COMPENSATION AND BENEFITS TRENDS IN THE MIDDLE EAST

OVERVIEW OF POLITICAL AND ECONOMIC TRENDS IN THE MIDDLE EAST

Our definition of the Middle East experiences some subtle variations year after year, although the Arabian Peninsula always constitutes the focal point. For example, this year we have left out Syria but have included Iran and Iraq. Egypt is covered within the Africa region, while Israel is discussed together with Europe for political reasons. What is certain is that we are talking about a large land mass roughly the size of Western Europe, with a total population of 170 million.

Change and instability are constant in the region. If we briefly review the past year, continued tensions with Iran, foreign embassy closures in Yemen, and the Syrian conflict have affected neighbouring countries, especially Lebanon. Furthermore, we have seen an increase of the "nationalisation" theme. Saudi Arabia, for example, recently cracked down on illegal workers, and 1 million foreign workers were deported from the country virtually overnight.

There has been some positive buzz: Qatar and the United Arab Emirates (UAE) are both boosting their economies with the 2022 World Cup and World Expo bid in 2020, respectively. However, in view of the political situation and instability in the region, it is fair to say that its economies and labour markets remain very volatile. The terms of comparison between countries in the region are also very uneven. If we look at population size and GDP, we instantly remark that Saudi Arabia and Iran are huge economies compared with all the others. Iraq has the second largest population, but its economy is not doing particularly well. UAE may have a good outlook and a high GDP, proportionally speaking, but it is a tiny economy. It remains a hub for foreign nationals, mostly in the service industry, but has very little production of its own.

If we compare Middle Eastern countries with Western economies, salaries are a few percentage points higher in the former (around 7% higher on average), reflecting the higher rate of inflation. GDP growth is also higher — not quite the low double-digit growth we witnessed a few years ago, but nevertheless, brisker growth (5%–6%) than more established economies. Unemployment figures are similar between countries in the region, with the exception of Lebanon, which has always had extremely high unemployment rates and a consequently high rate of emigration.

Next, if we consider the Mercer Cost of Living (COL) index for March 2013 (which uses New York City as the standard), Dubai and Abu Dhabi are quite close to the baseline, while Jeddah, Doha, and Riyadh are significantly lower, even though anecdotal evidence suggests otherwise. The Mercer survey looks at a consistent basket of goods — 200 goods that the expat population would purchase on a regular basis. That is why Amman and Beirut are quite high up on the index — because the availability of Western goods is quite low in those cities. European and Asian hub cities tend to have much higher costs of living, so the Middle East compares favourably to most European or US cities.

Despite the general perception of overdependence on the expat workforce in the Gulf Cooperation Council (GCC) countries, figures indicate that Saudi Arabia and Oman are up to 70% reliant on the local workforce, while in Kuwait and Bahrain the figure is about 50%. It is only in Qatar and UAE that the labour markets are dominated by the expat population (more than 80%).

Finally, the perception of extreme oil dependency is also increasingly false. Although Kuwait and Qatar derive more than 50% of their GDP from oil and gas, in Oman and Saudi Arabia the figure drops to around 50%, while UAE and Bahrain are lowering their percentages to just 30%. Year on year, this component of GDP has been decreasing as these countries try to diversify their economies through government expenditure or by attracting other sectors. They are keenly aware that they need to make sure they have assets in other industries when the oil runs out.

