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Macro Picture: Kuwait

To Create Jobs For Nationals, Reduce Dependence On Public Sector Employment And Low-Wage Foreign Labor

By

Alessandro Magnoli Bocchi

Fawaz Sulaiman Al Mughrabi

Carmen Pages Serra

Zafiris Tzannatos

13 October 2021

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Table of Contents

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For information about Rosa&Roubini Associates, please send an email to info@rosa-roubini-associates.com or call +44 (0)20 7101 0718.

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Executive Summary

Unsustainability Of Kuwait's Labor Market

- The 'COVID-19 pandemic' will likely accelerate the end of the fossil-fuel age. As a result, Kuwait's economy – which has already underperformed its GCC peers over the past decade – will suffer a challenging outlook.

Possibility Of Stagnation And Unemployment

- In absence of bold structural reforms, Kuwaitis will suffer an increasing shortage of jobs. In particular, Kuwait's labor market is unsustainable, as it suffers from deep imbalances and structural segmentation because, for decades: 1) public employment was the preferred vehicle for oil-wealth distribution to citizens; and 2) a skewed immigration policy created an abundance of foreigners working at low wages.
- As a result, public sector jobs – with guaranteed employment, higher wages and shorter working hours – employ 84% of the local labor force and ensure income redistribution to nationals.
- Conversely, private sector jobs rely mainly on low-cost foreign labor and provide more precarious employment, lower wages and longer working hours.
- Inevitably, most Kuwaitis: i) lack the incentives to invest in an education leading to higher-value work; and ii) find private sector jobs unattractive. In other words, locals are neither incentivized to acquire the skills required for white-collar positions nor to accept low-paying blue-collar jobs.

Creating Jobs For Kuwait's Nationals

- To date, easy-to-implement yet poorly designed labor market policies - such as, for example, the salary top-up scheme "da'am alamala" - have been unable to: i) provide proper incentives for nationals; and hence ii) increase their employment in the private sector. In the coming years, the twin 'COVID-19 and oil shocks' will accelerate the pace of change of the Kuwait labor market.
- Unless the economy is diversified and migration regulated: 1) long-term growth will be hampered; 2) job creation in the public sector, the favored solution so far, will prove fiscally unsustainable; and 3) risks will rise, as: i) job growth in the private sector will not result in higher employment for Kuwaitis, worsening the 'deficit of private-jobs' for locals; and ii) structural unemployment amongst nationals could eventually threaten Kuwait's economic viability.
- To avoid stagnation and unemployment, the government should adopt: i) a strategic medium-term plan, focused on sustainable growth and endowed with sufficient financing; and ii) sound labor market policies, able to incentivize a move from 'unproductive public sector jobs' towards 'meaningful private sector employment'.
- In particular, value-adding jobs can be created by: i) delinking 'oil-wealth sharing' from public employment, by – inter alia – providing all adult citizens with an 'oil dividend'; and ii) making the private sector less reliant on low-wage foreign labor, by – inter alia – introducing short-term wage subsidies for companies that employ local workers and a 'permanent resident' status for foreign workers.
- To implement viable reforms and create jobs for Kuwaitis, this paper suggests a gradual approach: 1) seven 'low-hanging fruits', ranked in order of political feasibility, for the short-term; and 2) seven key lessons from successful economies for longer-term job creation.

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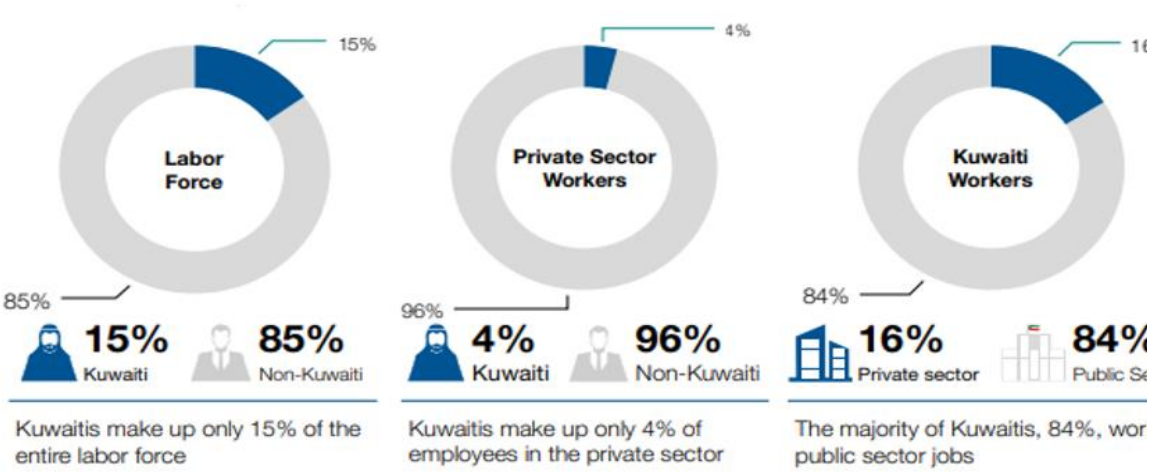
Key Picture: Unbalanced And Segmented, Kuwait's Labor Market Is Unsustainable



Source: Public Authority for Civil Information, 2021.

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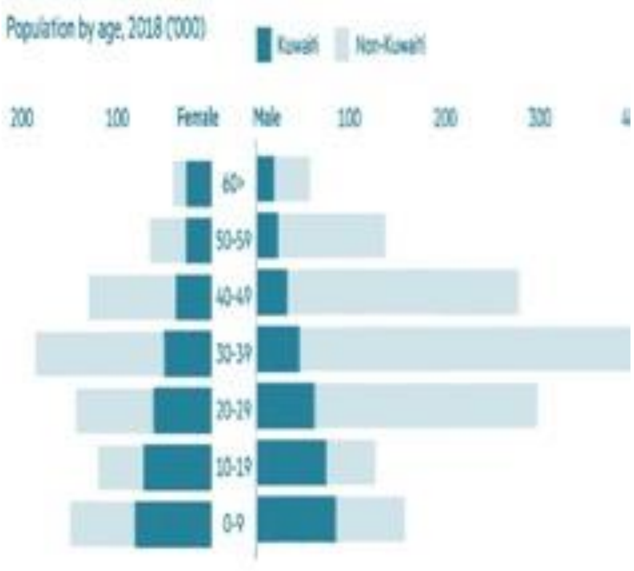
Key Concern: Unbalanced And Segmented, Kuwait's Labor Market Is Unsustainable

Kuwait's labor market suffers from deep imbalances. First, Kuwaiti nationals constitute only: i) 15% of the labor force; and ii) 4% of private sector employment (**Key Picture**). Second, the public sector employs 84% of Kuwaitis; public salaries and subsidies are: i) motivated by oil-wealth redistribution; ii) financed with oil receipts; iii) delinked from productivity; and iv) constitute 71% percent of the 2020/21 fiscal budget. Third, nationals are not incentivized to accept private sector jobs, let alone low-paid ones, given: i) high public-sector wages and benefits, and an undemanding work environment; and ii) the relative unattractiveness of the 'da'am al amala' – a 'wage top-up' subsidized by the government, provided to make employment in the private sector more attractive for nationals. Fourth, private sector employers – for both financial and regulatory reasons – prefer to hire foreigners, whether: i) 'blue-collar' workers, as most business-models rely on low paid immigrants; or ii) 'white collar' professionals, as many nationals do not have the hard and soft skills needed to work in administrative or managerial positions.

