Backgrounder: the old GCC social contract

Steffen Hertog, London School of Economics
October 2024

Ever since the 1970s oil boom, the GCC monarchies have operate a very unusual welfare system for their citizens: Much of welfare provision has been based on large-scale public employment and energy subsidies, while other forms of social safety have been relatively underdeveloped. This system has now come under strain for demographic and fiscal reasons and in some cases, notably the UAE, government has actively moved away from it despite no urgent fiscal need. The key socio-economic challenge in the coming years and decades will be to find a new social contract and welfare model. I have discussed options for such a new arrangement in several other publications (e.g. here, here and here). This paper provides detailed background on the old social contract, how unusual it is in international comparison, and where it has come under strain – notably the emergence of a stratum of labour market "outsiders" among citizens who do not have access to public jobs. I would like to thank the Strategy& Ideation Center for help with data acquisition and visualization.

1. Overview of the old social contract

Following the 1970s oil boom, the GCC monarchies developed a deeply unusual welfare model based on generous distribution of a wide range of benefits to their citizens. These include free public services, subsidized energy, a varying range of categorical (i.e. not means-tested) welfare benefits and, critically, a de facto public employment guarantee for most male citizens.

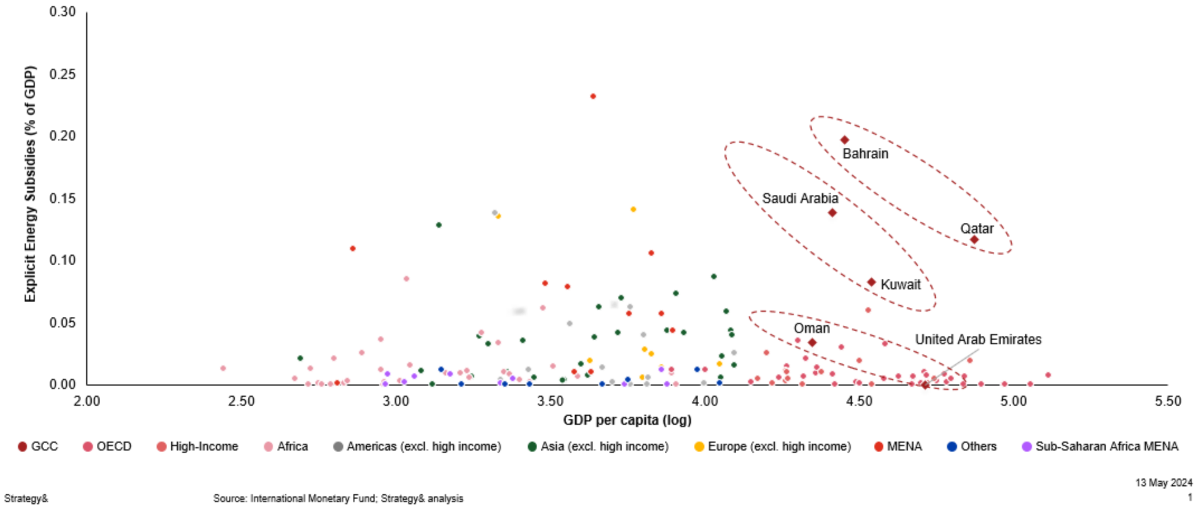
Free public services

The GCC monarchies have been among the fastest countries in the world to roll out universal public schooling, university education and healthcare for citizens, traditionally provided free of charge. While they have started to deploy contribution-based health insurance systems, health provision remains heavily state-supported.

Subsidized energy

While many advanced countries provide free schooling, subsidized or free university education and subsidized healthcare, the GCC monarchies have historically also provided very cheap electricity and fuels to their citizens – a more unusual welfare policy choice. Despite some reforms to energy pricing, energy subsidies remain considerable in most of the GCC countries (see figure 1 below). While a good public policy case can be made for subsidizing education and healthcare, which are public services with strong positive externalities, the same cannot be said about cheap (fossil) energy: It incentivizes inefficiency and overconsumption, has negative environmental externalities, and potentially deprives governments of precious fiscal revenue if the energy used would otherwise be exportable at global market prices. It also tends to benefit richer households more, as they tend to consume more.

