TRADABLE PERMITS
A MARKET DRIVEN APPROACH TO ACHIEVE NATIONAL EMPLOYMENT OBJECTIVES IN THE GCC
Gulf Cooperation Council (GCC) countries face three key labor market challenges as they seek to diversify their economies away from oil to industries of the future based on technology and innovation. The first challenge is low labor participation rates among the national workforce (particularly among youth and women), and the prolific use of expatriate labor across all skills categories. Second, there is a mismatch between the skillset of the national labor force and the demands of private sector companies. Third, the abundance of cheap expat labor has reduced incentives for firms to invest in automation and productivity improvement levers. These challenges are reducing the competitiveness and long-term growth prospects of GCC economies.

Adding to the problem is the preference of GCC nationals to work in the public sector: roughly 65 percent of the GCC workforce is employed in the public sector, which is viewed as less demanding, and offers more job security and higher salaries than the private sector (particularly for new hires early in their careers).

The trends in GCC employment are worrying, particularly given that fiscal constraints have reduced the ability of governments to expand the public sector wage bill, and demographic trends suggest that between 1.2m-1.6m youth nationals will enter GCC labor markets by 2019.

1 A weighted average of GCC nations (excluding UAE). Sources: Kuwait Central Statistics Bureau; Kuwait Public Authority for Civil Information; Qatar Ministry of Development Planning and Statistics; Qatar Bureau of Statistics; Saudi Ministry of Social Affairs and Development; Oman National Centre for Statistics and Information; Bahrain Information and Government Authority; Bahrain Labor Market Regulatory Authority

2 “Meeting the needs of a growing youth population in the Middle East”, Oxford Business Group
QUOTAS: THE CURRENT SOLUTION

Traditionally, GCC governments have relied on quota systems to encourage national hiring and manage the supply of expatriate labor. Kuwait was among the first GCC states to introduce quotas of private sector jobs for nationals. In 1993 a bill was passed proposing a quota of 30 percent private sector jobs for nationals. Penalties for not meeting the labor requirement quotas included bans on employing foreign workers and being barred from government contracts.³

The GCC’s best-known quota system is Saudi Arabia’s Nitaqat program, a labor market policy that was first introduced in 2011. The program aims to incentivize firms to hire Saudis by offering benefits based on their Saudization level. In its present form, the Nitaqat program divides companies into four color bands – platinum, green yellow and red - based each firm’s Saudization rate and sector of operation. For example, platinum and green statuses denote companies with Saudization levels of >28% and 6-28% respectively in the construction industry, while yellow and red denotes Saudization levels of 2-6% and <2%, respectively.

Firms with low Saudization rates are prevented from having new work permits issued for foreign employees. Best performing companies benefit from enhanced services from government entities, such as the Ministry of Labor and Social Development (e.g. unrestricted approval of new visas) and the General Authority of Zakat and Tax (e.g. six-month extension for the submission of the certificate of Zakat and Income Tax).⁴

Nitaqat has had some success in raising the labor participation rate of native Saudis. According to research, the program was responsible for adding an estimated 96,000 Saudi workers to the private sector over a 16-month period.⁵ Additionally, program compliance rates have been high, with construction firms increasing their Saudization rate by 0.2 percentage points on average for every percentage point they started below the quota.⁶

But success has come at a price. Mandatory labor quotas may have been responsible for the shutdown of roughly 11,000 firms, raising market exit rates by nearly 50 percent.⁷ The program may also have decreased total employment among surviving firms, with overall private sector employment declining by 418,000 workers from June 2011 to October 2012.⁸ (See Exhibit 1)

³ “Benefitting When Possible, Resisting When Necessary: Private Sector and Economic Diversification Policies in Kuwait,” Anastasia Nosova, London School of Economics
⁵ Ibid.
⁶ Ibid.
⁷ Ibid.
⁸ Ibid.
Alongside employment effects, the imposition of the Nitaqat program has likely had other unintended consequences that have negatively impacted the competitiveness of the Saudi economy. For example, the imposition of permits may have:

- Increased firm operating costs, as firms are required to employ and train less productive, quota-mandated workers
- Increased government costs due to the administrative burden of monitoring and enforcing the Nitaqat program
- Facilitated “Ghost” nationalization, whereby companies hire nationals solely to fulfill quotas, but do not require these individuals to show up for work despite paying them

The negative effects of Nitaqat have reduced the competitiveness of the Saudi workforce. Moreover, the challenges posed by expatriate labor have not been overcome: six years after Nitaqat’s launch, the Saudi economy employed 7.3 million expats, despite the fact that 10.6 million working age Saudis remain outside the labor force. (See Exhibit 2)

