



مركز الملك فيصل للبحوث والدراسات الإسلامية  
King Faisal Center for Research and Islamic Studies

# Can We Saudize the Labor Market without Damaging the Private Sector?

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Special Report

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Among all the economic challenges on the road to Vision 2030, job creation for Saudi citizens is the politically most important one—and after an initial focus on other Vision-related policy areas, it is increasingly taking center stage in the kingdom’s economic policy debate. However, a formula to guarantee sufficient, sustainable jobs for Saudi citizens is still missing: The Nitaqat employment-quota system has created significant employment since its introduction in 2011, but it has also imposed significant costs on business, and many of the Nitaqat-induced jobs appear to be unproductive or not even real. Relying on natural economic growth to put more Saudi citizens into employment will be insufficient: Not only has growth been muted due to ongoing fiscal adjustments, but whatever private jobs have been created have mostly gone to foreign workers instead. Finally, creating new government jobs is fiscally unsustainable and reduces incentives for Saudi citizens to seek more productive private employment.

Saudi Arabia, like other Gulf Cooperation Council (GCC) countries, faces a fundamental obstacle in its attempts to create private jobs for citizens: a significant difference in both labor rights and labor costs between citizens and foreign workers that almost invariably leads employers to prefer the latter. This report explores the roots and the consequences of this twofold gap and presents new ideas on how to narrow or even close it. The report draws on publicly available labor market data as well as original, as-yet unpublished employer and job-seeker survey data from Saudi Arabia to explore the perceptions and priorities among private firms regarding the employment of Saudi citizens. The employer perspective has often been missing from the Saudization debate, and it must be seriously analyzed if we want to identify policies that work on the ground rather than creating evasion through “phantom employment” and other manipulation techniques.

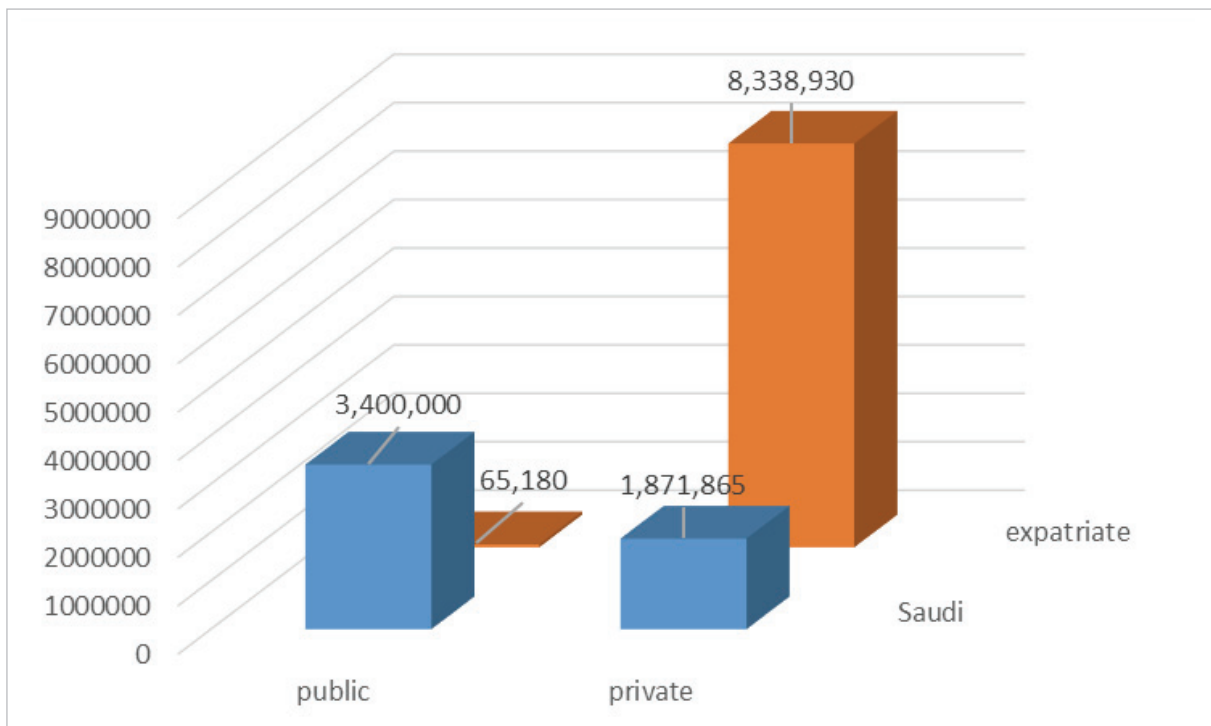
## 1. A Segmented Labor Market

Figure 1 shows the deep division of the Saudi labor market: Almost two thirds of citizens work in the public sector, while the private sector remains dominated by foreign workers. Saudi citizens’ reliance on government employment stands out in international comparison, as both advanced and emerging economies generally accommodate fewer than one fifth of their citizens in the public sector (Figure 2).

At the same time, the employment ratio of Saudi citizens is uniquely low: About 38% of Saudi citizens of working age hold a job (fewer than 20% among Saudi females), compared to 60–80% in advanced countries. Despite the government’s monumental job creation effort, most Saudi citizens aged 15 to 64 do not hold a job.