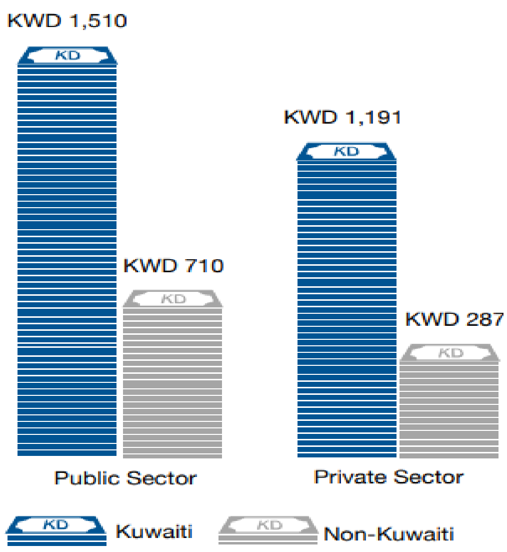
As a result, Kuwait's labor market can be divided into two distinct segments. The *first*, for Kuwaiti nationals – driven by the public sector, and heavily influenced by the benefits it grants – offers greater labor rights, more comfortable working conditions, and better wage prospects (**Figure 2**). While the employer has little or no control over the employee's productivity, high public sector salaries increase reservation wages (i.e., the wage a worker requires in order to accept a job) for locals, and crowd out private sector employment. The *second*, for foreign workers, far less generous, is preferred by the private sector and buoyed by favorable immigration regimes. A rigid sponsorship system – i.e.: the *'kafala'* – restricts internal mobility and makes expatriates easier to control than nationals. As a result, private businesses depend heavily on foreign unskilled labor but – given the ongoing global crisis – have increasingly enjoyed access to an abundant supply of skilled international expatriates.

Figure 1: Kuwait: Foreigners Are Twice The Nationals



Source: The Public Authority for Civil Information, 2021.

Figure 2: Kuwait: Nationals Earn More
(monthly wages by nationality, average)



Source: Central Statistical Bureau, 2020.

Kuwait suffers a deficit of private sector jobs for nationals, which will worsen in the coming years. The above-mentioned factors hamper future growth prospects, as they: 1) create a segmented labor market, and lead to an imbalanced demography (**Figure 1**, **Box 1**); 2) have negative implications for productivity, entrepreneurship and 'non-oil sector' development; and 3) skew economic activity towards low wage-low value-added sectors. Going forward, given current and expected oil prices and known reserves, it will be impossible to continue employing nationals at current rates (**Figure 3**). If nothing is done, unemployment of nationals will grow and an

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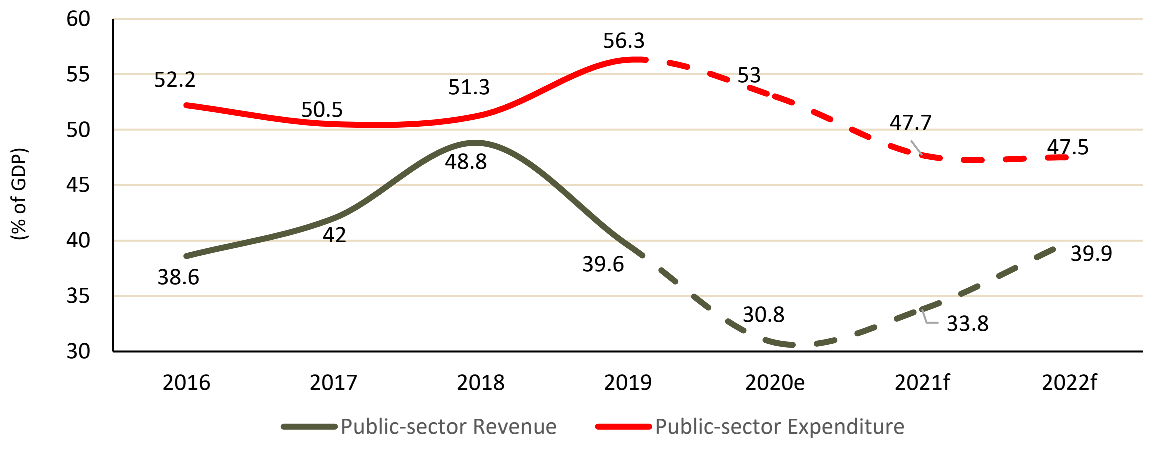
increasing fraction of the population will feel left behind, leading to diminishing living standards and possibly unrest.

Figure 3: Kuwait Public-Sector - Over 2016-2022f, Expenditures Outpace Revenues



Source: EIU, 2021.

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"*Kuwaitization*" efforts are limited by the lack of incentives for nationals to occupy roles currently performed by foreigners**.** Throughout 2021-22, the parliament and the government will focus on making progress on '*Kuwaitization'* efforts, and reducing the unemployment of nationals – particularly among the young, by: *1)* in the *public sector* – cutting the number of foreign workers and reserving government jobs for Kuwaitis; *2)* in the *private sector* – reducing the expatriate population as a proportion of the total workforce – by imposing 'nationality quotas'. Yet, given the disinclination of the locals to perform low-paid jobs, some sectors will maintain a high dependence on foreign labor.

Easy-to-implement policy options failed to provide incentives for job-creation, and proved unsuccessful. In the available policy spectrum, political feasibility and policy-impact are inversely related. Recent policy efforts were unable to tackle structural issues. Over the past decade, direct financial incentives provided to nationals employed in the private sector have proven ineffective; in particular, the income-supplementing "salary top-up scheme" (*da'am alamala*) – designed to: *i)* facilitate initial recruitment by employers; and *ii)* reduce the workers' preference for public-sector jobs – has so far brought about very mixed, feeble results. Similarly, trying to reduce cost-differences to the employers by levying: *1)* a tax on foreign workers; or *2)* additional fees on work permits is likely to: *i)* restrict foreign labor inflows; and *ii)* impose additional costs to local small and medium-sized enterprises (SMEs) – and are unlikely to significantly reduce the preference for government jobs.

