

Do Wage Subsidies to Nationals Enhance Their Employability? New Evidence from Kuwait

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Abstract

Due to the persistent unemployment of nationals in the midst of millions of gainfully employed foreign workers, Kuwait, the focus of this study, introduced a new generation of active labor market policies (ALMPs) in 2000, capped by an expansive wage subsidy to nationals who join the private sector. This study employs the Fully Modified Least Square (FM-OLS) model to evaluate the effectiveness of these policies by means of estimating employment elasticities of Kuwaitis in the private sector in response to wage subsidies. The results show that the subsidies have been ineffective, contrary to their well-documented broad positive impact in industrial economies. This outcome has been attributed generally to wage differentials between Kuwaitis and non-Kuwaitis. This study presents a holistic diagnosis of the problem by challenging the received 'wage differentials' as the sole cause. It identifies a host of heretofore-unidentified structural disequilibria in the labor market that are responsible for the subsidy's ineffectiveness such as the local economy's inherent bias towards low-tech methods of production that rely heavily on low-skilled labor, Kuwaitis' penchant to pursue higher levels of education, low national participation rates in the labor force, the absence of critical vocational training programs, and the government's liberal immigration policies. Based on the revised prognosis, a new integrated remedial plan of actionable steps is suggested to address the unemployment problem.

Keywords: wage subsidies, job nationalization, employment and substitution elasticities, Kuwait, GCC

1. Introduction

The continued presence of unemployed nationals amid millions of gainfully employed foreigners has long been an issue of national concern in the six Gulf Cooperation Council (GCC) countries¹. This paradox was first resolved by hiring nationals in the Civil Service Corps. However, as the number of nationals entering the labor market kept rising, the wage bill became burdensome and government bureaucracies became bloated. Governments then turned to private sector employers by appealing, and then (softly) mandating, them to hire nationals. When that failed, Kuwait, the focus of this study, introduced active labor market policies (ALMPs), the core of which lies in a wage subsidy paid directly to Kuwaitis working in the private sector.

This study serves several purposes. It provides the first evaluation of labor market policies in the region and, as such, it adds to the scant literature on the impact of ALMPs in developing economies. It also deviates from standard evaluation methods by singling out the impact on a subsector of the labor market, namely, *nationals* in the *private sector*. Additionally, it differentiates between the impacts of job creation (hiring nationals to fill new jobs) and job substitution (hiring nationals to replace non-Kuwaitis in existing jobs). The study also employs a robust econometric model that avoids the misleading results often encountered in past employment elasticity estimation studies due to non-stationarity and cointegration biases. Furthermore, it provides a holistic diagnosis of the problem by challenging the received 'wage differentials' as the sole cause, and based on the revised prognosis, a new integrated remedial plan of actionable steps was designed². Finally, lessons learned from Kuwait are more likely to influence ongoing labor nationalization discussions in the region.

This paper begins with a definition of the problem and a review of past domestic labor market policies. Next, the impact of ALMPs is quantified followed by an investigation into the underlying causes behind their unexpected

minimalist performance. A new diagnosis is made, and a remedial long-term strategy is proposed.

2. Background

Oil revenues transformed Kuwait from a rudimentary, resource-poor state to a modern functioning state.³ The transformation was made possible by the annual importation of thousands of workers to compensate for the country’s small, inexperienced workforce. Over time, unsettling employment and, hence, population imbalances surfaced. Kuwaitis became a minority in their country⁴ (Presently, they make up less than a third of the population). Nationals make up only 15.32% of total employment (Central Statistical Bureau [CSB], 2021); 85.27% of Kuwaitis work in the public sector⁵; and only 14.7% of all private sector jobs are held by Kuwaitis, while the remaining 64.11% are taken up by non-Kuwaitis (PACI, 2021). From 1993 to 2020, government jobs went mostly to nationals (209,480 versus 31,015 non-Kuwaitis) while private sector jobs went mostly to non-nationals (1.67 million non-Kuwaitis versus about 54 thousand Kuwaitis)⁶. In total, the economy generated an impressive two million jobs, of which only 13.4% went to nationals.

These developments generated other adverse side effects. First, dualities arose as the labor market became segmented into non-competing classes of labor. The segmentation ran along ethnicity (Kuwaiti vs. non-Kuwaiti) and workplace lines (public vs. private vs. household), each with different wage rates, regulations, labor rights, and job security⁷ (Forstenlechner & Rutledge, 2011). Second, anti-foreign sentiments, in general and against certain nationalities, surfaced and overtime, gave rise to concerns regarding: 1) social cohesion and national security⁸; 2) pressures on the country’s infrastructure; 3) the inability of the government to continue employing Kuwaitis apace; 4) the open unemployment of nationals in an economy awash with job availabilities; 5) large outflows of remittances; 6) gender disparities where foreign male workers outnumber foreign females in the private sector by a margin of 11 to 1; 7) exploitation of foreign labor through the sale of sham work permits; and 8) low and declining labor productivity.

3. The Problem

Despite the government’s preferential hiring of Kuwaitis, its numerous mandatory public instruments aiming at increasing the demand for nationals, the doubling of real GDP, the substantial growth in the aggregate demand for labor, and the introduction of the wage subsidy program [WSP]⁹, Kuwaiti unemployment persisted as shown in Table 1. Not only did their numbers increase, but the rate of unemployment also rose from 3.4% in 2003 to 7.2% in 2020¹⁰. Other anomalies emerged; more than half (52.4%) are unemployed longer than a year and 20% from 6 to 12 months; the share of Kuwaiti females in total unemployment grew from 15% in 1993 to 24.4% in 2000, and to 45.7% % in 2020; and 79.3% of Kuwaiti females are government employees¹¹ (CSB, 2021).

Table 1. Number of unemployed nationals, 1995 to 2020

1995	2000	2005	2010	2015	2021
2,540	2,449	12,358	10,558	11,670	32,851

Source: PACI, 2021.