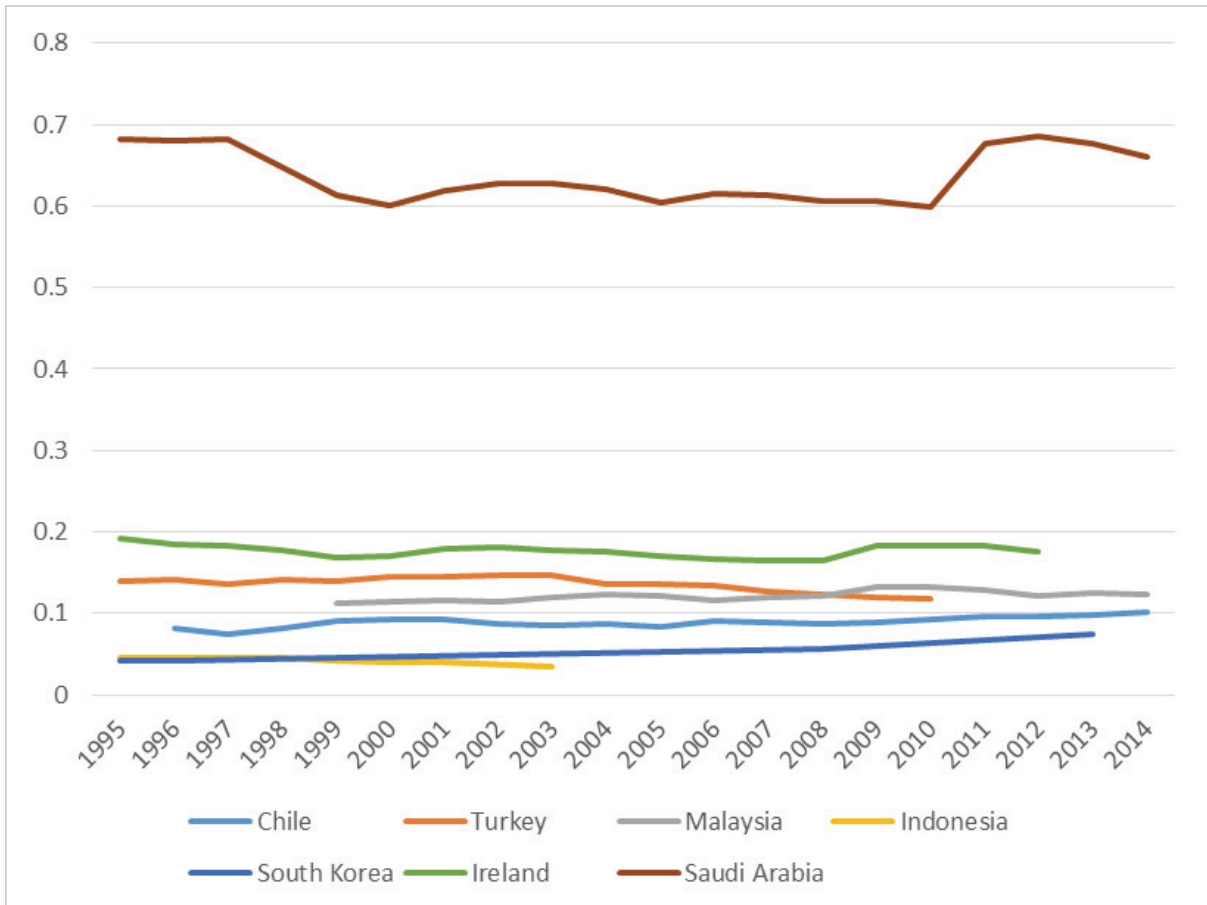
The vast majority of foreigners in the private sector, in turn, are low-skilled and are employed in sectors like construction, personal services, or retail. This is a key reason for stagnating levels of private sector productivity in the kingdom since the 1980s, which stand in contrast to continuous productivity improvements in almost all other countries of the world.

**Figure 1: Distribution of employees by sector and nationality (2017)**



Official unemployment among Saudi citizens is close to 13%. If more of the currently inactive Saudi women enter the labor force, this ratio is likely to creep up further, but even if that does not happen, the number of Saudi citizens of working age will increase by more than 200,000 per year for at least the next decade as large birth cohorts will reach maturity. Private sector job creation for Saudi citizens since 2015 has been significantly below 100,000 per year, creating a growing wedge between the jobs needed by Saudi citizens and the jobs created for them.

**Figure 2: Share of government employees in the economically active citizenry of select countries**

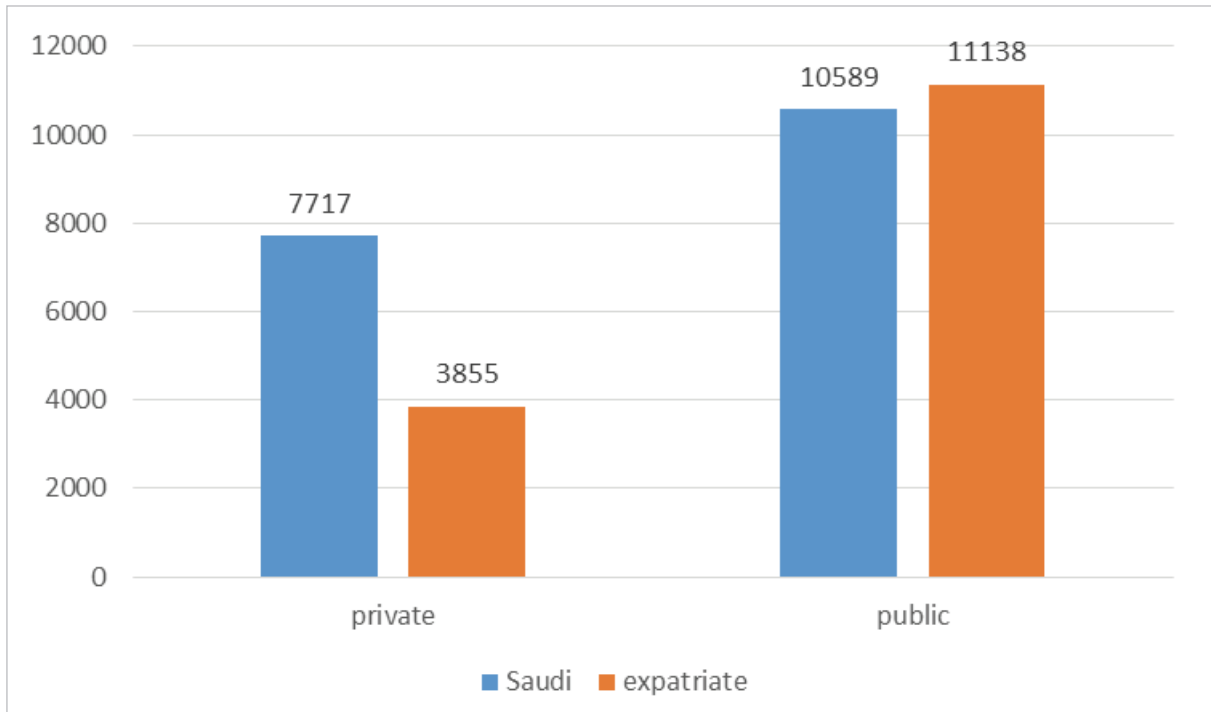


What explains the concentration of citizens in the government sector and the dominance of foreigners in the private sector? The key factor is a two-fold gap, in both wages and work conditions, between public sector Saudi employment, private sector Saudi employment, and private sector expatriate employment. In short, because of both better wages and more convenient work conditions, public sector jobs remain by far the most attractive option for nationals, to the extent that they either eschew private employment or develop unrealistic expectations about wages and conditions in the private sector. Private employers in turn usually prefer expatriate workers, who are willing to put up with much lower wages and have fewer rights in the Saudi labor market.

