

Labour market reform options and dual labour market structure

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Questions

- *What do we know about successful labour market reform options?*
- *Which countries have successfully moved away from a dual labour market structure?*
- *Gulf countries are of particular interest*

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1. Summary

The literature identified for this report discusses labour market policy options with some case studies. Success is rarely claimed and difficult to attribute as a mixture of policies tend to be in place and a combination of policies is recommended. Policies also may take some time to produce results. Barriers to success and recommendations are highlighted from the literature.

Dual labour markets are characterised by a segregation between jobs with higher and lower levels of security. In Europe the divide is characterised by fixed-term or short-term contracts.

In Gulf countries the divide is between the security of public sector employment and relative uncertainty associated with private-sector employment (of particular interest for this report). For example, in Oman around 12 per cent of the private sector workforce are national citizens compared to 53 per cent of the population being national. Public-sector jobs in Gulf countries have historically been secure and comfortable as the government used oil money revenues to look after their citizens. Now the government needs to tighten spending and so want encourage nationals into the private sector where the working environment is more competitive. This is generally an unfavourable option for locals who are used to the comfort provided by public sector work and the government want to make this transition with minimal social unrest. Private sector firms have a good supply of migrant labour who are happy to work in the conditions that are present. The private sector are important for diversified economies so governments must also maintain good relations and minimise the raising of costs.

Options for increasing nationalisation of the private sector workforce:

- **Education.** Residents need appropriate capacity to work in the private sector. This includes soft skills, vocational qualifications and high-level English language ability. Education reform should be undertaken as a long-term solution to the problem. Training schemes could be considered outside of regular education systems.
- **Subsidising private sector to employ nationals.** Anti-corruption measures are required for this to be effective.
- **Nationalisation quotas.** Mandating companies to employ nationals. Again, anti-corruption measures are required here and economic inefficiencies may be introduced.
- **Minimum wage for nationals.** The costs here may fall on the company or the wage may be subsidised by the government. Corruption is less likely for this policy.
- **Reduce expat work permits.** Allowing more job opportunities for the local population.
- **Employment agencies** to assist with job matching.
- **Hiring caps or admission exams** in the public sector to reduce nationals entering.
- **Reducing pay rises in the public sector** to reduce the attractiveness of public sector employment and improve efficiency.

There was little evidence on the merits of these measures identified within the scope of this review. One study suggests successful nationalisation in the banking sector in Saudi Arabia was due to employers' provision of specific training for locals and relaxation of working hours to make employment more attractive. Research which sought the opinion of human resource managers in private companies suggest education and English speaking skills are important. Increasing motivation of nationals was also highlighted as a problem by employers. Locals expect higher wages and these norms are going to take time to adjust.

Reforms in Europe have included relaxation of dismissal procedures which may be a useful consideration for public sector employment in Gulf countries. Countries such as Italy and Spain

expanded the grounds for redundancy and mandated reinstatement for unfair dismissals was dropped. Some improvements in labour market segmentation have been shown from these measures in conjunction with other policies. In Germany, reducing unemployment benefits has reduced the reservation wage¹.

A situation analysis should be carried out in-country to assess labour supply and demand trends when considering labour market reform policies.

The problem of dualism was noted as particularly difficult for young people in Europe but not different according to gender. Gender differences were not discussed in the literature on the Middle East. In Asia, a move against discrimination in hiring would ensure citizens of each gender have an equal chance.

2. Background

A dual labour market is characterised by segregation between job bands.² The upper tier are described as having higher salaries, benefits, security, and better working conditions compared to the lower tier.³ The upper tier are often well unionised. The lower tier tend to consist of greater proportions of youth and women.⁴ Reforms to address this predominantly reduce employment protection in the upper tier, and improve regulation of temporary work which tends to dominate the lower tier. Policies to make dismissal easier helps reduce segregation. The literature talks about moving to an ideal known as 'flexicurity' where jobs are more uniformly both flexible and secure (eg. Ehmer & Schwegmann, 2017; Eichorst et al., 2017)). No country is identified as having successfully moved away from this kind of segregation but some experience is reported and some level of success achieved.