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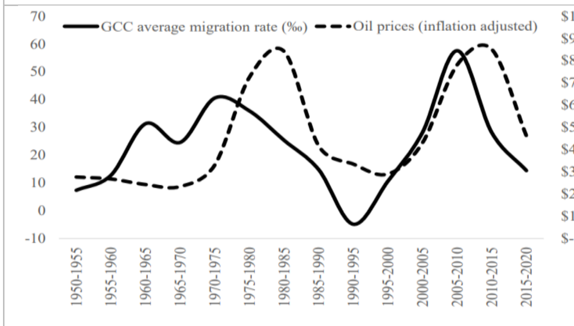
Box 1: The GCC Context - Kuwait Is Not An Exception

A segmented labor market, by policy-design. As of 2020, about 59.4 million (m) people live in the six Gulf Cooperation Council (GCC) countries – Saudi Arabia, the United Arab Emirates (UAE), Qatar, Kuwait, Bahrain, and Oman –expected to reach 66.4m by 2025. The GCC countries share similar demographic and labor force characteristics, such as: *i)* fast growing population; *ii)* heavy reliance on expatriates; *iii)* low levels of private sector employment for nationals; *iv)* low participation of women in the workforce; and *v)* fast-rising public unemployment among citizens. In the GCC, the labor market for foreigners is based on an 'individual sponsorship system' developed in the 1950s – called *'kafala'*: each employee must have a sponsor or *'kafeel'*.

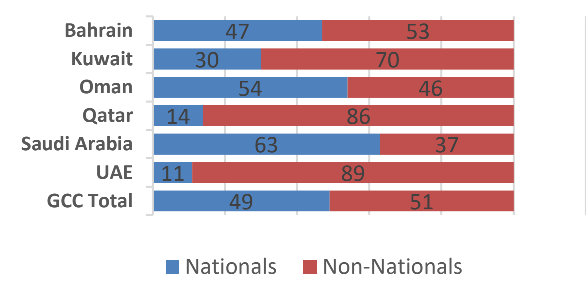
Over the past decade, millions of jobs were created, but the employment of locals did not rise. Locals lack: *i)* the incentives to accept low-paying blue-collar jobs; and often *ii)* the skills required for white-collar positions. Over the past ten years, about 10m new jobs were added in the region: about 7m vacancies were filled by foreign labor (**Figure 4**) – largely in the private sector; fewer than 2.8m went to GCC nationals. Most of the jobs were created in the low-skill construction sector, but a significant number of foreign white-collar expatriates were also hired, including in the public sector.

Figure 4: GCC: average net migration rates
(per thousand inhabitants)



Source: UNDESA, Population Division 2020.

Figure 5: GCC population: % of national and foreigners



Source: Gulf Labor Markets and Migration (GLMM), 2021.

An imbalanced labor market leads to an imbalanced demography. Over the next five years, the fast-rising GCC working-age population is likely to grow by about 4m citizens. At the same time, another 3m jobs are likely to be added. If past trends are a guide, less than one-third of the newly created jobs will go to locals. As a result: *i)* most GCC countries face significant imbalances in their demographic composition (**Figure 5**), due to expatriate labor becoming a majority; and *ii)* an additional 3m nationals could end up un- or under-employed.

Unemployment rates differ across GCC countries, but ensuring job-creation for locals is a common priority. In countries with very low levels of total unemployment – such as Kuwait, Qatar, and the UAE – efforts are made to create more opportunities for nationals in the private sector. In Saudi Arabia, unemployment affects the nationals, in particular youth and, increasingly, university graduates – i.e., new entrants in the labor market. Going forward, more and more youth may experience long-term unemployment – leading to increased numbers getting discouraged and leaving the labor market. In addition, skilled workers are often in jobs that don't fully utilize their skills. Across the GCC, if labor market structure and dynamics do not change, economic growth alone will not be sufficient to provide much needed local jobs.

Targeted policies, designed to increase the employment of nationals within the private sector, have so far failed. Over the past decade, GCC governments formulated labor market reform strategies to: *i)* create employment opportunities for nationals in the private sector; *ii)* limit dependence on expatriate labor; and *iii)* increase workforce participation. Each government launched its nationalization initiative: '*Emiratization'* in the UAE, '*Saudization'* in Saudi Arabia, '*Qatarization'* in Qatar, '*Kuwaitization'* in Kuwait, '*Bahrainization'* in Bahrain, and '*Omanization'* in Oman. To date, these policies proved largely ineffective, as they ignore the large differences between nationals and expatriates with respect to: *1)* gap in wages; *2)* working hours; and *3)* benefits and social protection.

Source: Authors, 2021.

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Looking Ahead: Without Bold Structural Changes, Stagnation And Unemployment Are Likely

Without policy interventions, the post COVID-19 economic recovery will be sluggish. Between 2021 and 2025, Kuwait's growth is expected to rise from 0.7% in 2021 to 2.5% by 2025. Inflation is expected to remain stable, averaging 2.4%. In 2021, oil-output is expected to slowly recover, possibly stabilizing local consumption, and asset markets. Yet, slow credit growth will constrain economic activities, and stock market performance, which in turn will induce a rise in non-performing loans (NPLs) in the banking sector. The implementation of *Kuwaitization* – the employment nationalization policy – will continue to add to private-sector costs, and reduce remittances to other Arab countries.

Fiscal stimulus and structural reforms are needed. Going forward, in the short-run, the Kuwait Central Bank (CBK) will: *i)* provide liquidity to the economy by maintaining easy monetary conditions; and *ii)* keep the Kuwaiti Dinar (KWD) linked to a basket dominated by the USD – i.e. a 'soft-peg'. However, in the long-run, unless the government pursues a mild fiscal expansion accompanied by structural reforms to spur rapid job-creating growth, the country risks years of structurally-anemic growth and financial instability.

Key challenges need to be faced. *First,* the government makes a paternalistic use of economic rents – and 'buys peace' by delinking wages and subsidies from productivity – hence inflating disposable income, consumption and living standards. *Second,* rapid demographic changes are not matched by adequate education systems. *Third,* the private sector remains focused on short-term gains, and powerful alliances between ruling and business families keep blocking competition to favor rent-seeking. *Fourth,* monopolistic practices and administrative red-tape keep hampering job creation. *Fifth,* rent-extraction and nepotism widen income inequality. To avoid economic hardship and income volatility – which tend to bring about political and social unrest – it is essential to limit elite-capture by: *i)* amending rent-capturing regulations; and *ii)* create a viable private sector – hence enabling value-adding job-creation.

