hire nationals. Companies are placed into one of four bands – red, yellow, green and silver – based on the proportion of Saudi nationals that they employ (the thresholds vary by sector and size of organization, while companies with fewer than ten employees are exempt). They then receive differentiated access to labour market services based on their Nitaqat category

– those in the silver category receive 'VIP' access to all Ministry of Labour services, while those in the red category are denied access to most services.

In parallel, efforts are being made to make vocational pathways through education more attractive and effective. 75% of Saudi youth say that an academic education is more highly regarded than a vocational education, the highest proportion of any of our survey countries (in Germany, for instance, the equivalent proportion was 49%). Saudi Arabia and Bahrain have begun to counter this by establishing new vocational education providers, generally with strong links to the private sector and support from leading international providers of vocational education. These include 11 'strategic partnerships' in Saudi Arabia, and the new polytechnic in Bahrain. Another example would be that GCC countries are gradually creating more liquid labour markets for expatriates differentiated by types of occupations. While in the past, all expat workers were tied to local sponsors, recent laws in the UAE, Bahrain, and Kuwait, have made transfers of sponsorship for higher skilled expats and those who have stayed beyond their initial contract period much easier.



- **Second**, that there are discrete segments on youth within each country which will need different interventions. In Saudi Arabia, for instance, we found four main segments who, together, accounted for 90% of youth. Just over a quarter (26%) of young Saudis were in the “well-positioned” segment – well informed and positioned, typically with clear focus on higher level government employment. They care a lot about their education and career, and have the knowledge and resources to pursue their aspirations. Another quarter (28%) were in the “too cool” segment. They see no benefit in further education, and are either completely disheartened or have little appreciation of education and expect future employment in low skill government jobs. A further 21% were in the ‘struggling’ segment – they are a lot about education but do not know what to do to get to the career they want. Often they are trying to make a private sector career work, but have too little information and guidance. Finally 12% were in the ‘too poor’ segment – they wanted to go into post-secondary education but did not have the financial resources to do so. Each of these segments will require different combinations of interventions and support to get them into the right jobs.

- **Third**, there are also different employer segments, which transcend traditional sector boundaries, with different appetites to employ and support locals. Some are already investing heavily in developing and training a national workforce, while others are unwilling to offer training or support to nationals preferring to employ only expatriates. Others have ‘high will’ but little capacity or understanding of how to best support youth into employment. Each segment of employers will need different interventions.

As a result of the above, every country needs to develop its own employment agenda along the three different dimensions laid out above; along different building blocks, tailored to specific segments of job seekers, and addressing the requirements of different segments of employers.

While GCC countries are starting to address the challenge in a much more differentiated manner compared to past efforts, we would still argue that no single country has yet developed a fully consistent and integrated employment agenda with all of the different elements being synchronized and reinforcing each other.

A Path Forward

“So what would an integrated labour reform look like?”

As described previously, we believe that there are six main parts to an integrated reform agenda.

Building block 1

Labour market observatory

Above we had mentioned the importance of an accurate fact base for informed policy decisions. Hence it is critical at the outset of the reform journey to start collecting, cleaning, and analysing all relevant data in a central repository, which we call ‘observatory’. This observatory would collect information about the unemployed (e.g., demographic information, skills, desired occupations, attitudes towards work, time to find work/time unemployed, future projections), the employed (e.g., expat and nationals, private and public, occupations, household income, salaries, productivity), the economy (e.g., projections on job growth, value add, skills requirements), the education system (e.g., seats by program, test results, quality standards), and the institutional performance (e.g., work permit issuance and renewal, unemployment benefits, matchmaking and counselling services).

The observatory would be based on administrative data, but will need to be complemented by surveys for additional qualitative information and in areas, where administrative data is unreliable. The key, in our experience, is then to link the IT and statistics function of collecting data with the right ‘intelligence’ using the facts as basis for evidence based policy development (e.g., research function, policy development). Two regional examples of working observatories are the Labour Market Regulatory Authority in Bahrain, and the Labour Market Observatory in Saudi Arabia.

One of the main functions of this observatory is to provide a solid foundation for the segmentation of job seekers and employers as a basis for all further efforts.

