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## **Gulf unemployment and government policies: prospects for the Saudi labour quota or *Nitaqat* system**

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**Abstract:** Saudi Arabia is facing a growing unemployment necessitating some radical rethinking of its current 'localisation' policies, and has introduced the *Nitaqat* or quota system which classifies local companies in different colour code zones according to the percentage compliance in terms of Saudi nationals employed, with penalties imposed for non-compliance. The government is cognisant that the private sector has to play an important role in job generation, albeit as willing partners, but one in five private companies operating in the Kingdom are a long way from meeting *Saudisation* targets. The government is also introducing incentives to companies that meet their *Nitaqat* quotas realising that the private sector's dependence on foreign cheap labour is causing a dilemma as Saudis are reluctant to replace expatriates at current wage levels for many unskilled and semi-skilled sectors. The paper examines the impact on overall national economic growth and productivity should the government also introduce a minimum wage level of SR 3,000 per month for the private sector equal to that in the public sector, under the so-called *Hafiz* system.

**Keywords:** unemployment; *Saudisation*; government labour subsidy; quotas; education; mobility; Gulf Cooperation Council; Saudi Arabia; expatriates; minimum wage; *Hafiz*; sponsorship; *Nitaqat*.

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### **1 Introduction and literature review**

Saudi Arabia has signalled its intentions to adopt a more invigorated programme to ensure that more nationals enter the labour market. The Kingdom has adopted, over many years, a policy of so-called *Saudisation* which is aimed at gradually replacing expatriate workers with Saudi employees, using a policy of inducements and punishments of private

sector employers such as charges for work permits or *Iqamas*, exit-reentry visas fees and the issuance of employment visas. During 2011, the Saudi Government started to implement a *Saudisation* quota system or *Nitaqat* which sets out specific employment targets for *Saudisation*. The implication of enforcing this new quota system is still not clear, but as will be argued in this paper, the process of *Saudisation* whether voluntary or quota imposed, should not take place at the expense of efficiency and productivity in the national economy and that a parallel policy of improved education and training is necessary to provide Saudi labour market entrants with the skills and quality of education demanded by the private sector (Al Gosaibi, 2008). This sector is being steered towards increasing the proportion of nationals in the various national development plans. How the government and private sector willingly cooperate to achieve the national goal of increased *Saudisation* will be the litmus test for the success of the *Nitaqat* or other measures, such as the proposed introduction of a minimum wage level for both the private and public sectors, first mooted at SR 3,000 (\$800) in 2011.

The political and social upheavals witnessed in the wider Arab world during 2011 has also introduced an added sense of urgency for national policy markers. The issue of unemployment and creating a sustainable economic environment to meet rising youth unemployment aspirations has been one of the most pressing concerns arising out of the so-called 'Arab Spring' (Al Munajjed and Sabbagh, 2011). However, even before the advent of the 'Arab Spring' events, there was widespread interest in the issue of job creation and so-called 'localisation' policies as adopted in the Gulf Cooperation Council (Al Ali, 2008; Al Munajjed and Sabbagh, 2011; Al Alawi, 2010). Despite its key role within economic development, human resources remains a fundamental challenge for most Middle East countries (UNDP/IRBAS, 2009). The literature on this subject is varied, but it is widely accepted that human resources development and management is an important factor in economic growth and for influencing changes in economic structure (Arthur, 1994; Barney and Wright, 1998; Kuruvilla, 1996; Heneman et al., 2000; Karoly, 2010; Peterson, 2009). Economic growth of a country requires both financial and human resources. While financial resources have not lately been a critical issue for Saudi Arabia, as evidenced by the planned expenditure for education and training which accounted nearly 25% of government budgeted expenditure for the 2012 budget (Saudi Press Agency, 26 December 2011).

There are divergent opinions on the various Gulf Economic Council (GCC) localisation programmes, with some arguing that *Saudisation* in the case for Saudi Arabia, can be both a blessing and a curse (Chaudhry, 1989; Kapiszewski, 2001; Cordesman, 2003). The 'blessing' is that inherent in Saudi Arabia's present dependence on legal (and some illegal) foreign workers lies one solution: to create Saudi employment by expelling or reducing most of the foreign workers. This seems to be the theoretical underlying basis for the introduction of the quota or *Nitaqat* system. The 'curse' however of the present dependence on foreign labour is that most of the non-Saudi jobs are of the type, due to social values, that many young Saudis do not want, although some unemployed Saudis are beginning to accept seemingly social 'demeaning' jobs such as cashiers, waiters and transport operatives. The issue of *Saudisation* and its effectiveness has received large attention but the views are mixed, with some (Looney, 2004, Al Sultan, 1998; Al Sheikh, 2001) being cautiously optimistic, but only if certain fundamental labour and wage reforms are put into place, while others feel that demographic pressures will cause long term problems if employment generation is not taken now (Al Toajery, 2001; Rahman, 1987; Al Dosary and Nahiduzzaman, 2010). This

theme is also stressed by other researchers who highlight the security implications of demographic pressures (Urdal, 2006; Coates-Ulrichsen, 2011; Forstenlechner and Rutledge, 2010; Spiess, 2010; Yousef, 2003; Winckler, 2010).

When reviewing the existing literature on *Saudisation* and job generation measures, it can be observed that the evaluation of unemployment trends and localisation policies within the region is still somewhat limited and that most studies have been descriptive quantitative data analysis, or prescriptive assessments of what governments should do rather than evaluations of what has happened and why. A key reason is that as a result of the political dimension of the problem of localisation, the sector is characterised by a general lack of data, and data which is often incomparable, inconsistent or not credible. Urgently needed information on the outcome of government policies tends to be confined to government reports, which for reasons of perceived sensitivity and confidentiality, are unlikely to enter the public domain. Hence, lack of available data and knowledge, next to political will, presents itself as a key limitation to informed and appropriate decision-making in this domain. The aim of this paper is to add original insight on the issue of how the *Nitaqat* quota system happened and why, and assess its political success based on fundamental economic principles.

Section 2 of the paper will address the characteristics of the Saudi labour market, with special reference on market forces and employment models, while Section 3 will discuss the newly introduced quota or *Nitaqat* system to boost Saudi employment. Section 4 will address the introduction of a minimum wage level for both the public and private sectors and try to quantify the effects on the Saudi private sector, as well as the introduction of the *Hafiz* or unemployment benefits, while Section 5 will conclude and make some policy recommendations arising from the introduction of the new Saudi measures.

## 2 Characteristics of the Saudi labour market

A labour market is usually an informal or formal market where workers find paying work, employers find willing workers, and where wage rates are determined by demand and supply forces. Labour markets may be local or national (even international) in their scope and are made up of smaller, interacting labour market segmentations for different qualifications, skills and geographic locations. They depend on a free flow of exchange of information between employers and job seekers about wage rates, conditions of employment, level of competition and job location. This is the theory of how an efficient labour market should operate.

