Financial Market Development and Employment Nexus in Saudi Arabia

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Abstract
Financial Market Development (FMD) could play a great role in economic growth and employment generation. This research has investigated the FMD and employment nexus in Saudi Arabia by employing ARDL cointegration on a period 1980-2015. In the long run, we have found the positive impact of FMD, Saudization and investment on employment. Human Capital Index (HCI) is found insignificant in employment generation and remittance outflows have negative influence on employment. We recommend the government of Saudi Arabia to promote and to relax the economic environment for general and financial investment in the Kingdom. Further, Saudization may also need further attention as it creates pleasant impact on employment.

Key Words: Employment; Financial Market Development; Cointegration
JEL: E23; O16; C12

1. Introduction

The FMD is very necessary for the economic activities and employment of any country. Financial market provide finance / credit to economic activities particularly which support the investment and employment level in any economy. But, crisis in the financial market can be responsible for mass unemployment. It is evidence from the financial crisis of 2008. In which, unemployment rate has even been touched the 10% of total labour force in USA due to financial crisis and credit contraction. It is due to a reason that employer are not able to raise funds during financial crisis.

Therefore, they reduce their investment and consequently reduce the demand for labour.

On the other hand, more and cheaper credit availability are encouraging the investors to invest more in business ventures and consequently demand for labour and employment could be increased. Therefore, FMD can support the employment level in any country by providing the loans and liquidity to business sector for greater economic activities. Further, modernization of financial services are also increasing further demand for financial sector. Without financial sector, the growth of business sector cannot be enhanced in the presence of modern development in monetary variables. For example, plastic money have been replaced the most of cash transaction in this modern age and without financial services, these kinds of activities could not be happened. Hence business growth and employment growth could be restricted in absent of FMD. Otherwise, FMD can accelerate the investments and economic growth level and resultantly, may have pleasant impacts on the employment. Aside from the debates on the relationship between FMD, investment and employment, financial sector helps in raising the overall aggregate demand in the economy through financing consumption, government spending and exports along with investments. More aggregate demand means more economic activities and more demand for further investment which is not possible without labour. Therefore, FMD is helpful in raising the cyclical employment directly and indirectly by supporting the aggregate demand and investment through financing.

In Saudi Arabia, financial sector is growing at very faster rate due to demand for modernization in financial sector, due to diversification policy of government and due to a recent liberalized banking policy of Saudi Arabian Monetary Agency (SAMA). In the banking sector particularly, twenty-four banks are operating in the Kingdom with thirteen local banks and eleven foreign banks. Banking sector is further growing at 12.3% to 12.6% during 2012 and 2014 due to a relaxed and friendly banking policy of SAMA for private sector and further due to increasing demand for financial sector among increasing population in the Kingdom. But, growth rate of financial market suddenly falls to 3.6% in 2015 which is in lined with oil price crisis of 2014. Further, insurance sector is also very faster growing sector in the Kingdom with thirty-five insurance companies working presently. Insurance sector is allowed to work and expand their business according to the Sharia law i.e. insurance on the model of Takaful which is clean out of interest and gambling practices. Further, insurance sector growth rate has been observed at rising even after oil price crisis of 2014 (SAMA, 2016).

Based on the discussion of FMD and employment nexus and condition of financial market Saudi Arabia, this present is aimed at finding the empirical connection between FMD and employment in Saudi Arabia. According to our literature survey, there is no single study which investigates this relationship in Saudi Arabia. Therefore, we are going to fill the literature gap by using a period of 1980-2015.

2. Literature Review

There is huge theoretical and empirical literature available in the relationship of FMD and un/employment issue. In the theoretical debates, Sharpe (1994) argues that financial distress is responsible for major business cycles and hence for cyclical

unemployment. He claims that firms' bankruptcy and financial leverage are majorly responsible for firms' operating behaviour and efficiency. He investigates this issue by using data of 1959-1985. He finds that business cycle and unemployment are closely depending on the firms' leverage and financial conditions as well in the small size firms. Therefore, small firms has to face the higher hiring and firing cost with cyclical trend of employment. Acemoglu (2001) argues that capital market weakness are majorly responsible for unemployment in Europe. He claims that technologies changes requires to invest in the new firms and efficient financial market in US is facilitating the firms and employment. On the other hand, inefficient financial market of Europe is responsible for high unemployment. Monacelli et al. (2011) argues that financial markets are very important in determining the employment. They explain that higher debt of firms are influencing the firms to bargain lower wages in time of financial crisis. Therefore, financial or credit shocks are responsible for long lasting fluctuation in employment.