GCC countries in general, and Saudi Arabia in particular, need an alternative to the existing quota system. The alternative should harness the benefits of existing quota systems,
namely the incentives to hire national labor, while mitigating the negative effects described above. A market approach that uses tradable permits to control the aggregate supply of expatriate labor could offer the benefits governments seek while mitigating the harmful effects in terms of reduced competitiveness and increased regulatory burden. A market approach using tradable permits would naturally allocate expat labor to the areas of the economy where it is most needed and minimize expatriate labor presence where credible alternatives exist. At the same time, a market approach would reduce the regulatory burden on the government, including the “inspection-regime” required by a quota system.

WHAT IS A TRADABLE PERMITS SYSTEM?

 Tradable permits effectively endow a party an exclusive right to exploit a resource. For example, taxi permits (i.e. licences or medallions) give drivers the exclusive right to charge customers for fares. Similarly, pollution permits give companies the right to pollute (see Sidebar).

Permit systems have three effects on markets. First, because the number of permits in a market is fixed in the short run, they restrict the aggregate supply of an activity (i.e. the total amount of pollution or the number of taxi drivers in circulation). Second, because permits can be bought and sold in an open market, they determine a value for the activity, expressed through a market price. Third, the ability of parties to buy and sell permits on the open market result in the permits being allocated to where their value added is the highest. In effect, the individual or firm that

---

Exhibit 3: Dynamics of a tradable permits system for labor

**Dynamics of a tradable permits system for labor**

1. All current expat labor is associated with a permit

2. Firms wishing to employ expats must buy a permit on open market

3. Firms can sell excess permits on an open market

---

POLLUTION EMISSIONS TRADING SCHEME

One of the best-known applications of tradable permits has been the emissions trading scheme (ETS) to reduce pollution established by the European Union. Under the scheme, participants hold permits which give them the right to pollute. Firms have three choices: reduce their own emissions so they can reduce the number of permits they are required to hold; match pollution levels with the amount of permits they hold; or purchase permits on the open market which enable them to increase their pollution levels. The market mechanism inherent in the permit scheme results in pollution reductions taking place where the costs are lowest, reducing the overall burden of combatting climate change (i.e. firms that can cheaply reduce emissions and sell unused permits on the open market will choose to do so).
derives the highest value from the activity allowed by the permit will be willing to pay the most for the exploitation right, and thus become the owner. As a result, tradable permit systems offer a decentralized market approach to allocate activities. This contrasts with the centralized, top down approach of quotas, where government actors decide which entities have the right to engage in an activity and by how much.

PERMITS IN LABOR MARKETS

While the concept of using tradable permits to manage labor markets is still in its infancy, it is beginning to make headway in policy circles, particularly in the United States. In 2012, a U.S. think tank proposed an auction-based market for temporary employment visas. The proposal recommended that Congress launch the market by determining the price per permit at auction, and allow employers to privately exchange permits thereafter. Crucially, the proposal highlighted the elimination of existing time-consuming labor verification procedures by allowing permit-holding employees to switch employers, thereby enhancing US labor market efficiency. Additionally, the policy recommended a self-financing approach for the federal government, which could leverage the finances raised at auction to fund the establishment of the permit market, as well as to offset additional costs arising from immigration flows.

The proposed permit system would be easier to operate and simpler to navigate for employers, foreign-born workers and their families. Additionally, it is expected to increase the economic benefits of employment-based immigration for the economy. For example, national hiring would occur where the costs to do so were the lowest for employers, thus lowering the overall cost of increasing nationalization rates.

TAXI MEDALLIONS

Another famous use of tradable permits has been New York City’s taxi medallion system, which in 1937 limited the number of cab licenses to 16,900 (with the number further decreasing to 11,787). By restricting the number of taxi licenses in circulation, the system has ensured the market does not get over-saturated by taxi drivers, enabling fair wages for drivers. Because medallions are bought and sold on an open market, the rights to act as a taxi driver end up with the people who value delivering the service the most, and presumably are able to do so in the most profitable way. By 2014 medallions were selling for more than $1 million each, although the value has come down somewhat due to competition from rideshare services.
In addition to enhancing market efficiency, the auctions would generate revenue for the federal government, which could be used to compensate local communities dealing with the structural changes that may be caused by changes in the labor market.

