

A Plan for Reforming the Bahrain Labor Market:

Introduction and Context: Labor market institutions and practices affect the performance of employers and of the economy as a whole, and they also shape the welfare of individuals and their families. As a result, employment decisions have important political dimensions to them and inevitably involve trade-offs. Understanding the arrangements governing labor markets is complicated by the fact that they are governed in part by economic laws and mechanisms and also by cultural, social, and psychological factors.

Unemployment is arguably the most important topic within the broad area of labor markets. Virtually all countries in the world, including Bahrain, are struggling to provide enough jobs for their population. Other than expanding government employment, an approach that has obvious limits, the way to create more jobs is for private firms to create more jobs. Few firms are interested in creating jobs per se. Their overwhelming interest is in making a profit, and they create jobs only where doing so helps them make more profit. So the problem for governments is to find ways to help companies to make more money – expanding jobs by creating new companies and having existing ones grow. Planning labor market interventions to improve the circumstances of employees is constrained by the concern to not hurt the competitiveness of their employers.

The process of globalization, where the economies of the world become increasingly interconnected, has made this challenge even more complicated for governments. Companies can move easily across national boundaries, they can even more easily rearrange operations, moving jobs across countries in the process, and their allegiance to any particular country – even their country of origin – may be weakened considerably. On the plus side, countries can find their job prospects considerably and rapidly enhanced if an existing company moves operations to their location; on the minus side, the reverse can happen if operations move out. Countries like Bahrain with small domestic markets are especially vulnerable to such shifts because their employers are more likely to be focused on international opportunities and markets.

In this new environment, the task of economic development boils down to creating opportunities that companies believe will enhance their ability to make money. In a few cases, it is obvious how those opportunities are created. Countries that are rich in natural resources, for example, may simply need to facilitate the ability of companies to exploit those resources. Most countries, however, have to rely on infrastructure as a means of supporting employers. Infrastructure includes systems of transportation, stable governments and laws, and especially relevant here, human resources. A country like Bahrain is more fortunate than many in having several resources that could help companies make money. But it is also crucial to understand that in a global economy, the value of these resources is relative, not absolute. Bahrain may have very good infrastructure in absolute terms and much better than in the past, but if other countries come up with better infrastructure, then Bahrain's infrastructure no longer has any

competitive advantage for employers. And some components of infrastructure, such as good communication systems, may simply be necessary conditions for allowing a country to compete in the international economy – every country is expected to have them.

The situation Bahrain faces should best be examined in this general context. It does have oil and gas resources that provide some resources for jobs, but those resources are not huge and are shrinking relative to the growth rate of the population. It has some captive companies that cannot leave the country, such as BAPTCO and ALMA (although they can shrink). But compared to other countries, Bahrain's small size means that the local market is not large enough on its own to sustain many companies, and its employers are on average more subject to global markets and opportunities. If Bahrain does not provide opportunities that are attractive for companies to prosper, opportunities that are more attractive than competitor countries, its long-run ability to increase or even maintain jobs will suffer.

One consequence of this situation is that any efforts to improve aspects of employment and labor markets has to be conscious of the possible effects that such efforts can have on employers and, in the long term, on jobs. Efforts to push the problem of improving conditions and opportunities for workers off onto employers, for example through mandates and regulations, may hamper the economic effectiveness of the companies and, in the long run, affect competitiveness and jobs.

The Unique Bahrain Context: Bahrain and the oil producing countries of the Gulf experienced something unprecedented with the oil booms over the past two generations, prosperity that was generated not from industry or commerce. An analogy might be for an individual to find a stash of gold bullion buried in their yard. The development of the oil reserves provided the resources for rapid economic development, and many of the skills needed for Bahrain to catch up quickly with the developed world quite naturally came from expatriate workers who were either hired directly into Bahraini companies or came to the country with foreign companies.

What was distinctive about the experience of the oil countries, however, is that the use of expatriate labor extended not only to skills that were not available in Bahrain but to lower level skills that were still available. Before the oil boom, Bahrainis were cooks, cleaners, construction workers, and held all manner of the jobs in the economy. After the boom, they did not. The question is why.

There is a view in Bahrain that the Bahraini workforce no longer wanted to do these lower level jobs, perhaps because they were now too wealthy to bother with them. While the economic benefits of the oil boom were not distributed equally across the population, many economic benefits did flow to the lower income classes. But the view that even working class and unemployed Bahraini have become spoiled by these good times and therefore will not think of doing these lower level jobs now seems at best incomplete, if not completely wrong, and it is easy to see why with some simple analogies.

Consider other countries in the world where per capita incomes and the wealth of the working classes is considerably above that of Bahrain, such as the Scandinavian countries. In a country like Norway, a country with oil resources equivalent to Bahrain, there are still plenty of Norwegian cooks, plenty of Norwegian construction workers, janitors, etc. Why is it that in these other countries, workers who are much wealthier than Bahraini's are still interested in doing these jobs?