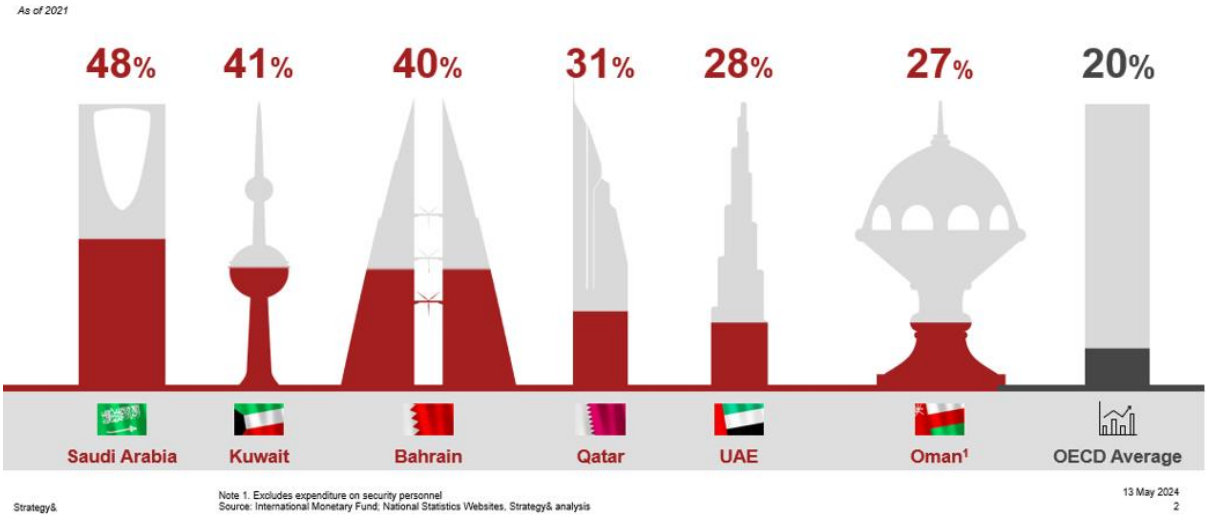
Figure 1: Estimated energy subsidies as percentage of GDP



<u>Categorical welfare benefits</u>
GCC governments have historically also provided a range of categorical welfare benefits, i.e. benefits that are not means-tested, to their citizens. These include cash grants for specific types of recipients like orphans, widows or university students as well as housing benefits either in kind or in the form of subsidized real estate loans. In some cases, GCC citizens are also entitled to subsidized foodstuffs. While these benefits have varied considerably across countries, the general approach of providing them without income or wealth tests is unusual. Governments have moved towards means-testing some of them, but the process remains incomplete.