4. Evolution of Labor Market Policies

4.1 Passive Labor Market Policies

Up to the 1970s, the unemployment problem was dismissed as a form of voluntary unemployment, especially during epochs of wealth accumulation and budget surpluses, and, as a result, little was done to deal with it. As it persisted, however, a host of piecemeal, quick fixes were administered during the following two decades, aimed at increasing the demand for Kuwaitis and, concurrently, restricting the supply of expatriates. The former took the form of: 1) limiting work permits in certain occupations to Kuwaitis only¹²; 2) setting mandatory Kuwaiti quotas in private sector companies with penalties for non-compliance; 3) charging training fees for Kuwaitis from non-compliant private companies; and 4) pressuring state-owned enterprises (SOEs) to hire more Kuwaitis.

Policies to limit the supply of expatriates included:

- Raising annual work permits fees
- Limiting approvals for importing foreign workers
- Restraining household employment by mandating high minimum wages
- Ending the hiring of expatriates under the age of 30 with a university degree in government jobs
- Excluding expatriates from the country’s free public education system
- Raising the minimum income for family settlement

- Rescinding expatriates' access to the free public health care system
- Actively deporting foreign sojourners (Baldwin-Edwards, 2011)
- Maintaining the *Kafala* (sponsorship) system
- Ruling against the issuance of permanent residency permits¹³

Other lesser inconveniences were also enacted (De Bel-Air, 2019). Recently, the Civil Service Diwan, responsible for placing nationals in public sector jobs, took the extra step of terminating jobs held by foreign workers who switched from government contracts to other entities (Alqabas, 2021), and instructing the Kuwait Municipality to lay off a pre-set number of foreign workers¹⁴.

4.2 Active labor Market Policies (*The Wage Subsidy Program*)

As the preceding policy instruments failed to rein in the rising unemployment of Kuwaitis, the government introduced the wage subsidy program (WSP) in 2000 to spur Kuwaitis to enroll in the private sector coupled with offering training opportunities and a modest unemployment insurance scheme. In addition, it established a SMEs Fund in 2013 with KD 2 billion in paid-up capital to encourage self-employment¹⁵. The most important policy, however, is the cash wage subsidy, as it represents 99.9% of total spending on ALMPs¹⁶ (MGRP, 2017).

Wage incentives are generally designed to assist disadvantaged workers such as youth, females, old, disabled, long-term unemployed, inexperienced, and first-time job seekers (Honorati & Posadas, 2019). They Wage incentives are normally transitory (usually 6 to 24 months), countercyclical, and set in relation to existing wages. In Kuwait, however, they are permanent, available to all nationals, unrelated to existing wages (they are based on applicants' education levels and marital status) and are paid directly to nationals on top of their private sector wages. The maximum monthly subsidy is set at KD 1,248 (~ USD \$4,000) for a married individual with seven children and a university degree in medicine, engineering, or pharmacology, and the lowest at KD 481 (~ USD \$1,500) for an unmarried individual with an elementary degree or lower.¹⁷

The overall profile of the program's beneficiaries can be briefly delineated in the following three characteristics: (i) more than half are 35 years old or younger (20% in 18–25 and 47% in 26–35 years); (ii) almost two-thirds are semi-skilled (36.2% with < high school, and 29.9% are high schoolers); and (iii) three-fourth (75.4%) receive less than KD 500/mo. Thus, the typical beneficiary is about 26 years old, has less than high school diploma, and earns a wage subsidy of about KD 600/mo. The 2010–2019 average annual cost of the WSP, which is partly financed by a 2.5% profit tax on listed companies¹⁸, is KD 555 million, adding up to KD 5.2 billion or about USD \$17 billion since its inception. In terms of the GDP, total ALMPs averaged 0.86% from 2001 to 2019¹⁹ (AhwalKuwait, 2020; CSB, 2021).

4.3 Pros and Cons of New Active Policies

On the positive side, the program addresses the needs of the young, inexperienced, and first-time Kuwaiti job seekers; provides the incentive to Kuwaitis without connections to join the private sector instead of waiting for an uncertain government job; and, more importantly, it elevated the participation of Kuwaiti women in the private sector²⁰. On the negative side, a few businesses (especially banking and communications) reduced wages of subsidized nationals. Private Kuwaiti professional businesses (attorneys, physicians, etc.) took advantage of the program. Business owners and board members switched identities to 'workers'²¹. Non-compliant applicants were not sanctioned, frequent fraudulent enrollments were observed, and participants' earnings were negatively affected due to the 'lock-in' effect in which enrollees were discouraged from searching for better job opportunities once they were locked in with an employer (Wunsch, 2016). More significantly, perhaps, the program overlooked the wage gap between nationals and foreigners in the private sector. Rather than using the subsidy to increase the economic value of nationals to the employer by narrowing that gap and, hence, encouraging private employers to hire them, it opted instead to subsidize workers' incomes (Brown, 2015), which makes it more of an income rather than an employment subsidy.

5. Effectiveness of the Wage Subsidy Program

5.1 Review of the Literature

The underlying goal of ALMPs is to help jobseekers find jobs. To do so, ALMPs incorporate an array of support schemes, including personal counseling, follow ups, placement services, training, employer subsidies, wage incentives, public works, business startups, and self-employment support schemes. ALMPs' scope, objectives, targeted groups, durations, sanctions, and financial rewards differ across countries and over time.

Due to their widespread usage since the end of WWII and their high costs, much has been written about their effectiveness. The bulk of the literature is confined to case studies from developed economies. With the

proliferation of such studies, several studies employed meta-analysis of mostly randomized control trials in search of common outcomes (Brown & Freund, 2019; Card et al., 2017; Crépon & Van Den Berg, 2016; Kluve et al., 2007; Pignatti & Van Belle, 2021; Yeyati et al., 2019). In general, however, common grounds are difficult to find in the literature because of the diversity of research methodologies and dissimilarities in labor market institutions, programs (Yeyati et al., 2019; Brown & Freund, 2019), time horizons, sample sizes, country groupings, testable outcomes, and the authenticity of published studies (government-sponsored vs. independent research). Even though it is safe to conclude that the most telling inference is that there is no consensus regarding ALMPs' effectiveness (Escudero, 2018), especially in emerging economies²², there are specific individual policies on which there is a strong consensus, either negative or positive. These policies are reviewed below in the order of their (positive) effectiveness.