In the empirical literature, Shabbir et al. (2011) investigate the role of FMD on unemployment in Pakistan by using a data of 1973-2007. They find that money supply has negative impact on employment rate. Further, FMD has pleasant impact on employment in short and long runs. Furthermore, FMD is also causing to the employment rates. Ilo (2015) investigates the influence of capital market on unemployment in Nigeria by using a period of 1968-2012. He finds that capital market is not supporting to the employments levels when economic growth is not supported by capital market. It means that economic growth is an essential requirement in the model to conclude a positive influence of FMD on employment. Rault and Vaubourg (2012) investigate the role of finance in determining the unemployment through labour market institutions by using data of eighteen OECD countries for a period 1980-2004. In causality analysis, they find that eight out of eighteen countries' employment are affected by finance.

Aliero et al. (2013) investigate the FMD and unemployment nexus in Nigeria by using a data of 1980-2011. They find that credit allocation in the rural sector has been found helpful in reducing youth unemployment. Further, they recommend to support the financial sector to control the youth unemployment. Feldmann (2011) investigates the financial stress and unemployment nexus in seventeen industrial countries by using a period 1982-2003. He finds that financial market extents a minute effect on the unemployment. However, banking and foreign exchange sector stresses are topping the unemployment at greater pace. Choudhary et al. (2012) investigate the different proxies of financial crisis on youth unemployment using a macro panel of seventy countries and a period of 1980-2005. They find that lags of financial crisis hit the youth unemployment more adversely than that of overall unemployment. They also report that present financial crisis has been affected the youth unemployment in the next five years than the year of crisis. Moreover, second and third years are found more adverse in the financial crisis effect of youth unemployment. Bayar (2016) investigates the FMD and unemployment nexus in sixteen emerging economies by using a period 2001-2014. They find a significantly pleasant impact of domestic investment on unemployment but FMD could not show any significant impact on unemployment in the long run analysis. Although, FMD causes to the unemployment in the causality analysis.

In conclusion of literature survey, we can find the deep connection of FMD and un/employment in the world literature. But, this relationship has not been tested in the Saudi Arabia. Therefore, this is our very first effort toward this issue and we can claim for an empirical contribution in the Saudi literature.

3. Methodology

3.1 Model

The major objective of our research is to investigate the influence of FMD on the employment in Saudi Arabia. For this purpose, we are hypothesizing the FMD, remittances outflows, human capital index and investment as determinants of employment. Our hypothesized model is as follows:

$$\log EMP_t = f\ (\log FMD_t, \log REMOUT_t, SAUDIZATION_t, \log HCI_t, \log INV_t) \qquad (1)$$

$\log EMP_t$ is log of employed labour and $\log FMD_t$ is log of ratio of total credit to GDP a proxy for FMD. Further, $\log REMOUT_t$ is log of remittances outflows from Saudi Arabia in million riyals and $SAUDIZATION_t$ is a dummy variable which carried 1 after start of Saudization since 1985 and zero otherwise. $\log INV_t$ is log of gross capital formation in million riyals and $\log HCI_t$ is log of human capital index. All data except HCI is sourced from SAMA (2016). HCI is taken from Federal Reserve Bank of St. Louis.