This report touches on different types of reform with a leaning towards relevance for increasing nationalisation of private sector work forces.

3. Encouraging public sector workers into the private sector in Gulf countries

A predominant labour market segregation issue in the Gulf is an excess of local people in well paid public sector jobs and migrant workers employed in the private sector. In Oman, only around 12 per cent of the workforce in the private sector are nationals (compared to 53 per cent nationals in the population), see table 1 (Carvalho, Youseff, & Dunais, 2018). Governments have over-staffed using oil revenue and public sector jobs are preferred for their favourable working

¹ The least amount a worker is prepared to work for. <https://marketbusinessnews.com/financial-glossary/reservation-wage-definition-meaning/> [Accessed 19/7/19]

² <https://www.hrzone.com/hr-glossary/what-are-dual-labour-markets> [Accessed 15/7/19]

³ <https://mitpress.mit.edu/books/dual-labor-markets> [Accessed 15/7/19]

⁴ <https://www.weforum.org/agenda/2014/12/lessons-from-polands-dual-labour-market/> [Accessed 15/7/19]

hours, wages and security. Expatriates are available for lower wages and are more likely to have the desirable skills.

Table 1: Share of nationals in private sector workforce and their share in the population (adapted from (Carvalho, Youseff, & Dunais, 2018).

Country	Proportion of nationals in private workforce	Proportion of nationals in population
Qatar	2 percent	12 percent
UAE	2 percent	16 percent
Kuwait	5 percent	31 percent
Bahrain	15 percent	46 percent
Oman	12 percent	53 percent
Saudi Arabia	22 percent	63 percent

There is a general drive to improve representation of local workers in the private sector in these countries. Governments are looking to reduce wage bills but maintain the social contract.

Saudi Arabia are undertaking education reforms so that young people may acquire the skills required to work in the private sector (Oxford Business Group, 2016). These include soft skills and vocational qualifications. They aim to increase enrolment almost 9-fold between 2016 and 2020.⁵

A consultancy report for the Gulf Co-operation Council (GCC) (Carvalho, Youseff, & Dunais, 2018) discusses seven policy tools for improving the representation of nationals in the private sector labour market:

- 1) **Subsidies for the private sector for employing nationals.** Anti-corruption measures are required to make sure that companies are not claiming for 'ghost employees'.⁶ In practice employers and employees have found loopholes which require a high-level of monitoring and inspection. Kuwait used this policy, which led to more nationals applying for private-sector jobs but resulted in an estimated 15 per cent of the national workforce in 'ghost employment'. To improve this, employers must now include training for graduates to be eligible for the subsidy.
- 2) **Nationalisation quotas.** Mandating companies to employ a certain number of nationals. The instrument must balance fines for non-compliance with benefits for those exceeding targets. The same problems are inherent as above, employees seeking money to be registered as employed although not working. There must be an adequate supply of nationals with the right skills for this policy to work. This policy has had some success in Saudi Arabia but also led to some business closures for those who could not absorb the higher cost of labour.
- 3) **Minimum wage for nationals.** Some countries within the GCC have different minimum wage for nationals than for expats. This tool tends to mitigate ghost employment, increases incentive for nationals to work in the private sector, and forces companies to improve productivity to overcome higher costs where quotas are in place; for example to replace lower-skilled workers with technology. Subsidising employees is recommended (rather than enforcing quotas) to neutralise the negative impact of having to pay a non-competitive wage.

⁵ <https://vision2030.gov.sa/en/programs/HCDP> [Accessed 15/7/19]

⁶ <https://www.gpayroll.com/blog/payroll/what-is-a-ghost-employee.html> [Accessed 15/7/19]