KEY BENEFITS OF PERMITS FOR MANAGING EXPAT LABOR IN THE GCC

A tradable permit system for managing expatriate labor would offer similar benefits to the current quota systems employed in the GCC. Specifically, a permit system would encourage domestic employment, and decrease the incentives for firms to rely on expatriate labor.

In addition to this, a permit system would overcome many of the challenges currently facing quota systems mentioned above. First, in terms of increasing costs, while firms would still be incentivized to hire and train GCC nationals that are likely less productive, they would be compensated for this from the revenues obtained through the sale of their permits when they relinquish the right to employ expatriate labor. While the cash injection from a permit would a one-time benefit, the value obtained from the market price should be sufficient to cover the costs, or the firm could simply hold onto its permit and continue to employ the expatriate labor. Should all firms decide to hold onto their permits, the permit price will increase, which will eventually incentivize firms to substitute expatriate labor for nationals. Furthermore, if the government feels that the substitution process is not happening quickly enough, it could purchase permits on the open market, which would reduce aggregate supply, further increasing the market price, which would further incentivize firms to substitute expatriate labor for locals.

Second, a permit system would reduce the administrative burden for firms and the government. Firms would no longer have to worry about employing a certain percentage of nationals. Rather, they simply need to decide whether the value of an expatriate laborer warrants the increased cost of purchasing a permit. Likewise, the government would not have to monitor individual firm compliance with quota levels, but simply manage the aggregate supply of permits in circulation. This could be done by requiring permit exchanges to operate on a government platform, and tying expatriate visa approvals with permits in circulation (i.e. if a firm wishes to hire an expatriate worker, it must have already own a permit before being granted approval).

Exhibit 5: Economic ripple effects of the tradable permits.

Economic effects of a tradable permits system for labor

<table>
<thead>
<tr>
<th>Expat labor more expensive</th>
<th>Local labor cheaper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor permits</td>
<td></td>
</tr>
</tbody>
</table>

Expat labor **becomes more expensive**, because firms **must buy permits**

Local labor **becomes more competitive**, compared to expats
Last, firms would have no incentive to employ “Ghost” nationals. The number of national laborers firms employ will be a function of the value added that these workers bring to the firm, meaning that national workers would be required to compete for jobs in the labor force.

A permit system would require firms to make a choice: hire expatriate labor and pay the additional permit costs, or hire national labor. Given the additional permit costs, the national labor would have an advantage in the market compared to competing expatriates. As a result, firms would only choose to hire expatriate labor (and pay the additional permit cost) if the value of the expatriate labor was high enough to justify the added permit cost. As stated, to manipulate firm decisions, the government could modify the permit price by increasing or decreasing the aggregate supply of permits through permit purchases or issuances.

**OVERCOMING CHALLENGES IN A PERMIT SCHEME**

A permit scheme would come with some challenges, but these could be mitigated through proper implementation. For example, firms might choose to hoard permits, reducing access by other firms that could benefit from employing expatriate labor. This challenge could be overcome by issuing permits with an expiry date, so only firms wishing to use expatriates within a certain timeframe would be incentivized to purchase and hold permits. Once a permit expires, a new one can be issued by the government to ensure the aggregate supply remains stable, but all firms operating in the market would have the opportunity to purchase the newly issued permit, eliminating the potential for hoarding.

Another problem with permits is that their high prices may result in the exclusion of expatriate labor in certain industries where profit margins are tighter. For example, an unregulated system may result in permits being used exclusively for high wage jobs (for example, law and finance) that can afford the extra costs of a permit. The result would effectively crowd domestic employment out of these professions, relegating national workers to lower value-added positions. This challenge could be overcome by creating different strata of permits that are tied to wages. Doing this would allow the government to control the amount of high, medium, and low value-added expatriates working in the economy (see Exhibit 6). For example, if the government deems that having an abundance

---

**Exhibit 6: Example of permit strata tied to wages for Saudi Arabia**

<table>
<thead>
<tr>
<th>Expat labor pyramid</th>
<th>Sample occupations</th>
</tr>
</thead>
<tbody>
<tr>
<td>High skill 16%</td>
<td>1.2 mn</td>
</tr>
<tr>
<td>Low range services</td>
<td></td>
</tr>
<tr>
<td>Mid skill 25%</td>
<td>1.8 mn</td>
</tr>
<tr>
<td>Mid-range services</td>
<td></td>
</tr>
<tr>
<td>Low skill 59%</td>
<td>4.3 mn</td>
</tr>
<tr>
<td>Low range services</td>
<td></td>
</tr>
</tbody>
</table>

Total expat labor force 7,355,120

• Lawmakers, Directors and business Managers
• Specialists/technicians in Professional, Technical and Humanitarian Fields
• Clerical work
• Mid-range services
• Low range services
• Manual labor

Stratifying the labor force will give the government more control over market behaviour in select industries.
of low value-added workers employed in manual labor was beneficial for the economy, it could allow more permits for this wage level to circulate. Also, if the government wanted to restrict the number of high paid expatriates in the market to offer better prospects for national labor, it could reduce the number of high skill permits in circulation.

