



## Relaxing Israeli restrictions on Palestinian labour: Who benefits?

Dorothee Flaig<sup>a,\*</sup>, Khalid Siddig<sup>a</sup>, Harald Grethe<sup>a</sup>, Jonas Luckmann<sup>a</sup>, Scott McDonald<sup>b</sup>

<sup>a</sup> Agricultural and Food Policy Group, Universität Hohenheim, 70593 Stuttgart, Germany

<sup>b</sup> Department of Accounting, Finance and Economics, Oxford Brookes University, UK

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### ABSTRACT

Palestinian workers have been employed in low-skilled jobs in Israel for decades. The second Intifada, from 2000, increased border restrictions severely and sharply reduced employment possibilities in Israel for Palestinians, increased unemployment and reduced income in the West Bank. Israeli employers responded by increasing the number of foreign workers, mostly from Asia. Growing unemployment among Israeli unskilled workers caused Israel to impose quotas on the employment of foreigners. This study evaluates the effects of reducing movement and access restrictions between Israel and the West Bank. The study uses a single country computable general equilibrium model, adapted to a Social Accounting Matrix of Israel for the year 2004, to simulate the effects of different Israeli labour policy regimes and to identify the inter sectoral, whole economy and distributional implications.

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### 1. Introduction

Palestinian workers commute to Israel on a day-to-day basis for, predominantly, employment in the agricultural and construction industries where wage rates exceed those in the West Bank and Gaza. By 1999 Israel was the largest employer of Palestinian workers, with 23% of the employed Palestinians working in Israel and its settlements (PCBS, 2010), but this had fallen to 8% of Palestinian employees by 2004 which had inevitable adverse consequences for employment and income in Palestine (PCBS, 2010). Fluctuations in the numbers of Palestinians working in Israel follow political relations between Israel and the Palestinian Territories: after the election of the Palestinian Authority in 1995 employment increased until the outbreak of the second Intifada, in 2000, when employment fell sharply. The Israeli labour market responded to these fluctuations by increasing the number of foreign workers,<sup>1</sup> mostly from Asia. More recently tighter quotas have been imposed on foreign workers following increases in the unemployment rates of Israeli low and unskilled workers.

The Palestinian Territories, the West Bank and the Gaza Strip, are de facto economically separate,<sup>2</sup> have different economic and social characteristics, are ruled by different parties, and experience different treatment from Israel. Unemployment in the West Bank decreased from 28.2% in 2002 to 17.8% in 2009, but remained high in the Gaza Strip, 38.6% in 2009, (see Fig. 1), with, in 2010, no cross-border workers from Gaza but about 14.0% of West Bank workers in Israel (PCBS, 2010). This study focuses only on the labour markets of the West Bank and Israel, since the bar on workers from the Gaza Strip is unlikely to be lifted soon.

This study estimates the potential benefits accruing to both economies from reducing labour movement restrictions between Israel and the West Bank. Such a policy change will impact differently on different industries in Israel and will have whole economy implications; hence the study uses a computable general equilibrium (CGE) model (STAGE) that has been adapted for this analysis. The data employed are provided by a Social Accounting Matrix (SAM) for Israel in 2004 (Siddig et al., 2011) developed for this study.

The next section provides an overview of the Israeli and Palestinian labour markets, while Section 3 describes the CGE model, its extension and the Israeli SAM, and additional data. Section 4 defines the scenarios analysed and presents and discusses the results. The conclusions and potential policy implications are discussed in the final section.

\* Corresponding author. Tel.: +49 711 459 22638; fax: +49 711 459 23752.

E-mail address: [d.flaign@uni-hohenheim.de](mailto:d.flaign@uni-hohenheim.de) (D. Flaig).

<sup>1</sup> Palestinians are not considered foreign workers.

<sup>2</sup> Less than 1.0% of West Bank workers have been employed in Gaza since 1995 and vice versa.

## 2. Labour markets in the West Bank and Israel

### 2.1. The West Bank labour market

The West Bank labour force is fast growing. In the 15 years to 2009 it nearly doubled, from 358 to 643 thousand (PCBS, 2010); largely reflecting the demographic profile but the potential for increase is large due to the relatively low participation rate, 43.8%, that derives from the low participation rate of women (17.4%).<sup>3</sup> Unemployment declined strongly in the late 1990s (Fig. 1) during a period of high economic growth. But unemployment increased with the outbreak of the second Intifada in 2000, which resulted in the closure of the Israeli–Palestinian border and the establishment of restrictions on movement, e.g., checkpoints and road barriers within the Palestinian Territories, and a sharp reduction in the employment of Palestinians in Israeli and its settlements (PCBS, 2005). Unemployment further increased with the contraction of the Palestinian economy, although since 2003 unemployment has fallen primarily due to employment growth in the West Bank.

Palestinian employment in Israel has long been substantial (Fig. 2), but access to the Israeli labour market by Palestinians is managed. In 1999 employment in Israel and its settlements accounted for 26% of West Bank workers, but this had declined to 13% by 2002; since then the number of Palestinians employed in Israel has doubled although it only accounted for 14% by 2009 due to the growth in the labour force (PCBS, 2010). Expansion of such employment has significantly increased the national income and demand (Palestinian Ministry of Finance, 2009).

