Quota counting
New Saudi employment rules to shake up private sector

► Saudi Arabia unveils new employment strategy to increase ratio of nationals in the private sector from current one out of every 10

► As youth unemployment tops most states in region, firms failing to meet quotas face residence visa cap, limits on foreign recruitment

► Plan could force some small firms out of business, but in long run lead to improved wages, efficiency, skills and nationalisation

► Potential downturn in remittances from world’s second-biggest source would have implications for receiving countries

There is a striking paradox in Saudi Arabia’s labour market. Expatriates working in the kingdom send home more remittances than those living in any country in the world apart from the United States. Yet youth unemployment among Saudi citizens is higher than every country in the Middle East and North Africa (MENA) except Iraq.

Confronting a dilemma of youth joblessness that persists despite reasonable rates of economic growth, Saudi Arabia is unveiling a major overhaul of the long-ineffective plan to nationalise a private sector workforce dominated by foreigners to the tune of nine out of every 10 employees. The private sector has been creating jobs, but they do not go to Saudis.

This month, the government will inform companies which of four categories – ‘excellent’, ‘green’, ‘yellow’ or ‘red’ – they fall under based on whether they employ enough Saudi nationals to comply with established quotas. Following a grace period, the new Saudisation scheme, known as Nitaqat (or ranges in Arabic), would level severe penalties on violators and offer incentives and rewards to those firms meeting quotas.

The government’s ambitious goal: to succeed in creating 1.12 million new jobs for Saudi nationals by 2014, or 92% of all new jobs created, as set out in the current development plan.

The previous Saudisation quota system required all sectors to have a blanket nationalisation rate of 30%—although only a third of that was achieved. The new system is more dynamic, applying 205 categories of quotas that vary based on the line of work and size of the company. In many cases, companies achieving more than 30% nationalisation would be classified as “excellent”.

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The state will impose a six-year cap on residency visas for expatriate workers if their employers fail to meet quotas. Companies falling in the ‘red’ category would be barred from renewing the work visas of their expatriate staff entirely, while ‘green’ companies will be entitled to, for the first time, recruit foreign workers freely from the other two categories and transfer their sponsorship visas without their current employer’s consent.

The initial shock of Nitaqat, if enforced with vigour, could lead numerous smaller businesses to shut down, shake already feeble foreign investor confidence in the economy, and further stall the private sector’s recovery. Private sector growth rates have lagged in recent years well below the 6% minimum we believe is necessary to stimulate enough job creation for a population that is nearing 28 million.

In the medium- to long-term, however, Nitaqat has the potential to introduce much-needed adjustments to wages and efficiency in the private sector, so long as it is supplemented with high-quality training programmes at Saudi schools and within companies. We expect the programme will succeed at improving Saudi participation in the private sector.

The private sector must evolve into Saudi Arabia’s main engine for job creation in order to relieve the burden from the state, which has frenetically created jobs for citizens to quell unemployment. This has led to unsustainable growth in its wage bill and taken a grave toll on public sector productivity. Beyond the kingdom, effective implementation of Nitaqat could lead to a downturn in remittances to countries that come to rely on them heavily for foreign currency, and could prompt them to reconsider employment strategies.
Desperate times, desperate measures

Remedying the disparity between recruitment of expatriate workers and nationals in the private sector is one of the biggest challenges facing Saudi Arabia’s labour market. When authorities conducted a census last year, they discovered that the non-Saudi population had grown more quickly than earlier estimated. Since the 1990s, the ratio of expatriates to the total population remained relatively stable, fluctuating at slightly above or below 27%.

But in the past five years this shifted noticeably as recruitment of expatriates intensified during an economic boom that tracked a rise in oil prices between 2003 and 2008. Since 2004, the ratio of non-Saudis to the total population rose sharply, reaching 31% of the 27.6 million people living in the country by the end of 2010, according to revised population data. Now, very close to one in every three Saudi residents is a foreigner.