A final challenge for the government is to ensure the correct permit prices are maintained for expatriate labor. Practically, a “correct price” would encourage the shift away from unnecessary expatriate labor over time without compromising economic growth objectives: if the price is too high, it could reduce firm competitiveness; while an excessively low price would reduce the incentive of firms to substitute expatriate labor for national labor. The optimal mix of national and expatriate labor would depend on a number of macroeconomic factors as well as policy objectives of the government, and may require the government to influence the price at times though sales and purchases in the open market. For example, during an economic expansion, the government may want to limit the number of expatriates working, and would thus gradually decrease the supply of permits, thus encouraging firms to hire local workers. Conversely, during an economic downturn, the government could release more permits, which would drive down expatriate labor costs. In effect, a permit system could offer an alternative to fiscal policy for managing the business cycle.

Exhibit 7: Price challenges for tradeable permits

- **High price** reduces competitiveness
- **Optimal price** achieves correct mix of GCC nationals & expats
- **Low price** reduces incentive to participate

- Government can stabilize price through sales & purchases

- Must commit to a price that encourages a shift away from expat labor but does not hurt economy
SUMMARY & NEXT STEPS

With a growing youth population, sustained high unemployment, and productivity challenges throughout the GCC, the time to act is now. Reforming the labor market in the GCC through tradable permits offers a powerful policy choice for GCC countries wishing to transform their labor markets.

A permit system would directly address the challenges facing GCC labor markets mentioned in this paper’s opening paragraph. First, a permit system would increase the competitiveness of national labor while reducing the incentives to hire expatriate labor. This would improve the low labor participation rates by national workers as well as help mitigate the over dependence of firms on expatriate labor. Second, the mismatch between the skillset of the national labor force and the demands of private sector companies would be indirectly addressed by permits. This is because greater inclusion of nationals into the labor market would help them to develop the required skills to operate in that market, while ensuring that expatriate labor continues to contribute where required. Third, reducing the abundance of low-wage expatriate labor in certain industries would encourage firms to invest in automation and productivity enhancing technologies, thus enhancing the competitiveness of GCC firms for the future.

It should be noted that labor market reform is a complex, system-wide issue, that requires balancing a number of issues such as education, public sector recruitment, and private sector competitiveness such as enhancing the ease of doing business. For this paper, we have focused on how a tradable permits system can encourage national hiring and enabling expatriate labor to be allocated to where its value added is the highest. To address the other issues, we invite you to read our previous paper on transforming labor markets in the GCC.9

9 “Increasing private sector employment of nationals in the GCC”, Carvalho, Youseff, and Dunais (2017)
AUTHORS
Anshu Vats, Partner and Head of Public Sector Middle East
Anshu.Vats@oliverwyman.com
Abhishek Sharma, Partner
Abhishek.Sharma@oliverwyman.com
Jeff Youssef, Partner
Jeff.Youssef@oliverwyman.com
Christopher Napoli, Engagement Manager
Christopher.Napoli@oliverwyman.com

CONTRIBUTORS
Special thanks go to Matthieu de Clercq and Abdulkarim Al Youssef

www.oliverwyman.com

Copyright © 2018 Oliver Wyman
All rights reserved. This report may not be reproduced or redistributed, in whole or in part, without the written permission of Oliver Wyman and
Oliver Wyman accepts no liability whatsoever for the actions of third parties in this respect.
The information and opinions in this report were prepared by Oliver Wyman. This report is not investment advice and should not be relied on for such
advice or as a substitute for consultation with professional accountants, tax, legal or financial advisors. Oliver Wyman has made every effort to use
reliable, up-to-date and comprehensive information and analysis, but all information is provided without warranty of any kind, express or implied.
Oliver Wyman disclaims any responsibility to update the information or conclusions in this report. Oliver Wyman accepts no liability for any loss
arising from any action taken or refrained from as a result of information contained in this report or any reports or sources of information referred
to herein, or for any consequential, special or similar damages even if advised of the possibility of such damages. The report is not an offer to buy
or sell securities or a solicitation of an offer to buy or sell securities. This report may not be sold without the written consent of Oliver Wyman.