- 1) **Policy Execution and Labor Support Institutions**: Pignatti & Van Belle (2021) used panel data from 121 developed and emerging countries and concludes that policy implementation (i.e., resources, continuity, and timing) is critical in enabling ALMPs to generate positive outcomes. A study based on data from 31 advanced economies over the period from 1985 to 2010 affirmed the same conclusion (Escudero 2018). Another meta-analysis study on Latin American countries reports that design, targeting, and implementations are essential in ensuring the programs' effectiveness (Pignatti & Van Belle, 2021). To strengthen the prospects of success, some go as far as to suggest piloting and evaluating programs prior to full implementation (Brown, 2015) while others go farther by promoting piloting policy innovations against competing alternatives while evaluating each to select the most effective outcomes (Mckenzie, 2017).
- 2) **Individual Services and Sanctions**: By far the next most influential policy instrument is the cluster of soft policies: e.g., job matching, counseling, vocational guidance, rehabilitation, monitoring, tracking of participants, and sanctions in case of non-compliance. Their significance stems from their: 1) ability to directly minimize information asymmetry between firms and workers; 2) reduce unemployment durations, especially for long-term unemployed workers (Kluve et al., 2007; Kluve, 2010); 3) target multiple objectives simultaneously such as job creation, increasing labor participation, and reducing unemployment; 4) exert greater influence in the short and long-term in contrast with other policies (Card et al. 2017) and 5) low cost. Based on meta-analysis of ALMPs in Europe, Kluve (2010) concluded that "services and sanctions may be a promising measure" when compared to direct government jobs (negative employment effects), or training (mixed and moderate effects). As with other instruments, job search is more effective when combined with other policies (Card et al., 2017; Escudero, 2018; Katz, 1996).
- 3) **Employment Incentives**: Employment incentives take the form of either direct subsidies to employers and/or indirect subsidies in the form of transferable cash allowances from workers to employers, both of which are designed to lower wages to meet the anticipated low productivity of subsidized workers. In some cases, employment incentives are designed to assist specific groups of workers, e.g., the disadvantaged, long-term unemployed, females, or youth, among others. Almeida et al. (2014) reports that wage subsidies serve this group of individuals well in developing countries even though they are not effective in creating jobs. As to their effectiveness, the evidence leans more towards their significance. Yayati et al. (2019) reports that their greatest medium impact is on earnings relative to a control group. Escudero (2018) contends that in combination with startup incentives, wage subsidies exhibit a significant negative impact on unemployment rates and on low-skill workers. Estevão (2003) finds that direct subsidies were most effective in raising employment in 15 industrial economies during 1985–2000, and Kluve et al. (2007) finds them beneficial to individual's employment probabilities in Denmark, Spain, Sweden, Norway, and Italy, in the 1990s. Betcherman et al. (2007) also confirms the benefits of wage incentives in OECD, especially when combined with firm-provided training. Generally, there is a near consensus that they are most effective when combined with other soft policies. A few others, however, arrived at a different assessment. Boone et al. (2004) states that subsidized jobs are not effective²³, Honorati and Posadas (2019) find that their impact is modest, and Sahnoun and Abdennadher (2018) determined that their effectiveness was limited to their duration.
- 4) **Training**: In contrast with other active measures, such as job search, which seeks to create new jobs, training builds human capital. It targets medium- to long-term results (Brown, 2015; Card et al., 2010). Training is the most expensive (Escudero, 2018), the oldest, and the most used ALMP. Evidence-based findings are, at best, mixed. While Boone and Van Ours (2004) found that training was the most effective in 20 OECD countries during 1985–1999. Yayati et al. (2019) reviewed 102 randomized control trials involving 652 estimated ALMP impacts and concluded that vocational training has had moderate effects.
- 5) **Research Methods**: Economists' choice of a research methodology is diverse. It varies from randomized

control trials, econometric analyses, difference-in-difference estimation, to the instrumental variable technique, all of which result in asymmetrical conclusions even when they are estimating the same causal relationship between a policy instrument and its outcome. A debate arose as to which approach is optimal. The randomized control group methodology, though common, has its drawbacks. Card et al. (2018) state that the estimated impacts based on randomized control trials are not too dissimilar, on average, from the results obtained from non-randomized studies. In a more recent report, Honorati and Posadas (2019) critiqued ALMPs’ literature in general, and control trials in particular. They maintain that they provide little evidence from developing countries; place less focus on formal employment and earnings, and offer scant evidence on skills acquisition or general equilibrium effects.

- 6) **Public Works:** Most studies affirm the ineffectiveness of this policy option (Brown & Freund, 2019; Card et al., 202010; Yayati et al., 2019) and some even judge it as detrimental (Katz, 1996).

6. Methodology

The evaluation of the effectiveness of ALMPs/wage subsidy in Kuwait centers on testing the hypothesis that wage subsidies to nationals enhance their employability in the private sector. This is captured by estimating the employment elasticity coefficients of nationals in the private sector in response to wage subsidies. *A priori*, a large and statistically significant employment elasticity coefficient would corroborate the hypothesis, while a small and statistically significant coefficient would reveal their limited effectiveness. A negative coefficient would mean ineffectiveness. Given that employability occurs as a result of either hiring Kuwaitis due to job creation or by replacing foreign workers, both hypotheses are tested. Additional explanatory variables are explored to explain changes in Kuwaiti private employment, *ceteris paribus*. Towards this end, an econometric model is developed to identify the predictors of changes in Kuwaiti private employment, while at the same time assessing the impact of wage subsidies.