Not creating value-adding jobs will hinder long term growth... Productivity, investment, and consumption are main drivers of economic growth, and are closely intertwined. To sustain post COVID-19 recovery prospects, a negative cycle needs to be avoided: *1)* in absence of productive workers, firms hesitate to invest and hire; *2)* unemployment, underemployment and low wages reduce disposable income (workers are consumers); and *3)* inevitably, when workers reduce their demand for goods and services, business confidence gets eroded – back to *1)* above.

… and could eventually threaten Kuwait's economic viability. As oil prices fell, and COVID-19 pushed growth below-potential, Kuwait's budget deficit deepened. Kuwait's fiscal breakeven – i.e., the price of oil needed to balance the fiscal account at current oil-outputs and spending levels – is rising. Today, the government needs oil at 65.7 US Dollars (USD) per barrel to meet spending commitments. Past savings can shoulder a few years of budget deficit as the fiscal position deteriorates because of lower oil revenues or higher expenditures. Entitlements are hard to cut, but in the long run lack of policy action will undermine the sustainability of both fiscal trajectory and growth model.

Remittances outflows hamper economic growth. In the 2019-20 fiscal year, expats remittances increased by 3.7%, to KWD 4.47bn – from KWD 4.3bn in 2018-19 (**Figure 6**). Indians, the largest expat community at 1.3m, sent around KWD 1.9bn to their home country. In Q2 2020, due to the repercussions of the COVID-19 pandemic remittances decreased by ~22% to KWD 1.057bn – from KWD 1.35bn in Q1.

Seven Low-Hanging Fruits: How To Create Enough Jobs For Kuwaiti Nationals In The Short Term?

*Creating jobs in the public sector, the favored solution to date, is facing increasing fiscal challenges (**Figure 3**).* Over the last ten years, social demands rose - as: 1) oil output volumes and revenues grew; and 2) reserves accumulated at: i) the CBK; and ii) the Kuwait Investment Authority (KIA, Kuwait's sovereign wealth fund). Swiftly, the government increased spending in public-sector salaries and subsidies, propping up consumption.

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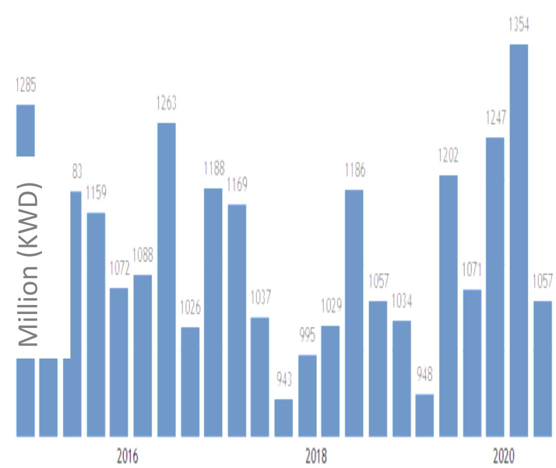
In 2012: i) with 84% of the national labor force employed in the public sector, civil-service wages were increased by 25%; and ii) 7% of GDP was spent on fuel-subsidies. Paradoxically, while Kuwait's fiscal expenditures rose, higher oil prices and export volumes improved the fiscal balances. Over the next decade, this bonanza-driven spending-spree cannot afford to continue: the twin COVID-19 and oil shocks will reduce oil revenues and accelerate the pace of change of the Kuwait labor market.

To implement sustainable reforms, a gradual approach is essential. The credibility of government policies is fundamental for the success of the reform effort. Hence, the design and implementation of key reforms should be sequenced in stages, adopting a gradualist approach. The following suggested steps are listed in order of political feasibility and 'ease-of-implementation'; in other words, the phases of the suggested transition are ranked in order of decreasing popularity and increasing political difficulty.

Step 1. Promote growth via counter-cyclical fiscal and monetary policy. The Asian experience has shown the importance of sound economic management for job creation. Economic stability matters for employment: maintaining it during a crisis requires strong institutional fundamentals as well as flexible macro-economic policies. When the 2008 crisis hit the Asian region, solid domestic fundamentals combined with coordinated policy responses upheld growth. Supportive fiscal policies coupled with monetary expansion absorbed economic and financial shocks. Importantly, large fiscal packages supported both GDP and employment: Asian countries spent on fiscal stimuli an average of 9.1% of 2008 GDP, far larger than the 3.4% of the advanced economies. Pursuing a stable and competitive real effective exchange rate also proved effective.

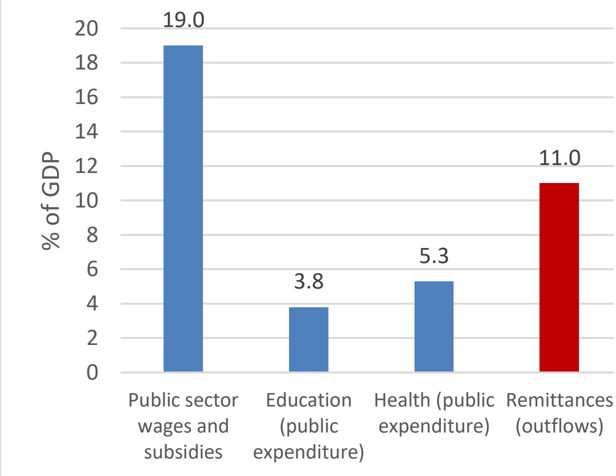
Step 2. Replace the Kafala system with 'permanent resident' status. The Kuwaiti economy needs to: i) reduce labor market rigidities; and ii) allow foreign workers to move across firms. New employment policies are needed, focusing on merit, skilled workers and talent management – independently from the nationality of the workers. A strict 'sponsorship system' - the Kafala - has become obsolete; a 'legal residence' status could reduce: 1) dependence on sponsors; and 2) remittance outflows – currently higher, at 8-12% of GDP per annum, than education and health spending (**Figure 7**).

Figure 6: Kuwait - Remittances ***(quarterly) …***



Source: CBK, 2021.

Figure 7: … Outflows Are Sizeable, A Lost Opportunity



Source: Central Statistical Bureau, 2021.