The Saudi labour model sets it somewhat apart from conventional labour models, by introducing 'Saudi specific' inter-connected socio-economic pre-conditions (Ramady, 2010). These are:

- *Continuous high economic growth*: High and sustained economic growth rates were once thought to make it possible for the country to achieve full employment and at the same time to provide sufficient scope for the redistribution of oil wealth. This feeling of 'well being' permeated Saudi society at all levels and contributed to high population growth rates. This labor model came under pressure in the period 1986–2002 but with higher oil prices and increased government expenditure from 2003, it gained a new lease of life.

- *High oil prices*: The oil export-led growth model was dependent on a high oil income compatible with the Saudi Government's welfare spending and investment. Until the oil shocks of the mid 1980s and the period 1997–2002, the country seemed to believe that oil prices could rise forever and that OPEC was in control of market supply. Today, the government does not publicize the effects of high oil prices, arguing that they are temporary and could be harmful to Saudi interest in the long run. One aim of such a low-key public policy is to avoid building up higher expenditure expectations, based on 'windfall gains' from higher oil prices that exceed forecasted revenues at lower oil price levels.
- *Availability of highly paid jobs in the public sector*: In Saudi Arabia, private sector compensation is generally lower than compensation in the government sector. There is a widespread view that the government has better pay and benefits for Saudis than in the private sector. This differs from most developed economies, where private sector pay generally outstrips the public sector, and is more in tune with economic productivity and measurable performance.

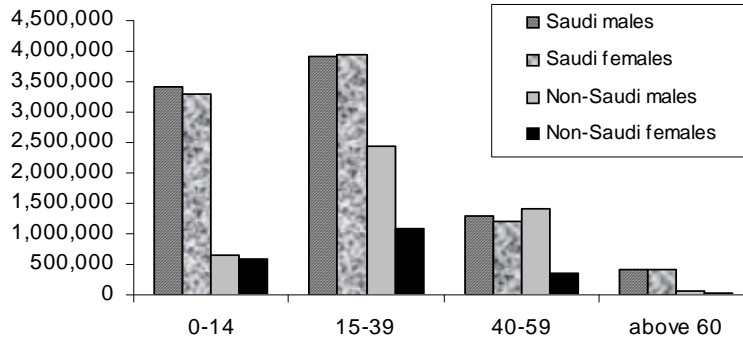
The labour market in Saudi Arabia has changed due to internal population dynamics, as well as a breakdown of the old Saudi labour model. The policy of creating special privileges for nationals in the labour market has had additional adverse long-term effects. For the younger nationals, it has meant growing up with the assumption that a standard of living higher than that of non-nationals is an inalienable right, irrespective of any personal contribution to the wealth and well-being of society as a whole. By guaranteeing positions in the public sector for their citizens, the authorities unintentionally engendered the notion that they were the universal benefactors of their citizens. Strong public signals are now being sent out that this will have to change, and that employment will be based on skill, education and productivity. The private sector has been arguing for this, rather than the arbitrary policies of *Saudisation* of economic sectors.

An evaluation of a country's labour market and its characteristics would be somewhat meaningless without an understanding of the underlying demographic trends and composition of the population. Such an analysis will provide an insight into the potential problems that might arise in the future, based on current government labour policies. By its own admission, Saudi Arabia is amongst the fastest growing nations in the world in terms of population growth (SAMA, 2011). The Kingdom's population grew three-fold from 7.3 million in 1975 to 27.1 million in 2010. Foreigners account for 8.4 million (SAMA, 2011). Most of the GCC countries exhibit what has been termed as 'demographic imbalances' to one degree or another. These demographic imbalances centre around a large element of non-nationals in the population, and secondly, to a large percentage of youth as a percentage of the total population or a 'youth bulge'.

These two demographic shifts could pose novel policy challenges to the GCC countries concentrating on the need to employ youth, and are projected to be also a security risk in a region where the national labour force is projected to increase in the future as analysed later below. Many studies have been conducted on a global scale indicating that countries with a large 'youth-bulge' proportion experience a high level of political violence and civil strife (Leahy et al., 2007; Urdal, 2006; Lutz et al., 2004). This is especially so when such a segment of society seems to be faced by a lack of meaningful employment opportunities, as dramatically witnessed by the 2011 'Arab Spring' events.

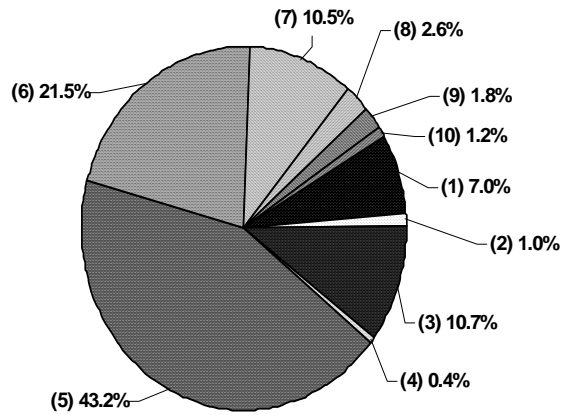
The Saudi foreign labour force and youth demographic imbalances are illustrated in Figure 1.

**Figure 1** Saudi Arabia’s population by age groups, gender and nationality (2010)



Source: SAMA (2011)

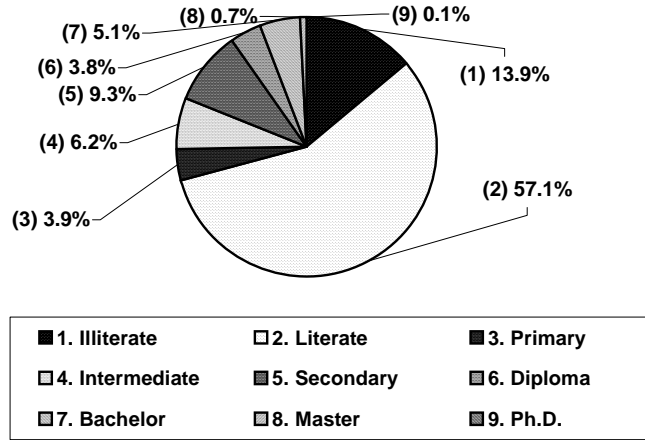
**Figure 2** Distribution of Saudi manpower in the private sector by major economic activity during 2010



- 1. Agriculture, Forests, Hunting and Fishing
- 2. Mining Oil, Gas and Quarrying
- 3. Manufacturing Industry
- 4. Electricity, Water and Gas
- 5. Construction
- 6. Wholesale and Retail Trade
- 7. Transport, Storage and Telecommunications
- 8. Finance, Insurance, Real Estate services & Business
- 9. Community and Personal Social Services
- 10. Other activiteis

Source: SAMA (2011)

**Figure 3** Breakdown of Saudi labour force in the private sector by educational level in 2010



Source: SAMA (2011)

In summary, the Saudi Arabia labour market is characterised by an emergence of a high youth participation, high levels of expatriate workers (mostly in the private sector), leading to a depressing of levels of average general wages, lower productivity, and potentially high unemployment levels for years to come. According to SAMA, foreign labour accounts for nearly 90% of the total labour force of 6.991 million in 2010, with the number of Saudis employed in the private sector around 725,000 (SAMA, 2011). The employment pattern is completely reversed in the government sector, with around 885,000 Saudis employed in this sector in 2010 or around 92% (SAMA, 2011).