Empirically, employability is denoted by an increase in the number of private Kuwaitis employment and/or by a rise in the ratio of Kuwaitis to non-Kuwaitis in the private sector over the study period from 2001 to 2019. Subsidies are measured by total spending on ALMPs/subsidies. The additional explanatory variables include real GDP; real non-oil GDP; government expenditures; terms of trade; educational differentials between Kuwaitis and non-Kuwaitis in the private sector; and wage difference of nationals in government and the private sector.

Since OLS methods to estimate regressions involving non-stationary and co-integrated variables result in misleading interpretations, we employ the fully modified ordinary least squares (FMOLS) model (Phillips & Hansen, 1990), which is asymptotically unbiased allowing for standard Wald tests using asymptotic Chi-square statistical inference. It also eliminates endogeneity by adding leads and lags. Tests of Engle-Granger cointegration using possible constant, trend, no employment variables and potential instrumental variables, are also performed to properly specify the deterministic components of the FMOLS specification. Additionally, tests of stationarity were conducted and the results indicate that all variables, except wage and education indices, are non-stationary and are either integrated of order *I*(1) or *I*(2).

To start with, Kuwait’s long-run aggregate employment elasticity is estimated as a comparator to the employment elasticity estimates of Kuwaitis in the private sector.

The long-term employment elasticity β_2 is measured by:

$$\text{Ln } E_t = \beta_1 + \beta_2 \text{Ln } Y_t + \beta_3 T + u_t \tag{1}$$

E_t is total employment in year t ; Y , real GDP; and T , Trend.

Table 2. Long-term employment elasticity estimates, 2001-2019 (Equation 1)

	Coefficient	Std. error	t-stat	Prob.	Summary Statistics
Y_t	0.580	0.136	4.265	0.0008	R^2 -adj = 0.980
Constant	8.369	1.376	6.081	0.0000	S.E. of Regression = 0.02854
@ Trend	0.023	0.004	6.418	0.0000	Long-run variance = 0.00124

Note. The Engle-Granger cointegration test of -2.2052 and p-value = 0.7113, do not reject the null hypothesis that the series are not cointegrated.

Source: *E* and *Y* data from PACI (2020, Tables 14,15,16).

The results reported in Table 2 show that all coefficients have the expected signs and are statistically significant.

They also indicate that the demand for labor (Kuwaiti and non-Kuwaiti) is inelastic in that a 1% growth in real GDP brings about a 0.58% increase in employment²⁴. When real GDP is replaced by real non-oil GDP in Equation (1), the results are less robust, reflecting the indirect influence of government procurements on the private sector’s demand for labor

6.1 Evaluation of ALMPs/WSP’s Job Creation and Job Substitution

Two tests are undertaken to evaluate the effectiveness of ALMPs/subsidy program in the private sector. The first measures the extent to which private employers fill up new job openings by Kuwaitis (i.e., job creation, E_{kp}) while maintaining their ratio to non-Kuwaitis constant and the second measures the extent to which Kuwaitis are hired as replacements for non-Kuwaitis (i.e., job substitution, E_{kp}/E_p). Job creation and job substitution tests are given in Equation (2) and Equation (3), and the results reported in Tables (3) and (4), respectively.

$$\text{Ln } E_{kp,t} = \beta_1 + \beta_2 \text{Ln } S_t + \beta_3 \text{Ln } Y_t^{no} + \beta_4 \text{Ln } W_t + \beta_5 \Delta \text{Ln } ED_t + u_t \tag{2}$$

$$\text{Ln } (E_{kp,t}/E_{p,t}) = \alpha_1 + \alpha_2 \text{Ln } S_t + \alpha_3 \text{Ln } Y_t^{no} + \alpha_4 \text{Ln } W_t + \beta_5 \Delta \text{Ln } ED_t + u_t \tag{3}$$

Where S_t denotes subsidies; Y_t^{no} , real non-oil GDP (which is used instead of real GDP since subsidies are tied directly to the non-oil private sector); ΔED_{t-1} , year-to-year changes in the ratio of educational level index of Kuwaitis to non-Kuwaitis in the private sector; and W_t , wage ratio of Kuwaitis in the government to the private sector.

Table 3. Long-term impact of the wage subsidy program on job creation, 2004-2019 [Equation 2]

	Coefficient	Stderror	t-stat	Prob.	Summary Statistics
Ln Y^{no}	0.771	0.204	3.789	0.0030	R^2 -adj = 0.9565 S.E.of Reg. = 0.0807 Long-run Variance = 0.004116
Constant	1.933	1.824	1.060	0.3120	
Ln S	0.341	0.029	11.905	0.0000	
Ln W	- 1.718	0.301	- 5.715	0.0001	
Δ Ln ED	1.0534	0.526	2.003	0.0705	

Note. The Engle-Granger cointegration test = -5.82992, with p-value = 0.0018 – do not reject the null hypothesis that the series are not cointegrated.

Source: E , Y^{no} , Y , W from CSB, 2021 and S from PACI (2020).

Table 4. Long-term impact of the wage subsidy program on job substitution, 2004-2019 [Equation 2]

	Coefficient	Std. error	t-stat	Prob.	Summary Statistics
Ln Y^{no}	0.904	0.245	3.689	0.0036	R^2 -adj = 0.8982 S.E. of Reg. = 0.0899 Long-run Variance = 0.005964
Constant	- 12.646	2.195	- 5.760	0.0001	
Ln S	0.145	0.034	4.207	0.0015	
Ln W	- 2.406	0.362	- 6.650	0.0000	
Δ Ln ED	1.468	0.633	2.319	0.0407	

Note. The Engle-Granger cointegration test = -3.7112, with p-value = 0.0553 – do not reject the null hypothesis that series are not cointegrated.

Source: See Table 5.