Step 3. Support SME growth to increase private sector employment. In Kuwait, entrepreneurship – measured as the percentage of self-employed in total employment - has been declining since 2011, down to less than 2% in 2020 (**Figure 8**). SMEs, owned by locals but run by migrants: 1) represent more than 90% of the Kuwaiti private sector; 2) employ about 50% of its labor force, mostly foreigner workers; and 3) contribute less than 40% of GDP because they are concentrated in less profitable, low-tech sectors. Governments should facilitate their access to labor, credit, and public tenders. For example, Saudi Arabia is providing partial guarantees to SMEs. Large corporations' contracts would also help SMEs grow. Greater and more stable revenues would allow for

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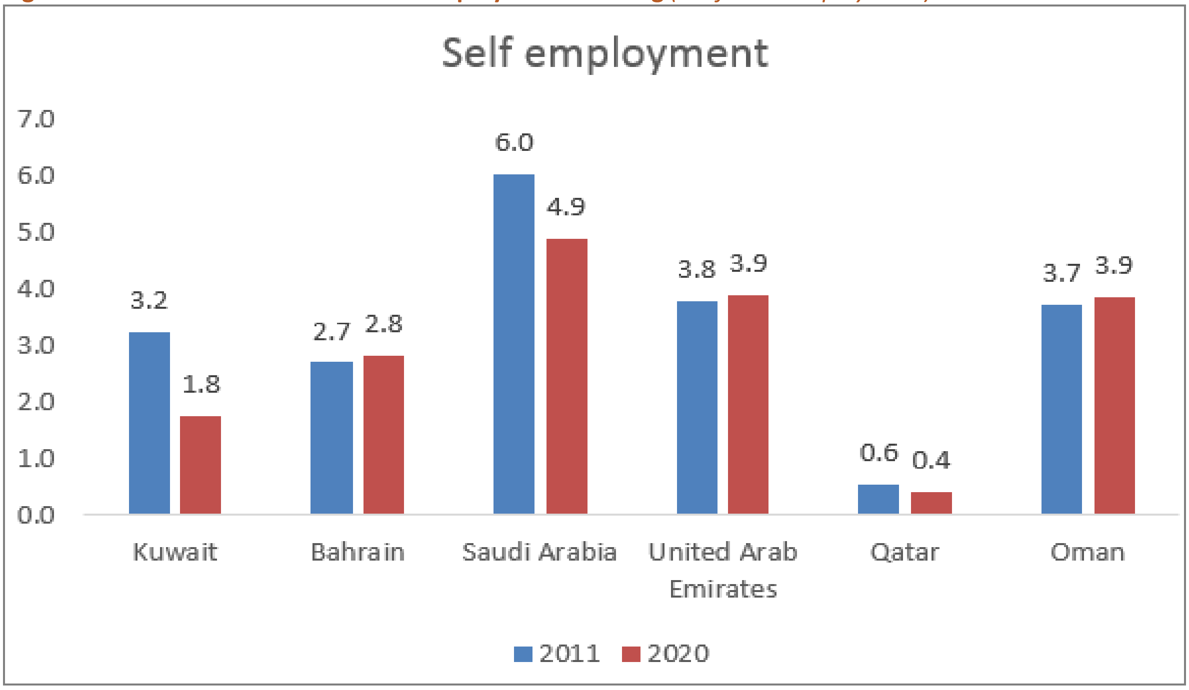
technology upgrades, financial stabilization, and – as a result – sustainable job creation. In other words, job creation for nationals needs to make 'business sense' to entrepreneurs: they should pursue it out of their own interest rather than, for example, a fear of fines. In short, the private sector should be made a partner, rather than a victim, in this endeavor.

Figure 8: Kuwait: The Number Of Self-Employed Is Declining *(% of total employment)*



Source: Modeled ILO estimate, 2021.

*Step 4. Formal labor market: make it more flexible for nationals, while supporting: 1) all adults with an 'oil dividend'; and 2) the private sector with wage-subsidies***.** Kuwait should consider adopting "*flexicurity*", i.e.: the ability to balance the "*flexibility*" needed to adapt to economic changes with "*security*", in order to maintain labor protection. In Asia, as a result of past pressures from domestic employers and foreign investors, most countries' labor regulation is sufficiently flexible and not financially onerous for employers. In the late 1990s, South Korea eliminated the guarantee of lifetime employment, but provided policies to compensate. In Singapore and Malaysia, employment is not protected but supported by active policies – such as skills training and self-employment promotion. Over the past decade China and South Korea reduced restrictions on retrenchment, but introduced unemployment insurance. In China, India (e.g., the National Rural Employment Guarantee Scheme) and Sri Lanka, where the informal and rural economies are large, governments often used public works, self-employment programs, and skills training to reduce unemployment. Over the next few years, the government should consider supporting:

1) its *citizens* with an 'oil dividend' for all adults – i.e.: income linked to the country's oil revenues, financed by: *i)* reforming existing wealth-sharing policies, e.g.: via a gradual trimming of the public-sector workforce; and *ii)* a reduction in government subsides – *de facto* separating public employment from the wealth-distribution process; and

2) the *private sector* with short-term wage subsidies, to compensate for Kuwaitization's initial: *i)* higher costs; and *ii)* lower productivity. To make sure the measure is temporary, subsidies should: *a)* be granted to companies that employ local workers (not to the workers themselves); and *b)* endure a gradual reduction of 10 percent per annum. Importantly, the private sector shall be regularly consulted - and its "buy in" obtained - on the implementation of key policy measures.

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Step 5. Make public-sector employment less attractive: enact reforms to link pay to productivity. Public employment is *not* the appropriate channel to share oil-revenues with the citizens. Over the next five years, Kuwait needs to: *i)* reduce the growth of the government's wage-bill; *ii)* close the public-private wage-gap; and *iii)* delink wealth-redistribution benefits from public sector employment - otherwise nationals will inevitably prefer the civil service to the private sector. Importantly, a public service reform should cut unproductive expenditures. Going forward, to: *a)* link compensation with productivity; and *b)* reduce the State's role as the main employer of nationals, the government should – in order of political feasibility and 'ease of implementation': *1)* introduce a performance-based pay system; *2)* reduce salaries and benefits of new government employees (Oman, 2020); *3)* freeze pay-rises for 5 years and anchor compensation to performance (used in over 60 percent of economies); *4)* set maximum targets for public employment in demographically driven sectors - e.g.: teachers and medical personnel; *5)* institute a competitive 'entrance exam' to the public sector, with clear: *i)* selection criteria; and *ii)* minimum entry-requirements; *6)* recruit on merit and on business needs (i.e.:, only when there are vacancies); *7)* base promotions – and salary increases - on 'new vacancies' in the next level – not on seniority and years of service; *8)* delay early retirement, and pay pensions only at 65 year of age and above - both for women and men; and *9)* announce and implement a '*zero public sector employment growth*' as of 2025, in order to: *i)* minimize immediate opposition; and *ii)* give younger citizens an incentive to invest in value-adding education.