3.2 Hypotheses

H_1: Greater the FMD, greater the employment

FMD means more credit to the economy as per proxy variable used. But, generally, financial market plays a great role in supporting the economic activities i.e. providing loans, performing business transactions and many other tasks performed by financial sector to support economic growth. At first, financial sector is directly providing a lot of financial job to labour so it directly enhances the employment. Further, greater FMD is a sign of greater economic activities and greater aggregate demand. For example, FMD is supporting to the consumption i.e. car and house finance, to the direct and indirect investments, to the government by providing loans and to facilitate the exports activities. Other than these discussed activities, a smooth running of economy or a business life is not possible without financial markets. Therefore, FMD is supposed to be positively contributing in the economic activities, aggregate demand and employment. Financial market is growing at faster pace because of diversification target of Saudi government in her "Vision 2030". Therefore, this faster growing FMD is expected to contribute positively in the employment generation in Saudi Arabia. Further, the pleasant theoretical linkages of FMD and un/employment has been argued by Sharpe (1994), Acemoglu (2001) and Monacelli (2011). Furthermore, the empirical findings of pleasant impact of FMD on un/employment has been reported by Shabbir et al. (2011), Aliero et al. (2013), Feldmann (2011), Choudhary et al. (2012). But insignificant impact of FMD on unemployment has also been reported by Bayar (2016). Therefore, the relationship between FMD and employment is an empirical question but we are hypothesizing this relationship as positive based on

theoretical arguments and based on mostly positive influence of FMD on employment in the findings of empirical studies.

H₂: Greater the remittances outflows, lesser the employment

More than 30% of Saudi population and more than 60% of total labour are comprising of expatriates in the Saudi Arabia. Therefore, a large remittances outflows has been observed from the Kingdom i.e. 5.6% of GDP has been outflowed in term of remittances in a year 2015. Remittances outflows are playing a negative role in the economic activities of any country as these are major leakages from circular flow of income in any country. Resultantly, aggregate demand can be lower than the aggregate supply which may become a major reason for lower employment level. Therefore, we are hypothesizing that remittances outflows could have negative influence on employment level in Saudi Arabia.

H₃: Greater the Saudization, greater the employment

Saudization means the replacement of expats labour with Saudi national labour. This policy has been initiated in the 4th developmental plan of Saudi Arabia commenced since 1985. This policy has been adopted to reduce the competition for Saudi labour in acquiring jobs as approximately 85% of labour force in private sector and 60% of total labour force are expatriates. On the other hand, Saudi labour participation in public sector is around 90% which is also reflecting the Saudization policy in Kingdom. Now-a-days, government of Saudi Arabia is targeting to increase the proportion of Saudi labour from 40% to 65% in total labour force in her "Vision 2030". Public sector has also been targeted to employ Saudi labour up to maximum level i.e. 100% in "Vision 2020". Saudization policy is expected to create more job opportunities and more employment as most of unemployment is found among the Saudi labour in the Kingdom. Saudization policy can furtehr enhance employment opportunities through rise in aggregate demand due to rise in income and employment level of Saudi labour. Marginal Propensy of Consume (MPC) of Saudi labour is greater than the MPC of expatriate labour as expats are usually transferring their major income in mother countries. Further, Saudi average wage is also observed high and more than double than that of expatriate labour's wage. Therefore, Saudization policy is expected to increase the aggregate demand and employment level at aggregate level and our study is also hypothesizing a positive influence of Saudization on employment.

H₄: Greater the HCI, greater the employment

HCI reflects the educational quality of a labour and definitely a more educated labour has more chance of employment if education is targeted to fill the gap of labour market. In Saudi Arabia, education sector is attracting a major proportion of government spending now-a-days. Therefore, HCI is expected to have a positive contribution in the employment.

H₅: Greater the investment, greater the employment

Investments either in public or private sector play a major role in determining the employment. Because, labour is major ingredient in the production process along with

capital or machine. Therefore, higher investment does means higher demand for labour as well. Further, investment is direct component of aggregate demand and higher aggregate demand with higher investment can definitely support the employment. One argument can be claimed that if investment is done in the capital-intensive technology then it could have adverse impact on employment as most of investments in Saudi Arabia are also f capital intensive in nature. This argument can be valid if labour is replace by machine in the currently working production processes. But, it is not a very valid argument as even in capital intensive investment, labour is further required. Therefore, we are hypothesizing a positive impact of investment in employment generation.