What is relevant for the purposes of our study is evaluating the effectiveness of the introduction of the new *Nitaqat* or labour quota system on average wage levels to assess the distribution and composition of the private sector labour force by economic sector, education and relative wages for Saudis and non-Saudis in order to assess whether the *Nitaqat* system will make an appreciable difference to the overall balance of the Saudi-non-Saudi labour force. Figures 2 and 3 illustrate these issues.

Analysis of Figure 2 by distribution of manpower in the private sector reveals that the bulk of workers, or nearly 75%, are in the construction, wholesale, retail, and manufacturing sectors – areas that had been traditionally shunned by Saudi labour, although there is evidence that young Saudis are now willing to enter the wholesale and retail trade. The Saudi Arabian labour force – both national and foreign – are generally literate, with only around 14% being illiterate, mostly comprising foreign household maids and menial labourers, as illustrated in Figure 2. Those holding diploma degrees and above, are at a respectable 10% of the total labour force, but still below OECD levels of 40%.

The capital-intensive nature of the oil industry means that there are relatively few workers employed in this sector, despite its importance for government revenue and export. There are fewer than 90,000 employed in the oil and gas industry in 2010 which accounts for a mere 1.0% of the total workforce as Figure 2 illustrated. The largest sources of employment in Saudi Arabia is in construction, retail trade, finance and real estate. The majority are non-Saudi Arabians. Most construction employment involves

housing and commercial projects for the private sector. For the housing and commercial projects a large numbers of unskilled and semi-skilled workers are required, most coming from the Indian subcontinent. They are paid relatively modest wages for the long hours they work, but this keeps construction costs low. Few Arabian nationals are interested in jobs in the construction industry (Abduljadial, 1991). Such an abundance of relatively cheaper foreign labour has tended to place a ‘drag’ on average Saudi wage levels and, until the most recent inflationary boom period of 2008, average Saudi wage levels had been in decline as illustrated in Table 1.

**Table 1** Average wage in Saudi Arabia during the period 1994–2008

	<i>Saudis</i>		<i>Non-Saudis</i>	
	<i>Males</i>	<i>Females</i>	<i>Males</i>	<i>Females</i>
1994	7,298	3,660	2,153	3,133
1995	7,896	3,864	2,142	3,016
1997	7,570	4,144	2,046	2,716
1998	7,473	3,812	1,934	2,740
2000	6,877	3,217	1,763	2,391
2001	6,684	3,151	1,710	2,403
2002	5,984	2,703	1,543	2,221
2008	7,650	3,100	1,650	2,480

*Source:* Ministry of Labour, SAMA

The above salary figures for Saudis include public sector salaries, and according to SAMA, the average monthly wages of manpower in the private sector in 2010 was SR 1,278 for males and SR 1,972 for females (SAMA, 2011). This somewhat contradicts the official figures in Table 1 and highlights the paucity of reliable government data in this sector to enable effective policy measures to be undertaken.

The fact remains however: the average wage level for a non-Saudi male is lower than for his Saudi counterpart. This is due to a large number of non-Saudi labour having low-level skills and work in menial wage professions. Again, such low wage levels are a problem for potential *Saudisation* and for Saudi entrants. Wide variations are found however in actual salaries: the banking, services, insurance, legal and accounting professions command high salaries and benefits that are comparable to, if not better than similar positions in Europe or the USA. Similarly, expatriate wage levels mask some extremely high salary levels for professionals and technical experts, whose tax-free compensation packages provide superior levels of earnings than similar jobs in their home countries. Overall though, until the post 2009 Saudi boom period, decreased economic growth, volatile oil prices, competition for jobs and the private sector’s desire to control labour costs have together tended to create a downward push on wage levels in the Kingdom. This is set to continue in the foreseeable future, with erosion in the purchasing value of wages also affected by recent rises in domestic inflation (SAMA, 2011).

The ‘duality’ of wages between Saudis and non-Saudis can be explained in terms of two distinct labour markets. The case was made by a Saudi economist, and it seems applicable to the wider GCC labour market (Al Sheikh, 2001). This is illustrated in Figure 4.

**Figure 4** (a) Duality of Saudi labour market (b) Demand and supply for expatriate labour in Saudi Arabia by market segmentation

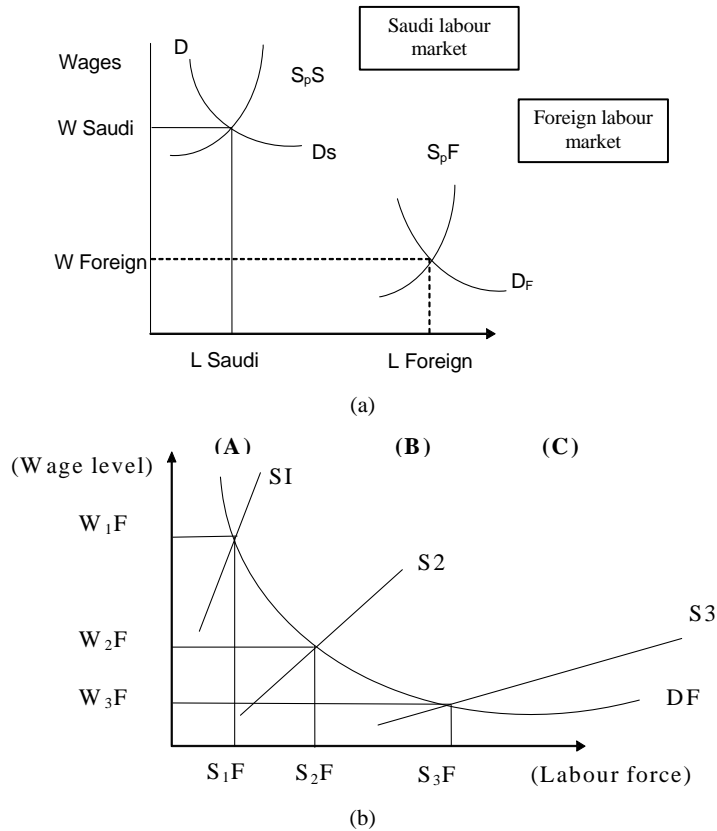


Figure 4(a) sets out the concept in terms of differentiated demand and supply for Saudi and non-Saudi labour markets. In the figure,  $D_s$  and  $S_pS$  stand for demand and supply for Saudi labour, while  $D_F$  and  $S_pF$  stand for demand and supply for foreign labour.

As pointed earlier, there are wide differences in wage levels, not only between Saudis and expatriates, but also between different skill groups of expatriates. As such the demand and supply for foreign labour in Saudi Arabia exhibits a greater degree of market segmentation and supply elasticity, leading to different wage levels amongst foreign workers. By supply elasticity we mean the responsiveness of the supply of labour to changes in the wage level. This is illustrated in Figure 4(b).