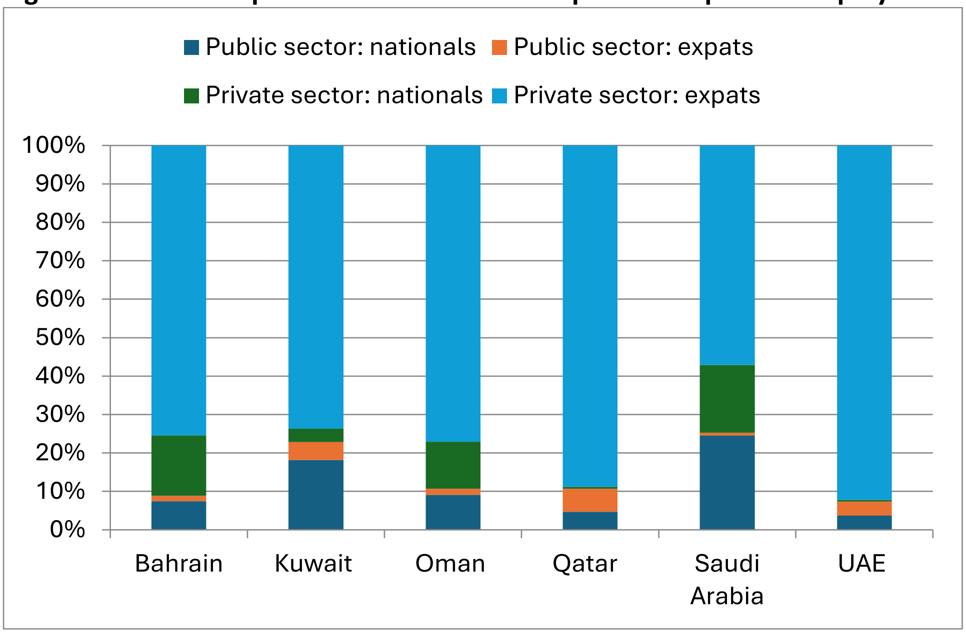
<u>Guaranteed state employment</u>
By far the most important and arguably most unusual tool of wealth sharing in the GCC has been government employment. From the 1970s on, GCC governments provided a de facto public jobs guarantee for most of their male citizens (and sometimes also for their female ones). While this implicit guarantee has eroded in several GCC countries due to demographic growth and fiscal constraints, wage spending in the GCC remains unusually high (see figure 2 below). In Kuwait, a full three quarters of government spending are devoted to salaries and subsidies. Even in more diversified and relatively lower-income Saudi Arabia, wage spending constituted 536b SAR or 42% of total government spending in 2023, despite the large non-wage resources devoted to Vision 2030 projects. This compares to shares of wage spending in OECD country budgets of between 20 and 30%.

Figure 2: Government expenditure on employee compensation (% of total expenditure)



Until today, the share of GCC nationals in public as opposed to private employment is unusually high, while private employment remains dominated by foreign workers (see figures 3 and 4).

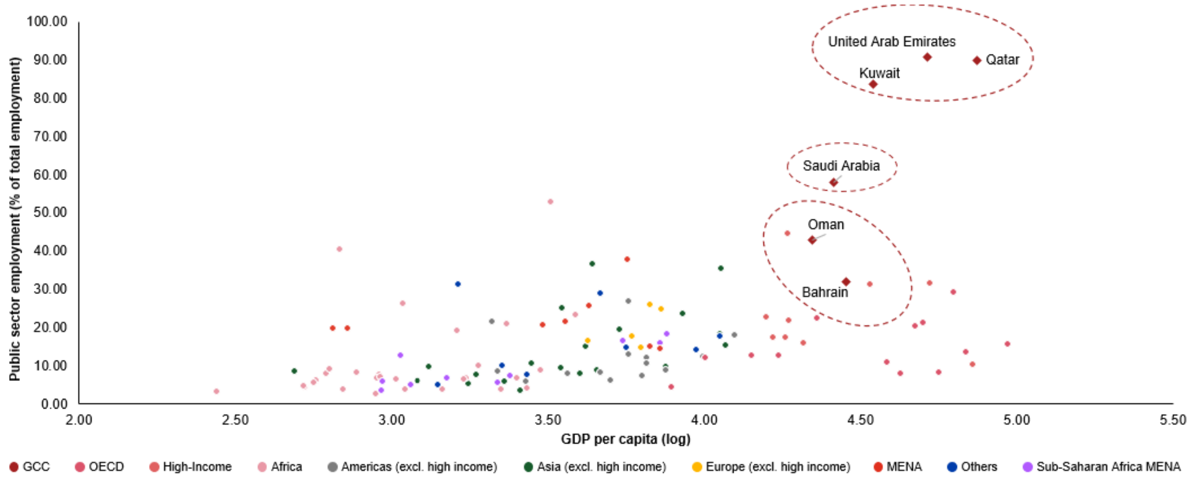
Figure 3: Share of expat and citizen workers in public and private employment[1]



Source: national authorities (most recent year available)

[1] The Bahraini public employment figure for nationals likely is a considerable underestimate as it does not include employment in the country's very large security sector.