3.3 Estimation Strategy

Before starting the regression on our equation 1. We should test each series in analysis for a unit root problem. For this purpose, we are using very efficient test recommended by Ng and Perron (2001). It is providing the efficient test statistic than that of Phillip-Perron test and it also utilizes the detrended data for unit root analyses as:

$$MZ_{\alpha}^{d} = (T^{-1}(y_{T}^{d})^{2} - f_{0})/2k \qquad (2)$$

Where y_t^d is showing the detrended form of our variable. This statistic is even provided efficient results in case of small sample. There are further 3 statistics which are available to verify the stationarity on a H_0: unit root problem. A rejection of H_0 will ensure the stationarity of data. For long run estimation, we are following ARDL procedure originated by Pesaran et al. (2001). ARDL for our employment model in equation 1 is as follows:

$$\Delta \log EMP_t = \phi_0 + \phi_1 \log EMP_{t-1} + \phi_2 \log FMD_{t-1} + \phi_3 \log REMOUT_{t-1} + \phi_4 SAUDIZATION_{t-1}$$

$$+ \phi_5 \log HCI_{t-1} + \phi_6 \log INV_{t-1} + \sum_{i=1}^{m} \beta_{1i} \Delta \log EMP_{t-i} + \sum_{i=0}^{m} \beta_{2i} \Delta \log FMD_{t-1}$$

$$+ \sum_{i=0}^{m} \beta_{3i} \Delta \log REMOUT_{t-1} + \sum_{i=0}^{m} \beta_{4i} \Delta \log HCI_{t-1} + + \sum_{i=0}^{m} \beta_{4i} \Delta \log INV_{t-1} + \varepsilon_t$$

$$(3)$$

Long run relationship in equation 1 can be claimed, from ARDL model chosen by AIC, if F-value from bound testing procedure is exceed the critical upper bound F-value produced by Pesaran et al. (2001) on a H_0: $\phi_1 = \phi_2 = \phi_3 = \phi_4 = \phi_5 = \phi_6 = 0$. Afterwards, we can find the long run impact of FMD, remittances outflows, Saudization, HCI and investment on employment by normalizing the coefficients through $\phi_2 = \phi_1$, $\phi_3 = \phi_1$, $\phi_4 = \phi_1$, $\phi_5 = \phi_1$ and $\phi_6 = \phi_1$ respectively. Further, ECM can be proposed for short run relationships in our ARDL model in following way:

$$\Delta \log EMP_t = \sum_{i=1}^{m} \theta_{1i} \Delta \log EMP_{t-i} + \sum_{i=0}^{m} \theta_{2i} \Delta \log FMD_{t-1} + \sum_{i=0}^{m} \theta_{3i} \Delta \log REMOUT_{t-1}$$

$$+ \sum_{i=0}^{m} \theta_{4i} \Delta \log HCI_{t-1} + \sum_{i=0}^{m} \theta_{5i} \Delta \log INV_{t-1} + \theta_6 ECT_{t-1} + \zeta_t$$

$$(4)$$

Here, a negative sign of θ_6 with statistically significant coefficient can be considered as a proof for short run relationship in our model. Further, the short run effects of respective variables can be explained from the estimated parameters of differenced variables.

4. Data Analyses and Discussions

Table 1 shows Ng-Perron test results with four statistic. Results show that all variables, except logHCI$_t$, are non-stationary at level. logHCI$_t$ is stationary at level at 1%. Further, all variables are stationary after their first differences. Hence, there is a mix order of integration with level and first difference stationary. But, we can go forward for cointegration as ARDL is efficient in this situation as well.

Table 1: Unit Root Tests

Variable	MZa	MZt	MSB	MPT
logEMP$_t$	-0.2774	-0.3723	1.3419	32.8212
logFMD$_t$	-7.0564	-1.8784	0.2662	12.9138
logREMOUT$_t$	-9.5455	-2.1817	0.2285	9.5586
logHCI$_t$	-57.3346***	-5.3162***	0.0927***	1.7663***
logINV$_t$	-7.6323	-1.7950	0.2352	12.2752
ΔlogEMP$_t$	-15.2451*	-2.7254*	0.1795*	6.6541*
ΔlogFMD$_t$	-16.2308*	-2.8487*	0.1755*	5.6148*
ΔlogREMOUT$_t$	-14.8482*	-2.6322*	0.1771*	6.6154*
ΔlogINV$_t$	-16.2875*	-2.7999*	0.1719*	5.9117*

Note: *, ** and *** showing stationary at 10%, 5% and 1%. () contains lag lengths.