Palestinians are mainly employed in unskilled or low skilled jobs in Israel, where the wages are at least 70% higher than the average wage in the West Bank (Bank of Israel, 2010a; PCBS, 2010). Compared to neighbouring countries, the wage level in the West Bank is relatively high (Aix-Group, 2007), which may be due to the possibility of employment in Israel, which raises the reservation wage (Bulmer, 2003).

### 2.2. Structure of the labour force in Israel

During the second Intifada domestic demand stagnated in Israel and unemployment increased, peaking at 10.6% in 2003. After 2003 the Israeli economy grew rapidly and wages and employment rates increased so that by 2006 there was “full employment in Israel” (Bank of Israel, 2010a) with the lowest unemployment rate (6.1%) in two decades and the highest level (56.5%) of labour force participation. Since 2009 unemployment has slightly increased; mainly due to declining employment in industries that intensively use low skilled labour.

Israeli low and unskilled workers compete with foreign (non-Palestinian) and Palestinian workers in the labour market. Israeli workers rarely take employment below the minimum wage (OECD, 2010c), while weak enforcement of the minimum wage law allows foreign and Palestinian workers to be employed below the minimum wage (Bank of Israel, 2010b; OECD, 2010c). Moreover Israelis who serve in the Israeli Defence Forces (IDF) are supported with privileges in the labour market (OECD, 2010c). Since Arab Israeli's rarely serve in the IDF this results in Jewish and Arab Israeli's being differentiated in the labour market.<sup>4</sup> The segmentation of the labour market implied by these institutional arrangements is confirmed by the wage rates implied by the data.

The wages in Israel range from 127 NIS per day to 160 NIS per day, the minimum wage (Table 1). Palestinian workers can earn between 70 and 110% more on the Israeli unskilled/low skilled labour market

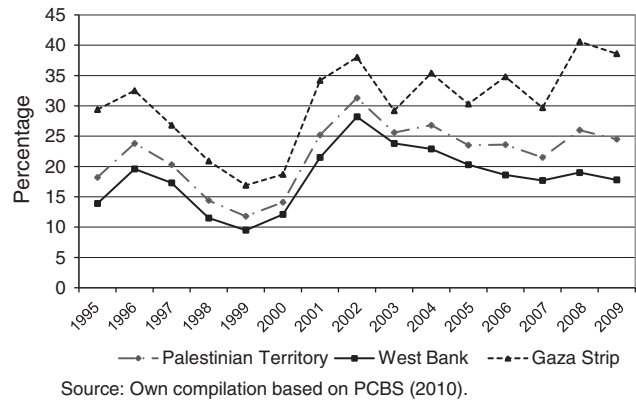


Fig 1. Unemployment rates in the Palestinian Territories (%), 1995–2009). Source: Own compilation based on PCBS (2010).

than the average wage on the West Bank labour market. The wage rates for foreigners on the Israeli labour market are higher than for Palestinians (OECD, 2010c); employers have to pay higher social contributions and fees for foreign workers, although Palestinians receive subsidised transportation. Consequently there are strong incentives for Palestinians to seek employment in Israel.

Since 1990 Israel has increasingly turned to foreign workers with the relative and absolute participation of Palestinians declining with the tensions in the early 1990s and again after 2000. There was a recovery after the election of the Palestinian Authority in 1995 and since 2003 there has been a slow increase, but the number of Palestinian workers is still well below the levels in the 1980s (Fig. 2).

Three Israeli industries are highly dependent on non-Israeli (Palestinians and foreigners) workers: agriculture, construction, and homecare. In 2008, 30% of all employees in construction and 37% of all employees in agriculture were non-Israeli (Bank of Israel, 2009). In these industries wages are low and employers have difficulties recruiting Israelis.

After 1993 the flow of Palestinians to Israel became irregular due to access restrictions that were determined by security, not economic, concerns. Changing security procedures increased uncertainty of whether the workers would be able to reach their workplace, even for those holding permits. This situation affected both employers and employees negatively (Aix-Group, 2007).

Since 1990 workers from abroad, mainly Asia, have been allowed to work in Israel on renewable three monthly work permits as employers lobbied to raise the number of foreign workers in Israel. For 10 years, the number of foreign workers in Israel increased rapidly (Fig. 2). Despite the number of permits issued remaining almost constant since 1995, with approximately 60 thousand permits released annually (Bank of Israel, 2008; OECD, 2010c), and quotas on foreign labour in agriculture and construction, the number of foreigner workers has increased, mainly due to ‘illegal’ workers (people who stay in Israel after their working permit ended). A period of stricter enforcement of work permits reduced the number of foreign workers in the early 2000s but since 2005 the number has been rising.

The short-run elasticity of Israeli demand for Palestinian labour in the late 1980s was estimated at between  $-1$  and  $-2$  (Angrist, 1996); this study also provided strong evidence that decreasing Palestinian labour supply in Israel significantly increased wages Israeli employers pay, especially for low-skilled workers in construction and agriculture. Since 1990 the presence of large numbers of foreign workers has changed the situation. The effects of foreign workers on the employment situation for Palestinian cross-border workers were analysed in an empirical study by Aranki and Daoud (2010) with data covering a period from 1999 to 2003. Their findings indicate that it is less the presence of foreigners

<sup>3</sup> In the Gaza Strip, the labour force participation rate was 37.6% in 2009.

<sup>4</sup> Certain Israelis are exempted from service in the IDF on religious grounds.

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