Figure 4: Public employment as share of total employment



Strategy&

Note: Employment figures for GCC countries exclude expatriates | Estimates based on employment data for varying years for countries
Source: International Monetary Fund; International Labour Organization, National Statistics websites, Strategy& analysis

13 May 2024
3

Large-scale public employment has created a broad citizen middle class across the GCC. The simultaneous reliance of private labour markets on low-cost expatriate labour has allowed rapid expansion of the private sector while keeping inflation and the cost of living of state-employed citizens in check.

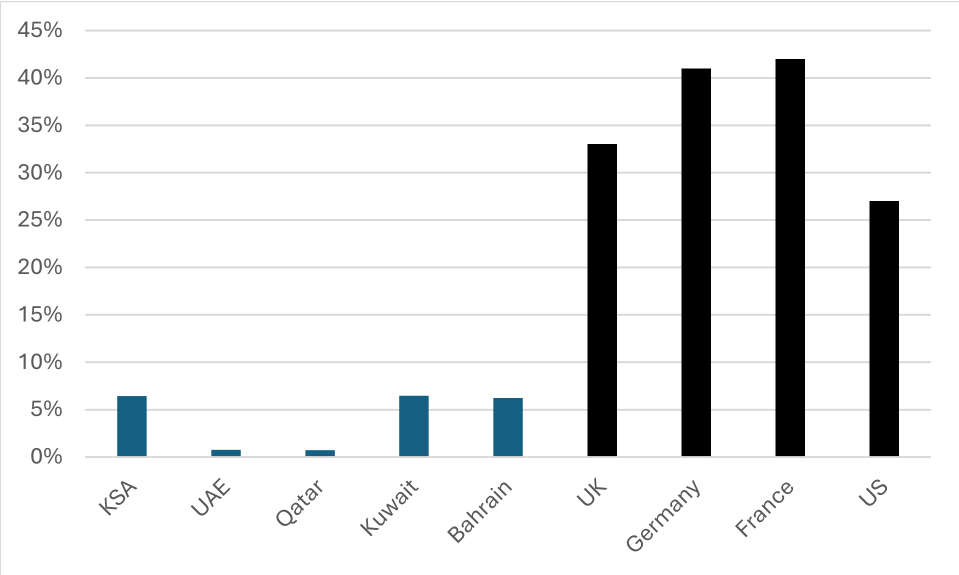
Yet citizen employment policies have come at considerable fiscal cost. In the case of the GCC countries with smaller oil rents per capita – Bahrain, Oman and Saudi Arabia – public employment spending has crowded out other forms of welfare or project spending for extended periods since the 1990s. Mass public employment has also made it harder to hold the bureaucracy accountable for performance and has led to administrative inefficiencies.

It has also distorted the labour market expectations and behaviour of citizens: Nationals have tended to wait for government employment rather than seeking private jobs or acquiring skills relevant in the private market – and if active in the private labour market, citizens have sometimes expected unrealistically short working hours or very high job security based on the public sector benchmark. As public hiring has slowed down, these attitudes have started to change – yet, as we will see below, many citizens have struggled to find middle class jobs on the private market.

<u>Summary</u>
In sum, some aspects of the old social contract have been very positive for welfare and economic development: Free public services have improved quality of life and citizen human capital, while other forms of wealth distribution have lifted large shares of GCC citizen populations out of the widespread poverty characterizing the region before the 1970s oil boom. Yet key parts of the old social contract have also created deep economic distortions. It is difficult to argue against universal provision of education and healthcare. But beyond this, the inherited distribution tools have become increasingly suboptimal. Energy subsidies have incentivized waste and pollution and have had regressive distributional effects as larger and richer households benefit more from them. Public employment guarantees have not only undermined government efficiency and crowded out other forms of state spending but also disincentivized citizen entrepreneurship and participation in the private labour market.

At the same time, modern means-tested welfare mechanisms remain comparatively underdeveloped across the region: Governments have introduced unemployment benefits and unemployment insurance systems as well as some means-tested cash grants, but total spending on such systems remains small. Figure 5 shows the shares of such spending in total government expenditure, which remain below 7% in all cases – much below levels in other advanced countries. Even when state pensions payments are excluded (which are large in ageing Western societies), social protection spending tends to amount to 15-20% in OECD benchmark cases.