Figure 4(b) shows that in segment (A), the supply of expatriate labour is relatively inelastic due to specialised technical or managerial skills, and as such, these foreign workers enjoy higher wages at  $W_{1F}$  levels. Segment (B) shows a relatively more elastic supply curve for foreign workers, including middle management, accountants, salesmen and others who command a lower salary level at  $W_{2F}$ , for Saudis are more competitive over these positions in terms of similar skills and training. Segment (C) shows the wage level paid in the almost perfectly elastic supply curve of manual and menial foreign labour at  $W_{3F}$ . A small adjustment in the supply of labour causes sharp movements to



salary levels. Effective short-term *Saudisation* policies should aim for job creation in segment (B) and eventual knowledge-based, high-value job migration to segment (A).

Although government planners in Saudi Arabia stress the role of the private sector in increasing employment for local citizens and reducing unemployment, there is no analysis of the workings of the labour market in the various development plans (Sheras, 1994). Some pertinent issues arise from the theoretical illustrations above. How responsive is the demand for labour to the expected wage rate, and is the current wage the rate that would bring demand and supply into equilibrium in the job market? Is the labour market in Saudi Arabia excessively fragmented, with insufficient occupational and geographical mobility? Is the labour market for Saudi Arabian and foreign workers completely segmented so that little competition exists between the two groups?

Some clarity to the above questions can assist in the analysis of whether the newly introduced quota *Nitaqat* system and introducing a minimum wage level of SR 3,000 for both the private and public sector can achieve their goal in raising the number of employed Saudis and increasing productivity.

### **3 Saudi quota *Nitaqat* system: objectives, expectations and assessing the cost**

Current government policies to reduce foreign labour and encourage *Saudisation* have had mixed results. It has been difficult to introduce and effectively manage the regulations restricting the number of expatriates, because the importation of foreign labour enjoys strong support from the powerful lobbies of trading and merchant families. Their fortunes have been built, to a large extent, on cheap expatriate labour. The sponsorship system of foreign workers or *kefalaa* artificially hinders market demand and supply forces, creating rigidities in certain sectors with surplus labour and supply shortages in others. This results in further importation of foreign labour under the sponsorship system. The government could consider a policy of gradually scrapping the sponsorship system after compensating those employers for the costs of sponsorship. These costs can be recouped from workers' wages on a pro-rata basis. In the short-run, the Saudi Government has decided to limit the number of new work visas they grant in order to curb new foreign labour entrants to the market and to create a Saudi 'labour supply' pool. This was the precursor of the introduction of the *Nitaqat* system in May 2011 to invigorate the policy of *Saudisation*.

Before assessing the objectives and expectations from the introduction of the quota *Nitaqat* system, the question must be asked on why the Saudi private sector, in general, is still seemingly reluctant to employ more Saudi nationals and prefer expatriate labour?

Some ascribe the reluctance to cultural attitudes towards work inherent in Saudi society. The fact is that due to negative attitudes about certain types of work among Saudis, there are many expatriates in the Kingdom, even though it is the only country in the GCC with a large enough population to carry out the country's development on its own (Looney, 1992; Nur, 1995). Additionally, the combination of importing foreign workers while offering generous state welfare benefits to nationals has reinforced this negative attitude towards work and created a vicious cycle that encourages Saudis to stay out of a large part of the job market. The issue of work ethics has attracted some debate

both from within and outside Saudi Arabia (Shatkin, 2002; Cordesman, 2003; Niblock, 1980).

That said, certain changes for the better have taken place. The younger generation has indicated its willingness to accept positions that have been traditionally rejected by their fathers, such as jobs at hotels, restaurants, barber-shops and other direct services to customers. However, there are several reasons for the private sector's resistance to *Saudisation*. These are summarised in Table 2 and are based on the comments raised in the media by several Saudi industrial leaders.

**Table 2** Private sector *Saudisation* issues

<i>Issues</i>	<i>Private sector justifications</i>
1 Labour cost	<ul style="list-style-type: none"> <li>The relatively high cost of Saudi manpower, compared to foreign manpower, results in private sector reliance on imported cheap manual labour, deployed in labour-intensive occupations. This helps private sector profitability despite government attempts to increase expatriate costs (residency or <i>Iqama</i>, visa renewals, etc.).</li> </ul>
2 Social and cultural perceptions	<ul style="list-style-type: none"> <li>Saudis are reluctant to take up and seriously pursue certain types of jobs, despite <i>Saudisation</i> directives. For example, the forced <i>Saudisation</i> of employees in the vegetable markets has failed. <i>Social status</i> is still important for young Saudis as it affects marriage and other social relations.</li> </ul>
3 Control over process of production	<ul style="list-style-type: none"> <li>Expatriate workers are easier to control and more disciplined than Saudis. Control is exercised through short-term employment contracts. In some cases, there are few legal obligations towards expatriates, who are prohibited from changing jobs without their sponsor's permission.</li> </ul>
4 Lack of social integration in multi-cultural work environment	<ul style="list-style-type: none"> <li>Local populations are reluctant to integrate into multi-cultural work environments, fearing that it might degrade their existing status.</li> </ul>
5 Job tenure	<ul style="list-style-type: none"> <li>It is more difficult to fire Saudi workers than foreign workers.</li> </ul>
6 Inadequate qualifications	<ul style="list-style-type: none"> <li>Saudi employees may have inadequate qualifications, a lack of good English or a non-technical background.</li> </ul>
7 Mobility	<ul style="list-style-type: none"> <li>Saudi workers are less mobile than foreigner workers; they are reluctant to change job locations.</li> </ul>

*Source:* Ramady (2010)

Confronting this dilemma of growing youth joblessness, despite some strong economic growth estimated at 6.8% growth in 2011 for the whole economy and 4.7% for the non-oil sector for 2012 (Jadwa, Investment, 2011), Saudi Arabia unveiled in May 2011 a major overhaul of the long-ineffective plan to *Saudise* the private sector workforce by introducing the quota *Nitaqat* system. The government will classify private sector companies into green, yellow and red categories depending on progress of employing locals (Arab News, 2011c). Before the announcement of the quota system in 2008, the Minister of Labour and Social Affairs issued a decree setting forth the applicable *Saudisation* rates for private sector companies at a general rate of 30% of the workforce, but with a different rate for particular sectors of the economy as a whole:

- business engaged in processing industries: 20%
- hospitals that employ more than 50 persons: 15% (exclusive of administrative jobs)
- business engaged in contracting, cleaning and operations maintenance activities 10%
- engineering consulting firms: 8%
- contractors executing government projects: 5%.