Three important findings emerge: first, while the impact of the wage subsidy (S) is positive but its magnitude is modest at best and negligible at worst in that an $x\%$ increase would generate only $0.34x\%$ increase in hiring nationals and $0.15x\%$ rise in the ratio of Kuwaitis/non-Kuwaitis, *ceteris paribus*. This is corroborated by actual data from the corporate sector wherein the employment of Kuwaitis increased only from 5.5% to 6.5% during the WSP’s life cycle. That is, of the additional 29,139 private Kuwaitis jobs during the period 2003–2019, 5,709 are accounted for by SOEs and the remaining 23,430 (80.4%) are hired by 42,082 privately owned enterprises (CSB, 2019). This implies that each private firm, on average, hired 0.56 Kuwaiti workers over 16 years, confirming the WSP’s limited effectiveness in the private sector.

Second, regarding the elasticity of the demand for Kuwaitis in the private sector in response to economic growth (Y^{no}), the results, which show that all coefficients have the expected signs and are statistically significant,

indicate that it is inelastic ($\beta_3 = 0.77$). That is, a KD 2 billion increase in non-oil GDP (= 8.6% annual growth rate) would create about 4,800 new jobs for Kuwaitis, which falls short of the approximately 25,000 Kuwaitis entering the labor market each year. Similarly, economic growth exerts a marginal influence on the substitutability of Kuwaitis for non-Kuwaitis in the private sector, albeit in a slightly stronger extent ($\alpha_3 = 0.90$).

Third, two variables stand out as the most impactful on private Kuwaiti employment: wage differentials (W) and the education index (ED). The former shows a noticeable negative influence on job creation ($\beta_4 = -1.72$) and job substitution ($\alpha_4 = -2.46$). Such a strong response can be traced to money wage differentials in addition to various non-pecuniary benefits associated with government jobs, described below. On the other hand, the education index indicates that higher levels of education among Kuwaitis compared to non-Kuwaitis is strongly associated with a higher demand for Kuwaitis. This is due to: 1) the relatively narrow wage *and* skill gaps between Kuwaitis and non-Kuwaitis compared to their low skilled cohorts; 2) the competitive edge of educated Kuwaitis in terms of their social, cultural, and language comparative advantages; and 3) less-skilled Kuwaitis' disdain of low skill, low-wage jobs.

7. Causes of ALMPs/WSP's Failure

Given the overall positive influence of wage subsidies elsewhere and their marginal impact in Kuwait, other heretofore-overlooked factors are examined in an attempt to explain away the divergence between them.

7.1 Kuwait's Economy is Intensive in the Use of Less-Skilled Labor

Since the start of the import-substitution industrialization of the 1960s, Kuwaiti investors did not actively seek foreign investments on account of the country's capital surplus, especially after the 1973 oil price hike (Girgis et al., 2003). They opted instead for low-skill intensive technologies in light of the abundance of cheap foreign workers and the familiarity with, and access to, simple technologies in neighboring countries²⁵. Statistical evidence corroborates the low skill bias; in 2020, less skilled workers (secondary education and lower) made up 77.4% of the workforce (PACI, 2021). In contrast, the comparable figure in an industrial economy, such as the US in 2010, is 41.8% (Bean et al., 2014). Furthermore, less-skilled jobs accounted for the largest increment in the labor force between 2000 and 2020: 1,188,473 less skilled versus 244,913 high skilled (> secondary).

Over time, this bias was strengthened by the gradual shift in consumer demand towards tertiary sectors (wholesale and retail trade, hotels, restaurants, and community services), which are typically low-skill-labor-intensive activities. To wit, the share of these activities in GDP rose from 29.3% in 1966–1968 to 44.5% in 2013–2015, and to 58.3% in 2020 (CSB, 2021). The bias was further reinforced by the dominance of monopolistic market conditions, which has had the effect of disincentivizing businesses from modernizing their dated technologies. Estimates of the Herfindahl-Hirschman's market concentration index show that 329 product groups (at the 5-digit ISIC) out of a possible 493 are 'highly concentrated,' and 136 of those are pure monopolies²⁶. Additional evidence of the bias is seen from the state of managerial skills in SMEs, which represent 99.9% of all enterprises. A recent survey of more than 39,000 registered firms shows that only 0.4% conduct manpower training programs; 2.5% maintain final audited accounts; 0.21% use computers; 0.2% carry out market surveys; and 6.2% have access to the Internet. Furthermore, only three enterprises met all five conditions. Over time, the number of SMEs that carried out audited accounts, training, and Internet use, increased from 30 to only 47 from 2003 to 2018 (Girgis & Al-Fulaij, 2018). In brief, apart from large enterprises, most of which are SOEs, entrepreneurship in Kuwait is steeped into low-tech systems, favoring low-skilled workers, and the latter are considerably cheaper when imported than when hired from the local market.

7.2 Kuwaitis Pursues Higher Levels of Education That Deviates From Private Sector Needs

While the private sector keeps on hiring less-skilled workers, Kuwaitis continue pursuing high levels of education to qualify for high wage, white-collar jobs. Between 1965 and 2020, the weighted average index of education of Kuwaiti workers rose from less than Read and Write (1.6 yrs.) to Secondary (12.05 yrs.)²⁷, while for non-Kuwaitis, it inched up slightly from less than Primary (3.03 yrs.) to slightly above Primary (5.45 yrs.). That is, while the average Kuwaiti worker acquired 10.45 additional years of education, the private sector, the dominant employer, required only 2.42 additional years of education. In fact, the number of less skilled Kuwaitis was 653 less in 2020 than in 2000. Conversely, high-skilled Kuwaitis increased their share in total employment from 30.2% in 2000 to 46.9% in 2020 (PACI, 2021). In 2020, they made up about half (49%) of all Kuwaiti employees. Clearly, the private sector's demand for labor and the supply of Kuwaiti workers have been trending in opposite directions.