Figure 5: Share of social benefits spending in total government spending



Source: IMF, OECD, most recent years available

Even more strikingly, the share of social benefits spending in total expenditure in the GCC is considerably smaller than implied spending on energy subsidies, with the sole exception of the UAE. It also is just a small fraction of salary spending in the public sector, while benefits spending in other advanced countries often rivals that on state salaries.

2. The old social contract is wearing thin

The aspect of the old social contract that has probably seen the most change is domestic energy subsidies, an area in which fiscal opportunity costs and economic distortions have been widely documented by academic and policy researchers. All GCC governments have lifted at least some energy prices during the last decade or so, although many of them still remain below international benchmark prices and in some cases governments maintain lower tariffs for citizens than for foreign residents.

In some cases, citizens have been compensated for higher energy costs with cash grants – notably through the means-tested "citizens' account" system created in 2017 in Saudi Arabia, which is generally considered regional best practice by economists and international organizations. Such compensation systems have helped to modernize the social contract: reducing economic distortions and fiscal costs while making sure that resources continue to go to the neediest rather than the richest households.

There has also been change on the public employment front, but the process has been less deliberately planned and, as a result, less integrated with general welfare modernization. GCC governments were by and large able to guarantee public jobs for new labour market entrants – initially mostly male but increasingly also female – from the 1973 oil boom to at least the 1990s. Since then, oil prices have fluctuated and citizen populations grown, making open-ended growth of the government payroll increasingly difficult in fiscally constrained Bahrain, Oman, and Saudi Arabia.

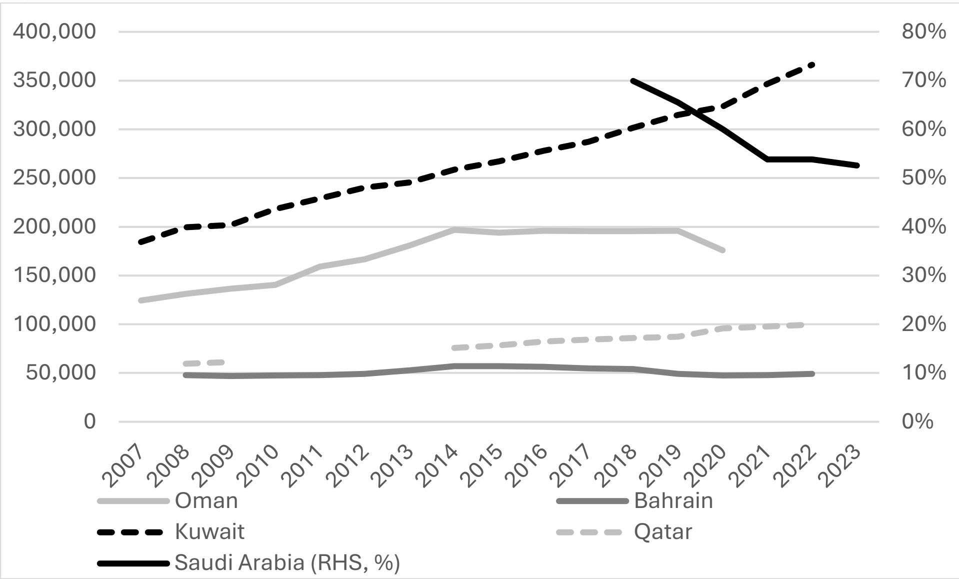
Some political leaders, notably in the UAE, have also dialled down the implicit job guarantee for social and strategic reasons, seeking to motivate young nationals to search for opportunities in the private economy even though the fiscal resources for public employment continue to be there in principle. Yet expectations of government employment have in some cases created high expectations of secure and well-paid jobs that the private labour market has not always satisfied.

Simultaneously, governments have started to modernize parts of their welfare systems, for example introducing temporary unemployment benefits for job-seeking citizens or temporary wage subsidies in the private sector. Yet such benefits remain much less generous than the implicit transfers built into traditional public employment. An unintended result of the gradual shift away from the public job guarantee therefore has been the emergence of a growing cleavage between older "insiders" who retain their public employment privilege and a growing stratum of citizen "outsiders" who have to make do on the private labour market. The region has, by and large, not yet defined a clear social contract for these outsiders that would be comparable to the implicit welfare guarantees that insiders enjoy. There are some innovative policy approaches like Abu Dhabi's cash assistance program which tops up family incomes to guarantee an adequate standard of living, but such models have not yet spread throughout the region.