The answer turns on a policy decision made by Bahrain and the other Gulf countries to allow a sharp expansion in the number of unskilled workers who entered the country and the subsequent impact on unskilled jobs. This increase in the supply of unskilled and semi-skilled workers kept the price or wage of these jobs down, kept the employers from competing for workers by offering better conditions of work and benefits, and sharply reduced their incentives to invest in equipment and capital to improve labor productivity and reduce labor costs. In Scandinavia and in most of the rest of the world, as overall economies grew wealthier, the wages for unskilled jobs also grew, the conditions of these jobs improved. Higher labor costs created incentives for employers to invest in productivity improvements, so that over the long run, fewer workers were needed to do these jobs. In Bahrain and the oil countries, in contrast, even as the overall economy grew and average prosperity rose, the steady supply of low-wage workers meant that the wages for these low-end jobs stagnated, working conditions did not improve, and labor productivity lagged that in the rest of the world. A Bahraini construction site, for example, looks like a European construction site from the 1940s. White collar office jobs in Bahrain, in contrast, look identical to those in contemporary Europe.

The particular arrangements for handling expatriate labor in Bahrain exacerbate this problem. Most countries address the demand for expanding the labor force through immigration where workers enter the country and become citizens with the same rights in the labor market that native workers enjoy. In Bahrain, the expatriate workers do not become citizens who are free to move within the labor market. Instead, they remain expatriates who are tied to the employer who brought them into the country. Their choice is to accept the terms and conditions offered by the employer or go home. Often, those conditions worsen once they are in Bahrain, and while it is theoretically possible for expatriate workers to redress that situation through the Government, the process appears to be neither easy nor sure.

In most cases, the low-skill, expatriate workers come from the most depressed, lowest-wage labor markets in the world, such as Pakistan and Bangladesh. As long as the Bahraini employer beats the terms and conditions prevailing in those countries, the workers are happy to stay. But it also means that the wages and conditions for these jobs in Bahrain only have to remain at a level slightly above the lowest level in the world, so that is where they stay.

Now we have an answer to the apparent puzzle as to why Bahrainis are not interested in many of the jobs that their grandparents had earlier performed. In relative terms, the quality and wages of those jobs have deteriorated enormously. The excess supply of

labor driven by expatriate workers has meant that these jobs are now considerably worse in relative terms than they were when their grandparents worked in them.

It is worth pointing out that there are some important economic benefits from having cheap, unskilled labor in the economy, just as there are important benefits from having low prices for any commodity. The users of that labor get tremendous value from it. The price of everything from services like car washes to home construction that makes use of low-skilled labor is lower as a result. If one compares, e.g., a country like Brazil with a huge supply of unskilled labor to a country like Sweden with relatively little, one finds that the standard of living of the middle class and above is considerably higher in Brazil: Even lower-level managers can afford to have a maid, a cook, a gardener, etc. In Sweden, because such jobs pay well, typically too well for the middle class to afford them, even higher-level managers and their families do those tasks themselves.

The expatriate workers themselves are also typically much better off than they would be back at home. Indeed, they are often able to support entire families in their home country with their savings. The downside of this for the hiring country, of course, is that much of their wages leave the country and with it, the economic stimulation that might come with domestic consumption.

It is also worth pointing out that it is much, much easier to manage a workforce under the model where labor is abundant and especially under the expatriate worker model where foreign workers cannot quit, except to leave the country. Workers who are desperate for work and who are being paid well above their opportunities elsewhere will put up with a great deal in terms of abuse and poor management practices.

One should be clear that there is nothing intrinsically better about these expatriate workers. They are not per se more loyal, harder working, or more committed to the employer. They are simply managed with a system that elicits that behavior: The deal they receive is so much better than their alternatives, which are artificially constrained. One could likely get the same behavior from Bahrainis if one could pick a few good ones out of the country, as Bahraini employers essentially do from large countries like Pakistan, and offer them a job dramatically better than their alternatives. Apparently two generations ago, Bahrainis were sought after as expatriate workers for jobs around the Gulf.

Another misunderstanding that seems to be popular in Bahrain is the assertion that white collar workers in Bahrain are competitive in an international market while low-wage Bahraini workers are not based on the fact that multinational employers prefer to hire Bahrainis for white collar jobs rather than use expatriates but the reverse is true for low wage jobs. The real story is that the employment practices of multinationals make local white collar employees cheaper than expatriates *everywhere in the world*, not just in Bahrain. When these companies bring in an expatriate manager or white collar worker, they pay their moving and travel expenses, the costs of having their families with them, trips back home, sometimes paying a premium for foreign duty, etc., so a typical expatriate white collar worker costs about three times what a local worker costs.

Multinational employers do not use expatriates for low-level jobs. While low-wage Bahraini workers are disadvantaged because of government policies regulating expatriate workers, white collar Bahraini workers are advantaged because of the employment policies of multinationals. Neither set of jobs is operating in anything like an open market.

All market-based countries allow foreigners to work in their economies, and all industrialized countries have allowed proportionately large numbers of immigrants and expatriate workers to become part of their workforce. The question is not whether Bahrain should have foreign and expatriate workers but under what conditions. Most countries have elaborate policies to decide who enters the country because entering as a worker opens up the possibility to stay as a citizen. That appears to be less of an issue in Bahrain because entering as a worker does not necessarily open the door to remaining as a citizen. Most countries think carefully about the impact of foreign workers on their indigenous employees and regulate the flow of entrants to minimize that adverse impact. Singapore, for example, goes further and actually taxes employers proportionately to the amount of low-wage foreign workers they use.