- 4) **Expat Work permits.** Preventing expats from entering the country to work. This could be limiting the number of visas issued or levies on a company seeking a work permit for an employee. Work permit fees can be raised and set at different levels depending on industry, job title or skill level as the government may choose; balancing other policies in place. Care must be taken in raising costs for the private sector as they are very important for keeping a diversified economy.
- 5) **Job-matching and training services.** Governments sponsoring employment agencies to assist in matching employees and employers. This could be in-person or online. This can also include counselling and training. In the absence of education for private-sector skills on-the-job training is recommended. Some governments organise country-wide training schemes with large private employers. In Switzerland, 70 per cent of teenagers are enrolled in apprenticeship programmes running alongside school.⁷
- 6) **Hiring caps or admission exams in the public sector.** Preventing or reducing nationals from entering the private sector.
- 7) **Performance-based compensation in public service.** Making evaluation processes for pay rises more stringent. Including measures which are not subjective by the reviewer reduces cultural habit of rating employees as outstanding. These might include attendance, and meeting pre-defined targets. In Kuwait the vast majority were achieving the highest score in their annual evaluation. They have updated the evaluation to include attendance and hard indicators.

The last two measures, public sector initiatives, may be unpopular but begin to send messages about the changing social contract.

The GCC consultancy report advises an in-depth situation analysis to understand where labour supply and demand is headed before setting policies. This includes assessing labour force capabilities and workforce needs. And accounting for macro-economic political, regional, and technological trends. Once in place, monitoring and feedback loops are required. A mixture of policy tools are recommended for greatest impact and each market will have different needs. Policies to improve the business environment and the education sector must be considered alongside. Independent authorities should be established and to ensure policy implementation and transparency.

A survey of executives and human resource managers in the United Arab Emirates (UAE) looked for perspectives on nationalising private sector workforce (Al-Ali, 2008). Barriers to employing locals highlighted were low standards of education and inadequate skills, insufficient English speaking ability, and low levels of trust in the effort of nationals. Another survey of human resource personnel in UAE identified lack of motivation of locals as a key barrier and also concern over what rights would be expected by national employees (Forstenlechner et al., 2012). These were identified as more of an issue than lack of educational qualifications and high reservation wages. A paper analysing business-focussed newspapers finds skill standards to be the biggest challenge for recruitment of Emirati nationals, followed by salary and benefits, and thirdly, business hours (Aljanahi, 2017).

A conference paper analysed determinants of success in nationalising private-sector workforces in Saudi Arabia (Alanezi, 2012). Institutional determinants came out as most important for success. This includes organisation rules; regulation constraints; penalties for violations; social and behavioural values of the organisation; and social-cognitive perspectives of employers.

⁷ <https://www.forbes.com/sites/nicholaswyman/2017/10/20/jobs-now-learning-from-the-swiss-apprenticeship-model/> [Accessed 15/7/19]

Effective increase of national employees in the banking sector in Saudi Arabia has been due to bank provision of specific training for local recruits and revised working hours to promote the attractiveness of the post (Edgar et al, 2016).

4. Dual labour markets in Europe

Labour markets in Europe are said to be characterised by 'extensive dismissal protection, little flexibility at employer level, and dual structures' (Ehmer & Schwegmann, 2017, p1). The divide between secure and insecure jobs is related to macroeconomic efficiency, the wellbeing of workers and social cohesion (Eichhorst et al., 2017). After the 2008/9 financial crisis, European countries aimed to improve flexibility by decentralising wage bargaining and reducing protection of dismissal. Working hour regulations were also relaxed. World Economic Forum surveys suggest this has made the labour markets more efficient, particularly from 2014 in Spain and Italy (Ehmer & Schwegmann, 2017, p1).

Italy's labour market was highly segmented. Reforms aimed to reduce protection of dismissal but also improve employee rights. Reforms in 2012 expanded the economic grounds for redundancy. Unemployment support was introduced across the board including longer periods of income support. More stringent legal conditions were imposed on certain temporary contracts. Employers were taxed more on temporary employees, and they would be refunded if employees were made permanent. In 2014, a 'Jobs Act' was introduced. This banned court-ordered reinstatement of workers who had been dismissed for economic reasons (Eichhorst et al., 2017). These provisions only apply to the private sector and not to public administration (Pinelli et al., 2017). Contracts restrict job-sharing and joint ventures with contribution of labour. New contracts reduced severance payments and unemployment benefits were again expanded. The uncertainty that made dismissals costly has been reduced and data suggests the new rules on dismissals has reduced segmentation. Employers were incentivised for hiring new employees and open-ended contracts. Hiring incentives have improved reallocation. Certain temporary contracts were simplified to improve access to the labour market, particularly for young people. The Act has reduced unemployment rates to some extent (Eichhorst et al., 2017). The relaxed dismissal protection is only in place for new employees so will take time to yield results. Employers were given financial incentives to put the new contract into use.