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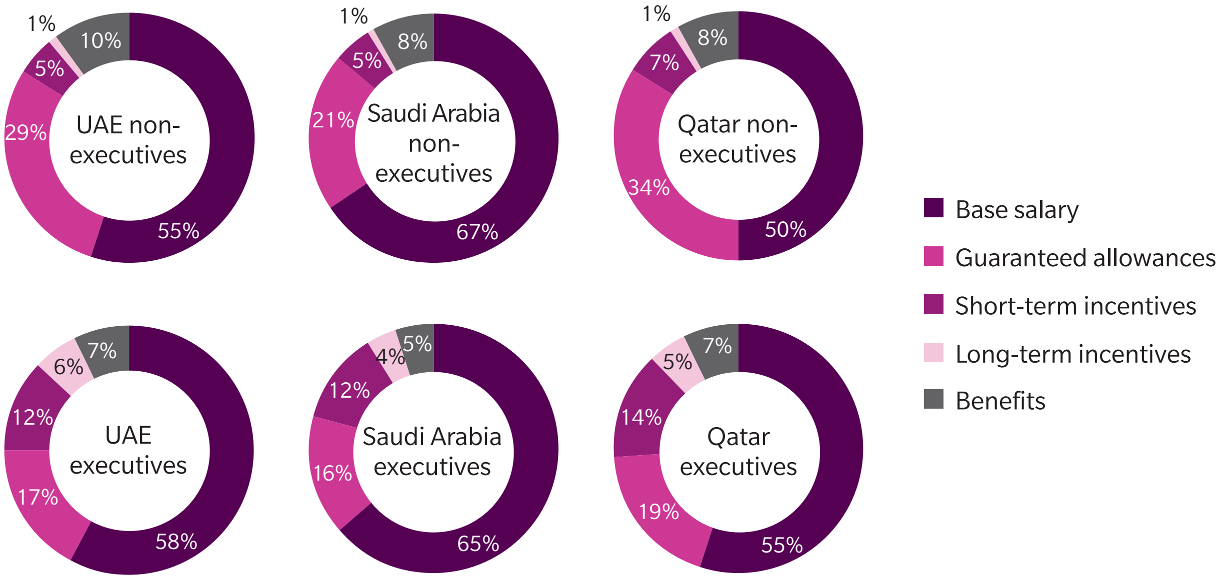
Companies in the GCC region like to maintain the belief that their annual salary increases over the past three to four years have remained constant at 5%, and they are not far off the mark, although Saudi Arabia is closer to 6%. In the Levant region, where economies are less developed, salary increases run at 6%–7%, while Iran's 25% increases can barely keep up with inflation. This is the first time that Mercer is conducting Total Remuneration Surveys in Iran, Iraq, and Lebanon, so we have no historical data to establish patterns or trends at this point.

Labour markets in the region present extreme complexities. Overall, the workforce is dominated by expats, who typically have different spending patterns and salary practices. Furthermore, the employer sponsorship system makes it difficult for expats to change jobs. Because of the lack of retirement plans, companies use end-of-service benefits (all of which have different calculation mechanisms but are linked to the base salary), and this has resulted in an extremely generous suite of allowances for the region. Locals are often on packages very similar to the expat packages (what is known as the "local plus" structure) — a tradition that is difficult to change. Two other factors that make labour markets in the region quite unique are the tax-free income environment and the government-led nationalisation drive.

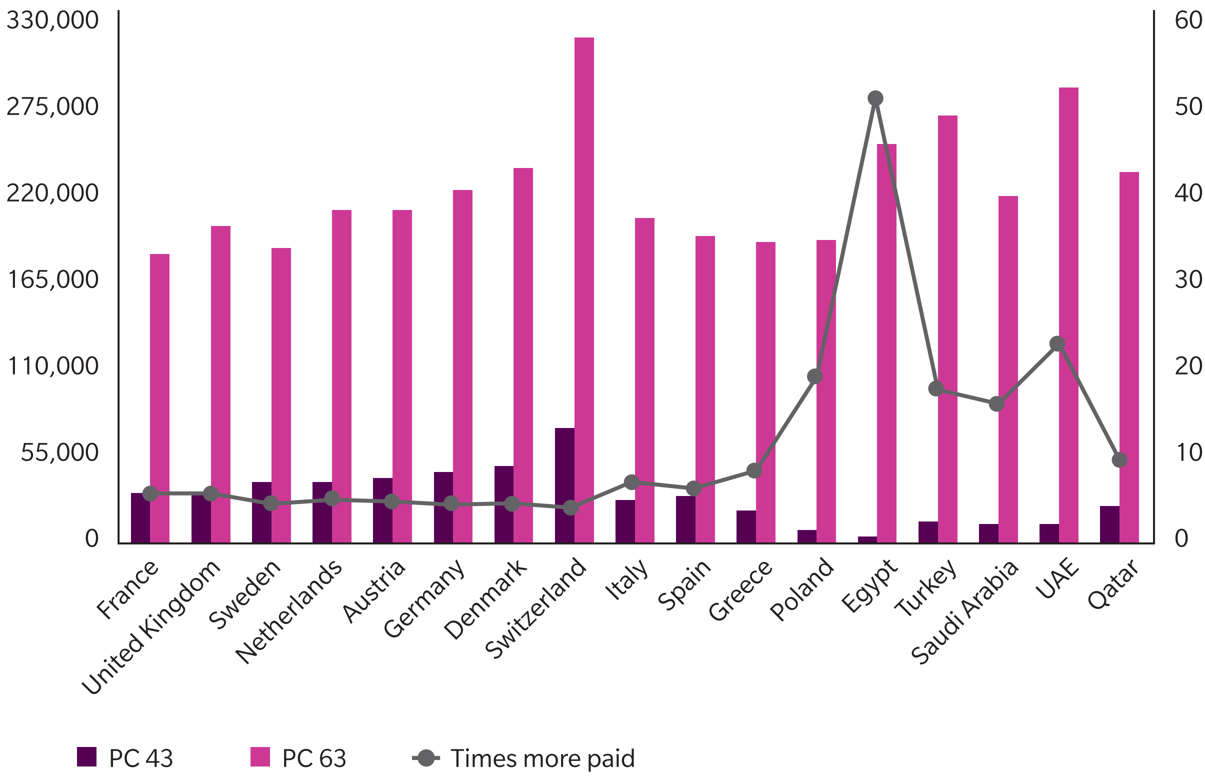
Figure 1
Total Remuneration Mix — Country Comparison



