

Chapter 2

The Labor Market

The slump in the labor market persisted in 2002, with the deepening of the recession due to the continuation of the security unrest and the global slowdown. The slump was expressed in the 1.1 percent decline in the number of persons employed in the business sector, with a slight rise in hours worked per employee. The unemployment rate rose steeply, and averaged 10.3 percent. The participation rate dipped by 0.2 percentage points, in contrast with the long-term upward trend, offsetting 0.5 percentage points from the rise in the unemployment rate. The continued rapid expansion of public-services employment (by 3.1 percent) worked in the same direction. Although the decline in the employment rate encompassed most of the business sector, the 3.9 percent contraction of employment in manufacturing was notable. The number of foreign workers remained unchanged, and employment of Palestinian workers declined.

The nominal wage per employee post fell by 0.4 percent in 2002, an occurrence not seen in the past. The real wage was eroded by 5.7 percent—something that has not happened since the 1980s—explained primarily by the recession, but also by the unexpected inflation, the absence of a valid cost-of-living agreement until the end of the year, and the freeze imposed on the minimum wage. The decline in business-sector wages was led by financial and business services, where there had been a marked increase in 2001. Real unit labor cost in the business sector rose by a moderate 1.3 percent in 2002 due to the decline in labor productivity, but this was partly offset by the erosion of the real wage.

In 2002, as well as in the Arrangements Law accompanying the 2003 budget, far-reaching legislative changes were introduced which substantially cut transfer payments, especially to recipients of child allowances, income support, and unemployment benefit. The object of the legislation was primarily to bring down growing fiscal costs, as well as to encourage participation in the labor market, thereby increasing households' income. In the absence of a comprehensive system analyzing recipients' needs and helping them to find employment during a period of rising unemployment, and without a reduction in employment of foreign workers, poverty will increase.

1. MAIN DEVELOPMENTS

The labor market was affected by the deepening recession, which led to a sharp drop in demand for labor in the business sector, as well as by the continued rapid expansion of employment in the public services.

In 2002 the labor market was influenced by two main factors. The first was the deepening of the recession, in the context of the persistence of the Intifada and the global slowdown, which led to a sharp drop in demand for labor in the business sector. The second was the continued rapid expansion of employment in the public services, far exceeding the growth rate of the civilian labor force. The first factor served to reduce business-sector employment by 1.1 percent—a rate which has not been seen since the Economic Stabilization Program of 1985—alongside stability in Israeli employment and a rise in unemployment. The second factor, together with the decline in the participation rate—in contrast with the long-term upward trend, contributed 0.8 percentage points to preventing the exacerbation of unemployment. All in all, the unemployment rate rose by almost 1 percentage point, to stand at an annual average of 10.3 percent, the highest rate ever known in Israel except for 1991–92 (the start of the influx of immigrants) and the period of recession prior to the Six Day War.

The recession led to a marked deterioration in the labor market in 2001:III—the contraction of employment in the business sector and rise in the unemployment rate, which persisted until 2002:II (Table 2.1). Later in the year business-sector employment rallied, and the sharp rise in unemployment was curbed. Employer surveys indicate that the number of employees dismissed exceeded that of positions filled (a negative employment balance), but the gap between the two has been narrowing since the beginning of 2002, largely due to the reduction in the number of workers dismissed for cost-reduction reasons.

The number of hours worked per Israeli employed declined consistently in the business sector in 2001, a development characterizing the beginning of a recession. As the recession persisted, in 2002, the number of Israelis employed did not increase, and the number of hours worked per employee rose by 1.2 percent. The labor input of Israelis employed rose by a mere 1.1 percent in the business sector, compared with a 1.0 percent decline in 2001.

Employment in the unskilled-labor-intensive industries declined relatively moderately (except for manufacturing, where the decline was very steep), while in the skilled-labor-intensive industries (e.g., high-tech and computer services) it contracted sharply, and there was a marked 3.9 percent fall in manufacturing employment. Because of the series of terrorist attacks an additional 6,000 security guards were employed in 2002.