**Table 3** Private sector *Saudisation* issues

<i>Zone classification</i>	<i>Segment analysis</i>
1 Green zone company ( <i>Saudisation</i> ratio is between 10%–27%)	<ul style="list-style-type: none"> <li>• In compliance with <i>Saudisation</i> rules.</li> <li>• Eligible for incentives such as ability to secure a transfer of expatriate employees from a 'red sector' and 'yellow sector' company without having to obtain approval from the non-compliant company.</li> <li>• Will be able to hire from any part of the world, get new visas with open professions and change professions of workers even to 'restricted' categories.</li> </ul>
2 Yellow zone company ( <i>Saudisation</i> ratio is between 4%–10%)	<ul style="list-style-type: none"> <li>• Reserved for companies that are not in compliance with the <i>Saudisation</i> requirements but which are expected to achieve compliance within a specified 'reasonable' time frame.</li> <li>• If non-compliance then this segment company will be re-graded to a 'red zone'.</li> <li>• 'Yellow zone' companies will not be able to apply for new visas, visa transfers or change of workers professions starting September 2011.</li> <li>• 'Yellow zone' companies will be allowed to renew their workers permits provided they have not completed more than size years in the Kingdom.</li> <li>• Expat workers working in 'yellow zone' entities will not be able to renew their work permits after March 2012 and they have to find a 'green zone' by then to renew work permits but can stay in Saudi Arabia as long as their work permits are valid.</li> </ul>
3 Red zone company ( <i>Saudisation</i> ratio is less than 4%)	<ul style="list-style-type: none"> <li>• This segment is designated for entities that are not in compliance with the <i>Saudisation</i> requirements.</li> <li>• Entities in this zone will be penalised in various ways such as being prevented from renewing work visas for their expatriate workers or being denied some or all of the services provided by the labour office.</li> <li>• These denials will include no change in workers professions, transfer or visas, issuance of new visas, and opening files for new business branches of the company.</li> <li>• Foreign workers can leave to complying companies without sponsor's approval.</li> </ul>

Source: Ministry of Labour

The wide disparity and exemption from the general *Saudisation* ratios for many labour intensive sectors was also undermined by the further relaxation for smaller businesses with fewer than ten employees which were exempt altogether, and businesses with 10 to 19 employees were subject to a 20% *Saudisation* rate. What exactly are the *Nitaqat* (meaning zones or systems) colour codes? Table 3 summarises these.

Besides the above three 'zones', the Ministry of labour also introduced what was termed a 'premium' zone where *Saudisation* ratios reached more than 27%. Not surprisingly, the introduction of the new *Nitaqat* system was greeted by alarm and panic by many employers and expatriate workers, especially when the Ministry of Labour admitted that half of Saudi firms fell into the yellow and red zones (Arab News, 2011b; Wahab, 2011).

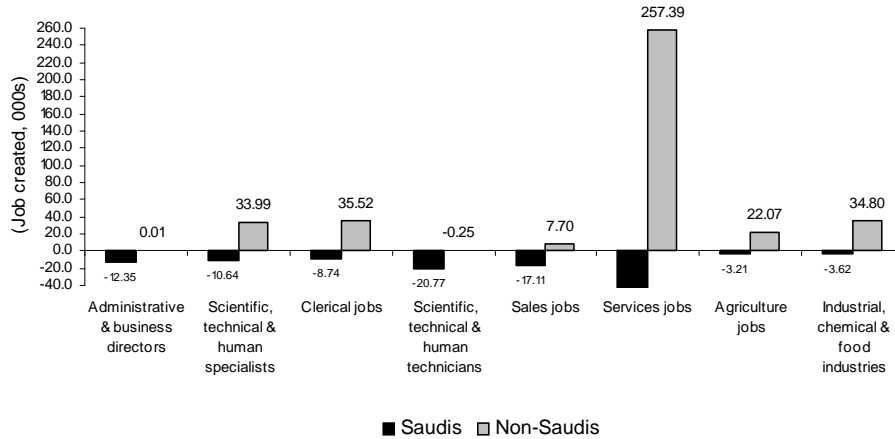
These uncertainties and confusion on how the Ministry would implement the scheme, given a rather loose definition of what really constitutes full *Saudisation* compliance in the bands as seen in Table 3, prompted the Minister of Labour to try and explain the 'fairness' of the new system (Jabarti, 2011). It was noticeable that the Minister's clarification was also aimed at the large expatriate community that this would not threaten their livelihood, bearing in mind the potential loss of productivity should foreign workers feel threatened and voluntarily 'withdraw' part of their work effort.

A major comparison between the old *Saudisation* system and the new *Nitaqat* zoning system seems to be in the manner by which the Labour Ministry now classified Saudi companies' industrial activities. Under the 'old' system, there were only eleven industrial activities with a relatively fixed percentage *Saudisation* quota of 30%. Under the 'new' system, there is now a new classification of 41 industrial activities, each with its own variation of *Saudisation* quotas depending on the type of economic activity. Secondly, each industrial activity is further classified by labour size such as very small, small, medium, large, very large. According to the Saudi Labour Minister, the new system is more 'realistic, practical and fair' (Jabarti, 2011) and that the private sector's industry specific concerns on hiring qualified Saudi labour would be accommodated. The introduction of the *Nitaqat* system has been rightly dubbed as being the hallmark of 'desperate times, desperate measures' (Banque Saudi Fransi, 2011b). The reason seems obvious: the private sector is creating jobs, but these seem to be taken up by foreigners and Saudi unemployment is high despite overall employee additions. These are illustrated in Figures 5 and 6.

In recent years, and especially from 2010 and 2011, the government sector and publicly linked firms absorbed many of the new Saudi job market entrants as illustrated in Figure 5. As will be discussed in Section 4, this bias among Saudi citizens towards government jobs offering better salaries and greater job security has had the effect of weakening public sector productivity, stifling labour competition and pushing government public sector salary expenditure upwards (Sfakianakis, 2011). At the same time, there is an anomalous situation with a growing pace of Saudi youth unemployment despite net additions of jobs by the private sector as illustrated in Figure 6. As many Saudis struggle to find work, the number of work visas for foreigners has risen. According to the Ministry of Labour data, 982,420 work visas were issued to the private sector in 2009, more than double the number granted in 2005, and 1.2 million work visas were issued in 2007 and 2008 (Sfakianakis, 2011). The above trend does not auger well for meeting Saudi Arabia's forecasted development plan objectives whereby, according to the current ninth five year plan, the private sector is expected to grow by 6.6% per year on average for the period 2010–2014, the most aggressive growth forecasts in three

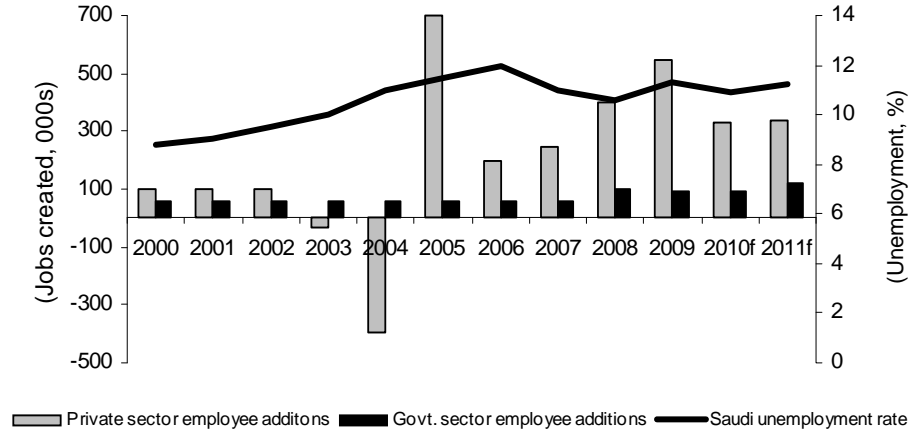
decades (Ministry of Planning, 2010). The ninth five year plan aims to halve the national unemployment to about 5.5%, while the previous five year plan aimed to reduce this to 2.8% for the 2005–2009 period, whereas unemployment actually rose to 10.5% in 2009.