Step 6. Infrastructure and education: bet on public-private-partnerships (PPP). As private investment is constrained by a number of institutional factors that are difficult to address in the short run, schemes for more public-private risk sharing are needed. To alleviate bottlenecks, the government should both: *i)* reduce the risk; and *ii)* increase the return on private investment. In other words, it is necessary to stimulate risk-sharing among investors – for example, via PPP – by co-financing public works (e.g.: transport and communications) and in education, by addressing under-provision of training in areas where skills are lacking. Local people's investment in skill acquisition and organizational capacity only materializes if private returns are appropriable.

Step 7. Provide incentives and subsidies to increase productivity, rather than public employment. In the long run, initiatives to: *i)* enhance productivity in the private sector; and *ii)* stimulate private-sector activity and value-adding job creation will be less expensive than creating public jobs. More effective policies are needed: *first,* incentivize nationals to acquire productivity-enhancing skills, and become attractive for private-sector employment. *Second,* offer the private sector financial and other incentives to employ trained nationals, by providing targeted subsidies for hiring of new labor market entrants. For example, Saudi Arabia and other GCC countries are implementing new programs to match job seekers with employers, through job placement services and training, as well as education schemes. Importantly, Kuwaitization targets NOT in terms of ratios but number (what matters is real flows – ratios are arbitrary and may not correspond to citizen inflows to the labor force).

Seven Lessons For Long-Term Job Creation: What Can Kuwait Learn From Successful Economies?

Sound reforms take years. For stronger growth and sustained employment generation in the long-term, Kuwait should learn from successful economies. In particular, can the Asia-GCC proximity (Box 2) become an inspiration?

Box 2: Kuwait Needs To Create Jobs. What Are Asia's Best Practices?

The GCC shares many similar traits with the Asian continent. Their political economy is very similar, and countless trade corridors, and investment ties intertwine the two areas. In the past, Arab dhows sailed the waters of the Indian Ocean, and Asian caravans transported textiles and spices across the desert. Today, the oil-rich Gulf and an "energy-hungry" Asia have intensified their political and financial relations. Every day, Middle Eastern resources – above all, capital and energy – spur East Asian growth, and Asian governments seek in the Arab world supplies for their domestic demand, and markets for their goods.

Since the beginning of the century, East Asia was the fastest job creator in the world, closely followed by South Asia. Over the last twenty years, Asia grew rapidly thanks to high rates of savings and investment, human capital accumulation, diversification and knowledge transfers. Most of all, it put unskilled labor to work, and

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fostered productivity-enhancements. The informal sector – characterized by low skills and low earnings – contributed the most to job creation. While the agriculture sector shrunk in size all over the continent, manufacturing spurred job creation in East Asia – and services drove employment in South Asia. If both the formal and informal sectors are considered, India's example stands out. Over 2000-20, employment grew by an average of 2.5% per year, and the economy generated a yearly average of about 10m net new jobs. Over the same period in China, employment grew by 1%, and the economy created 7m new jobs.

Kuwait can learn from Asia's model of job creation. *First,* Asia has shown that it is possible to preserve macro stability while sustaining employment growth with counter-cyclical fiscal, and monetary policy. *Second,* sufficiently flexible labor markets permit to take advantage of the demographic dividend. *Third,* competitiveness is spurred by infrastructure and education spending, and promoted by well-functioning economic zones. *Last,* economic diversification and a competitive real effective exchange rate could help reduce rent-seeking, and *elite capture*.

Make good use of the demographic dividend and develop local capabilities. By putting its citizens to work, Asia used its demographic dividend well. Kuwait has not – thus far. Over time, Asia evolved from low- to middle-income status by transferring a large pool of unskilled labor from subsistence-level activities into manufacturing jobs. Supported by capital expenditures, and enhanced by imported technology, labor productivity rose – and sustained GDP growth. For more than a decade, annual average increases in real wages were kept below productivity growth. Of course, when the pool of unskilled labor started shrinking, and the expansion of manufacturing peaked, growth slowed; today, the model needs rethinking. In other words, attaining high-income level requires better human capital, more sophisticated home-grown technology, and organizational capabilities.

Source: Authors, 2020.

What can Kuwait learn from successful economies? What follows are a list of measures that jointly can restore equilibrium in the labor market and provide the basis for higher growth, and full employment for nationals. Importantly, the below-recommended policies are listed in order of political palatability and – alas – in reverse order of effectiveness.

Lesson 1 – Invest in quality infrastructure, reduce red tape. In the World Economic Forum's Global Competitiveness Report 2019, Kuwait: *i)* lags its GCC peers; and *ii)* is ranked 66th out of 141 countries in terms of its infrastructure quality. Excessive red tape, due to a large public sector bureaucracy, hampers growth-enhancing capital spending. Inevitably, the lack of infrastructure: *i)* hampers job creation in the private sector, as it hurts SMEs; *ii)* restrains growth in the non-oil sector, and its multiplier effects; and *iii)* discourages entry of domestic start-ups and foreign investors. Oil revenues should finance an upgrade of the logistical network of the country, while maintaining a sound fiscal policy and improving public spending efficiency.

Lesson 2 - Promote competitiveness via well-functioning economic zones. Kuwait needs to guarantee simplified business procedures, and enhance *in situ* competition, by ensuring – for example – that local institutions treat domestic and foreign firms equally and transparently (e.g., in dispute reconciliation). An *"economic zone"* must lie in a geographically defined area, where domestic and foreign agents can find: *i)* first-rate infrastructure and human capital; *ii)* investment incentives and simplified procedures; *iii)* domestic and international linkages; *iv)* enabling institutions, such as equal treatment of domestic and foreign firms, and transparent dispute reconciliation mechanisms; and *v)* coordination with a comprehensive country-wide reform, in the context of an overall growth strategy. A key lesson comes from Asia's economic zones. Over the last three decades, several Asian countries – when a rapid nation-wide reform of their governance was neither possible nor credible – created "economic zones" to promote trade, spur exports, and stimulate economic development. These industrial enclaves created new employment, and increased export flows. Although their track record is mixed across the continent, they have overall been successful in attracting investment and fostering economic development. Examples are the *Export Processing Zones* in Singapore, and Malaysia in the 1970s, and the *Special Economic Zones* in China, in the 1980s and 1990s. Well-performing economic zones create new wealth, and bring

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about efficiency gains – without forcing an immediate redistribution of oligopolistic profits. This leads to rising investments in non-traditional activities, and provides demonstration effects for prospective entrants. Over time, the enhanced dynamism of the export-oriented sector is likely to diffuse beyond the original location, acting as a catalyst for reform of the economy as a whole.