The number of non-Israelis employed fell by 7 percent in 2002. The number of foreign workers remained unchanged, despite the reduction in the number of permits to employ them, steps taken to deport illegal foreign workers, and intensified policing of employers. These measures were intensified towards the end of 2002. Employment of Palestinians contracted, particularly at the time of the Defensive Shield operation, and expanded subsequently.

Table 2.1
Principal Labor Market Indicators,^a 2002

(percent)

	Increase or decrease from same quarter in 2001 ^b				Increase or decrease from previous quarter ^c			
	I	II	III	IV	I	II	III	IV
	Working-age population	2.3	2.2	2.2	2.1			
<i>of which</i> Immigrants who arrived in this period	-32.8	-22.1	-26.2	-14.0				
Participation rate in civilian labor force ^d								
Total	54.0	53.5	54.5	54.5	54.4	53.9	54.0	54.2
Men	60.0	59.7	60.7	60.4	60.5	60.0	60.0	60.1
Women	48.2	47.7	48.7	48.8	48.5	48.1	48.3	48.5
Civilian labor force	2.7	1.3	1.2	2.4	1.0	-0.4	0.7	0.8
Israelis employed	0.6	-0.1	0.2	2.8	0.7	-0.1	0.6	1.1
Full-time employees	-0.1	-2.4	3.9	12.4	3.2	-0.2	3.1	0.5
Part-time employees	3.0	10.6	-6.5	-15.5	-3.8	-1.9	-1.9	3.1
Temporarily absent from work	-2.5	-19.8	-4.6	-5.4	-2.0	0.3	-6.4	8.4
General government employees	4.6	4.4	1.7	1.8	1.5	0.0	-0.6	1.1
Business-sector employees (Israelis)	-1.2	-2.1	-0.4	3.2	-0.1	0.2	1.2	1.8
Foreign workers in business sector ^e	15.8	0.5	-5.1	-8.7				
Business-sector employees (Palestinians) ^e	-21.8	-67.9	-58.8	-14.7				
Average weekly hours worked per business-sector Israeli employee	0.0	-1.0	1.0	4.1	2.3	-0.5	0.5	1.1
Israeli labor input in business sector	-1.2	-3.1	0.6	7.4	2.2	-0.3	1.7	2.9
Business-sector labor input of foreign workers ^e	13.8	-1.7	-9.8	-6.8				
Business-sector labor input of Palestinian workers ^e	18.8	-65.0	-55.7	-21.9				
Unemployment rate ^d	10.1	9.6	11.2	10.3	10.6	10.3	10.3	10.1
Number of unemployed persons	26.1	17.6	10.1	-0.6	3.5	-3.1	1.4	-1.7
Real wage per employee post, total	-3.2	-5.5	-6.8	-7.4	-1.8	-2.0	-2.2	-1.8
Business sector	-4.8	-4.7	-7.3	-8.3	-2.7	0.1	-3.7	-2.5
General government	1.1	-7.2	-5.5	-5.1	0.9	-4.4	-1.2	-0.6
Business-sector unit labor cost					3.0	-0.4	-5.3	-2.9
Net business-sector domestic product per hour worked ^f					-3.9	6.1	1.1	-7.3

^a The numbers of foreign and Palestinian workers include both reported and unreported workers.

^b Unadjusted data.

^c National Accounts data.

^d Seasonally adjusted data.

^f At constant prices.

^e Actual level, not rates of change.

SOURCE: Central Bureau of Statistics, Labor Force Surveys and National Accounts data.

The employment of Israelis in the public services rose steadily in 2001 and 2002:I, after which it remained virtually unchanged for the rest of the year, so that it expanded by 3.1 percent annually. The number of hours per employee in the public services rose by 1.2 percent, and labor input increased by a marked 4.4 percent, compared with 3.2 percent in 2001.