**Figure 5** Private sector creates jobs for expats in 2009, Saudi numbers fall



Source: SAMA, Banque Saudi Fransi

**Figure 6** Saudi unemployment high despite employee additions



Source: Ministry of Labour, SAMA, CDSI, Banque Saudi Fransi

Research carried out in other labour importing economies such as Malaysia and Singapore (Ruppert, 1999), has shown that economic growth in both countries has been integrally linked to job creations and increased value added, thereby contributing to private sector growth through aggregate demand and positive synergies conducive to economic growth. This is in contrast to the oil based economies of the Gulf and Saudi Arabia, whereby the majority of their national output is driven by petroleum production and the vagaries of world oil prices. The argument is then put forward that private sector

activity is typically residual and primarily driven by public expenditure, that in turn, depend on cyclical oil revenues.

Table 4 attempts to quantify and ask the following questions: to what extent does the private non-oil sector contribute to Saudi gross domestic product? What is the level of Saudi non-oil exports as a tool of diversification of the economic base? Finally, what is the relative economic added-value of foreign labour to the Saudi non-oil private sector?

**Table 4** Contribution of the private sector to the Saudi GDP and value added by foreign labour

		2007	2008	2009	2010	
(A)	Contribution of private sector to GDP (at current prices and %)	(SR Bn) 404.9 (28.3%)	(SR Bn) 440.3 (24.9%)	(SR Bn) 453.8 (32.4%)	(SR Bn) 482.6 (29.0%)	
(B)	Non-oil exports and as % of total exports	(SR Bn) 104.5 (11.9%)	(SR Bn) 121.6 (10.3%)	(SR Bn) 114.6 (15.8%)	(SR Bn) 117.6 (12.6%)	
(C)	GDP of major economic activity in SR billion, and by foreign labour participation as % of total labour force in each economic activity	Agriculture	SR 39.4 Bn (97.8%)	SR 39.7 Bn (98.0%)	SR 39.5 Bn (98.5%)	SR 39.9 Bn (98.1%)
		Manufacturing/oil	SR 97.6 Bn (79.3%)	SR 103.5 Bn (78.9%)	SR 105.1 Bn (84.2%)	SR 109.7 Bn (83.8%)
		Public utilities	SR 13.1 Bn (51.7%)	SR 14.0 Bn (55.2%)	SR 14.9 Bn (70.8%)	SR 16.1 Bn (62.9%)
		Construction	SR 56.8 Bn (90.7%)	SR 57.6 Bn (90.9%)	SR 57.9 Bn (93.6%)	SR 60.3 Bn (93.3%)
		Wholesale/retail	SR 66.6 Bn (85.6%)	SR 71.2 Bn (84.3%)	SR 72.9 Bn (88.4%)	SR 77.2 Bn (87.4%)
		Transport	SR 49.7 Bn (84.0%)	SR 55.8 Bn (84.8%)	SR 59.9 Bn (90.6%)	SR 64.7 Bn (84.6%)
		Finance/insurance	SR 102.3 Bn (66.6%)	SR 104.7 Bn (64.6%)	SR 107.5 Bn (69.1%)	SR 109.2 Bn (90.7%)

Source: SAMA Annual Reports (45th, 47th Annual Reports), 2009, 2011

According to the data for the period 2007–2010, the contribution of the Saudi private sector to GDP has increased in value at current prices, while remaining at around 30% of GDP. Non-oil exports have also gone up steadily and account for around 13% of total exports, with the share falling in years of higher oil priced exports. What is highlighted however from Table 4, is the significant value added contribution of non-Saudi labour to the various economic sectors, which includes manufacturing (and oil and mining in this sector). The largest economic sectors by value are manufacturing, followed by finance/insurance, and construction. Wholesale/retail and the transport sectors are also important, with agriculture being the smallest economic sector. With the exception of the public utilities sector, the non-Saudi labour force accounts for the overwhelming majority of those employed, with an increasing, rather than decreasing foreign labour participation level in key value added economic sectors such as finance/insurance and manufacturing. Foreign labour participation levels exclude categories such as drivers, maids and other

private sector employment. A conclusion from the above analysis is that economic growth is creating jobs for foreigners, who are adding real value to the national economy, despite unequal comparable wages to Saudi labour, as explained earlier in the paper.

In order to be successful on a sustained basis, jobs created over the next decades would need to be those that appeal to Saudi nationals as well as paying 'reasonable' living wages. Without the *Nitaqat* system, private sector companies have greater incentives to employ foreign labour, particularly from Asia. However, deterring and punishing Saudi private sector companies without also examining some of their grievances will not solve *Saudisation* issues. The private sector has complained of Labour Laws which makes it prohibitively difficult to fire Saudis and easy to fire foreigners. They argue that the Labour Law should instill less protection and engender greater competition amongst Saudis if the private sector is to become the preferred employer for citizens (Sheras, 1994).

It is still too early to judge whether the *Nitaqat* system will achieve its aim to increase Saudi employment. While desperate times might call for desperate measures, the private sector, especially those firms in the 'red zones' might also resort to desperate measures to remain operating and some might even consider hiring Saudis to raise their quotas but without giving them either meaningful tasks or training – the so-called 'stay at home employed' Saudi phenomena in order to beat quotas. However, while having to contend with *Nitaqat*, the introduction of a Saudi minimum wage level of SR 3,000 from March 2012 is also a reason for worry for the private sector as discussed below.

#### **4 Minimum Saudi wage level and unemployment benefits 'Hafiz' system: private sector implications**

The issue of introducing a minimum wage level for Saudis has long been discussed (Banque Saudi Fransi, 2011a) but there was little consensus on the final effect on the Saudi economy, especially on productivity. In 2011, following the events of the 'Arab Spring', the Saudi Government announced that it would pay out unemployment benefits or *Hafiz* effective from 1st January 2012 to those eligible under the programme. During 2011, the government also announced that the public sector minimum wage level would be raised to SR 3,000 per month (\$800) and that the private sector would follow suit by introducing a similar minimum wage level for Saudis by March 2012. The reasoning behind the equalisation of the minimum wage level for both sectors was this would prevent Saudi employees from resigning from their jobs and registering for the 'Hafiz' unemployment benefit scheme set at SR 2,000 per month. The second aim of the introduction of the private sector minimum wage was ostensibly to 'encourage work and foster job stability in private sector companies' (Saudi Gazette, 2011b).

The public's response to the unemployment benefit '*Hafiz*' scheme has been overwhelming, with more than two million people, according to the Saudi Human Resources Development Fund (HRDF), applying for the programme, but with only 700,000 qualifying for assistance, 70% of whom were women (Ghafour, 2011; Jago, 2012). The *Hafiz* programme was launched with the aim of providing unemployment assistance for one year, but there is some concern that with its introduction, the scheme could create a permanency of its own and might not be easily reversed, given the 'rentier'

economic relationship between citizens and the state in the resource rich economies of the Gulf (Abir, 1988, 1993; Auty, 2001; Gelb et al., 1998).