Whereas seeking higher levels of education is a personal choice, it has nonetheless been encouraged and financed by the government through free education policies across all levels, cash stipends to university students, and fully financed wide-ranging external and internal university scholarships²⁸, among others. This choice is also

driven by a strong expectation of qualifying for a government job, since governments tend to employ relatively more educated employees.²⁹ This factor is of special importance in Kuwait because government jobs offer significant non-financial benefits, which the private sector can ill afford. To wit, besides higher wages, government jobs demand minimal academic qualifications, grant frequent salary raises, and offer job security, less accountability, shorter working hours, and fast promotions based on nationality and/or connections. Government employees are also allowed to double dip by running their own private businesses³⁰, a benefit buttressed by legal rentier practices. These explain the seemingly paradoxical juxtaposition of 32,851 unemployed Kuwaitis in 2021, of whom 9,458 are high skilled, while the private sector employs 159,041 foreign cohorts (PACI, 2021). It is this paradox that underpins the unemployment phenomenon in Kuwait. Due to the government's lucrative pecuniary as well as non-pecuniary perks, most Kuwaitis prepare to work in the government sector, and since minimal qualifications are demanded, they select less demanding academic disciplines and, for some, specialize in fields in which they know *a priori* that are not within the domain of private sector needs.³¹ Many wait long periods for the 'right' government job.³² Meanwhile, local businesses are reluctant to hire them due to a perception of their low-quality education³³, higher wages, and a lack of technical, as well as, soft skills.

That the labor market has become highly segregated as a result of past labor market policies, can be seen from estimating the Duncan Index, which measures the degree of occupational segregation between Kuwaitis and non-Kuwaitis. The index $D = \frac{1}{2} \sum |E_{k,i} - E_{nk,i}|$ where $E_{k,i}$ is the % of Kuwaitis in total Kuwaiti employment in occupation i and, $E_{nk,i}$ is the % of non-Kuwaitis in total non-Kuwaiti employment in occupation i . Total segregation is indicated by $D = 1$ and perfect demographic representation or total integration by $D = 0$. From 1994 to 2021, the index increased from 0.575 to 0.667 (computed from PACI, 2021).³⁴ Notable outliers of near equal demographic representations ($D = \leq 0.011$) are observed in 'corporate managers,' 'legislators and senior officials,' and 'physical, mathematical, engineering science professionals' occupations, while, adversely, those that lie at the other end are observed in 'models, salespersons, and demonstrators,' 'ordinary workers,' and 'drivers and mobile plant operators' occupations, which are overwhelmingly manned by foreign workers ($D = \geq 0.11$). In brief, too many university-educated Kuwaitis are chasing a few top white-color jobs and too few less-skilled Kuwaitis are available to meet the considerable demand for blue-color laborers.

7.3 Low Participation Rates in the Labor Force

The participation rate of Kuwaitis in the labor force is much lower than in other countries; it was 46.6% in 2018 (PACI, 2021) compared to a global average of 66.5% (World Bank 2019)³⁵. That almost half of the national labor force chooses not to work is attributed to a host of factors, including social norms that limit females' participation, a generous retirement system, and, to some, a rentier mindset in which one earns income without effort such as in renting business licenses, selling work permits, receiving job promotions through connections, etc. The national work/leisure decision is greatly influenced by a local growth model designed to improve living standards through oil dividends. The result is a welfare model that subsidizes practically every aspect of life, e.g., free health care, free education, free foodstuff, job entitlement, monthly child allowance, and wage subsidies, in addition to other support schemes for marriages, housing, building materials, rents, mortgages, energy (gas, water, and electricity), price controls (bread), free medical treatment overseas, and no taxes. In FY 2020/2021, KD 14.3 billion were earmarked for subsidies, grants, social benefits, and salaries, which comprised two thirds of government expenditure and exceeded oil revenue by KD 5.5 billion (Ministry of Finance, 2021).

7.4 A Small Population

As of mid-June 2021, there were 1.4 million Kuwaitis employing 2.4 million foreigner workers. Moreover, 560,317 or 38.03% of all Kuwaitis are outside the labor market as they are either younger than 15 or older than 65 years. Clearly, neither the population size nor its above-mentioned demographic anomalies bode signs of being able to rebalance the current Kuwaiti/non-Kuwaiti labor market disparity³⁶, a fact that implies that the disproportionality of Kuwaiti and non-Kuwaiti residents would appear to remain the same for the foreseeable future.

7.5 Laissez Passe Immigration Policies

In theory, employers hire workers when their economic value to the firm exceeds their cost. Employers in Kuwait have been able to meet their increasing demands for labor over the last five decades by relying on imported foreign workers whose costs are considerably lower than the value of their marginal physical product. This strategy was made possible by the government's *laissez passe* immigration policies, representing an escape hatch, which has long underscored the political weight of the business class in matters of national labor market policies.

7.6 Limited Training

Available official data show that training constituted 0.16% of total ALMPs/WSP spending in 2016 (MGRP, 2017), which explains in part the program's ineffectiveness.

8. Conclusion and a Proposed National Renewal Plan

The preceding assessment indicates that Kuwait's demographic challenges stemmed in large part from pursuing well-intended short-term policies with unintended consequences. Examples include subsidizing Kuwaitis to join the private sector while bolstering the rewards of working in the government sector, or by imposing restrictions on the functioning of the labor market (e.g., the Kafala system along with the other short-term fixes) while trying to integrate the labor market. Or by incentivizing nationals to pursue higher levels of education while expecting them to replace low-skilled foreign workers. Or by actively distorting factor and product prices through widespread consumption and production subsidies serving short-term goals while overlooking their inherent adverse economic effects on the country's demographic structure. Or by giving considerable financial support to the traditional education system while disregarding the need to train large numbers of Kuwaitis—who do not wish to pursue a university education—to acquire the technical skills required to replace highly paid foreign workers engaged in critical government-owned oil, medical, and public utilities companies.