There was a notable increase in public administration employment, mainly in local authorities (9.6 percent), and in the civil service (half of it due to additional recruitment by the police force). The number of persons employed in education services increased by 2.9 percent in 2002, accounting for two-fifths of the rise in total employment in Israel.

The participation rate, which was stable in 2001, declined in 2002:II and recovered slightly later on (an annual average of 54.1 percent). The participation rate of men fell rapidly in 2002, while that of women rose more moderately than the long-term trend. These developments, which offset 0.5 percentage points of the rise in the unemployment rate, attest to the discouraged worker effect. While the participation rate of men declined in and after 2002:II, reaching an annual average of 10.1 percent, that of women remained high throughout the year, and averaged 10.6 percent in spite of the rapid increase in their employment in the public services. The proportion of the long-term unemployed rose, so that chronic unemployment deepened.

Real unit labor cost in the business sector grew by 1.3 percent in 2002, after a rapid 6.3 percent increase in 2001 (Table 2.2), because of the sharp decline in labor productivity, partly offset by the reduction of hourly labor cost. It would seem, therefore, that the process of adapting labor inputs and wages to contracting demand has not yet come to an end.

The deepening recession was expressed in the 0.4 percent contraction of the nominal wage per employee post—an occurrence unknown in the past—as a result of a 1.2 percent increase in public-services wages and a 1.0 percent decline in business-sector wages. The real wage per employee post was eroded by 5.7 percent in 2002—a rate unparalleled since the 1980s. This was the outcome of the contraction of nominal wages and labor productivity, the unexpected inflation, and the absence of a valid cost-of-living agreement until the end of 2002, and also to some extent to the freeze imposed on the minimum wage. The decline in the real wage encompassed the entire business sector.

Labor disputes decreased in 2002. A cost-of-living agreement for 2002 was signed in November, with a 2.0 percent increase up to an income ceiling of NIS 7,700 to be paid in installments in January 2003 and January 2004. This represents a very partial compensation for the increase in prices, which amounted to 6.5 percent during the year. In 2002 the arrangement whereby new recruits to the public services were members of a funded (contributory) pension scheme rather than an unfunded (non-contributory) one went into effect. This agreement has far-reaching implications for the labor market, too, with a deterioration in the terms of employment of new recruits but an improvement as regards the possibility of employment mobility between the public and the private sectors.

In 2002 and in the Arrangements Law, which accompanied the 2003 budget, extensive legislative changes substantially reduced transfer payments and mark a turning-point in social policy. *Inter alia*, child allowances were cut by 15 percent, income support payments were reduced by over 20 percent for most recipients, alongside the reduction of associated benefits (as well as changes in the terms of eligibility and the structure of

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Table 2.2
The Labor Market,^a 1999–2002

	(change over previous year, percent)			
	1999	2000	2001	2002
Population (annual average)	2.6	2.7	2.3	2.1
Working-age population	2.7	2.9	2.6	2.2
Participation rate in civilian labor force ^b	53.7	54.2	54.3	54.1
Men	60.7	60.8	60.7	60.2
Women	47.1	48.0	48.2	48.4
Civilian labor force	3.5	3.8	2.8	1.9
Total employees	3.9	3.9	1.3	-0.1
Israelis	3.0	3.9	2.1	0.9
Non-Israelis	10.7	4.3	-4.6	-7.0
Public-sector employees	3.3	2.9	4.4	3.1
Public-sector labor input	3.9	1.9	3.3	4.3
Business-sector employees	4.1	4.3	0.3	-1.1
Israelis	2.9	4.3	1.3	0.0
Foreign workers	12.5	16.4	15.6	-0.4
Palestinians	8.4	-15.3	-49.0	-40.4
Share in business sector of foreign and Palestinian workers ^b	15.9	15.9	15.1	14.2
Business-sector labor input	4.0	5.5	-1.6	-0.4
Israelis	3.8	5.9	-1.0	1.1
Foreign workers	5.6	15.5	15.7	-1.7
Palestinians	3.6	-15.8	-50.7	-40.4
Real wage per employee post	2.6	6.2	3.0	-5.7
Business sector	3.6	6.6	3.2	-6.3
Public sector	0.1	5.3	2.7	-4.2
Minimum wage (real)	2.2	4.9	7.9	-3.1
Business-sector unit labor cost	1.0	-1.2	6.6	1.3
Net business-sector domestic product per hour worked ^c	-1.9	4.4	-1.8	-3.7
Unemployment rate, ^b total	9.0	8.8	9.3	10.3
Men	8.5	8.4	8.9	10.1
Women	9.5	9.3	9.9	10.6