Building block 2

Technical and vocational training

While the performance of the overall education system (primary, secondary and university) is a long-term driver for prosperity and participation in the labour market, the GCC countries are facing the immediate challenge to accommodate young labour market entrants, which the existing system has already ‘produced’, which are in many ways ‘not fit for purpose’, and which are waiting for employment opportunities.



Here, short and practical programs of 6 weeks to 2-years ('diploma') in applied technical and administrative fields are the only promising solution at scale (e4e= employment for education). In this context, GCC countries typically face three challenges: First, in terms of quantity the existing systems are much too small. While in the GCC an average of 10 per cent of a cohort joins technical and vocational training, the OECD average is approximately 45 per cent. Second, the quality and practical relevance needs to be increased. Typical drivers here are (practical) qualification of trainers/teachers, mix and curriculum of programs, governance of institutes, and overall quality assurance. Third, technical and vocational training is suffering from its low reputation (partially, but not exclusively based on sub-standard quality). Typical levers here would be – apart from increasing the overall quality and chances of employability – the introduction of more attractive career tracks (e.g., polytechnic, pathways to academic careers), more awareness of interesting job opportunities (for example, in IT, services, high tech), and targeted career counselling of high school students.

Most of the GCC countries have been addressing the topic. For example, Saudi Arabia is currently increasing the capacity in technical and vocational diploma programs from 100k to 250k through innovative PPP models. Abu Dhabi and Qatar have

established similar private sector led models. Bahrain tries to address the issue of low acceptance of vocational tracks by introducing the 'Bahrain Polytechnic'. Some of the most recent trends in this sector in the GCC are:

- Reliance on private sector delivery by inviting world class providers to open operations in the GCC
- Establishing close strategic partnerships between providers and key employers – specifically large renown 'flagship companies'
- Introducing independent regulators, creating transparency by participating in global rankings, and allowing for national student testing
- Tying incentives for training providers and providers of other labour market interventions to outcomes (e.g., graduation rates, employment rates)
- Developing more integrated service models along a portfolio of different interventions (e.g., combining, training, incentives, subsidies, counselling into an integrated services offering)



Building block 3 Job Creation

Simultaneously to supply side interventions, any policy maker also needs to address the demand side, i.e., creating sufficient job opportunities of the right qualifications, with attractive wages, and in the right location. While this may not be a concern in the GCC's faster growing countries and urban areas, it definitely is an issue in rural areas and for marginal segments of the labour market (e.g., uneducated, females).

In our experience, a three-pronged approach has proven successful.

First, create a business friendly environment and drive productivity improvements across sectors. Ease regulatory barriers to open and grow businesses, provide access to financing and create a conducive environment particularly to small and medium sized businesses.

Second, focus on specific sectors and supply chains. From our experience, we understand that cross-cutting regulatory reforms in an emerging market environment may still not unlock the full growth potential. In addition, we believe that government can incubate specific opportunities and accelerate growth, specifi-

cally focusing on export oriented sectors. One example would be the special economic zones in the UAE, Oman, Bahrain, and Qatar, with regulatory privileges, dedicated infrastructure, and effective enablers for job creation.

Third, a very immediate measure for government would be to use its purchasing power of goods and services to stimulate local content. For example, large regional oil companies are using their purchasing and procurement of multi-billion dollar contracts every year to stimulate local content and national job creation, the creation of a local supply chain, and consolidation of individual businesses into large-scale 'national champions'.

Building block 4 'Nationalization' policies and labour market reforms

GCC labour markets are characterized by comparatively easy expat access, but very rigid internal labour markets (as opposed to western labour market models, which function exactly in the opposite way). Nationals found employment predominantly in an increasingly bloated public sector. As a result, expat labour costs are artificially depressed; nationals labour costs artificially inflated. The resulting labour market mechanisms are dysfunctional and provide no equal playing field to compete fairly for jobs.



There is only one way out of this dilemma: gradually increasing expats' labour cost through tighter management of immigration, and simultaneously decreasing the salary differential for nationals in the private, compared to the public sector. However, this is a painful process, which touches a lot of vested economic and political interests, and requires a gradual transition. While the UAE has been much more successful on managing this economic shift compared to many of its neighbours, it still has some way to go to accomplish a truly equal playing field and competitive labour markets.