Lesson 3 - Pursue a stable and competitive real effective exchange rate. A stable and competitive 'real effective exchange rate' helps to achieve rapid and sustained growth, by*: i)* fostering the diversification of the industrial base; *ii)* inducing investment and entrepreneurship in tradables; and *iii)* promoting the production and export of non-traditional manufacturing and services. In past decades, fast-growing developing countries have simultaneously exhibited not-overvalued real exchange rates, high domestic savings, and current account surpluses. China is the present-day example, but in recent years this was the case also in high-performing Asian economies such as South Korea, Malaysia, and Thailand. The Asian experience shows that a volatile and overvalued currency is not conducive to the expansion of new exportable, and negatively affects the production of tradables. In sum, a competitive exchange rate increases demand for exports and import substitutes, and motivates entrepreneurs to produce non-traditional export commodities, expand investment, employment, and economic growth.

Lesson 4 - Diversify the economy via trade exposure. Kuwait's economic activity is dominated by the capital-intensive oil and gas sector, which creates relatively few jobs and employs less than 3% of the national labor force. The economy needs competitive diversification. Cross-country comparisons show that growth accelerations are associated with the production and export of non-traditional manufacturing and services – in other words the products *"in demand"* in the industrialized nations. Hence, development policies should strategically promote a structural transformation toward these *"more sophisticated"* economic activities, by providing production incentives to new exportable goods and services. To induce investment and entrepreneurship in the tradable-sectors, a new set of economic policies should promote the manufacturing – and export – of non-traditional manufacturing and services, to foster a market-driven expansion of non-traditional products.

Lesson 5 - Attract private sector investment in high-value added sectors. Over the next decade, targeted policies are needed to move from low-cost, labor-intensive industries to advanced, high-skill, capital-intensive and value-adding industries in a dynamic, fast-growing non-oil sector. The examples are there: *a)* the UAE has diversified into service provision; and *b)* Saudi Arabia has developed a petrochemical industry. Importantly, to train workers in new skills for high value sectors the government should: *i)* promote private sector-led, private-public associations to identify the skills and public goods needed to promote high value-added sectors; and *ii)* award competitive grants to companies that invest in upskilling or reskilling workers – and allow the youth to learn new skills on the job.

Lesson 6 - Upgrade education and training systems, to promote employability. The government must better align education outcomes with the skills demanded by the private sector and international competitiveness standards. A major overhaul of the educational system is needed, in order to: *1)* build a knowledge-based economy; *2)* an adaptable workforce; and *3)* a sustainable economy. As already done in several GCC countries, it is important to: *i)* incentivize top global higher education institutions to set up branches in Kuwait; *ii)* create competition for research grants between public and private-owned educational and training institutions; *iii)* set up tracking systems to monitor educational outcomes and the employability of graduates in all higher education institutions; *iv)* provide training to improve the skills base. In addition, placement services need to be significantly upgraded.

Lesson 7 - Address rent seeking and elite capture. Kuwait should implement gradual reforms to tackle its rent-seeking conglomerate economy. Well-established in sectors that are strategic because of multiple backward and forward linkages, the conglomerates – by producing expensive inputs – seek rents from the economy, and shrink

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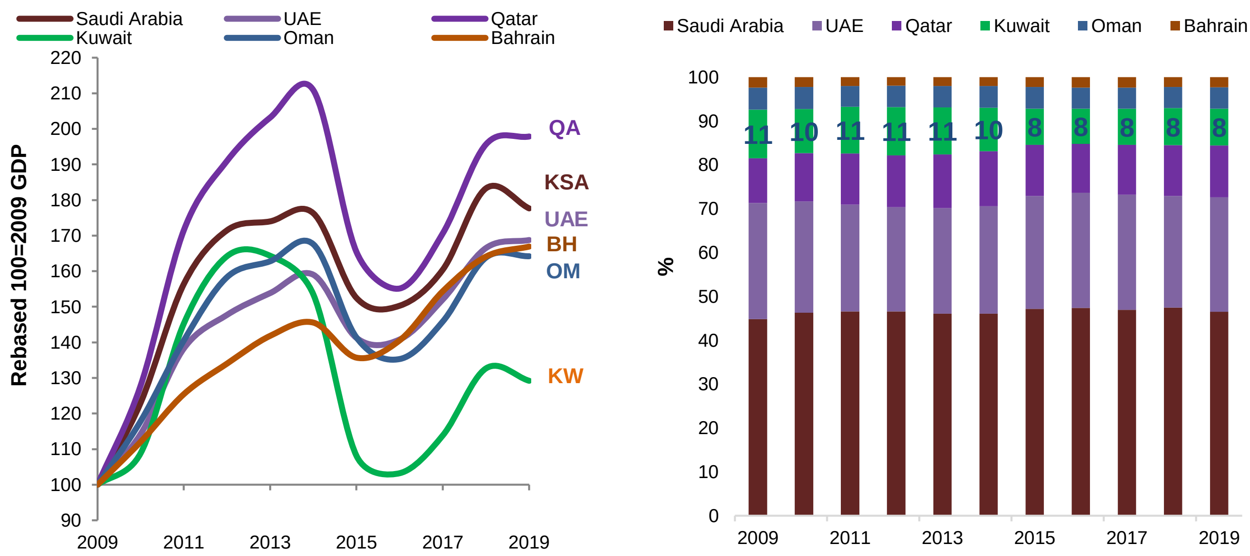
the margins of the potentially most dynamic agents: the small and medium domestic private producers. They also control bank credit, and dominate state procurement contracts through political connections. To accelerate economic growth, increase employment generation, and generate public resources for social programs, rent seeking by the elites that exercise political and economic power – or "*elite capture*" – must be addressed. First steps are improving the investment climate and competitiveness, and disseminating information on the distributional effects of government policies. However, the key measure to attract investment and create more local jobs is opening and reforming the sectors dominated by rent-seeking corporate conglomerates. Greater access to bank lending for unconnected companies (e.g.: foreign corporations, domestic medium and small firms) should be promoted. Given the strength of rent-seeking interests, the reform of oligopolistic practices in the traditional sectors of the economy can occur only gradually. Over time, the expanding competitive sectors should shrink the relative importance of patronage networks, and build – in association with the businesses that are currently bearing the costs of rent-seeking – a pro-reform political constituency.