Table 2 represents the ARDL results. FMD creates a positive influence on the employment in Saudi Arabia in long run with elasticity coefficient = 0.3519. This is confirming the validity of our H$_1$ and one percent increase in FMD is supporting 0.35% employment in the Kingdom. Therefore, we can claim that FMD is supporting the economic activities and aggregate demand components in Saudi Arabia by performing the sufficient financial service to the Kingdom. Resultantly, employment are supported by the higher economic activities. Further, financial sector is also directly providing a lot of jobs to labour and is supporting the employment. This pleasant influence of FMD on employment is also corroborated by the findings of Shabbir et al. (2011), Aliero et al. (2013), Feldmann (2011), Choudhary et al. (2012). Further, our second hypothesis H$_2$ is also buoyed with significant coefficient of logREMOUT$_t$ and one percent increase in remittances outflows are responsible for 0.75% decrease in employment. This is a very heavy shock to employment level in the Kingdom due to remittances outflows. We have discussed, in detail, the reason for this negative and strong impact. For example, expatriates are remitting 5.6% of GDP of Saudi Arabia to their countries which is a heavy shock to aggregate demand in Saudi Arabia. Therefore, remittances outflows are majorly responsible for declining employment level. The hypothesis H$_3$ is validated with a positive and significant coefficient of Saudization = 0.5172. This is showing that government policy to support the Saudi labour is remained helpful in raising employment level in the Kingdom. It is also showing that further Saudization as targeted in government's

"Vision 2030" would be helpful in raising employment level in the Kingdom. As discussed in relationship of remittances outflows that expatriate labour is transferring a major income to mother countries so they are not supporting aggregate demand in the Kingdom. On the other hand, Saudi employed labour is spending all of thier income in the Kingdom majorly and further their MPC is also more than more than MPC of expatriates. Therefore, Saudization is supporting the employment in a great amount as one unit increase in Saudization brings 0.52% employment in the Kingdom. Our estimates do not confirm the forth hypothesis as coefficient of $\log HCI_t$ is insignificant. It convey a message that human capital in Saudi Arabia is not strong enough to support the employment. Lastly, we achieve the validity of our H_5 by a positive and significant coefficient of $\log INV_t$. Investment is a major component of aggregate demand and it plays multiplier effect on the income and on the components of income. Therefore, increasing investments are found pleasant for employment level. But, lower elasticity (0.03) is showing that investment is playing a minute positive role in determining employment. Further, this result also validate our argument that most of investments in Kingdom are of capital intensive nature and therefore, it has minute effect on the employment.

Table 2: Regression Results

Long Run Estimates			
Variables	**Coefficients**	**t-value**	**p-value**
$\log FMD_t$	0.3519	4.5446	0.0452
$\log REMOUT_t$	-0.7533	-7.3540	0.0180
$SAUDIZATION_t$	0.5172	9.6002	0.0107
$\log HCI_t$	-0.0418	-0.5445	0.6406
$\log INV_t$	0.03146	7.5932	0.0169
Intercept	12.8216	14.0382	0.0050
Short Run Estimates			
$\Delta \log EMP_{t-1}$	-3.0325	-4.3866	0.0482
$\Delta \log EMP_{t-2}$	-3.1026	-4.6174	0.0438
$\Delta \log EMP_{t-3}$	-2.4701	-5.2887	0.0339
$\Delta \log FMD_t$	0.0057	0.0271	0.9808
$\Delta \log FMD_{t-1}$	-0.0913	-0.7430	0.5349
$\Delta \log FMD_{t-2}$	0.2163	1.9066	0.1968
$\Delta \log FMD_{t-3}$	1.0277	4.0195	0.0567
$\Delta \log REMOUT_t$	0.6354	2.1559	0.1638
$\Delta \log REMOUT_{t-1}$	-0.2987	-1.953	0.1900
$\Delta \log REMOUT_{t-2}$	0.4601	3.8139	0.0624
$\Delta \log REMOUT_{t-3}$	-0.4771	-2.2967	0.1485
$\Delta \log HCI_t$	1.4114	3.1835	0.0861
$\Delta \log HCI_{t-1}$	1.5818	5.2027	0.0350
$\Delta \log HCI_{t-2}$	-2.5669	-5.0561	0.0370
$\Delta \log HCI_{t-3}$	1.8446	3.7628	0.0639
$\Delta \log INV_t$	-0.0209	-4.8916	0.0393
$\Delta \log INV_{t-1}$	0.0301	4.8853	0.0394
$\Delta \log INV_{t-2}$	0.0114	3.8872	0.0603
$\Delta \log INV_{t-3}$	0.0165	4.0322	0.0564