Evidence of labour market dualization

Figure 6 shows the continued growth of citizen jobs in the public sector in the two high-income GCC countries with available data, Qatar and Kuwait, which have by and large maintained their public job guarantee. The trends in Bahrain and Oman are quite different, showing a stagnation in numbers since the mid-2010s despite continued population growth (and only slow employment growth in Bahrain even before then). In Saudi Arabia, the share of publicly employed citizens as share of all employed citizens, while still high, has dropped substantially since 2017, as public hiring has stalled while private employment has grown fast (annual absolute figures are not available on a consistent basis).

Figure 6: Citizens employed in public sector

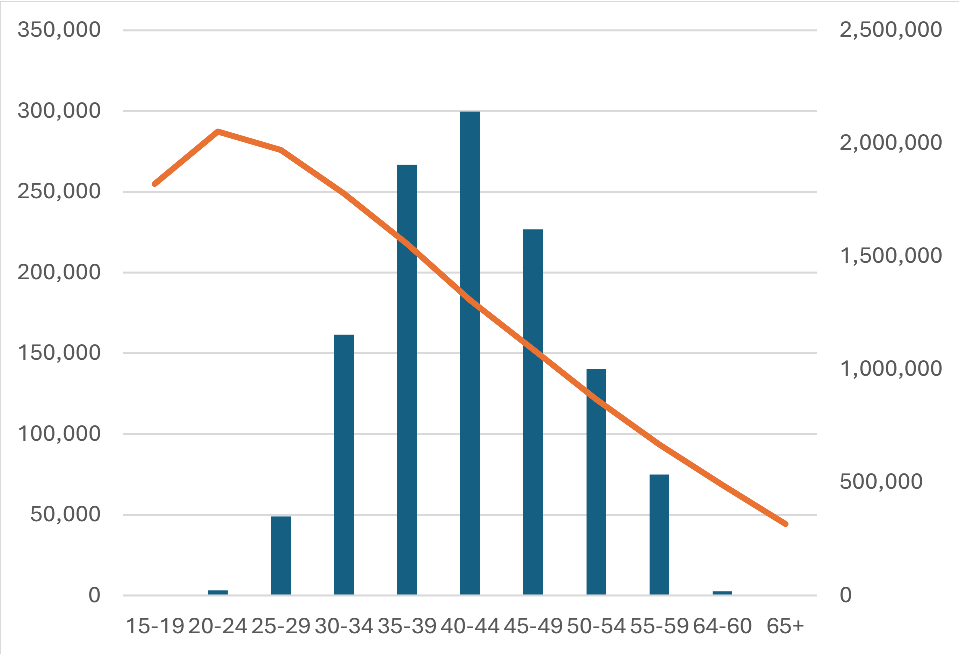


Sources: national authorities

Note: Saudi figure shows proportion of publicly employed Saudis among all Saudi employees

As a result of the strong reduction in public hiring, middle-aged Saudis are strongly over-represented in the civil service, while there are very few publicly employed young citizens (see figure 7).

Figure 7: Age breakdown of Saudi civil servants (left axis) and general citizen population (right axis)



Sources: Labor Force Survey bulletin, Q4-2020 (tab 39); GASTAT population estimates

As public jobs have become scarce, young citizens have the joined private labour market in unprecedented numbers in Bahrain, Oman, and Saudi Arabia. Given the costs and distortions created by excess public employment, this is in principle a very positive outcome. Yet economic outcomes for the vast majority of these young citizens have been worse than for their peers in the public sector.