The current arrangements in Bahrain seem problematic on several dimensions. First and most important, the decisions about entry of expatriate workers have been made in an ad hoc way, and no one can even be sure how many are in the economy and what they are doing, let alone what impact they are having on the economy. Second, abuse of the system seems rampant, especially the “free visa” arrangements where expatriate workers are turned loose on the labor market by their sponsors to find their own work, paying the sponsor a percentage of their wages in the process. Third, the government has essentially become the labor supplier to the economy, and what this means in practice is that government agencies and bureaucracies have had to take on what in most economies is one of the most dynamic tasks in the economy, matching workers and skills to job requirements. One way to describe this situation is that the political choices and trade-offs with respect to expatriate workers were not made explicitly and did not reflect the interests of the overall economy or society. And making the government responsible for one of the fundamental day-to-day tasks of running an economy creates an impossible task and inevitable resentment toward the government.

Finally and most important, the importation of large numbers of low-skilled expatriate labor depresses the wages and terms and conditions for all these jobs, depressing the economic circumstances for native Bahraini’s in those labor markets. The arrangements that bind expatriate workers to their employers mean that they are much preferred – harder working, unlikely to quit, etc. – as compared to Bahrainis even at the same wage. Given this, economically rational employers are likely to take expatriate workers first, so Bahraini’s will get jobs only as a last resort. This situation by itself explains perhaps most of the unemployment among low-skilled Bahrainis.

It is worth noting that minimum wage proposals, which have been suggested as a solution to the preference of employers for expatriate workers, are unlikely to work. The notion behind these proposals is that if employers can no longer pay the expatriate workers less

than some minimum and presumably acceptable wage, they will have no incentive to prefer such workers. But the arguments above about the greater ability to control expatriate workers and their greater motivation based on poorer prospects at home suggest that employers will prefer expatriate workers even at equivalent wages.

Assessing the costs of this unemployment against the benefits of the expatriate labor to the economy is a political decision, and all countries weigh those costs and benefits in determining how many foreign workers to admit. But there should be no doubt that there is a trade-off between the benefits of having low-wage services and the costs of a depressed low wage labor market for one's citizens.

An overall model for the Bahraini labor market and economy:

Perhaps the best way to think about an overall model for Bahrain's labor market and employment system is to begin with the tasks that need to be performed and decide which of these should be the responsibility of the government and which the responsibility of the private sector and of an active labor market. As noted above, the preferred model in most all countries now – and certainly the model that is growing in influence – is to leave as much to the operation of markets and the private sector as possible. The reasons are many: The alternative, regulation, is imperfect, slow, subject to corruption, and will make the government the focus of complaints about employment issues, whether merited or not. Further, markets operate independently of government regulations and will create distortions unless the regulations happen to match perfectly the needs of the labor market. The preferred solution, therefore, tends to be to regulate the infrastructure that surrounds and supports the market. This infrastructure can be organized around four key issues:

1. What role should the government play in providing the workers with the necessary skills to the labor market through education and training;
2. What level of expatriate workers is appropriate, a subset of the above concern but one important enough in the Bahrain context to be a separate topic;
3. How should the employment relationship be regulated, especially the right to dismiss workers and the protections workers should have as a result;
4. What should be done specifically to help disadvantaged members of the workforce, the unemployed and low-wage workers;

The discussion below suggests very general organizing principles to address these four questions. Each question, in turn, would be the focus of a separate study that would go beyond general principles and provide much more specific and detailed recommendations based on best practices from other countries for improving arrangements in Bahrain.

The Supply of Skills:

How should employers get the workforce they need? The answer begins with the education system where the goal should be to provide a high level of basic cognitive skill

and academic skills. Virtually every developed country has struggled with determining what those skills should be, but the basic conclusion from endless reports on this subject is that there seems to be no real conflict between what educators think the important skills are and what employers need in a workforce. The ability to communicate effectively, to analyze situations and use problem-solving techniques, to work effectively with others, are all at the heart of both education and business critiques about how to improve the education system. The serious conflicts one sees around the world under the topic of reforming education do not lie between education experts and business leaders, who tend to want the same outcomes. They lie in trying to implement changes and encourage the education providers to do something different that is often also more difficult.

There have been a number of interesting investigations in both the U.S. and Europe about how employers might be able to help the education system do a better job at providing academic skills and helping students make the transition into the workforce. The phrase “school-to-work” or “school-and-work” is used to describe models where employers provide experiences for students in the workplace that illustrate or apply the conceptual material used in classrooms. All the evidence suggests that these arrangements contribute to serious academic learning no doubt because, as cognitive science studies are increasingly illustrating, people learn best when they see concepts in some concrete context that matters to them. They also help build positive work attitudes because students at an impressionable age are exposed (if done right) to appropriate role models in the workplace.

The important extension of these school-and-work principles is to help students who are more vocationally-oriented and do not intend to go onto college to make the transition directly into the workforce. Here the evidence is also clear that the tighter the links between education and employers – the more joint programs, the more integrated the experiences – the more academic material these students learn and the easier the transition is to the labor market. Improved learning comes from the fact that people learn best when abstract concepts are illustrated in a practical context. The fact that students can see why concepts matter and that adults in positions of influence care about them helps the students take them seriously.