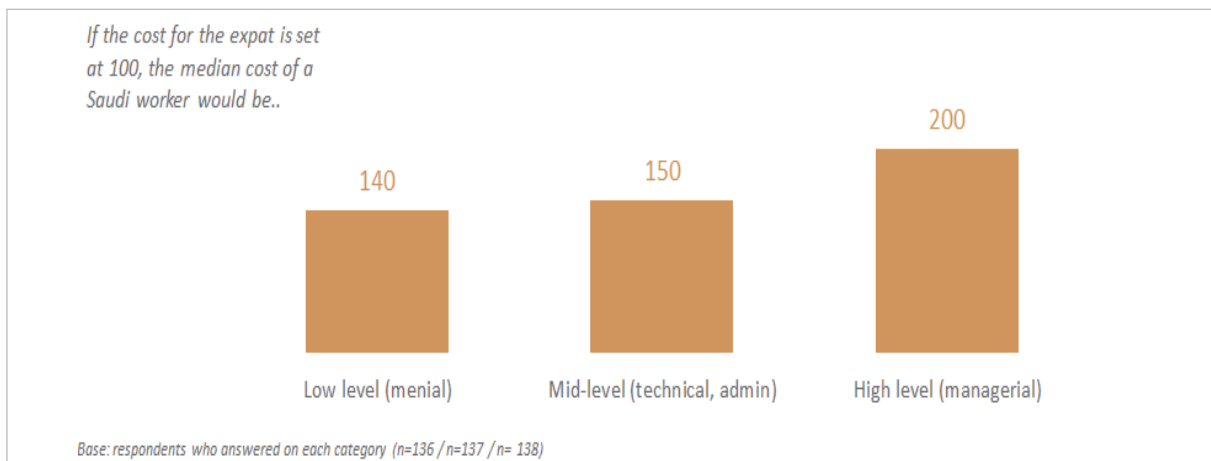
Figure 3 illustrates the labor cost gap in the Saudi labor market: Saudi citizens, on average, make the most money in the public sector. However, the average wages for Saudi citizens in the private sector are still twice as high as those of private sector foreign workers.

The cost differential in the private sector is also reflected in data from a 2014 YouGov survey in which we asked Saudi employers to compare the cost of Saudi and foreign workers for the same types of jobs. Foreign workers turned out to be considerably cheaper even if factors such as skills, age, experience, and nonwage costs are controlled for, which gives employers an obvious reason to prefer foreigners (Figure 4).

**Figure 3: Average wages in the Saudi public and private sectors (SAR/month)**



**Figure 4: Reported costs of Saudi employment in the private sector**

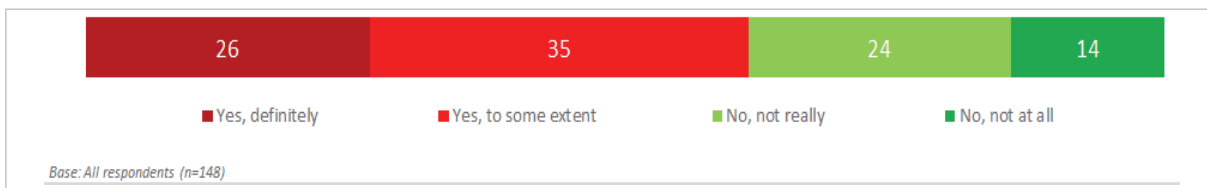


At the same time, the public sector remains the most attractive employment option for most Saudi citizens—not only in terms of wages but also in terms of job security, working hours, holiday entitlements, and near-guaranteed promotions. While the most talented Saudi job-seekers often have better opportunities in the private sector, the bulk of regular Saudi citizens have strong incentives to prefer government employment.

This is reflected in data from our survey in which we asked Saudi employers whether government is the main competitor in recruitment. As Figure 5 shows, 61% of employers agreed at least somewhat with this statement. The question was asked at a time when competition for Saudi employees *within* the private sector was already strong due to Nitaqat quotas. While government hiring has dropped considerably since 2015, many Saudi citizens still hold out for an eventual government job. Interviews with private employers indicate that many firms are concerned that job applicants might be on the waiting list for a government position and could leave them as soon as a public sector position becomes available—one of many incentives for employers to prefer foreign workers.

The benchmark of public sector employment also seems to influence work attitudes among Saudi citizens. Figure 6 shows survey data on the desired number of working hours among Saudi job-seekers. More than half of respondents expect six or fewer working hours per day, which might be feasible in many government offices but is not realistic in the private sector.