This substantial rise in the expatriate population likely triggered alarm bells among the kingdom’s policymakers, who had been charged with improving the employment situation for citizens. Many new jobs were created during the boom years—but more often than not they went to foreigners rather than to Saudi nationals.

According to official data, in 2009 alone almost 674,000 new jobs were created in the private sector, and another 42,189 in the public sector. Yet that year, unemployment among Saudi nationals rose to 10.5% from 9.8% in 2008. The jump in unemployment, which we believe was more-or-less sustained in 2010, resulted from a particularly sharp increase in the incidence of joblessness among youth. In 2009, some 27.4% of Saudis under the age of 30 were without work, including 39.3% of those aged 20-24.

Due to the announcement this year that unemployment...
benefits will be paid for the first time, the official unemployment rate could increase this year as more individuals register their employment status.

Saudi Arabia’s youth unemployment dilemma is acute even by regional standards. International Labor Organization data show Saudi Arabia is second only to Iraq for the highest youth unemployment in the region, and has higher joblessness rates than Tunisia, Jordan, Egypt and Lebanon.

**Time for a private sector shake-up**

In its current five-year development plan, the government wants the number of Saudis employed by the private sector to grow 5.3% per year. Of an estimated 1.22 million new jobs it estimates will be created between 2010 and 2014, some 1.12 million of them, or 92%, should go to Saudi nationals, according to the plan’s stated objectives.

Yet up to now the private sector has perpetuated the kingdom’s employment quandary rather than alleviated unemployment among nationals. As many young Saudis struggled to find work, 982,420 work visas for foreigners were issued to the private sector in 2009, more than double the number granted in 2005, Ministry of Labour data show. Data for 2010 has yet to be released, although the labour minister said in May that two million visas were granted to foreign workers in the past two years.

Some 6.21 million of a total 6.89 million private sector employees in 2009 – or nine out of every 10 – were non-Saudis, up almost 30% from 2006.

The trends are not surprising when pay expectations and skill level are considered. Private sector companies have greater incentives to employ foreign labour, particularly from South and Southeast Asia, because foreigners tend to demand...
lower wages than Saudis and are highly skilled. As a result, there are few incentives to improve training programmes.

Private sector firms have not been motivated to change the status quo because they save money due to the economy’s low-wage equilibrium and the government had not been aggressive in enforcing previous Saudisation policies. The new Nitaqat scheme could drastically alter this equation by forcing companies to hire nationals, invest more in training and increase wages if they want to stay in business.

Companies falling in the ‘red’ and ‘yellow’ categories, and hence do not employ enough Saudi nationals, will be unable to renew visas of their expatriate staff or issue new visas unless they reach compliance in the number of Saudi employees they hire. Nitaqat assigns different nationalisation rates according to the size and activity of companies – so smaller companies have smaller overall quota requirements than larger ones do. As an example, a small company in the wholesale and retail sector wanting to attain ‘green’ status should have 10%-26% nationalisation, whereas a medium-sized firm needs 17%-33% and large firm should have 24%-34%, according to Ministry of Labour documents.

Given the skewed balance of employment in the private sector toward non-nationals, as many as 30% of private sector companies, mainly smaller in size, will struggle and possibly be forced to shut down as a result of the policy if it is widely enforced. The Ministry of Labour said one out of every five companies falls in the ‘red’ category, while the majority are ‘green’. Red companies often have fewer than 10% Saudi nationals working for them, in many cases less than 5%. In the longer term, new companies will likely be founded on higher national labour content and could focus on productivity from the onset to save costs, but dependence on low skills will not change overnight.

**Wrong side of the line**

Companies falling in the ‘red’ category—those that “resist the Saudisation process”—will be unable to get new licences, renew their licences, renew their employees’ visas or hire new foreign labour. By the end of November, companies falling in this category will have all work permit renewal services suspended. Firms with a ‘yellow’ label will be able to renew work permits on the condition that employees have not spent more than six years in Saudi Arabia until February 23, 2012, but their rights to new visas and transfers ends by September 10.