A simple part of the explanation as to why these programs aid the transition to work is that employers see who the best students are on the job and try to hire them before the students even begin a job search. This also explains why employers might be interested in these programs – it makes recruitment and selection much more effective. The 1994 School-to-Work Opportunities Act in the U.S. provided seed funds for these programs and some guidance as to how to do them, but the interest in these programs exploded once the labor market tightened and employers were looking for good workers: The number of programs doubled between 1997 and 2000.

There are endless variations to the models as to how employers and schools should work together and how elaborate the mechanisms should be. The basic points are that the classroom work and the work experience should have some integration. The classroom

instruction should teach concepts that one can see on the job, and the work experience should illustrate those concepts. The key point is that the more integration, the better. Some limited oversight is needed to ensure that employers do not simply provide experiences that offer no real learning and that exploit “free” student labor and, in tight markets, that employers do not hire students before they finish their programs. In more clearly craft-related tracks, such as carpentry, more vocationally oriented educational experiences might be appropriate, that is, some limited classroom experiences (e.g., the last year of secondary school) that teach explicit job-related skills. But there is also concern that too much vocational training simply means that the programs can become dumping grounds for less academically able students, provide an excuse for not teaching academic material, and create a stigma against the vocational students who attend different schools, have different degrees, etc. The research suggests that even vocationally-oriented students need more academic content than they are getting. The best of these vocational programs use exactly the same principles as school-to-work for regular students, and that is to engage employers in helping to teach academic material through a practical context. The only difference is the greater use of work-based material.

The details of effective collaboration between employers and schools matters less than simply getting such collaboration underway. At least in other countries, efforts to reform education have been reasonably popular politically, and there is little risk from advocating and advancing reform efforts. Reforming the academic part of education to improve standards has proved quite difficult to do, however, in part because schools have only a limited influence on the performance of students (family, friends, and society in general play important roles) and because the education system per se is often hard to influence. Particularly in the U.S., efforts to reform the primary and secondary school systems have pursued many different tracks, from using standardized test results to assess and reward schools to letting for-profit private schools try their hand, and the jury is still out as to which works best.

Exactly the same principles should apply to post-secondary education, especially to the tracks that are explicitly designed to offer job-related skills at the end. Employers should have some role in oversight on the skills being taught and how they are taught; internships and on-the-job work experience should be part of the student’s experiences; students should have good career counseling information to let them know what the odds are on finding jobs in any particular academic area.

Job Training: The issue of training, as opposed to basic and fundamental education, is more complicated because training involves skills that are mainly useful for employers, so the question of who directs the training and who pays for it becomes more complicated. The general operating principle, which appears to be universal, derives from basic economic principles, and that is to have employers directly provide or pay for skills that are unique to them because they can then retain the benefits and the workers. The more useful the skills are across employers, the more general the skills are, and the more likely that either the workers themselves or the government should pay for the

skills. Whether the government or private providers actually deliver the training for these general skills is a separate matter.

Some countries, such as Germany and the Scandinavian countries, have extensive systems of vocational training that are paid for in large part by the government and are designed and regulated by the government. Other countries, especially the U.S., make use of for-profit vocational training providers and mainly non-government systems of certification and credentials. The essential difference is the extent to which the government wants to take control of attempting to predict and then provide the skills that employers will need. Most countries have moved away from serious attempts to predict and plan labor supply at the level of individual occupations because of the difficulty in anticipating changes in the world of business. But no country has stepped away from at least some efforts to influence and shape the training market.

The minimum and arguably most effective government intervention is to provide information first in the form of data about labor market opportunities (where the jobs are), second in the form of information about training providers (standards and certification), and finally, in the form of information about potential employees (credentials and certifications). One could make a strong case that forecasts about labor market opportunities are the most difficult to provide because all predictions are difficult. Certification for training providers is designed to ensure that trainees do not waste their time, and possibly their money as well, on poor quality training. Certification of the skills of trainees is designed to provide the same assurance for employers. It is reasonable to assert that of these, certification of the trainees by objective standards is the more important intervention as it can also easily be used to provide information about the quality of training providers: What percentage of the graduates of various training providers passed their certification tests and received credentials?

Many of the most important training credentials issued in the world today are issued by nongovernmental organizations. Virtually all of the information technology credentials, for example, are issued by private companies (e.g., Microsoft Certified or Cisco Certified). Industry groups also provide their own credentials (e.g., actuarial and insurance functions), sometimes backed by government enforcement (e.g., in the medical, legal, and accounting professions). In other areas, governments are more or less involved in creating skill certifications. The elaborate apprenticeship systems in Scandinavia and Germany create certification tests and credentials for virtually every manual job and many lower-level white collar tasks. The United Kingdom developed an elaborate but voluntary system of skill standards for jobs and credentials for individuals. Singapore has something similar. Exactly how far one wants to go in the direction of government-sponsored credentials for employees in part depends on how many private credentialing arrangements already exist as well as how far the government wants to be involved and responsible for labor market activities. The advantage of these apprenticeship and certification arrangements is that they help workers move across employers, assist employers in making informed hiring decisions, and more generally regularize job matching. The disadvantage is that it can take a good-size bureaucracy to manage and enforce these arrangements. Some critics also suggest that apprenticeship and

credentialing arrangements can go too far, creating arbitrary distinctions between jobs. For example, the efforts to establish skill standards in the U.S. led to draft standards that were considerably different for secretaries in the chemical industry and in the electronics industry, even though most outside observers thought the two jobs were essentially equivalent, because the process for generating standards in the two industries was different.