Percentages in graphs may not total 100% due to rounding.

Compensation packages are split in quite similar ways across the GCC countries. Base salary makes up 55%–65% of the total, guaranteed allowances (such as housing and transport) cover 20%–30%, benefits account for 10%, and short-term incentives for 5%. Variable pay is still not widely used in the region, and long-term incentives (such as stock options) barely enter into the mix. In UAE, the long-term incentive mechanism with the biggest growth is a deferred cash bonus.

Figure 2
Salary Differences — Annual Base Salary, PC 43 vs. 63 (USD)



Source: Mercer Total Remuneration Surveys, 2012

A base salary comparison across all pay levels shows considerable consistency across the region, with Saudi Arabia only slightly lower than Qatar and UAE. When we compare 2012 net base salaries worldwide, UAE is the highest-paying market for upper-middle managers, followed by Switzerland in second place and Saudi Arabia in third.

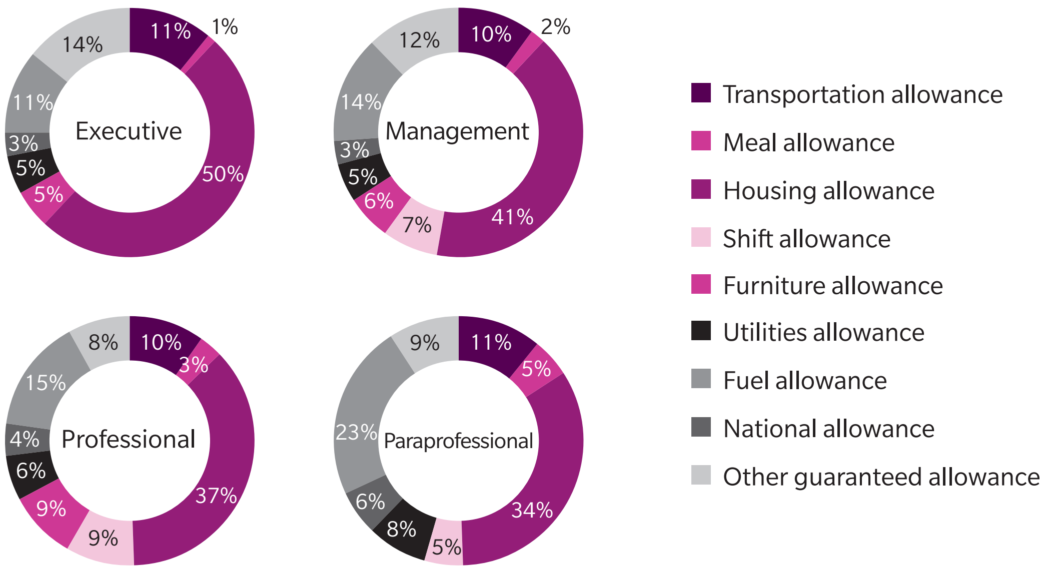
Comparing salary increases across industries, we notice that although most stay within the desired 5%–5.3% range, some industries, such as services and hi-tech, fall below that range. We could speculate that the hi-tech industry has traditionally been one of the highest-paid so it is ahead of the curve and is currently slowing salary increases.