**Figure 5: Employer survey: Is government the main competitor in recruitment for you?**



**Figure 6: Expected number of working hours**

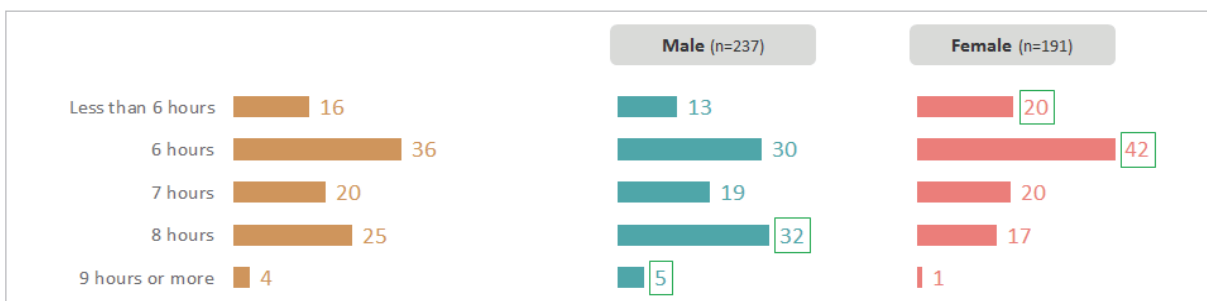


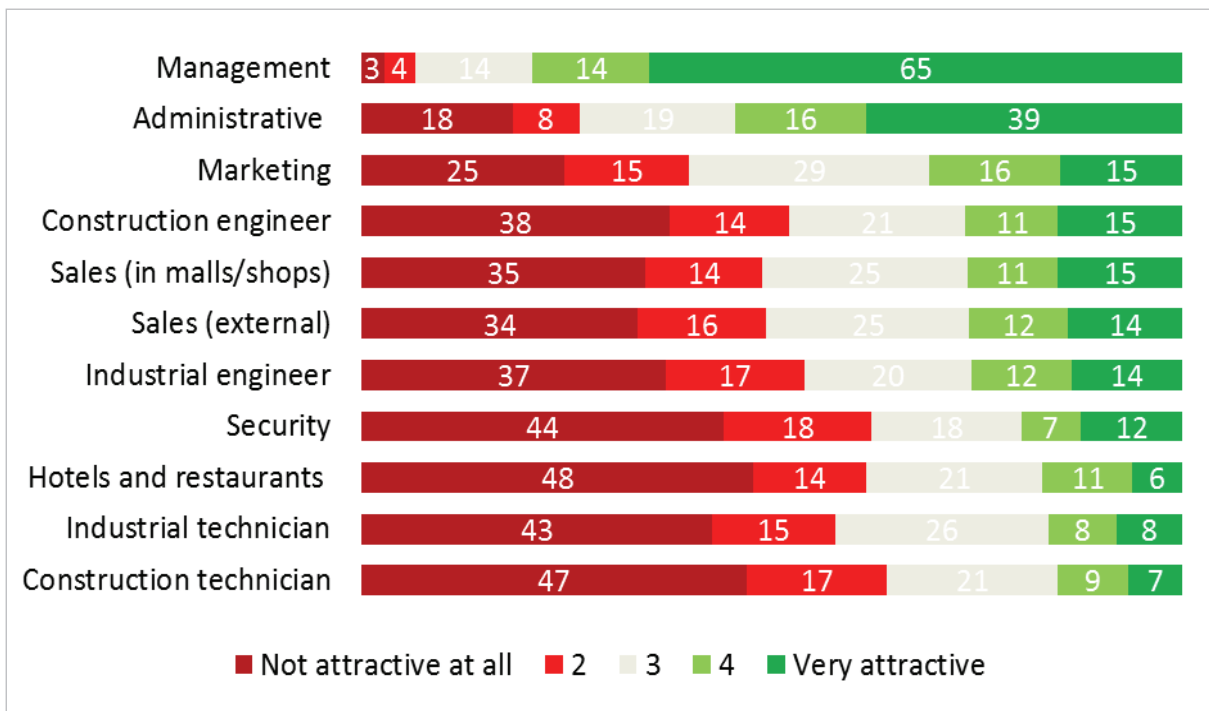


Figure 7 shows how attractive different types of private sector occupations are to Saudi job-seekers. Saudi citizens turn out to be quite selective, rejecting the majority of jobs that are available in the private sector. This again is quite likely a result of the historic availability of higher-status, white-collar jobs in the government sector.

The survey also showed that current Saudi employees in the private sector—who should, if anything, be more in favor of private employment than their peers—would prefer a government job by a large margin: 76% would prefer a government position with similar salary, higher job security and working hours from 7:30 to 2:30, while 71% would prefer a government job even with the same working hours as they currently have.

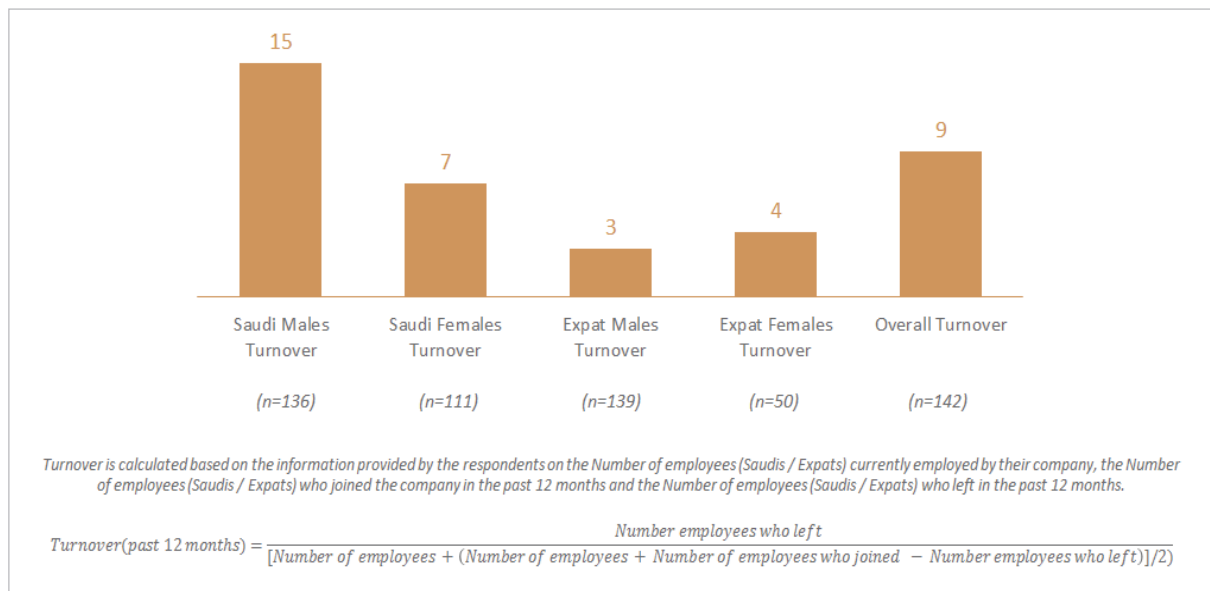
These data are from 2014, and anecdotal observations suggest that since that time, job-seekers have become more flexible in the types of jobs they are willing to accept. However, the shift has been gradual, and many Saudi citizens retain a strong preference for white-collar, managerial jobs, which are limited in number. Saudi job-seekers’ limited willingness to consider many types of private jobs is an important obstacle to Saudization.

**Figure 7: Job preferences of Saudi job-seekers**



Labor costs and competition with government as an attractive employer are not the only factor making employing foreigners more attractive to the private sector. Foreigners are also often willing to work particularly long hours, as they have no family in the country, and to put up with more difficult working conditions. Equally important, the mobility of foreign employees on the local labor market is restricted through the sponsorship system. As Figure 8 shows, this leads to considerably higher turnover among Saudi employees than foreign employees.