Even more so that with the topic of education reform, it is vitally important for employers to be involved in the process of developing training standards and credentials. It is also important for representatives of labor to be involved to ensure that the credentials and standards are fair to both current and future workers.

Most governments also go further and help provide training for occupations that are useful across employers, such as nursing or accountancy, typically as part of an alternative track for secondary education but sometimes as well through post-secondary education. Many people believe that the most effective and responsive education providers in the U.S. are community colleges, which are supported by local governments and often have strong ties to local employers. The State of North Carolina, for example, uses the community college system to subsidize employers and attract new ones into the state by providing occupational training for the employer's workforce. These arrangements include requiring that job applicants take and successfully pass courses at the local community college that are designed for that specific employer before the employer will offer them a job. Similar claims were made for the polytechnic institutions in the U.K. (they have been transformed into universities in the past decade).

There appear to be real advantages to having a separate educational system that is post-secondary provide occupationally-related skills. First, the students are older and more serious at that point about learning. The fact that older, experienced workers are in the classes also helps to settle down the younger school leavers. Second, the fact that the programs are independent of the secondary schools helps make their mission clearer and allows them to focus more on providing work-related skills without being tied to all the other tasks that secondary schools must pursue.

Specific recommendations:

1. Begin focusing attention on reforming secondary schools, picking a path for raising academic standards that begins with articulating the need for change and the goals. These moves have tended to be politically popular elsewhere. Such reforms take a long time to achieve results, however, which is why it is important to get started. A great deal can be learned from reform efforts and debates well underway around the world.
2. Introduce explicit school-and-work reforms involving employers at the secondary school level. A key principle is to introduce these practices across-the-board and not just for vocationally-oriented students.
3. Work on similar reforms at the post-secondary level by involving employers in the more career-related tracks. At higher levels, the government might think

- about expanding the use of the Crown Prince's Scholarship Program along the lines of Singapore, where the recipients of foreign education are required to come back to Bahrain and work for a few years in the government, where they are given special opportunities and experience. This program essentially "pays" for the scholarships, allowing them to be expanded, and also helps inject new thinking and very able workers into the government.
4. Consider a separate academic system – like the European Polytechniques or U.S. Community Colleges – designed to provide occupational training for post-secondary students as well as older workers seeking new or different skills.
 5. Set up arrangements within the Ministry of Labor to provide information to interested parties on where the jobs currently are and projections on where they will be at least in the immediate future (the simplest and best approach is just to survey current employers).
 6. Begin work on a system of certification for skills where the goal should be to use arrangements that are already in place and encourage the involvement of non-government groups. Exactly how much of the labor force one wants to develop certifications for is ultimately a political choice.
 7. Finally, encourage transparency in the labor market in ways that will suggest to students that if they follow the system, do well in school, pursue further education or training programs, it will pay off for them. The objective is to reduce the sense that, because of discrimination or favoritism in hiring, there is no point in developing their own human capital. The best way to do this is to encourage the use of systematic criteria in employee selection – basing hiring on objective criteria that include credentials, the results of standardized or explicit tests, prior experiences, etc. – and reducing the use of subjective assessments such as unstructured interviews. Research suggests that unstructured interviews are essentially worthless for predicting who is a good worker in any case, and they can help create the impression that gender, religion, race, or other discriminatory criteria were at work in the process *even when they are not*. This approach should be led by the example of the government, which should reform its own hiring practices along more systematic lines.

The Use of Expatriate Labor:

How should the use of expatriate workers fit into a system of labor supply? Several general principles stand out. First, the decisions on labor permits should not be made in an ad hoc way, based on one-off interactions with individual employers. The Government should decide overall how many workers with what type of skills are allowed to come into the country. The problem with the current arrangement is that the Government has to take the word of every employer about the skills that employer needs and also about the assertion that those skills are not available in the domestic labor market. Doing so creates a substantial enforcement burden on the government. It also places the government in the position of effectively being the labor supplier – employers go to the government when they need workers. And if an employer cannot find workers, then it becomes the government's problem. Second, the fact that expatriate workers are not allowed any of the labor market rights of domestic workers creates a number of

problems noted above in addition to the ethical burden of disparate treatment. It essentially creates two systems of employment in the same country: One for Bahrainis, which is a real market, and one for expatriates, which is not. The expatriate system is an administered arrangement that exists because of a legal framework.

Allowing expatriate workers some of the rights of native workers, especially the ability to change employers, is a simple intervention that might lead to a number of improvements. It would reduce some of the advantages that expatriates have in the labor market by giving them the opportunity to leave jobs that pay below the market wage or where employers mistreat their employees. Expatriates might well be preferred on other dimensions, such as their greater motivation given more limited opportunities in their native lands, but the artificial advantages of a legally constrained relationship would be eliminated. The free visa problem would also be eliminated as sponsors would no longer “own” the expatriate workers and be able to exploit them. It essentially gets the government out of the business of being a labor supplier. If the supply of skills in the economy is adequate, then it is the employer’s job to figure out how to hire them, even if that means offering higher wages to do so. This approach also helps eliminate abuses of contracts struck between the expatriate employee and the employer before the employee arrives, for example, indentured servitude arrangements where the employee agrees to pay back inflated travel or living expenses. In order to enforce those contracts once the worker arrives, the employer would have to go to court in Bahrain and expose those abusive arrangements to public scrutiny.