The open unemployment of nationals is a long-term, structural phenomenon whose solutions must address its symptoms and seek long-term structural remedial changes. In what follows, we suggest such a policy: a package of interrelated, market-driven set of actions designed to achieve a long-term solution to the existing unemployment problem. The proposed plan, which consists of three stages, is in effect a national renewal plan, as it simultaneously tackles other related socio-economic challenges.

The first stage, *human capital investment*, calls for the establishment of special two-year colleges for the upgrading of nationals' skillsets. The training would be in occupational specialties emphasizing analytical disciplines like higher mathematics, statistics, computer programming, English language and, possibly, managerial skills. The choice of skill training should begin with areas in which Kuwait is especially dependent on high-paid foreigners and in areas where the highest rates of replacement have already taken place in recent years³⁷. Priority must be given not only to critical foreign-dominated skills in areas such as power generation, water desalination, oil refining, petrochemicals, and health care, but also to soft skills. Student graduation must be contingent upon enrollees' superior performance based on objective evaluations. While government support to on-the-job training in SOEs and private firms is necessary, it should be partially funded to give the institutions a stake in the program, to improve the selection of trainees, and to avoid the O-J-T becoming a dumping ground for unqualified individuals.

Simultaneously, the second stage, *labor market reforms*, would pursue:

- Abolishing the *Kafala system* and eliminating rentier practices to motivate Kuwaitis to compete on equal footing with non-Kuwaitis
- Advocating self-reliance in place of dependence on government paternalism e.g., by ending government's job guarantee to nationals
- Initiating civil service reforms by matching government salaries to levels of job qualifications and responsibilities
- Selecting nationals based on merits, instituting performance-based promotions, and moderating public job expectations
- Curbing and eventually eliminating cronyism (*wasta*) and tribalism, especially in critical leadership positions
- Restructuring incentive systems to encourage skill acquisition
- Improving the administration of labor market agencies
- Focusing on promoting innovation, exports, and expansion in the private sector rather than on restricting the supply side of the labor market (McKenzie, 2017)
- Raising the cost of employing white collar foreign workers
- Increasing the incentives of private sector employers to seek nationals by modifying the wage subsidy to narrow down the wage gap of high skilled jobs between Kuwaitis and non-Kuwaitis, and also by limiting the duration of the wage subsidy to 2–3 years
- Reenergizing the SMEs Fund

- Linking production subsidies to hiring of nationals
- Scaling down social dividends and government wages to lower nationals' reservation wages
- Enhancing labor market information system and, most importantly
- Reversing the deterioration in the quality of education across all levels³⁸.

The preceding two stages contain the necessary conditions. The third stage, the *socio-macroeconomic structural reforms*, embodies the sufficient conditions. It relies on four fundamental structural adjustments. The first calls for modifying the social contract from the current ad hoc distribution of oil wealth, which has created an expansive and distortive 'womb to tomb' welfare system, to one in which oil revenues are distributed equally as a form of income to all citizens. This policy, adopted successfully elsewhere, would eliminate current consumption subsidies and remove factor and product price distortions, leading to a more optimal resource allocation and reviving past self-reliance among nationals. The second involves pursuing a long-term, *high value added strategy* in which domestic production centers of tradables are to be relocated to foreign low-wage countries, while high-value-added functions (e.g., engineering, finance, design, accounting, marketing, etc.) are to stay in Kuwait, thereby hollowing out the demand for less-skilled foreigners while expanding the demand for high-skilled Kuwaitis (CMT, 1989; Amsden & Girgis, 1990). The third rests on enabling the private sector to widen its base through a transparent privatization of the current expansive SOEs sector and loosening current restrictive business regulations, thereby broadening the scope of the demand for nationals. Lastly, this stage must maintain safety net provisions, especially those that augment productivity, such as health and education.

If pursued as proposed, this national renewal plan would serve Kuwait's macroeconomic goals as well, namely, the provision of sufficient meaningful jobs for all job-seeking Kuwaitis, economic diversification, productivity growth, better balanced demographics, fiscal restraint, and a self-sustaining economic development.

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Notes

- ¹ The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.
- ² To the extent that labor market imbalance is the *raison d'être* of the population imbalance, corrective policies of the former will have analogous effects on the latter.
- ³ The Kuwaiti economy is heavily indebted to oil revenues in that between FY 2009/2010 and FY 2019/2020, it contributed 91.5% of the government budget and made up 53.7% of the GDP (CSB, 2021; Ministry of Finance, 2021). However, due to the instability of the oil market, per national capita, which reached USD 113,418 in 2010, fell to USD 71,379 in 2020.
- ⁴ Kuwaitis became a minority as far back as in 1962 when there were 174,812 nationals and 178,104 non-nationals (CSB, 2021).
- ⁵ The 'public sector' heretofore refers to the government sector plus state-owned enterprises [SOEs].
- ⁶ This implies that the private sector absorbed 20.4% of the net increase in Kuwaiti employment between 1993 and 2020, and the remaining 79.6% were given government jobs (PACI, 2021).
- ⁷ In all, most foreign workers earn substantially lower wages and face more regulations, fewer rights, and less job security. Official statistics show that the average monthly wage rate of Kuwaitis is 4.5 times that of non-Kuwaitis (KD 1,490 vs. KD 331) in 2021 (CSB, 2021).
- ⁸ Forstenlechner & Rutledge (2011) concluded that "national/non-national demographic imbalance now tops the political agenda of most if not all, [GCC] states," (Forstenlechner & Rutledge, 2011).
- ⁹ Kuwait's employment data are distorted by the extent to which the *Bedoons* (stateless residents) became noncitizens after 1989 (De Bel-Air, 2019). It is estimated there are 90,000 to 115,000 *Bedoons*.
- ¹⁰ There were 49.3 expatriate jobs (excluding household jobs) for every unemployed Kuwaiti in 2020 (PACI, 2021).
- ¹¹ Besides the rise in females entering the labor force, the government's slowdown in hiring nationals account for their rising rates of unemployment, especially that government jobs to Kuwaiti females are first, and often, last priority.
- ¹² This policy is practiced widely in the GCC. Oman, in 2022, restricted work to nationals in 207 occupations.