**Figure 8: Mobility gap—average turnover of Saudi private sector employees (%)**



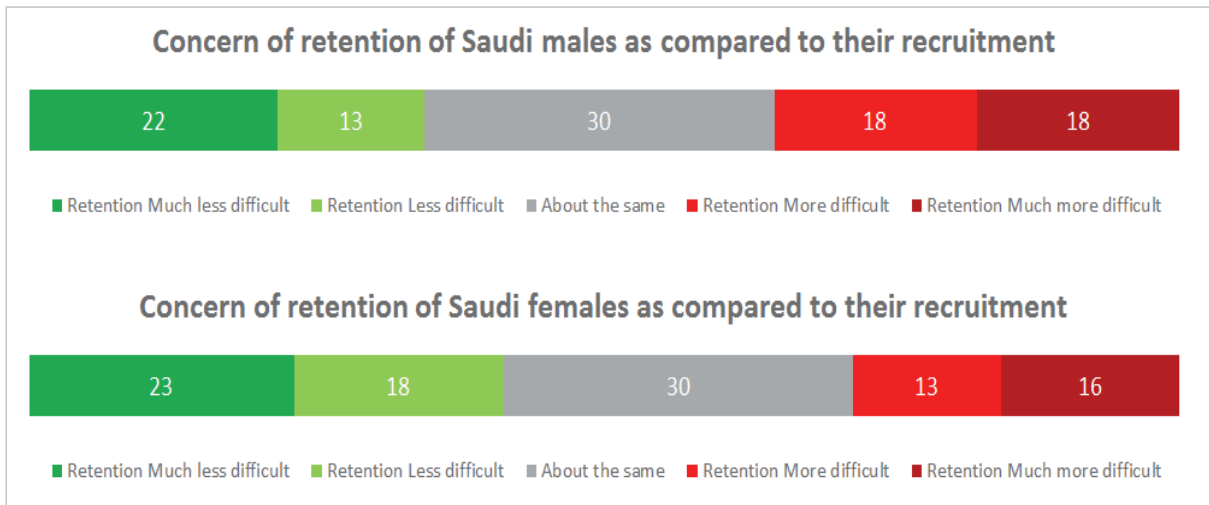
Turnover among Saudi citizens typically is a result of their decision to leave a job, while foreign workers are usually tied to their current employer through sponsorship, which weakens their negotiating position and makes them easier to control. If they leave a job, it is typically because they are let go.

Figure 9 shows that the retention of national employees is an important concern among employers. Given that recruitment in the age of Nitaqat-induced hiring competition is already difficult, the similarly large worry about retention is significant. At the same time, citizens also tend to be harder to dismiss than foreigners, as reflected in Figure 10.

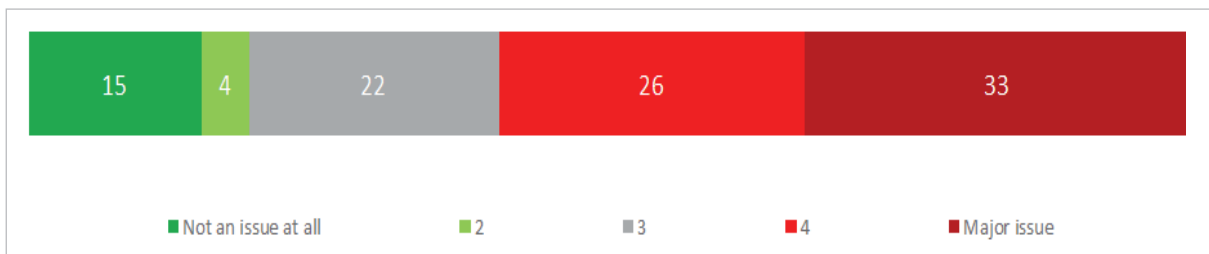
In sum, nationals are more difficult to recruit, leave jobs more easily, and are harder to fire than foreigners (despite recent amendments to Article 77 of the Saudi labor law that have, in

principle, made layoffs and redundancies easier to carry out). All these differences in labor rights and practices provide more reasons for employers to prefer foreigners over citizens in the private labor market. The end result is that the private employment of Saudi citizens is unlikely to happen through organic economic growth. Instead, targeted policy interventions are needed.

**Figure 9: Retention of citizens as concern for employers**



**Figure 10: How much of an issue has it been for you to dismiss Saudis as compared to foreigners?**



## 2. Do Quotas Work?

The most important such policy intervention has been the implementation of employment quotas for nationals in the private sector, organized since 2011 under the Nitaqat system, which prevents companies with less than a minimum share of Saudi employees from conducting vital transactions with the Ministry of Labor. Since the introduction of the Nitaqat system, the number of Saudi employees in the private sector has tripled to close to 2 million, and it is likely that Nitaqat accounts for the bulk of the newly created jobs.

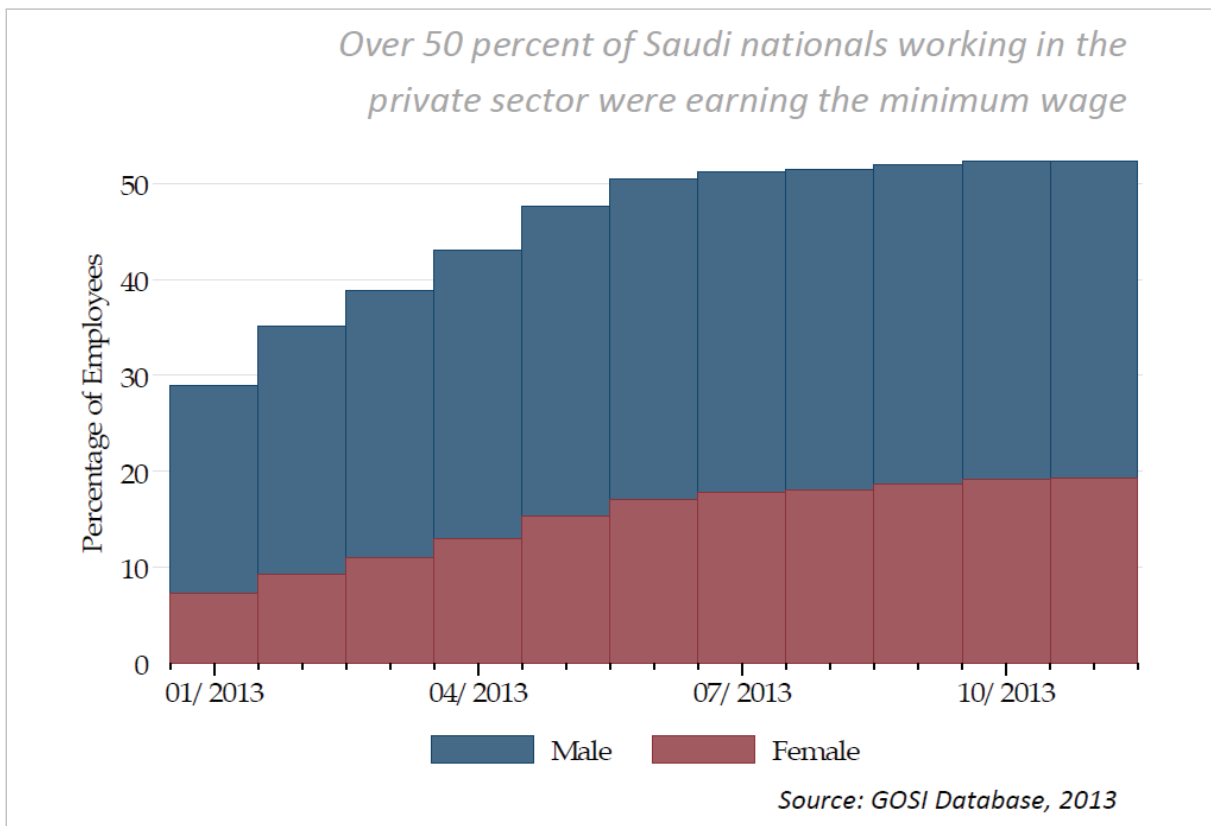
That said, there is evidence that significant numbers of the new jobs are unproductive or do not involve any actual work at all. The share of Saudi citizens earning 3,000 SAR/month, the minimum qualifying wage for Nitaqat purposes, has increased substantially since the introduction of the program (Figure 11). Interviews indicate that Saudi employment in the construction sector—which has seen disproportionate Saudi job growth since 2011—seems to often consist of “phantom employees” who receive the minimum qualifying wage but are not expected to show up for work.