This intervention also raises some complications, however. In the short term, employers would have to learn how to truly manage workers as their legal power over an expatriate workforce would diminish. Here the most immediate issue is turnover. Employers say that the expatriate workforce is loyal – another way to describe that is simply that they cannot quit. A change in the rules binding these workers to their employer will lead to immediate increases in turnover, employers will complain bitterly about this and will blame the government for it. (It will be a difficult argument for them to sustain, however, to suggest that employees – even foreigners -- should not be allowed to quit: If they were treated well, why would they leave?) It is important, therefore, that there be some transition to this period where employers have the opportunity to absorb why things in their workplace are as they are and how they are likely to change. Part of the transition should be to explain to them how to manage their workforce better and address issues like turnover.

Some countries, particularly Singapore and Hong Kong, go further to encourage employers to prefer local workers by charging a tax or levy on their use of expatriate workers, effectively raising the relative cost of such workers. The levy can be adjusted to labor market conditions. It is worth noting that Bahrain already has something like this arrangement in that the training levy is applied disproportionately to expatriate workers. It could be raised further to affect more significantly the relative cost of employing expatriates.

The government cannot get out of the business of managing the expatriate supply of labor, however. It has to somehow decide how many and what type of workers should be allowed in the country. The simplest solution is basically to keep the existing system, allow employers to continue to submit applications for labor permits based on their needs, and continue to assess whether those applicants have merit in the sense that there are not available workers in Bahrain. The difference here is simply that the expatriate workers will become free agents when they come into the country, and it is up to the employer to retain them. The government will consider these expatriates as part of the pool of workers that are available in deciding whether labor permits are needed. In the prior regime, the decision rule was simply whether Bahraini workers are available to do the job. Now the decision rule would be whether any workers – expatriates or Bahrainis – are available.

The difficult part of any reform effort in this area is to come up with criteria for deciding whether additional expatriate workers are justified in the economy and to make that decision separately for each type of job/skill set. The current process of ad hoc decisions requiring employers to have a minimum percentage of Bahrainis in their workforce before using expatriates is bitterly resented by employers and is certainly seen as burdensome by the international business community. The process of sending specific Bahraini applicants to the employer to make sure that no Bahrainis are qualified for the jobs puts the government in the business of being a labor supplier with the very difficult task of making matches between workers and jobs.

An alternative is simply to rely on labor market information to make those decisions. For a job such as electrician, the criteria might include the number of unemployed workers who claim to be electricians (here one can see another reason why having clear occupational credentials in the economy would help) as well as changes in the wage rates for electricians in the economy – stagnant wages, e.g., suggest no labor shortage. Such criteria require the ability by the government to measure developments in the labor market quickly. Further, this approach is only useful for jobs numerous enough to have real functioning labor markets, for broad occupations such as accountant. The good news is that most of the concern about expatriate workers centers on such jobs at the lower end of the labor market.

The more difficult decisions come where jobs are not so numerous, where there is no labor market information detailed enough to be useful. Here the government is still back in the position of making judgment calls about whether the required skills are truly unique and not available. If the jobs in question are really small in number, though, then the effects of making a mistake, at least on the economy as a whole, will not be so great: If too many expatriate ceramic glazing technicians are admitted, e.g., the oversupply affects only a handful of workers. The most difficult calls will be where the “skills” are organizational-specific knowledge – e.g., this worker has worked with us elsewhere, has worked on this particular machine already, etc. – and at the margin might be thought of as simply an attempt by the employer to avoid the kind of initial training or start-up costs that should be anticipated with any new hire. Fortunately, the number of jobs with truly idiosyncratic skills is likely to be a reasonably small part of the workforce.

What happens when an employer brings in an expatriate worker to handle a job that appears to be truly idiosyncratic in that no workers are available to do the job and that worker then quits? Should the employer be allowed to bring in another? The concern here is whether the employee quit because they were being managed poorly or because there are, in fact, competitors for these skills and that there is a market for them. If the job is truly unique and the worker's skills in that job are not useful elsewhere, then the fact that the worker chooses to quit and go elsewhere suggests that the management of the employee must really have been bad to have driven that worker away. It could also be that the job is not truly unique, that there are other competitors whose jobs require the same skills and that more are needed in the labor force. So judgment calls will be required here as well.

There are proposals afoot to manage the immigration process differently so that the government is not necessarily in the business of certifying which worker should be admitted but simply whether a worker should be admitted. Some other agency or perhaps even a non-governmental organization might then try to match workers with the firms needing to hire.