Citizens on the private labour market do enjoy a number of government-provided privileges such as national employment quotas, citizen-only wage subsidies, unemployment and training benefits as well as job placement services. Yet they have to compete with an almost unlimited pool of international workers whose reservation wages are set in low-income countries of origin like Pakistan, India or the Philippines – a situation that qualitatively distinguishes GCC labour markets from virtually any other labour market.[2] The volume of assistance programs for citizens in the private sector remains comparatively limited; benefits tend to be temporary and they do little to bridge the gap to the wages and job conditions available in the public sector (the Nafis program in the UAE is probably the most generous, yet it also has to compete with quite generous public sector packages).

As a result, the relatively lower-income Gulf monarchies Bahrain, Oman and Saudi Arabia have seen citizen unemployment as many blue-collar jobs remain unattractive to them – and when citizens are in private employment, they typically work longer hours, enjoy less job security and have lower incomes than their peers in the public sector. Many young citizens struggle to obtain the middle-class living standards that the social contract in the region has historically provided to GCC nationals.

[2] The only other labor market in which private employment is similarly dominated by foreigners from low-income countries is Brunei, another oil-rich monarchy.

Table 1 below shows that in cases where data are available, citizens earn more in the public sector than in private employment. The figures likely understate the difference because private sector averages are pulled up by a small segment of high earners. The divergence in median wages therefore is bound to be even larger – as is the difference in hourly wages, given the typically longer working hours in the private sector. This contrasts with most other countries, where differences between public and private salaries are much smaller and sometimes reversed.

Table 1: Average monthly wages for citizens

	Bahrain (BD, 2011)	**Kuwaiti men (KD, 2022)**	**Kuwaiti women (KD, 2022)**	**Saudi men (SAR, 2023)**	**Saudi women (SAR, 2023)**	**UAE (AED, 2009)**
government	910	1,910	1,337	14,053	12,872	16,940
private sector	589	1,380	822	11,412	5,373	13,550
Private/public	64.7%	72.3%	61.5%	81.2%	41.7%	80.0%

Source: national authorities

All three mid-income Gulf monarchies have seen the emergence of low-income workers among their citizens. The most frequent monthly wage bracket of Bahrainis newly entering the labour market in 2019 was 300-349 BD ($800 to $925).[3] Even in a country with free education and healthcare and almost no taxation, this is a quite low wage. In Saudi Arabia, 1.3m of the 2.27m Saudis employed in the private sector in Q3/2023 earned less than 5000 SAR/month (1330 US$). In Oman, 79,000 out of 262,000 Omanis employed in the private sector in 2019 earned between 325 and 399 OR a month ($840 to $1040). These wages are still higher than what most of their expatriate competitors earn, yet much below what was historically available or citizens in the public sector.

Unsurprisingly, survey data from across the region show that government remains the employer of choice for GCC jobseekers, not only due to higher wages but also due to better job security, shorter working hours, (typically) less work pressure, longer holidays, and better benefits, all of which constitute additional privileges for public sector "insiders".

One macro-economic by-product of typically low wages available for nationals in the private sector is that private employment creates only limited demand in the economy: The total public wage bill of 532b in Saudi Arabia in 2023 compared to an aggregate wage bill of all privately employed Saudis of only about 200b SAR.[4] This means that different from most other advanced economies, consumer markets remain strongly dependent on spending from state employees rather than organic private demand creation, which constitutes a hindrance to sustainable non-oil diversification. Citizens on low private wages also struggle to acquire property, marry or start a family, which has wider ramifications for quality of life and social development.

The emergence of a "dual" labour market for citizens, divided into relatively privileged insiders and relatively disadvantaged outsiders, is not unusual in international comparison. There are similar structures in Europe and other parts of the Global South, just that the divides there are not usually between public and private employment. Instead, in Europe the dividing lines typically run between well-unionized employees in "core" sectors and precarious workers in the service economy. In the Global South, the main dividing line lies between workers with formal contracts and social security on one hand and those in the informal economy on the other. Another important distinction of the GCC is the presence of a very large, low-cost expatriate workforce, who in many ways are even more

[3] Data from Labor Market Regulatory Authority.
[4] The aggregate expatriate wage bill is higher but a large share of it leaks abroad through remittances.

distinct “outsiders”, and whose presence makes the challenge of providing a new social contract for citizens in the private sector more complex.