By contrast, businesses that have complied with quotas will benefit from incentives. Those falling in the “excellent” and “green” categories will be able to recruit workers from the other categories without having to obtain their employer’s consent – which had been a drawback of the current system. Talented expatriates who have been working in the country for years are key beneficiaries of the new system, by encouraging companies to compete in order to retain top talent. The Ministry of Labour also said it intended to lift a ban on 70 professions now restricted to Saudis. Further, ‘green’ companies will benefit from a streamlined visa...
approval process that would grant their employees visas within 10 days as the ministry moves toward decentralising visa issuance.

If the private sector responds dynamically, there could be some much needed and welcome mergers and acquisitions that take place in order to enable smaller firms to be better able to cope with higher wages and training costs. But small- and medium-sized enterprises have tended to be disfavoured for government contracts and they may also have a harder time enforcing quotas due to their small size and inability to afford the extra costs associated with hiring nationals. The policy could, hence, hamper the development of the SME sector if nationalisation requirements provide difficult to implement. Quotas do not address the lack of incentives in private sector work for national jobseekers.

With Nitaqat, the cost of doing business in Saudi Arabia is likely to rise, although demand among Saudis may also rise if more are employed, thus providing greater overall momentum in the economy. Confusion over the programme risks shaking already weak investor confidence, potentially leading to a decline in foreign direct investment (FDI) as companies wait to see how the programme will be implemented.

This would hurt the private sector’s recovery and dampen the country’s effort to support its most-important engine for job creation. A robust private sector growing at 6% or more each year is needed to create jobs for the Saudi population. We expect the private sector to grow 3.7% this year, up from 2.7% in 2010, too low to have a meaningful impact on job creation. Still, a less open immigration policy and sub-optimal growth may be a necessary precondition of improving the job situation for Saudis.

**Pay adjustments**

Yet the benefits of the programme may outweigh the short-term costs. Compelling the private sector to move away from its reliance on cheap expatriate labour and pay higher wages is the right step longer term. Saudis will have greater incentive to invest in improving their skills to get better-paying jobs in the private sector, which would in turn enhance their buying power, and boost aggregate demand.

Currently, private sector companies do not offer as high of pay and benefits as the public sector, so Saudi nationals tend to incline toward government jobs. Some 866,774 Saudi nationals worked in government sectors in 2009, according to SAMA data, 92% of the total workforce. Shorter working hours, comfortable pension schemes and higher over all pay have made the public sector the employer of choice. But it is the private sector that needs to carry the economy and cater to the needs of the job market.

The average private sector wage in 2009 was SR3,137 for Saudi nationals – considerably below wages for many public sector jobs. The state raised the minimum wage for a public sector job to SR3,000 this year —and the pay scales reach multiples of that based on the position and tenure. Private sector jobs need to, over time, pay the same or more than the public sector in order to entice Saudis with higher skills and improve productivity.
Setting and enforcing minimum wages for private sector employment and limiting the working day officially to eight hours could help boost the numbers of Saudis working in private sector roles, in addition to offering them pension plans similar to those offered for the public sector.

Only part of the solution

Moving away from a blanket quota for nationalisation toward a dynamic system whereby quotas are more reasonable and most companies comply with them is a smart move by the Saudi government. Still, forcing the private sector to be more proactive in employing Saudi nationals is only part of the solution. The education system has been unable in the recent past to produce enough qualified graduates who are able to fill crucial jobs in the kingdom. Humanities and arts remain the single-largest majors chosen by Saudi students, accounting for 41% of total university graduates in 2009.

Yet what are needed are specialists in technical, engineering, science, computer science and medical programmes. The Ministry of Higher Education is working toward rectifying this skills gap, but it will take many years before the skills makeup of the population changes to suit the needs of the economy and reduce the need for foreign talent.