Specific recommendations:

1. Give expatriate workers the right to quit and seek employment elsewhere, possibly after some period of notice to their employer;
2. Create a system of national targets for the number of expatriate workers according to skills sets. This system requires a classification of jobs (it is easiest to use existing frameworks from other countries, such as ILO classifications). The targets will require some assessment of supply and demand in the labor market based on wage movements, e.g.
3. Within the Ministry of Labor, expand the competency to classify jobs according to skills, to track the state of the labor market, and to make judgment calls as to whether idiosyncratic skills are truly important for a firm's competitiveness.
4. Consider whether a levy on expatriate workers, perhaps through an extension of the existing training levy, is needed to shift the preferences of employers toward domestic workers.

The Regulation of the Employment Relationship:

Most governments find themselves involved in regulating the relationship between employers and employees in various ways. These include issues such as safety and occupational health in the workplace and terms and conditions of employment (e.g., hours of work, vacations, leaves of absence). The most fundamental topic, however, concerns employment itself, the rights of employees to quit and the rights of employers to dismiss employees. Few countries limit the rights of employees to quit a job – in part

because of questions of principle (to require employees to submit to an employment relationship is essentially to permit indentured servitude) and in part because of the difficulty of enforcement. But most do constrain the right of employers to terminate employees, in large measure because the decision to dismiss a worker has such profound consequences for that employee and his or her family.

The regulation of the right to dismiss employees therefore becomes an important topic for governments and a central issue in the law. Here the crucial distinction is between firing an employee for cause – malfeasance, crimes, and generally not performing their duties – and layoffs where their services are no longer needed. The former are obviously seen as at least largely a result of the employee’s own actions while the latter are clearly not. The distinction only matters, however, if there are different outcomes associated with the two forms of dismissal. One difference in consequences is just the reputation of the terminated employee and their subsequent employment opportunities. This difference matters much more for jobs where references are important, and here the system is at least partially self-enforcing. Employers who layoff workers through no fault of their own should be willing to provide references. Employers are less willing to do so for employees who have been dismissed for cause.

The important difference in consequences in most countries relates either to absolute prohibitions or limits on the ability to dismiss – uncommon for firings but typical for layoffs -- and to the demand for compensation from the employer – typically no compensation for fired employees but often some recompense for laid-off employees. Once this distinction is made, then important issues of enforcement are raised because the two parties to the relationship have incentives to be dishonest about the cause. The employer can avoid paying out compensation by claiming that the employee who was actually laid off was fired; similarly, the employee who was actually fired may have an incentive to argue that the employer actually had no need for them any more and was “firing” them to avoid compensation. Governments typically get involved in adjudicating these claims, and most (India and Egypt are examples) have special labor courts designed to provide quick and simple resolutions to them.

The restrictions on the ability to lay-off employees, either in the form of restraints or compensation, have become a topic of economic interest because they raise the fixed costs of employment, hindering the ability of firms to restructure and, more important, reducing the interest of employers in hiring. The debate on the relative labor market experience of Europe, where restraints on layoffs are significant, versus the U.S., where they are not, reflects the concern about the fixed costs of employment. The argument is that the U.S. has had much greater job growth because the fixed costs of employment are reduced. Europe, in contrast, has seen much lower levels of job growth but also lower layoffs. The unregulated sectors of their labor markets – temporary and part-time work in some countries -- have grown, however, as employers find ways to adjust their use of workers to changing conditions despite these regulations. There is little doubt that current employees benefit from restrictions on layoffs, there is also little doubt that employers at least believe that these restrictions are a burden on them, and, quite possibly, the job prospects of the unemployed are harmed by them as well.

The question, therefore, is how to balance the employee's understandable interest in protection from job loss and the employer's interest in having the flexibility to adjust their hiring to changing demand conditions. One way to do this that many countries have used is to compensate employees for layoffs, rather than restrict the layoffs per se, and then to try to separate the costs of that compensation somewhat from the current operating expenses of the employer. The question is how to do that.

Unemployment insurance benefits, which pay employees some income when they are laid-off, are typically the mechanism to compensate employees. (It is interesting that some developed countries like Singapore do not have unemployment benefits, perhaps because until now, they did not have much of an unemployment problem.) The trick is how to fund those benefits. A payroll or wage tax is usually the answer. One of the basic lessons from economics is that it is never clear to what extent the employee or the employer will ultimately pay for these taxes: A tax on payrolls "paid" by the employer may ultimately lead to a reduction of wages in slack labor markets, therefore the employee essentially pays for it; a tax on wages "paid" by the employee may lead to an offsetting increase in wages in tight labor markets, hence, the employer ultimately pays for it. To the extent that employers pay these taxes, they represent an increase in the costs of labor, albeit a cost that drops when workers are laid-off and payroll falls. These taxes then reduce the incentive to hire workers because they raise labor costs, but the disadvantages of that approach (some modest reduction in total employment) may be worth the gains of protecting workers. High payroll taxes have much the same effect on reducing incentives to hire workers

Variations in the tax rate across employers according to their use of layoffs, so-called "experience rating," is an additional refinement that assigns costs according to use of the benefits, providing something of an incentive for employers to avoid layoffs. It also avoids the situation where employers who do not lay off effectively subsidize those that do.

There is a concern that unemployment benefits will cause those who receive them to avoid getting another job, but this concern has not proved to be a major problem in practice. First, the willingness to search for a new job and to take one if offered are typically conditions for receiving these benefits, although this can be difficult to enforce. Second, the benefit levels are typically well below the income one had received from working, so it is difficult to maintain one's living standards for long while receiving these benefits. Further, having some financial cushion when unemployed can actually help the operation of the labor market by allowing the unemployed to spend some time searching for a job that best suits their abilities and skills.