What's Next? In A Challenging Macro-Context, Meaningful Jobs Are Needed

2009-2019: Kuwait lagged behind GCC peers. Over the past decade Kuwait has underperformed GCC peers, and today its GDP constitutes a smaller share of total GCC output. Between 2009 and 2014, in the immediate aftermath of the financial crisis, all GCC economies endured a period of recovery (**Figure 9**). Yet, after the oil price drop of mid-2014 most GCC economies recovered - although modestly, but Kuwait has lagged behind. Today, Kuwait's economic output constitutes only 8 percent of total GCC output, compared to 11 percent at the start of the decade (**Figure 10**).

Figures 9 And 10 - Kuwait's Underperformance: GDP Declining As % Of Total GCC Output



Source: Authors' calculations on World Bank, 2021. IMF WEO, 2020. *Note:* 2019 figures are estimated by the IMF.

The Kuwait government must provide an enabling environment... The State must provide: *i)* a vision for Kuwait's economic future; *ii)* a coherent mission for both the public and private sector; *iii)* a strategic medium-term plan, endowed with sufficient financing; and *iv)* the institutional framework for the markets to operate, by introducing clear and impartial rules (i.e.:, "*level play field competition*"). In absence of an economic strategy and the enabling environment for its implementation, the restructuring of civil service – and hence the needed reorganization of the labor market - are unlikely to work.

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… build a sustainable economy to ensure the stability of the political system … To avoid state failure, Kuwait's government should reform from a position of strength, before the window of opportunity closes. While the country still has large financial buffers, the double-shock – driven by the COVID-19 pandemic and low oil prices – has intensified financing challenges. Today, the fiscal breakeven oil price, at 61.2 USD/b is well above the 2020 average (41.4 USD/b). The public sector deficit is widening: *i)* revenues are falling: from 40.9% of GDP in 2019 to below 30.0% in 2020; *ii)* expenditures are growing: from 58.2% of GDP in 2019 to 61.5% in 2020; and *iii)* the fiscal deficit is expected at ~16.6 bn KWD or 40.5% of 2019 GDP.

… implement a 5-year restructuring plan to help the economy and commit to reforms. To avoid a long-term fiscal crisis, the government must propose – and the parliament must pass – a plan to lock in: *a)* structural reforms; and *b)* the needed financial resources for the next 5 years. Both a public debt law and civil service reform law must be approved at the same time. Inaction is dangerous: while prolonged policy uncertainty constrains investment, current spending keeps outpacing capital outlays. As a result, in absence of reforms: *i)* infrastructure spending and non-oil exports are likely to lag behind; and *ii)* competitiveness indicators will inevitably deteriorate. Over the years, meaningful reforms, access to infrastructure and an educated labor-force could promote the circulation of goods, people and knowledge.

Focus on the 'big picture': a 'national employment policy' is not just a 'job replacement program' … Kuwait should focus on correcting the unsustainable demographic imbalance and reform its economy. A national employment policy – endowed with both: *1)* a vision for creating 'a competitive private sector'; and *2)* a practical plan to move to a new 'labor-market equilibrium', less reliant on migrant workers – is needed to achieve Kuwait's employment goals. To maintain the state's social contract with citizens, but also to avoid stoking discontent or resentment towards expatriates, the government must take a strategic approach to 'human resource management and recruitment', and: *i)* limit public sector recruitment of Kuwaitis to both business needs and the applicants' merit; *ii)* increase the incentives of national workers to invest in productive skills, rather than in *credentialism*, so to make them more appealing to private firms; and *iii)* work with the private sector to train and offer lifetime education in-line with the changing global demands.

… in the interest of future generations of Kuwaitis, labor policies should not merely focus on full employment of nationals. Transferring and adapting technology and organizational blueprints from abroad does not work anymore. Kuwait's future growth is restrained by a lack of: *i)* skilled workers; *ii)* value-adding infrastructure; and *iii)* a modern system of education that would, in-line with the changing nature of the global economy, continuously adapt so to provide nationals with the human capital needed by the private sector. The government needs to: *1)* consult widely to reach a common agreement across all interested parties, including employers' and workers' organizations; *2)* consider a broad range of social and economic issues across various programs; *3)* involve all institutions – not just those in charge of labor and employment – that influence the demand and supply of labor, and the functioning of labor markets; and *4)* promote international labor standards, social protection, and workers' fundamental rights as an integral part of job creation.

A productive employment is essential for social cohesion. Since the beginning of the Arab Spring, not much has changed. Back then, social unrest highlighted the importance of employment for social cohesion throughout the MENA region. Going forward, the challenge is to promote the employment of nationals without: *i)* eroding competitiveness; or *ii)* reducing growth. To generate sustainable employment and income for its citizens, Kuwait's government must invest in productive activities while focusing on skills and productivity.

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Statistical Appendix

Year	Saudi Arabia		UAE		Qatar		Kuwait		Oman		Bahrain		GCC total
	GDP (USD bn)	% of total	GDP (USD bn)	% of total	GDP (USD bn)	% of total	GDP (USD bn)	% of total	GDP (USD bn)	% of total	GDP (USD bn)	% of total	GDP (USD bn)
2009	429.10	44.8	253.55	26.5	97.80	10.2	105.99	11.1	48.39	5.1	22.94	2.4	**957.77**
2010	528.21	46.3	289.79	25.4	125.12	10.96	115.42	10.1	57.05	5.0	25.71	2.3	**1,141.30**
2011	671.24	46.6	350.67	24.3	167.78	11.6	154.03	10.7	68.02	4.7	28.78	2.0	**1,440.52**
2012	735.97	46.6	374.59	23.7	186.83	11.83	174.07	11.0	76.62	4.9	30.75	1.9	**1,578.83**
2013	746.65	46.1	390.11	24.1	198.73	12.3	174.16	10.7	78.78	4.9	32.54	2.0	**1,620.97**
2014	756.35	46.0	403.14	24.5	206.22	12.55	162.63	9.9	81.08	4.9	33.39	2.0	**1,642.81**
2015	654.27	47.1	358.14	25.8	161.74	11.7	114.57	8.3	68.40	4.9	31.13	2.2	**1,388.25**
2016	644.94	47.4	357.05	26.2	151.73	11.15	109.42	8.0	65.48	4.8	32.25	2.4	**1,360.87**
2017	688.59	46.9	385.61	26.3	166.93	11.4	120.71	8.2	70.60	4.8	35.42	2.4	**1,467.86**
2018	786.52	47.4	422.22	25.5	191.36	11.54	140.65	8.5	79.28	4.8	37.65	2.3	**1,657.68**
2019	762.26	46.5	427.88	26.1	193.50	11.8	136.94	8.4	79.46	4.8	38.29	2.3	**1,638.33**

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