ECT$_{t-1}$	-3.1378	-3.1154	0.0894
Bound Test (F-value)	16.1385		
Heteroskedasticity	0.2201		0.9808
Serial Correlation	0.2129		0.7248
Jarque-Bera	2.2441		0.3256

In the short run results, all lags of employment are showing the negative impact on the present employment. Here, last employment is not supporting the present employment. It can be due to a reason of fishing-out that once a labour get employment in any time period, job market have lesser job for future applicants. Therefore, chance of employment is reducing for future applicants. Further, FMD is positively impacting the employment in short run but its lag are not showing any significant impacts. It means that FMD has pleasant impact on the employment in the current period only. This result is contradictory to the findings of Choudhary et al. (2012) who finds that lagged FMD has stronger impact on employment. Remittances outflows are showing the insignificant impact in short run mostly but its second lag is showing negative influence on employment in short run. It means that remittances outflows do not create immediate negative impact on employment. This impact is reflecting after two years because of fall in aggregate demand first and then reflect in employment in proceeding years. Saudization have mix kind of impact with different lags. With first lag, it creates negative impact and with third lag, it creates positive impact on employment. HCI is showing a supervising result as it is positive and significant in short run but this impact was insignificant in long run. In case of investment, its impact without lag is negative which proofs an argument capital intensive investment in short run. But lags effects of investment are positive and significant. It means that investment with lags is impacting the employment positively.

5. Conclusions and Policy Recommendations

This research is aimed at investigation of the FMD and employment nexus in Saudi Arabia. This objective has been achieved through employing ARDL cointegration in the relationship between FMD and employment by incorporating HCI, Saudization, remittances outflows and investment as control variables in the model and by utilizing the annual data of 1980-2015. In estimation, we have found a mix order of integration hence cointegration is proved in the model. In the long run results, FMD has a positive influence on the employment in long run. Therefore, we can claim that FMD, by performing the sufficient financial service to the Kingdom, is supporting the economic activities, aggregate demand and employment in Saudi Arabia. Further, remittances outflows have negative impact on employment. It means that remittances outflows are creating negative shock on aggregate demand and hence on employment. Further, Saudization policy remains helpful in raising employment level. HCI is not supporting to employment in our analysis. Therefore, we can conclude that human capital is not well developed in the Kingdom to support employment. Lastly, investment has pleasant impact on employment with a minute magnitude of its coefficient. In short run, past employment has negative impact on present employment. FMD, HCI and Saudization are playing positive role in determining the employment.

Based on our finding, we recommend the government of Saudi Arabia to support financial sector in terms of subsidies and to frame easy procedures for establishment of the financial sector business. Further, investments should be supported by tax holidays or subsidies as it has pleasant impact on employments. On the other hand, HCI could not help in raising employment. Therefore, government should spend more on educational institute and should frame policies to develop human capital in line of labour market need. Saudization policy is found helpful in raising employment. Therefore, this policy need to be further promoted as it is also in "Vision 2030" of the government. Last but not least, remittances outflows have negative impact on employment. Therefore, remittances outflows should be restricted up to some optimal level or some investment opportunities should be provided to foreigners to keep money inside the Kingdom.

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