There is a danger, too, that Saudi nationals will be hired just to boost official employee counts, but will not be active participants in the companies they are working in. Hiring Saudis who are not productive just to have them on the payroll will simply exacerbate productivity challenges and do little to rectify longer-term job market imbalances.

The long-term goal should be to create an education system and jobs market that is able to rely on a highly skilled indigenous labour pool. But this will demand drastic shifts in cultural perceptions of work and entitlement.
One of the troubles with nationalisation policies in the Gulf region has been that citizens will often take jobs, and private sector firms will invest in training them only to have them hop to new positions for higher pay at the earliest opportunity. This mentality needs to change as it has curtailed efforts to offer on-the-job training.

The quota system should take into consideration the difficulty in recruiting citizens for certain positions. At present, Saudis account for more than three-quarters of all management jobs, and form the majority of employees holding clerical posts as well as technicians in humanitarian fields.

They are, meanwhile, very inactive in many fields – auxiliary engineering, industrial, chemical and food industries, and sales positions. Saudis account for only 14.2% of auxiliary engineering jobs, and 19% of positions in industrial and chemical industries, CDSI data show. According to the 2014 plan, even in these areas the vast majority of new jobs should go to Saudis including, for instance, 85% of new jobs in auxiliary engineering.

Such expectations will likely prove to be unrealistic as it will take time before investments in changing the quality of instruction at primary and secondary education are felt in the job market. It would be better to ease into such requirements gradually, giving the education system and community’s work ethos time to adjust. Otherwise, many companies could face higher human resources costs and lower productivity as more-qualified foreign employees are forced to shoulder the workload. This could deter many firms from expanding in the kingdom.

Productivity problem

A key barrier facing the Nitaqat programme’s success will be the government’s policy of creating tens of thousands of new public sector jobs this year. Saudis prefer public sector employment and, as such, private sector firms could face difficulty competing for qualified employees who would prefer civil service jobs.

This month, the king ordered 66,000 jobs created in the public sector for graduate teachers and health diploma holders, including 39,000 jobs in the education sector for women. The king had earlier this year asked the Ministry of Interior to offer 60,000 new jobs to beef up security forces, and create almost 2,000 other jobs in market supervision and regulation.

The state’s hiring strategy offers a short-term fix to the joblessness dilemma but it could complicate the success of Nitaqat because it may hinder the private sector’s ability to recruit Saudi staff in the medium term. It also promotes inefficiency as productivity per employee will wane further. Government sector productivity has suffered due to big employee additions without a simultaneous gain in the output of government services.

Since 2004, productivity has fallen quickly in the public sector, primarily as the state struggles to offer citizens jobs in a market that favours expatriates. Higher productivity is essential because it contributes to better economic growth rates and acts as a sustainable engine for job creation.
The private sector’s productivity has also declined in recent years, although not as sharply as the public sector’s. A good deal of this was because a downturn in output by banks and other private sector firms did not lead to any mass layoffs of staff following the onset of the global financial crisis. As the private sector grows, productivity should also pick up.

This is why the introduction of policies that alienate private sector firms or deter new ones from establishing in the kingdom could backfire. If private sector businesses find employment quotas for Saudis too daunting they may not set up at all, which would slow down the private sector’s recovery further and dampen efforts to improve productivity.

Hitting remittances

Another implication of implementing Nitaqat would be the affect on outward remittance flows from the kingdom. In 2010, expatriate workers in the kingdom sent home SR98.2 billion ($26.2 billion) in remittances, almost double the value of remittances in 2005, initial estimates released by SAMA show. The World Bank has ranked Saudi Arabia in second place among the world’s biggest remittance-sending countries, only behind the United States, which is home to a population that is roughly 11 times larger than Saudi Arabia’s.