^a The numbers of foreign and Palestinian workers include both reported and unreported workers.

^b Actual levels, not rates of change.

^c At constant prices.

SOURCE: Central Bureau of Statistics, Labor Force Surveys and National Accounts data. Business-sector employment includes workers in education and health imputed to the business sector.

the benefit), and more stringent conditions of eligibility were laid down in the Unemployment Insurance Law. These and other measures were intended first and foremost to curb the rapid expansion of transfer payments, which cannot be long sustained, as well as to encourage participation in the labor market, thereby increasing the labor income of low-income households. For this purpose, a program will be introduced in 2003 aimed at subsidizing the wage of persons employed in areas of high unemployment or in preferred industries; experimental employment centers will also be established—very belatedly—for recipients of income support payments, as recommended by the Tamir Committee in 2001. In the absence of comprehensive

systems analyzing recipients' needs and helping them to find work at a time of rising unemployment, and without a reduction in employment of foreign workers, poverty may increase.

2. THE POPULATION AND THE WORKING-AGE POPULATION

The working-age population (aged 15 and over) was up by 2.2 percent in 2002 from 2001, the lowest growth rate since the start of the influx of immigrants from the former USSR in the late 1980s. Only 34,000 immigrants came to Israel in 2002, compared with 44,000 in 2001, and an annual average of 68,000 in 1996–2000. The number of immigrants from the former USSR (who accounted for 85 percent of all immigrants in 2000) has plummeted, while there has been a marked increase in immigration from Argentina due to the economic crisis there, and from France apparently in view of the decline in personal safety there—although this has not been on a major scale. Note that the absorption grant given to immigrants from the west was gradually increased in 2002.

As immigration to Israel declines, the share of natural increase in population growth (including the working-age population) will rise. Natural increase is expected to slow because of the predicted decline in the fertility rate.

The number of Jews in the former USSR is currently estimated at 440,000.¹ Whereas these Jews represent less than 6 percent of the Jewish diaspora, the potential for immigration to Israel among residents of the former USSR under the Law of Return (estimated at 1 million persons) is greater than it is in the developed countries. Nevertheless, their number is rapidly diminishing because of low fertility, aging, large-scale assimilation, and high divorce rates. Immigration to Israel from the former USSR is affected by internal factors, such as economic and political stability, as well as by the economic and security situation in Israel. It also depends on the immigration policies of several western countries: in recent years slightly more than half the immigrants leaving the former USSR who were eligible under the Law of Return came to Israel, while the rest went mainly to Germany and the US. Most of the immigrants from the former USSR who came to Israel were from the periphery, where the level of development is relatively low, and are less educated, or younger, than the immigrants who came in the early 1990s.

The immigration from the former USSR in the 1990s was characterized by a relatively high proportion of persons of working age in general, and prime working ages in particular. The fact that immigration to Israel has become younger, together with the entry into the labor market of the children of the veteran 'baby-boomer' (born between 1967 and 1977), has served to slow the process of the aging of the working-age population in Israel.

¹ Sergio Della Pergola (2002), *Jewish Demography: Current and Expected Trends and Policy Implications*, paper presented at the Balance of Israel's National Security, 3rd Annual Conference.

