**Labor Market Distortions in Oil Rentier States: The Citizens' Income and Other Possible Solutions**

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**Background and Issues**

States with a high per capita hydrocarbon income like the monarchies of the Gulf Cooperation Council face inevitable political pressures to distribute the hydrocarbon rents among the population. The fact that money is distributed is less problematic than the way in which it is done, which has led to a number of perverse incentives for labor market and general consumption behavior among citizens in all of the GCC and, to a lesser extent, mid-rent countries like Algeria, Libya, or Venezuela.

Government energy pricing and public sector employment regimes incentivize over-consumption of precious oil and gas and price nationals out of the private labor market. In the Arab world, both problems have become more acute with the Arab uprisings, to which incumbent regimes have reacted with stepped-up subsidies and public employment, both of which are unsustainable given current demographic trends. A turnaround however will remain difficult as long as nationals continue to play only a marginal role in the private sector.

Against this background, this paper analyzes a number of alternative mechanisms of rent distribution that could be less distortionary and more conducive to private job generation for nationals. It will focus in particular on the "citizens' income" concept of unconditional cash grants for adult nationals that could be provided in lieu of other, more unequal, discretionary and distortive forms of subsidies and rent circulation.

**Structure and Methods**

**1. Introduction: Overview and Motivation**

**2. Objectives, Status Quo, and Implications**

**(i) Objectives**

The paper starts by mapping out general economic and developmental objectives that should guide the utilization of government resources, which are generally agreed in principle but often lost out of sight in practice.

<u>The key policy question:</u> How to distribute governmental rents in the least distortionary way, both statically and dynamically, in resource-rich developing countries while pursuing the three dominant policy objectives

<u>Basic and generally agreed policy objectives:</u>

(i) Long-run fiscal sustainability (in view of finite resources expected resources prices)

(ii) Autonomous growth path (i.e. technological progress and long-term independence of natural resources and migrant labor)

(iii) High welfare through continuous, efficient, and equal wealth distribution (i.e. less dependency on oil price, more bang for the buck, and more access to all)

**(ii) Status quo of rent distribution**

In addition to uncontroversial conventional development and public service spending (infrastructure, security, basic education and health services, etc.), a number of peculiarities characterize most rentier states' resource allocation relative to otherwise comparable non-rentiers:

- Over-employment of citizens in the public sector at wages above their marginal productivity
- Direct or indirect provision of energy to consumers and industry for free or below market prices or opportunity costs
- Free or subsidized public goods and services above international standards, including fully free health care, subsidized or free housing, free higher education, consumer and producer subsidies for specific goods and sectors

*An empirical illustration of the Saudi case*
The structure and broad scope of rent-financed subsidies in Saudi Arabia

- Public employment: benchmarking high-rent countries against non-oil developing and developed countries
- Underpricing of public services and domestic energy: opportunity costs
- Expatriate labor markets as means to address Dutch disease and as a source of private rent: estimates

**(iii) The economic implications**

The economic implications of the status quo of rent distribution are comparable in all developing world rentier economies and result in an inconsistency of current wealth distribution with all of the three objectives outlined above – fiscal sustainability, autonomous growth path, and better wealth distribution – and unsolvable tensions among them.  The paper will offer a short summary for each of them.

Basic to all economic implications are the labor market distortions that the current subsidy approach introduces to the national labor force which will be highlighted specifically with regard to

- Educational choices
- Public employment preferences and queuing
- Private sector wage and productivity gaps to foreign workers

**3.  Investigating Alternative Approaches: The Citizens' Income Compared**

Realistically speaking, some distribution of rents to the population has to happen. At least in the short run, a reasonable level of citizens' welfare is not realistic just on the basis of a free private labor market, even if migration levels are reduced. Beyond this, there arguably is a moral imperative that some of the national wealth should be shared – at least on a level that would guarantee a permanent income stream – independent of existing welfare levels. How much welfare to provide through rent distribution is also a moral and political decision that economic optimality considerations alone cannot solve. Economics comes in when deciding *how* to distribute however. The paper discusses the citizens' income concept as a complement and/or substitute to the above channels of rent distribution, and its putative effects on all three above objectives

**(i) Introducing the "citizens' income" concept**

- What is a "citizen's income"?
- How is it expected to avoid the above problems/able to contribute to the three objectives?
- The "basic income" debate in the OECD and the concept's unique applicability in the GCC context – a brief literature review

**(ii) Micro-economic and labor market implications of a citizen's income**
The static and dynamic impact on the three above-mentioned objectives will be analyzed relative to

- A stylized status quo
- A hypothetical "brutal austerity" scenario without any distribution of rents to citizens

- conventional (means-tested) welfare measures, and
- conditional subsidies for the private employment of citizens

Specific micro-dimensions to be analysed for the different scenarios include the impact on educational choices, job seeking behaviour and reservation wages, time allocation on the job, and productivity. Macro-level dimensions to be analysed include aggregate employment (public vs. private, expatriate vs. local), output and sectoral productivity outcomes.

**(iii) Design and implementation issues**
If a citizens' income approach were to be selected in the GCC countries there would be a number of detailed design issues to be addressed for which good questions and answers are still outstanding, i.e.

- Eligibility (age of access, treatment of families, initial exclusion of civil servants, etc)
- Benefit (level, form and frequency of payment; hypothetical clawing back with income tax that does not yet exist, etc.)
- Administration (implementing agency, transition scenarios)

**(iv) The fiscal dimension of citizens' income**
with focus on three issues

- Scope and development relative to the status quo (including long term demography and employment scenarios)
- Source of the CI, i.e. from current hydrocarbon income or from dedicated investment funds that convert underground hydrocarbon wealth into permanent income
- Scenarios with various counterfactuals, such as substitution of vs. complementing public employment and other subsidies, or substitution of vs. complementing social security tools

**(v) A discussion of the known unknowns**

- Size effects on the labor market (i.e. activation et al.)
- Effects on social behavior more generally (i.e. motivation et al.)
- Others (such as effects on other distributional pressures, potential inflationary effects, etc)

**4. Conclusions**

- Summary of findings, including open research questions to guide policy design
- Building political support for unconditional cash grants
- Next steps, e.g. options for piloting CI through a small, randomized experiment

**ANNEX:** Existing cases of direct resource distribution in rentier states

- Iran's family cash grants
- Alaska's permanent fund dividend
- Bolivia's renta dignidad