Nitaqat can also be manipulated by registering firms in different sectors than the one in which they actually operate and by employing foreign workers who are formally under someone else’s sponsorship. Finally, Nitaqat provides uneven incentives: Firms have no reason to exceed the employment-quota thresholds that put them into the desired Nitaqat category. Saudization policies should instead incentivize the hiring of Saudi citizens at any employment ratio, even for firms that have already achieved the minimum requirements.

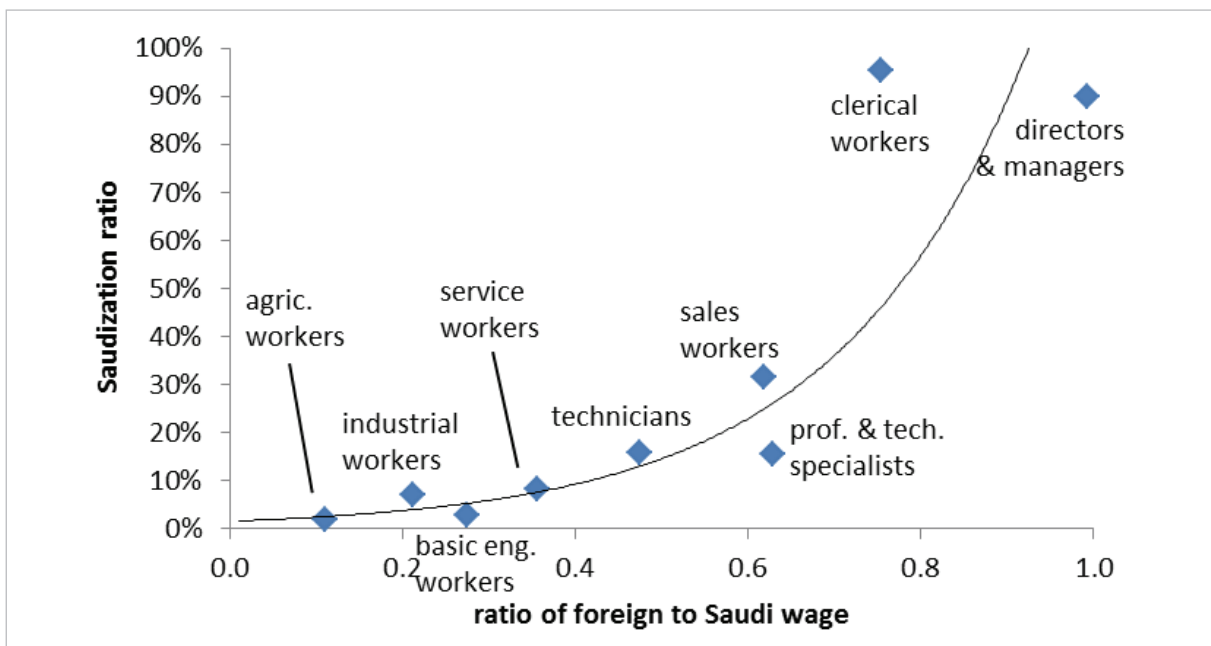
As firms have struggled to absorb the Nitaqat quotas, private job growth for Saudi citizens has slowed drastically since 2014. Why do firms struggle to employ more Saudi citizens and instead resort to phantom employment and other techniques to evade the Nitaqat regulations? The main reason is that quotas per se do not address the persistent gap in labor costs and labor rights between nationals and expatriates, as was outlined in this analysis. To remain competitive, employers remain under pressure to predominantly employ cheaper and more easily controlled foreign workers. Genuine market-driven Saudization will only come about in response to closures of the gaps in wages and rights. What can be done about this requirement? We will discuss the two gaps in turn.

Figure 12 provides strong evidence that reducing the gap in wages promotes the nationalization of jobs: Jobs with equal average wages for Saudi citizens and foreigners are already largely Saudized. Unfortunately the most frequent jobs in the private labor market, including in sales and service, retain a fairly high ratio of Saudi to foreign wages and remain dominated by foreigners.

**Figure 11: Increase in minimum wage jobs for Saudis since the introduction of the Nitaqat program**



**Figure 12: Saudization ratios versus wage ratios of different professions**



### 3. Can We Close the Gap in Labor Costs?

How could the gap be closed or at least narrowed? The introduction of new levies on foreign worker, however unhappy businesses have been about them, is a step in the right direction as they make employing foreigners relatively less affordable. That said, the average labor cost differential is too large to be bridged simply by increasing the cost of employing foreigners as on average, Saudi citizens earn almost 4,000 SAR/month more than foreigners in the private labor market. Closing this gap through taxation alone would require prohibitively high fees, which would drive many companies out of business and trigger significant inflation.

It would make more sense instead to close the gap from two directions; namely, to use fees to make foreign workers more expensive for employers but also make the employment of Saudi citizens cheaper through enacting permanent wage subsidies. Subsidies can be fiscally expensive, but one attractive feature of using simultaneous revenue and expenditure tools in the labor market is that they can be combined to be fiscally neutral: In other words, the government could use higher foreign worker levies to directly finance subsidies for Saudi employment. Figure 13 shows how this could affect net wages and costs for employers, assuming 6 million foreign and 2 million national workers in the private sector and a monthly levy per foreign worker of 800 SAR.