Specific recommendations:

1. Allow employers to dismiss workers for poor performance where the criteria for poor performance are articulated clearly and the process that employers

- must follow to dismiss employees (e.g., written warnings in advance to employees whose performance is poor) is clear;
2. Allow employers to layoff workers subject to a series of constraints (e.g., advance notice of the layoffs);
 3. Provide unemployment benefits funded by a payroll tax to employees who are laid off. The exact form of the tax is to a policy decision based on national circumstances;
 4. Create a system of labor tribunals/labor courts to determine whether dismissals were truly for cause, in effect, to decide who should be eligibility for benefits (referring to #1 and #2 above);
 5. Think about providing best practice guidelines for employers who need to restructure. These might include alternatives to layoffs and best practices for minimizing the costs to employees where workers have to be laid-off;
 6. Require job-hunting skills training and possibly skill upgrading for those receiving unemployment benefits. Contract with the leading private providers of outplacement services at least initially to learn how to provide such training. Cut off benefits for those who refuse to search or to take acceptable jobs.

Helping the Low-Wage and the Unemployed:

Most countries believe that completely unregulated labor markets will generate outcomes for some disadvantaged people in the form of chronic unemployment and/or low wages that are unacceptable. The question is what, if anything, the government can do to help.

One explanation for the inability of some people to find and keep jobs or to receive decent wages if they find work is the limits on their own human capital. They lack the skills needed to find or keep jobs and are not worth much to employers if they do find jobs. The answer here is for governments to help these people raise their human capital, in part by doing a better and more thorough job of the regular education and training system and by providing remedial training and education for those who do not succeed the first time.

Most reasonable observers believe that this answer is not sufficient, however, and there are two additional alternatives. The first ties assistance to employment through active labor market policies, and the second lies outside of the labor market arena and is associated with traditional welfare programs. The active labor market programs are typically dominated by minimum wage policies which mandate that the employer pay anyone who works for them a reasonable, minimum wage. Most observers see this approach as at best imperfect. While it raises wages for some workers, it also means that jobs will be lost. Employers will eliminate those jobs that generate value below the level that can be sustained by the new, higher minimum wage. Eliminating low-wage jobs hurts the goal of expanding job opportunities for low-wage workers, and employers

dislike this approach, which they rightly see as pushing the problem of helping the poor onto them.¹

There are other alternatives for improving incomes for low wage workers without cutting low wage employment. Rather than prohibiting low wage jobs, these alternatives attempt to supplement it through various kinds of subsidies. The caution here is that these subsidies can also have perverse and unintended consequences if not designed with great care. For example, programs that subsidize employers to hire disadvantaged workers have great appeal in that they do encourage employers to give opportunities to these workers, but they may not per se generate new jobs, leading to charges that employers simply displace existing workers for the subsidized new ones. A less controversial approach is to subsidize the disadvantaged employees directly. Here the key principle is to reward work by giving subsidies when the recipients are working. Where countries have income taxes, for example, one popular approach is to actually reverse the taxes and transfer payments to these low-wage workers, the so-called “negative income tax.” The way it works is that employees receive a larger subsidy when their wages are very low. The subsidy declines if their wages rise, but they still receive something until their combined income from wages and subsidies rises above some subsistence level. The idea is to avoid the situation where a worker could end up worse off by earning more money because they would then lose their subsidy.

The other alternative is simply to deal with the problem of poverty by providing economic assistance directly to the poor – as long as one’s means are below a given income level, they receive some welfare benefit. The problem with this approach from a labor market perspective is that it may well reduce the incentive to find work: If I receive payments because I am poor, and I will lose those payments if work-related income causes me to no longer be poor, my incentive to find a job is greatly reduced. Most countries differentiate such payments based on whether one is unable to work versus those who potentially could work. The former receive something like disability payments, while latter often receive benefits tied to participation in job training programs. Some countries have found it necessary and useful to create or perhaps reserve a limited number of government jobs for those who are unable to find work through more traditional channels.

Specific Recommendations:

1. Work-related subsidies based on negative income tax model to raise living standards for those in low-wage jobs. The exact level of subsidies and the criteria for receiving them (e.g., differentiated by family status) are policy decisions.

¹ There has been a contentious debate in the U.S. around the impact of minimum wage laws on employment. The debate concerns whether recent mandatory increases in the size of minimum wages had a discernable, negative effect on employment levels – to what extent jobs were lost when minimum wages rise. The debate is not about whether introducing a minimum wage in the first place will cost jobs. No one seriously doubts that conclusion.

2. Training vouchers to offset some or all of the costs of vocational training for selected recipients, based on need. The vouchers are designed to be used with regular training providers, integrating the recipients into the mainstream training system and avoiding the stigma of a special “disadvantaged worker” training experience. Again, the decision as to who is eligible for them (e.g., based on length of unemployment, dislocation of previous jobs, etc.) are policy decisions.
3. Set up remedial employment skills courses for those who cannot find jobs and require participation in those programs in return for welfare-related benefits.