Table 2.3
Principal Labor Market Indicators,^a 1999–2002

					('000s, annual averages)			
	1999	2000	2001	2002	Change from previous year			
					1999	2000	2001	2002
Working-age population ^b	4,358.5	4,486.7	4,604.7	4,706.2	115.5	128.2	117.9	101.5
Civilian labor force ^b	2,345.2	2,435.1	2,498.9	2,546.7	79.2	89.9	68.5	47.8
Number of unemployed ^b	208.5	213.8	233.9	262.4	15.1	5.3	19.3	28.5
Employees, total ^c	2,434.2	2,529.9	2,562.5	2,561.2	91.4	95.7	32.6	-1.3
Israelis	2,135.1	2,217.9	2,264.9	2,284.4	62.5	82.8	47.0	19.5
Non-Israelis	299.1	312.0	297.6	276.8	28.9	12.9	-14.4	-20.8
<i>of which</i>								
Foreign workers	183.6	214.0	247.6	246.8	20.0	30.4	33.6	-0.8
Palestinians	115.5	98.0	50.0	30.0	8.9	-17.5	-48.0	-20.0
Public-sector employees ^{c,d}	590.2	607.1	634.0	653.8	18.6	16.9	26.9	19.8
Business-sector employees ^{c,d}	1,844.0	1,922.8	1,928.5	1,907.3	72.8	78.8	5.7	-21.2

^a The numbers of foreign and Palestinian workers include both reported and unreported workers.

^b Labor Force Survey data. Changes from 2000 to 2001 are calculated using the survey's new method of extrapolation.

^c National Accounts data, including data from education and health imputed to business sector.

^d Israelis and non-Israelis.

SOURCE: Central Bureau of Statistics, Labor Force Surveys and National Accounts data.

3. THE LABOR FORCE

The labor force grew by 1.9 percent in 2002, far less than the working-age population. In 2001, even though there was a recession and the unemployment rate soared towards the end of the year, the participation rate rose only slightly more slowly than its long-term trend. In 2002, on the other hand, it dipped by 0.2 percent, averaging 54.1 percent. The combination of the decline in the participation rate and rise in the unemployment rate was also evident in previous periods of recession, for example in the late 1980s.

The decline in the participation rate of men accelerated in 2002 and stood at 0.5 percent, while that of women rose slightly, after rising steeply for several years, slowing in 2001. These developments attest to the discouraged worker effect. As of 2000:II the manpower surveys contain data on discouraged workers, and these indicate that in 2000 women, persons with only a few years of schooling, and non-Jews accounted for a higher proportion of them in the civilian labor force. The slump in the labor market in 2001 led to an increase in the proportion of men and the less-educated among discouraged workers; this applied especially to non-Jews, who had difficulty finding work near their areas of residence. Although the participation rate rose in 2001, among persons with a higher level of education it declined considerably—possibly as a result of the contraction of activity in the high-tech industry; the participation rate of Arab males and residents of development towns in the north and the south, where unemployment is rising, also fell.

The participation rate of men declined markedly in 2002, while that of women rose more moderately than the long-term trend.

The long-term trend of a decline in the participation rate of men aged 50 and over and of persons with few years of schooling, has led to a considerable loss of product and a decline in their standard of living.

For some time there has been an ongoing decline in the participation rate of persons aged 50 or more,² and this is especially prominent among men and persons with only a few years of schooling, whose participation rates are anyway low (Table 2.4). There are various reasons for this: institutional arrangements in the public services enable early retirement on easy terms; in some cases deliberate contraction of business activity bestows considerable compensation, especially in the traditional industries which have been exposed to competing imports and technological change, reducing the demand for unskilled workers; the supply of non-Israeli workers, who compete with Israeli blue-collar workers, has risen. Another possible explanation is the increase in life expectancy and decline in its variance, serving to increase individuals' confidence in their ability to benefit to the maximum from their retirement.