It is difficult to predict to what extent (pre-tax) wages of foreigners and nationals will change as a result of fees and subsidies. Economic theory predicts that Saudi workers will somewhat reduce their pre-subsidy wage expectations as their combined (post-subsidy) income will increase—which is, in fact, what happened among Kuwaiti employees when the Kuwaiti government introduced its *da‘m al-‘amala* subsidy system in the early 2000s.

Conversely, employers are likely to pass some of the new fees on to foreign workers in the form of (even) lower wages. However, unless foreign workers indirectly bear *all* the fees and Saudi employees capture *all* the subsidies, the gap in employment costs between the two groups of workers will shrink. Moreover, while employers would pay higher fees on foreign workers, they would recoup these losses through lower employment costs for hiring Saudi citizens.

At current levels of expatriate employment, a labor fee on foreigners of 800 SAR/month could finance a subsidy of 2,400 SAR/month for nationals, which could increase the desirability of many jobs that currently pay too little for Saudi citizens. A labor fee of 1,600 SAR/month could

finance a subsidy of 4,800 SAR/month, as a result of which foreigners in many cases would be more expensive than Saudi employees. It would be important to make the subsidies permanent: the currently available, time-limited Human Resources Development Fund (HRDF) subsidies for first-time employees still do not create sufficient incentives for firms to hire Saudi citizens as the firms will become responsible for their full wages after two years or less.

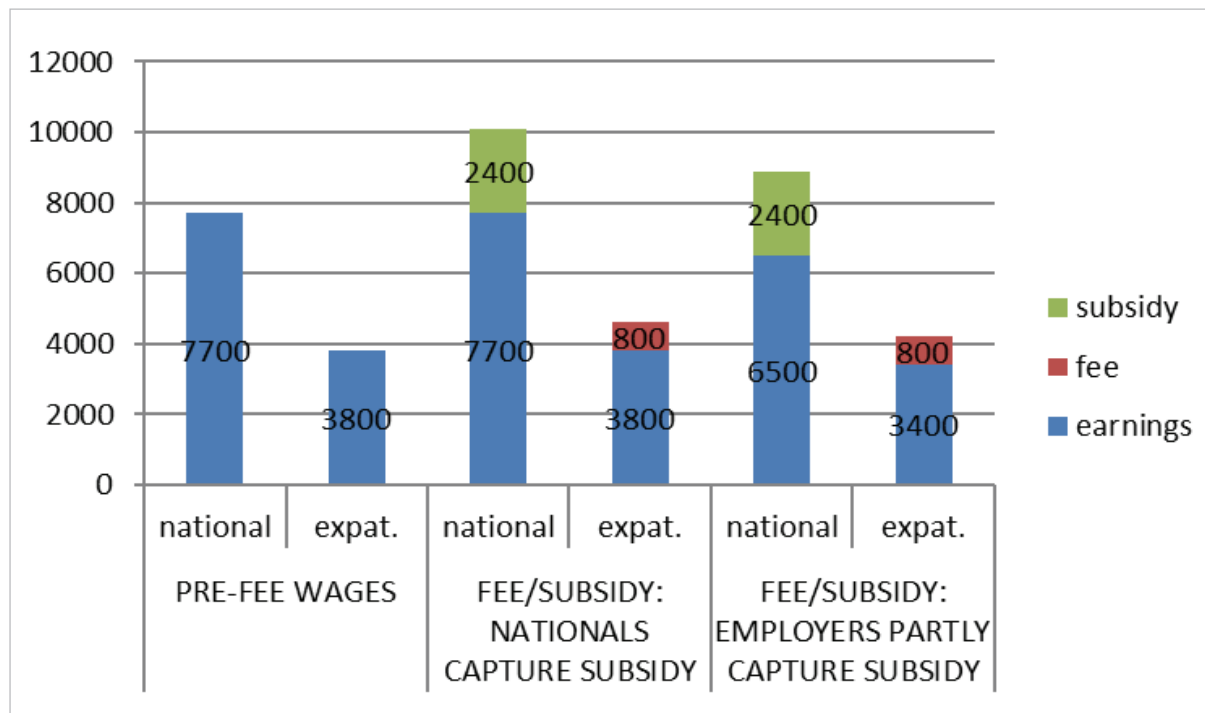
In practice, fees and subsidies should lead to disemployment among foreign workers, and hence to a relatively lower revenue basis—but also the availability of more jobs to Saudi citizens. Fees and subsidies should be gradually increased over time, allowing the government to measure their effect on employment and calibrate them so as to achieve full employment for Saudi citizens, and also allowing the government to make them revenue-neutral. Even if the number of foreign workers should drop to a level at which reasonable wage subsidies cannot be fully financed through fees on expatriates, the fiscal savings from not having to employ additional Saudi citizens in the government apparatus would far outweigh the cost of subsidies.

The government should also consider a minimum wage for foreigners to prevent employers from passing on new fees to the worst-paid and most vulnerable foreigners. Such minimum wages already exist in Kuwait and Qatar and are being actively debated in other GCC countries.

Subsidy systems can be subject to manipulation—and Kuwait’s otherwise successful *da‘m al-‘amala* system has indeed been exploited by nationals who receive subsidies for phantom jobs, in which they do no actual work. Such abuse needs to be minimized through tight monitoring and sanctioning mechanisms. Nonetheless, even a subsidy system that is subject to some “leakage” remains preferable over quota systems: Not only are quotas rigid, they also leave little flexibility to firms, while subsidies allow market forces to adjust the distribution of foreign and Saudi employment across individual employers.

Unlike subsidies, quotas also give no real economic incentives for Saudi citizens to seek private jobs. Subsidies are also far preferable to the old policy of using the public sector as the employer of last resort, which is much more costly and strongly distorts general labor market incentives. Given that subsidies would be financed through fees on foreign workers, any “leaked” subsidies would at worst function as a privately financed, de facto unemployment benefit.

**Figure 13: Potential impact of a combined fee-subsidy regime for private employment (monthly wages in SAR)**



## 4. Closing the Mobility Gap

There remains the second major gap in the field of labor rights. The central issue here is mobility; namely, the ability to switch employers, which greatly varies between nationals and foreigners. As we have seen, restricted mobility makes foreigners more attractive as employees. The key policy change required here is reform of the sponsorship system to give foreign workers more freedom to move between employers. This would bring Saudi Arabia closer to labor market regulations in advanced economies as well as neighbors like the UAE and Bahrain, which have undertaken significant reforms to their sponsorship regulations.