Once the 'Hafiz' programme was announced, a whole host of clarifications and seeming back-tracking on who is eligible and who is not started to emerge, when it was announced by the Minister of Labour that unemployed Saudis over the age of 35 will not qualify for unemployment assistance (Saudi Gazette, 2011a). Instead, the over 35's will get skills training paid for by the state according to the Ministry of Labour, through the HRDF. Public reaction to this age bar was scathing and many citizens called for it to be scrapped, arguing that many Saudis, especially female graduates, have been searching for jobs for many years and are now over the age of 35.

Other citizens were also disappointed to find out that the SR 2,000 monthly *Hafiz* payment was not the actual amount they would receive, and instead payments would be based on many criteria, including education level which meant a high school certificate owner would be paid SR 975 (\$260) per month and others SR 1,200 (\$320) for receiving additional state assistance (Al Jassem, 2011).

Faced with amounting criticism, the Ministry also hit back and announced that the *Hafiz* programme was being abused when it discovered that three thousand dead people had found their way onto the list (Arab News, 2011b), and that some unemployed citizens saw *Hafiz* as a social security scheme. To ensure that those unemployed who received *Hafiz* payments continued to be eligible, the Minister of Labour announced that SR 200 (\$53) would be deducted from the monthly SR 2,000 allowance if the candidates did not try 'hard' enough to find a job, or a training course or attend a job interview (Arab News, 2011b). The amounts at stake for the government was significant, estimated at SR 4 billion (\$ 1.07 billion) per month (Banque Saudi Fransi, 2011a).

While the introduction of a social security net for those less fortunate in society is something all governments, whether in the Gulf or in the West seem obligated to do, and then fine-tune in effectiveness, monitoring and compliance over time, the issue of introducing a minimum wage has more far-reaching economic significance on an economy such as Saudi Arabia. The core issue is one of whether a minimum wage level would increase or depress productivity, and hence economic growth and scarce resource allocation.

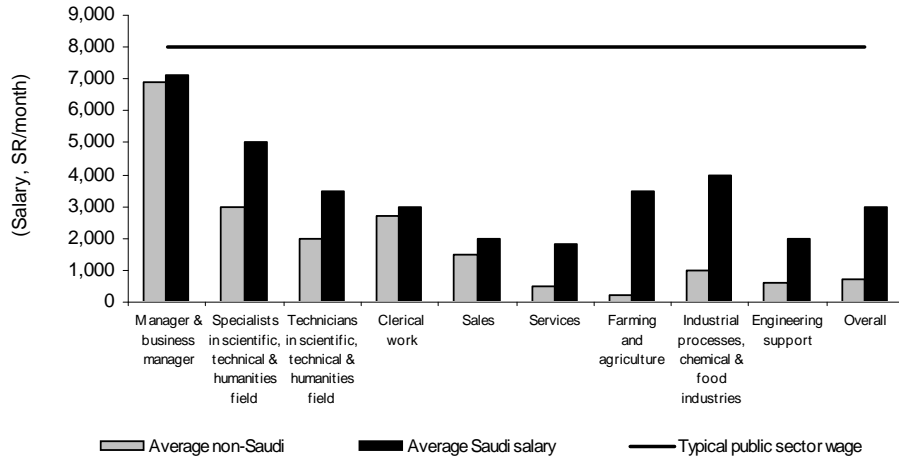
For the Saudi minimum wage level to be economically effective, the local labour market would need to shift from one relying on cheap imported labour to one exhibiting high wage equilibrium to encourage more meaningful Saudi participation. The theory is that higher wages will provide incentives for employees to enter the labour market, become productive and remain in one place over a longer period of time, gaining further wage rises due to productivity and training, instead of job hopping seeking higher wages. The phenomena of job hopping has been observed amongst young Saudis which has had the effect of curtailing on-the-job training by private sector companies. Once an 'acceptable' minimum wage level is established, the argument goes that Saudis would be more secure in their private sector jobs and training programmes will be more readily offered by employers.

The introduction of a mandatory minimum wage level has many consequences. For Saudi employees, this means not only competing within the domestic labour market but also with international labour markets of countries from where the expatriates are imported. The hike in minimum wages to SR 3,000 will force both the private and public sector to adjust their wage curves and pay structures, while keeping an eye on productivity per employee in order to remain competitive. As Figure 7 illustrates, the



private sector lagged behind average public sector wages and this reinforced the desirability of obtaining government jobs amongst Saudis.

**Figure 7** Private sector wages not competitive with public sector wages



Source: Ministry of Labour, Ministry of Civil Services, Banque Saudi Fransi

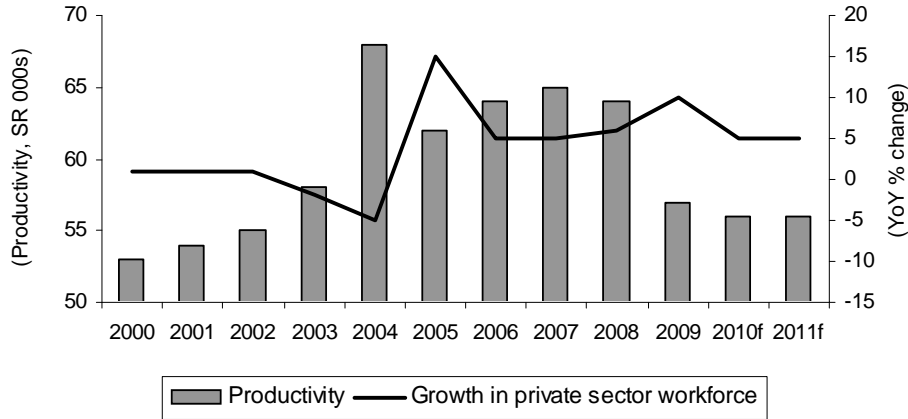
Productivity improvements are key catalysts for sustained economic growth, and even high cost industrialised countries such as Germany have seen sustained economic growth and export gains due to productivity gains. In Saudi Arabia, this has not been the case, either for the public sector or the private sector, despite the latter’s reliance on relatively cheap foreign labour. These productivity declines are illustrated in Figures 8 and 9.

**Figure 8** Public sector productivity drops as state hires



Source: Ministry of Finance, SAMA

**Figure 9** Private sector productivity likely to continue falling



Source: SAMA, Banque Saudi Fransi

From Figure 8 we note that government sector productivity has suffered due to large scale employee additions to this sector, especially during the 2010 and 2011 economic stimulus programmes. In 2009, productivity fell almost 5% from 2008 according to Banque Saudi Fransi estimates based on official government data, almost all due to the large intake of government employees. Government hiring seems to be a tool to ease short term employment bottlenecks rather than fill gaps in employment. The private sector’s productivity performance is also not encouraging as illustrated in Figure 9.