In Spain, the proportion of employees on temporary contracts is particularly high. Reforms in 2010 and 2012 strengthened decentralised wage determination. Employers could make individual agreements with employees rather than having to use industry or regional levels. This is thought to have improved the balance between wages and productivity (OCED, 2014). Businesses were also allowed to modify wages and hours according to economic needs. Employees can then have more choice in responding to shocks other than dismissal. Protection against dismissal was loosened allowing wider technical, organisational and economic reasons (Eichhorst, 2018). Employers previously had to prove that the employee being dismissed would adversely affect future profitability, and severance payments for wrongful dismissals were halved. However, enforcement must be adequate and judicial procedures reasonably paced to ensure liberalisation in this area (Wölfl & Mora-Sanguinetti, 2011). Small firms were subsidised for hiring younger and older workers. One-year probation periods are allowed in new contracts in small- and medium-sized enterprises. Labour market segmentation has not yet shown improvement since the reforms (Ehmer & Schwegmann, 2017).

Dismissal protection of permanent contracts has also been reduced in Slovenia. Permanent contracts were implemented with a shorter notice period and lower severance pay. Dismissal procedures were simplified in 2013. Monetary compensation was allowed instead of reinstatement for unfair dismissal cases, and firms no longer need to prove that redeployment was attempted before dismissal was issued. The long-term effects of the reform cannot yet be assessed. A preliminary evaluation was positive (Vodopivec et al., 2016).

Portugal carried out reforms 2012 (Eichhorst et al., 2018). Severance payments were lowered and aligned between fixed and permanent contracts. This covered new contracts only. Reasons for dismissals were also widened. Dismissals were further encouraged by making employers pay into a monthly dismissal fund to cover severance payments and support employees in the case of company bankruptcy. On-the job search and hiring have improved though regulatory gaps still persist, fixed-term contracts were liberalised at the same time. Economic uncertainty makes employers reluctant to hire permanent staff.

Greece and Slovenia also reduced notice periods and severance pay for newly hired permanent workers (Eichhorst et al., 2017). Reforms in France are relatively recent. Dismissal protection has been introduced but is taking some time to change employers' behaviours (Eichhorst et al., 2018). Overall, labour reforms in Europe in the 2010s have not shown clear impact. In Germany in 2005, unemployment benefits were reduced which lowered reservation wages and encouraged the unemployed into work and unemployment has been reduced since 2005 (Kirkegaard, 2014).

The European Parliament's Committee on Employment and Social Affairs produced a paper looking at addressing the dualism characterised by the divide between temporary and permanent employment (Eichhorst et al., 2018). Single-open ended contracts are proposed to bridge the divide between fixed-term and temporary contracts. Dismissals can then be spread more evenly over employees with differing degrees of seniority. These have not yet been rolled out by any country. Case studies in the paper show that re-regulation of temporary work has been the main instrument used to address dualism.

5. Dual labour markets in Asia

A rapid assessment of the literature on dualism in Asia seemed of low relevance to the situation in the Middle-East so is only touched on briefly here.

Korea have experienced similar problems to Europe of duality between permanent and temporary employment (Grubb et al., 2007). Japan are developing a system of "Equal pay for Equal work" with a legal framework for fair and equitable treatment of workers regardless of status, fixed or part-time, working conditions and pay (Thévenot, 2017). An IMF paper proposes policy-options to reduce duality in Japan (Aoyagi & Ganelli, 2013). These include replacing fixed- and short-term contracts with single open-ended contracts; limiting regular contracts by job content, working hours, or relocations; and a "moral suasion" strategy encouraging employers to increase wages but with government not being part of the negotiations. The paper suggests that reforms for converting non-regular employment to regular are unlikely to work.

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