¹³ Whereas most foreign-labor-importing countries have citizenship-paths mechanisms for immigrant workers, Kuwait does not provide any, nor do the other five GCC countries.

¹⁴ Other institutions balked at the Diwan's interventionist stance. Example: Kuwait University decided to halt staff Kuwaitization for four years (Alqabas, 3/3/2022) when it was requested to lay off 391 out of 534 non-Kuwaiti staff members to meet its Kuwaitization quota.

¹⁵ However, in response to fiscal exigencies facing the government budget in FY 2021/2022, the Fund suspended its lending activities.

¹⁶ Hence, wage subsidies and ALMPs are used interchangeably.

¹⁷ A Kuwaiti Dinar is worth about USD 3.30.

¹⁸ It is not known if and by how much government funds contribute to WSP. However, government budget data show that in FY 2015/2016 (the latest available), total income and profit taxes amounted to KD 141.9 million, while spending on the WSP was KD 459.2 million. This clearly shows that the bulk of the WSP is borne by public funds.

¹⁹ This compares favorably with 0.5% in OECD (Brown & Freund, 2019) and 0.4% in Latin America (Pignatti & Van Belle, 2020). Kuwait's estimate is computed as the percentage of cumulative ALMS spending in GDP during the nine-year period from 2001 to 2019, to avoid swings in income due to oil price fluctuations.

²⁰ Kuwaiti females in 2020 made up 50.2% of Kuwaiti employment in the private sector (CSB 2020).

²¹ Based on a firm-based survey, 21.3% of Kuwaitis were identified in 2003 as owners. This percent dropped to 3.3% in 2019 despite the increase in the number of firms surveyed from 38,639 to 42,577, respectively (CSB 2019).

²² Whereas active labor market policies interact with passive labor market policies, reinforcing each other to positively impact employment in developed economies, they negatively influence "all outcomes of interest" in developing and emerging economies (Pignatti & Van Belle, 2021).

²³ In Jordan, wage subsidy participants were given six non-transferable monthly vouchers to be presented to employers. The face value of the voucher was close to the minimum wage rate. Groh et al. (2016) evaluated the program and concluded that its impact was limited to its duration. Little long-term effect on employment was observed. The same conclusion was reached in a similar study of wage subsidies in the US from 1979 to 1994 (Katz, 1996).

²⁴ Based on the 0.58 employment elasticity coefficient, and given the economy's overall average growth rate of 4.5% annually, the economy creates more jobs (77,191) than Kuwaitis looking for jobs (25,000).

²⁵ The technological bias was supported by a local protective environment (e.g., low customs duties, exemptions on raw materials, and 25% protective tariff on competitive imports) in addition to the free passage of local goods to the other five GCC-free-trade states.

²⁶ While low-tech systems reduce the cost of production, dampen inflation pressures, and strengthen the competitiveness of local firms, they also conceal low productivity levels. Employing the identity $G = EV$, where G denotes real non-oil GDP (2015 = 100); E , employment; and V , labor productivity (G/E), a straightforward calculation shows that V fell steadily from KD 19,894 in 1993 to KD 13,094 in 2020, or by 34.2%²⁶. This is confirmed by the IMF, which showed that total factor productivity exhibited negative growth rates during 1990–2012²⁶ (IMF, 2013).

²⁷ The fastest educational progress among Kuwaiti employees occurred between 1965 and 1985 (1.6 to 8.31) compared to 2005 to 2020 (11.21 to 12.05). In contrast, non-Kuwaitis' levels fell from 6.21 in 1985 to 5.08 in 2005.

²⁸ The government sponsored 40,262 scholarships during 2001–2022, most of which are in overseas universities. Allowances for US-based students, as an example, consist of \$2600/mo. plus \$2,756 for books and clothes (Ministry of Higher Education website, Statistics).

²⁹ In Kuwait, the weighted average level of education in government is 13.9 yrs. (> secondary) compared to 9.5 yrs. (slightly higher than intermediate) in the private sector.

³⁰ In a recent CSB survey of unemployed Kuwaitis, 58% expressed willingness to work only for the government.

³¹ Examples of the widespread educational mismatch: the Civil Service Diwan reports an excess supply of Kuwaitis with university degrees in 2018 in Islamic Jurisprudence (587), mechanical engineering (481), law (411), and industrial engineering & MIS (370), among others. Private sector employers attribute the lack of demand to either irrelevance (e.g., Law or Islamic Studies) or dated technologies (e.g., I.E. or ME) or inept managerial capabilities (e.g., MIS).

³² The Civil Service Diwan reports 6,081 job offers were rejected by unemployed nationals in 2018, and, on average, each applicant rejected a government job offer five times.

³³ Kuwait University is ranked 801–1000th in 2021, down from 601–800th in 2017 (QS World University Ranking, 2021).

³⁴ This also indicates that the labor market was significantly segregated even before 1994.

³⁵ The low rate of participation of nationals in the labor force is not overwhelmingly gender biased, as is generally believed in the GCC, in that females' rate in Kuwait in 2020 is only slightly higher than males': 57.6% vs. 42.4% (CSB, 2021).

³⁶ The claimed goal of reversing the population mix from 30/70 (Kuwaiti/non-Kuwaiti) to 70/30 does not seem feasible due to the considerable magnitude of the demographic gap, as well as to natural physical demographic constraints of the Kuwaiti population. This desired demographic reversal is the more difficult when one considers the 1.5 million foreigners privately employed, plus the 714 thousand in the household sector (PACI, 2021).

³⁷ An analysis of the evolution of the value of the D Index regarding the 27 different occupations listed in PACI's dataset would provide clear signals as to which occupations are most favored by Kuwaitis.

³⁸ See a thorough treatment of required labor market reforms in short-, mid- and long-terms in Girgis et al. (2003).

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