Here, private sector productivity is measured by the real non-oil private sector gross domestic product divided by the total number of employees in the private sector and it registered a 7.4% fall in 2009 compared with 2008, after a rise of 23% between 1999–2007. However, the productivity average masks sectoral differences with finance, manufacturing, construction, wholesale, retail trade, transport and communication witnessing falling productivity, but electricity, gas and water sectors improving productivity from 2006 to 2009 (Banque Saudi Fransi, 2011a). One reason for the latter’s productivity rises could be due to the Saudi Government’s massive infrastructure and capacity investment in these sectors.

Introducing a minimum wage level for Saudis might be an attractive social and political objective as long as it does not drag productivity further down. The fear is that the private sector will find ways of circumventing the minimum wage level by either hiring the minimum required Saudi labour ratio to ensure they remain at the ‘green’ or ‘yellow’ *Nitaqat* zones but and rely on the unregulated illegal ‘underground’ foreign labour market to keep factor costs down.

## 5 Conclusions and policy implications

From the above review of the introduction of several new Saudi Government labour related initiatives, in the face of obstacles in the implementation of the previous *Saudisation* policies, several policy considerations stand out:

- a developing new employment opportunities rather than substituting local workers for foreign workers is the only long term solution to accommodate a growing national labour force
- b training new entrants for likely jobs openings is the way to a successful national employment policy.

As such, instead of quotas and threat of punishment, *Saudisation* should be implemented through market forces and incentives, induced through an expanded and reformed education and national training programme (Al Dosary, 2002). *Saudisation* should be implemented in a manner that provides new jobs for Saudi nationals through increased competitiveness and a strong and sustainable non-oil growth in the economy (Al Gosaibi, 2008).

Other macro-economic factors that could derail the meaningful implementation of the *Nitaqat* and minimum wage levels are:

- 1 From the perspective of private sector firms, the demand for Saudi workers is inversely related to the cost of their hiring and firing. It is also inversely related to the cost of employing low-skilled expatriate workers. Since a reduction in the number of low-skilled employees likely reduces the marginal productivity of national workers, an increase in the cost of employing low skilled workers would reduce the demand, not only for these workers, but also for Saudi workers.
- 2 If skilled expatriate workers are sufficiently substitutable with Saudi workers, then demand for Saudis should be positively related to the cost of employing skilled expatriates increases in these costs would lead firms to reduce their demand for skilled expatriate workers and to substitute them with national workers.
- 3 The demand for Saudi workers is positively related to their level of human capital, the stock of capital, and technology because increases in these factors should raise the return to employing an additional national worker.
- 4 The supply of national workers to the private sector should depend on the compensation relative to their reservation wage (the minimum wage one is willing to accept for their work). Reservation wages in turn are determined by the wage, social benefit, and employment policies of the government. If the public sector provides relatively high wages, social benefits and job security to nationals, then the reservation wage and benefits will be relatively high for the private sector. The equalisation of public and private sector minimum wages will only add to a higher reservation wage for the private sector.

The new *Saudisation* and minimum wage policies could also affect other Saudi Government initiatives as opening up the Saudi economy to globalisation. Making it attractive to foreign direct investment (FDI) could cause conflict for the twin objectives of *Saudisation* and liberalisation. The Kingdom's aggressive *Saudisation* policy could be seen as too negative for foreign companies that prefer to operate in an open labour market, one that is dictated by experience, qualification and the needs of market supply and demand. Key foreign companies might refuse to comply with imposed *Saudisation* quotas, necessitating yet more 'exceptions' to government policy (Ibrahim, 2007).

One area of impact from *Saudisation* may be a reduction of (FDI) in the Kingdom. Foreign firms may feel that *Saudisation* not only puts them at a disadvantage compared to

their foreign competitors, but that the whole *Saudisation* programme itself is unpredictable, with rules and quotas changing without warning. This element, combined with concerns over domestic terrorist violence, may drastically reduce FDI inflows. Concern over *Saudisation's* impact on foreign investors likely underlined the Kingdom's decision to reduce the rate of tax on profit on foreign companies to 20% from 40%. There is also another dimension concerning the issue of how foreign labour is treated in Saudi Arabia and affecting the country's reputation. Cases of mistreatment of foreign workers have received widespread coverage internationally, and in 2005 the government of Saudi Arabia created a special department – the Saudi Department of Protection of Domestic Workers – after pressure from the Philippines (Migrants News Monitor, 2005).

In 2012, the Saudi Government has gone further and has taken practical steps aimed at scrapping the individual sponsorship system, such as changing the term 'transfer of sponsorship' to 'transfer of services' and preventing sponsors from holding passports of foreign workers and also cancelling the condition to obtain the sponsor's approval for workers to bring their families to the Kingdom (Arab News, 2012). These restrictions had been key foreign worker's grievances for many years.

Like any major policy initiative, *Saudisation* clearly creates disturbances with some sectors of the economy affected more than others. The ultimate goal of development and higher growth comes with a cost in the form of short term transitional disruption. It is too early to gauge the impact of *Saudisation* on the economy, but there are 'new' concerns. Many firms may feel that *Saudisation* will reduce their competitiveness and for that reason may decide to leave the Kingdom for a more business-friendly environment. These would most likely be firms in the service sector. *Saudisation* of jobs would likely cause a loss of business to other regional centres, particularly Dubai, with a reported 2,500 Saudi companies opening up shop in Dubai, rather than in the Kingdom (Looney, 2004).

The exodus to labour-friendly GCC countries could accelerate if the Saudi *Nitaqat* system is aggressively pursued. Some have argued for a drastic rethink and overhaul of the current Saudi sponsorship or *kafala* system, calling for its abolition (Metaweia, 2011). The Saudi Sponsorship Law was enacted some 60 years ago and has caused both domestic and international controversy especially in cases related to human right abuses. The Bahrain government decided in 2010 to abolish private sector expatriate labour sponsorship, and instead introduced legislation to ensure that foreign labour were now under the sponsorship of the government and that all labour – foreign or Bahraini – were free to seek jobs and to determine their wage levels based on market supply and demand forces. Other GCC countries are looking closely at the Bahraini model, and even Saudi Arabia has announced that preliminary approval has been given to launch the first large scale manpower import company to supply foreign labour to both the private and public sector (Arab News, 2011a). Given the precedence of security related issues in Saudi Arabia, it will be a long time before foreign labour will be allowed to operate under a free labour mobility scheme such as that in Bahrain. However, the Saudi Ministry of Labour has, according to reports, began drafting new laws that will end individual sponsorship in the Kingdom and see the creation of an agency affiliated to the Ministry to look after foreign workers (Saudi Gazette, 2012a). The state of Qatar seems to have also gone one step further than Bahrain and announced that it is considering the establishment of a trade union to protect labour rights and to scrapping the sponsorship system. The union will be run by Qataris but foreigners will have the right to vote but not run for board elections, according to Qatari officials (Saudi Gazette, 2012b).

In conclusion, the Saudi Government is caught in a dilemma – nurturing the private sector to play a more effective role in a sustained and diversified economy, while at the same time trying to manage a rising tide of youthful unemployed through government imposed quota decrees.

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