Remittances from expatriate workers offer a significant source of hard currency income for oil importing states in the Middle East and Asia, such as Pakistan, India and Egypt. Pakistan is particularly reliant on such flows, with Saudi Arabia accounting for 25% of its total remittances in 2010. Pakistani workers in the kingdom sent home $1.92 billion last year, an amount that has almost doubled in just four
years. Saudi Arabia is Pakistan’s second-most important source of remittances behind the UAE, and ahead of the United States.

Filipino workers in the kingdom sent home almost $1.5 billion in remittances last year – more than 50% of the total from Middle East countries, while remittances from the kingdom also account for almost a third of Bangladesh’s total.

Egypt, which counts remittances as among its top sources of hard currency along with tourism and Suez Canal receipts, got $1 billion in remittances from Saudi Arabia in the last fiscal year, although Egypt has become much less reliant on Saudi Arabia as a source of remittances. In the 2009-2010 fiscal year, 10.3% of Egypt’s remittances came from the kingdom, down from almost 17% five years earlier. Egypt more heavily relies on remittances from Kuwait (20.4%), the United States (29%) and the UAE (17.7%).

While the effort to create jobs for Saudis would likely reduce reliance foreign workers in the long term, this would not necessarily lead to a rapid decline in the number of expatriates working in the country. With oil prices around $100 a barrel, the central bank’s foreign assets at record levels, and fiscal and current account balances likely to remain in surplus, the Saudi economy has the potential witness a good resurgence in private sector activity in the coming years under the right conditions.

As such, a properly functioning private sector encouraging small and medium-sized enterprises would create job opportunities for nationals while continuing to open the door for foreign talent. This is why authorities must tread carefully with the Nitaqat programme to ensure it does not wipe out small firms exhibiting potential for long-term growth. It should be balanced with adequate incentives, more streamlined rules for doing business and obtaining visas, and emphasis on quality training and instructions both in schools and in the workplace.
# Key Saudi Arabia Economic Indicators

## MACRO-ECONOMIC INDICATORS

<table>
<thead>
<tr>
<th>Year</th>
<th>Nominal GDP (USD bn)</th>
<th>Nominal GDP (SR bn)</th>
<th>YoY % change</th>
<th>Real GDP growth rate, %</th>
<th>Non-oil private sector real GDP growth rate, %</th>
<th>Government real GDP growth rate, %</th>
<th>Oil sector real GDP growth rate, %</th>
<th>Inflation, YoY % change</th>
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## BUDGETARY INDICATORS

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## FOREIGN TRADE INDICATORS

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## EXCHANGE RATE (=USD1)

- Saudi riyal: 3.75

## BANKING INDICATORS

- Bank claims on private sector, year-end % change: 10.0
- Total private credit, year-end % change: 12.4
- Total bank credit, year-end % change: 12.3
- Broad money M3, YoY % change: 14.7

## SAVING & INVESTMENT INDICATORS

- Gross fixed capital formation, % of GDP: 18.1
- Non-oil government investments, % of GDP: 2.6
- Non-oil private investments, % of GDP: 13.8
- Gross domestic savings, % of GDP: 37.1

## DEMOGRAPHIC INDICATORS

- Population (in millions): 21.5
- Non-Saudi: 5.8
- Unemployment rate (% Saudi): 9.7
- Non-Saudi: 0.5

## OIL INDICATORS

- Argus Sour Crude Index (ASCI): 59.4
- Average oil price (WTI) (USD/barrel): 26.3
- Average Saudi oil price (USD/barrel): 23.4

## STOCK MARKET INDICATORS

- Tadawul Stock Index (TASI) (period-end): 2,518.08

Source: Saudi Arabian Monetary Agency, other Saudi Arabian government authorities, Banque Saudi Fransi forecasts
Disclosure appendix

Analyst certification

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Additional disclosures

1 - This report is dated as at 14 June 2011.

2 - All market data included in this report are dated as at close 13 June 2011, unless otherwise indicated in this report.

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