The salary ratios of mid-level executives and lower positions is an increasingly popular topic in the European press, but it is an unfair comparison in the Middle East, as the lower positions are typically paid far less than in Western countries.

If we compare the total value of guaranteed allowances across different professional levels for Saudi Arabia, Qatar, and UAE, we notice that allowances in Saudi Arabia are lower, reflecting the lower housing costs in that country. Of the huge diversity of allowances, Mercer covers the eight most commonly found: transportation, meal, shift, fuel, furniture, housing, national (for the local population), and utilities. All these allowances make compensation very complex to manage and even administer — payrolls with 100 line items are not uncommon. Housing and transportation are the most prevalent and most generous allowances.

Figure 3

Mix of Allowances by Career Stream (Multiple Allowances Are Still Prevalent in UAE/GCC)



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Companies are trying to bundle allowances under a single name: a cost-of-living allowance with no clear split between different components. In the long run, bundling allowances is certainly the right move for most organisations, because it simplifies the process of defending the accuracy of amounts given. However, communication is key in this area, as employees may feel that they are losing out on some of their allowances. It may take a generation to change perceptions about these distinct allowances, as it is such an ingrained historical benefit. However, because of the end-of-service benefit, these allowances will stay outside the base salary for the foreseeable future.

CONTROVERSIAL TOPICS

HOUSING

Housing costs have increased across the whole region (at an average of around 18%), while housing allowances have not kept pace (increasing at a rate of only 8%). In some cases, it is a matter of perception — for example, in UAE, accommodation costs dropped dramatically in 2009 and remain below the maximum 2008 level, but expats now expect a higher quality of housing in that country. This is a hotly contested topic, and it will be interesting to see how Qatar fared in the COL index this year in light of reduced housing allowances.

SCHOOLING

Schooling is classed as a benefit rather than a guaranteed cash allowance. Seventy to eighty percent of companies provide a schooling benefit; the most common practice is to offer a reimbursement or a cash allowance per dependent child. This allowance is usually intended to partially cover education costs (commonly 75% of tuition costs). Because private schools are the only option in the region, costs will keep rising. Allowances have not increased, however, and in UAE they have remained flat.

MEDICAL COSTS

Medical expenses is another area where costs continue to rise; costs have increased 20% in the last year alone. Private medical insurance is compulsory in many countries. Companies feel that medical benefits are very generous and are consequently misused. Patients are relying too heavily on doctors; doctors are prescribing more than they need to. Companies are seeking to understand how to optimise health plans, perhaps by reducing certain coverages that do not have high usage rates. Some companies are considering a move to flex benefits (basic coverage with top-up options); however, this is still in the early stages of development, as there are no tax benefits in place.

NATIONALISATION

The Middle East is bucking the international trend regarding population growth. The populations of countries in the region are not ageing as rapidly as in Western countries. On the contrary, four times as many young nationals are estimated to enter the labour market over the next 10 years as in Western economies. We expect to see much more legislation around expat worker quotas and other forms of nationalisation regulation. Expectations are that the regulations will take the form of a kind of indirect tax — companies will either have to pay unemployment benefits to young people or employ a certain percentage of locals.

Unemployment is certainly becoming a matter of concern — Saudi Arabia's unemployment rate currently stands at 10%. Furthermore, according to research that Mercer conducted jointly with the World Economic Forum, only 20% of employers in the Middle East believe that their education system adequately equips staff with the necessary workplace skills. The preferred option for the local workforce has been to take government jobs, but in the long term there will not be enough government jobs for all. Organisations operating in this region will need to develop strategies to deal with this increase in local labour.

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