A relevant example can be found in the recent experience of the UAE, which partly liberalized its sponsorship system from 2011 on, making it easier for foreigners to switch employers after completing the first two years of their work contract. As a result, the number of foreign workers switching to a new employer has gone up significantly—and as Figure 14 shows, this has led to significant increases in the wages they receive. These increases are both due to the improved

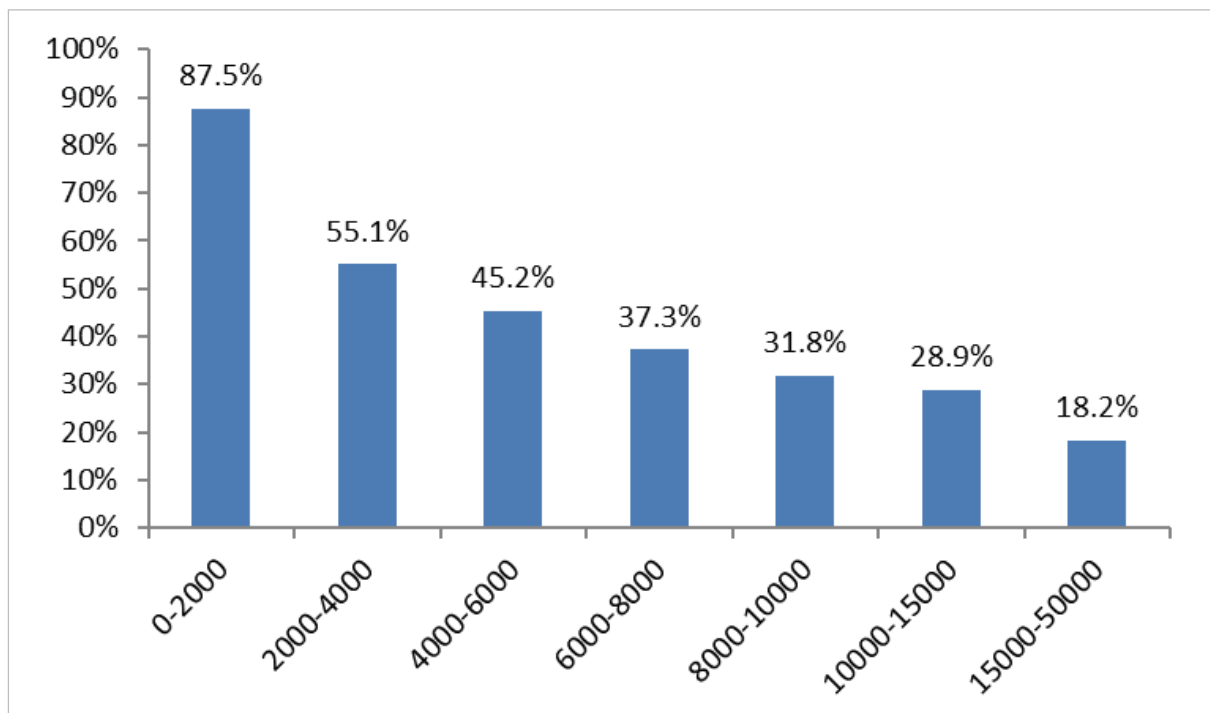


productivity resulting from better matching between workers and firms and also to the better bargaining position that labor mobility provides the foreign workers.

Wages resulting from a better bargaining position in turn help to decrease the gap in labor costs between foreigners and nationals and make the latter relatively more attractive to employ. Perhaps more important, closing the gap in mobility as compared to nationals takes away the incentive for employers to hire foreigners because they are more easily controllable (and sometimes exploitable).

Formal relaxation of the sponsorship system should be accompanied by policies that facilitate expatriate worker mobility in practice, including the creation of a powerful central labor regulator that controls and supervises mobility in place of the employers. Foreign workers should be allowed temporary unemployment while remaining in the country in case of resignation or dismissal, a provision that was recently introduced in the UAE.

**Figure 14: Wage gains of foreign workers who changed employers in 2013, by wage bracket (dirhams/month)**



The government should also consider advancing its plans for a green card that would give deserving foreigners a residency status not tied to a specific employer or employment status. Labor ombudsmen and case officers should be created to help foreign workers in the case of conflicts with employers, and sanctions for abuse by employers (e.g., false reporting of absconding workers) should be strengthened. In addition, recruitment agencies and databases should be set up to facilitate the local recruitment of expatriate workers rather than conducting it outside the kingdom, as is done currently.

## Outlook

The policies outlined in this report could contribute significantly to closing the existing gaps in labor costs and workers' rights gaps, thereby giving Saudi citizens powerful incentives to seek private jobs while providing employers with economic reasons to recruit Saudi workers. That said, even with the best policy package, the transition to a scenario in which the majority of Saudi employees work in the private sector will not be easy: Abandoning the government job guarantee historically provided to male citizens will be politically challenging. The policies to facilitate such a transition might have to go beyond labor fees and subsidies and reshape the Saudi wealth distribution system on a more fundamental level, for example through a universal basic income.<sup>1</sup>

Creating sufficient private jobs for new cohorts of Saudi job-seekers is the key socioeconomic challenge that the kingdom will face into 2030 and beyond. While it has experimented with new policies in many economic areas, labor market regulation has been left largely untouched since the introduction of Vision 2030; in fact, other GCC countries have in many respects overtaken Saudi Arabia as laboratories of labor reform. Given the government's newfound willingness to experiment and break taboos, the kingdom should accord higher priority to modernizing its labor regulations to address the root causes that keep Saudi citizens out of private employment. Only if these causes are addressed will Saudi workers come to play a major role in their country's economic diversification, as they deserve to do.

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(1) Steffen Hertog, "Making Wealth Sharing More Efficient in High-Rent Countries: The Citizens' Income," *Energy Transitions*, Vol. 1, No. 2, 2017, <https://link.springer.com/article/10.1007%2Fs41825-017-0007-2> .



## King Faisal Center for Research and Islamic Studies (KFCRIS)

The KFCRIS is an independent non-governmental institution based in Riyadh, the Kingdom of Saudi Arabia. The Center was founded in 1403/1983 by the King Faisal Foundation (KFF) to preserve the legacy of the late King Faisal and to continue his mission of transmitting knowledge between the Kingdom and the world. The Center serves as a platform for research and Islamic Studies, bringing together researchers and research institutions from the Kingdom and across the world through conferences, workshops, and lectures, and through the production and publication of scholarly works, as well as the preservation of Islamic manuscripts.

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