In the short term, GCC governments only have regulatory incentives to encourage national private sector employment. While previous nationalization efforts were very crude and largely counterproductive, Saudi Arabia's most recent experiments with the 'Nitaqat' system are interesting. Instead of a sector- or occupation specific quotas companies are compared to their peers in terms of economic activity and size. Are they performing above average in terms of their nationalization performance, they receive regulatory privileges and flexibility; if they perform below average, they are increasingly put under pressure.

Simultaneously, GCC governments are also re-assessing their 'old' labour market model, which has run out of steam: Kuwait and the UAE have eased some of their rigid sponsorship rules, allowing for more flexibility and fluidity in the labour markets. At the same time, the UAE, Bahrain and Saudi Arabia are gradually increasing the cost of access to the labour market and gradually equalizing labour laws and working conditions for expats. Most recently, Saudi Arabia – for example – introduced a fee of approximately USD 55 per month to close the wage differential between nationals and expatriates, to recover government subsidies to expats (in form of free infrastructure, utilities, and government services), and to finance qualification measures for the national workforce.

While the jury is still out, whether any of these policy proposals are eventually going to be effective, remarkable accomplishments have been recorded in individual pockets of the economy (e.g., financial sector, retail, etc.).

Building block 5

Social protection

What we have been describing in the previous sections are massive challenges to the socioeconomic model of the GCC. One of the reasons that societies have so far still coped is a tightly knit social support network, which has supported those in need. However, increasing demographic and economic pressure is testing the limits of these traditional support models.

Hence, we propose to complement the economic reforms with social reforms in the form of unemployment benefits for those young job seekers, who would fall between the cracks of the social safety net. Saudi Arabia's Hafez scheme is a great example, of how such a program can be implemented in record time (less than 9 months) for more than 1.5 million recipients. The critical element here is to design a system to protect the weak, while maintaining the incentives for the unemployed to continue seeking employment opportunities.

One of the most innovative elements of the Hafez scheme in Saudi Arabia is the fact that it is based entirely on online interactions, without a branch network. Unemployment registration happened via SMS or online; the eligibility check was conducted through an automated system connecting more than 25 government institutions, and payments were made through electronic payment channels. The features of the system earned a UN price for innovation and are now being copied in Europe.

Building block 6

Creating a national employment agency

The last building block builds on the idea of the unemployment benefit scheme and complements this with an effective career counselling and matchmaking mechanism, combined with active labour market interventions (e.g., subsidies, training, incentives).

Based on our work we have identified a few success factors to such an employment agency: First, create pull, not push. Traditionally, employment agencies aimed to push job seekers into jobs. A more effective approach is to work jointly with employers to create the right incentives for them to pull job seekers into employment. Second, segment the market. Traditionally, employment agencies adopted a 'one-size-fits-all' approach. However, every job seeker has a different story to tell, and obstacles to employment can vary dramatically. Hence modern agencies have adopted an approach to focus on removing individual obstacles (which may not have anything to do with the labour markets, for example, providing child care). Third, and last, intelligent IT systems help creating transparency on supply and demand and find intelligent algorithms to enable the right matches. Effective systems here also require close linkages to the labour market observatory.

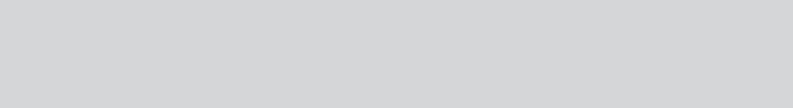
The benchmark here is the German (and Dutch) Labour Agency, which, over the past decade, has managed a remarkable transition from an ineffective bureaucracy to a customer focused service provider with distinctive employment outcomes. Some of the most recent innovations in this area were intelligent needs-based customer segmentation models and a 'virtual labour market', which supports intelligent matching of supply and demand.



Conclusion

In summary, we believe that – while some progress has been made in recent years - GCC countries still have a long way to go to create a sustainable job creation engine for their local populations. We argue that past paradigms need to change along several dimensions

1. Each GCC country tells a different story and will need to pursue a different path. Copy and paste solutions – as have been tried in the past – are not going to work
2. Policy interventions need to become much more granular, addressing specific segments of job seekers and jobs. The ‘one-size-fits-all’ policy solutions of the past have run out of steam and are likely going to be counterproductive.
3. Each country needs to develop an integrated reform agenda along the framework suggested in this document, with each building block reinforcing each other.



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