The fall in the participation rate of men aged 50 and over has led to a considerable loss of GDP, as well as to a decline in their standard of living. It will also require allocating additional public funds in order to finance the needs of the elderly population.

In the last few years there has been growing global awareness of the need to define long-term quantitative policy targets, such as the deficit and inflation, in addition to the main aims of improving the standard of living by means of sustainable growth. Reference is also made to specific social and labor-market objectives, such as reducing poverty and inequality of income distribution, raising the employment rate, etc.

The employment rate, defined as the proportion of persons employed in a working-age-group, is the outcome of the participation rate in the work force and the share in it of persons employed. A low employment rate prevents full utilization of the economy's productive capacity, leads to a fall in the standard of living of households with low or no income, and expands poverty and dependence on transfer payments.

Israel's employment rate in the 15–64 age-group was 55.7 percent in 2001, compared with 65.3 percent in the OECD countries; the gap is due primarily to the low participation rate and to some extent to Israel's high unemployment rate in recent years. Over time the participation rate of men has declined more rapidly in Israel than in the OECD countries, so that the gap between the employment rates was about 15 percentage points in 2001. The participation rate of women in Israel rose faster than in the OECD countries, narrowing the gap between the employment rates to less than 5 percentage points. Israel's population is younger than that of the OECD countries, and persons doing their military service are not in the civilian labor force. Consequently, the gap between the employment rates in the prime working age-groups (25–54) is smaller—6 percentage points. The participation rate of Arab women, ultra-orthodox men, and persons with few years of schooling is generally lower (Table 2.4), while the employment rate of non-ultra-orthodox Jews is similar to that prevailing in western countries. Nonetheless, some of those countries also harbor groups which tend to have a lower participation rate.

² R. Klinov and S. Amir, *Changes in the Participation Rate of Men in the Workforce and in Exit Rates from it, 1973–83, 1994–98*, forthcoming (Hebrew).

Israel's employment rate is lower than that of the OECD countries. In order to raise it, it is necessary to adopt macroeconomic policy that stimulates growth, reduce the number of foreign workers, dampen the disincentives to work implicit in the various transfer payments, and introduce programs aimed at supporting the return to the labor market of the weaker segments of the population.

Three kinds of measures are required in order to increase the employment rate in the medium and long run, while improving the participation rate and reducing the unemployment rate.³ First, the budget deficit and the tax burden on labor must be reduced alongside an increase in the share of public expenditure intended to stimulate the business sector, including investment in the infrastructure, which makes employment more accessible. Enlightened investment in education also makes a significant contribution to increasing the employment rate in the future. Second, the number of foreign workers must be reduced, largely by increasing the cost of employing them and enforcing the legal restrictions on employers more stringently (Box 2.4). Third, the disincentive to work embodied in the various transfer payments must be reduced, and programs intended to stimulate the employment of the weaker segments of the population introduced. Some changes along these lines have recently been made, such as the reduction of income support and the subsidization of wages, and experimental employment centers are to be set up, in line with the recommendations of the Tamir Committee (Box 2.1). In addition, the Unemployment Insurance Law has been made more—and unnecessarily—stringent (Box 2.2), and improvements can be made in the functioning of the Employment Service (Box 2.3) and the vocational guidance network.

Box 2.1

Changes in Income Support Payments in 2002 and 2003¹

Income support payments are made by the National Insurance Institute to working-age families whose members have tried to find work but remained unemployed or the wage they receive is very low. Half of the recipients of income support are not required to undergo the employment test administered by the Employment Service, while the others have been exempt from it until recently (e.g., persons who are unemployable, and mothers of young children).

The main parameters for the income support level in effect until the legislative change of 2002 and the Arrangements Law of 2003 were as follows: the amount of the payment was determined in accordance with the composition of the household (e.g., 42 percent of the average wage for a couple with two or more children), the length of time it has been in the income support framework (e.g., an additional 7 percentage points for a family as specified which has been in the system for at least two years), and the age of the recipient. The payment was offset from wage and other income

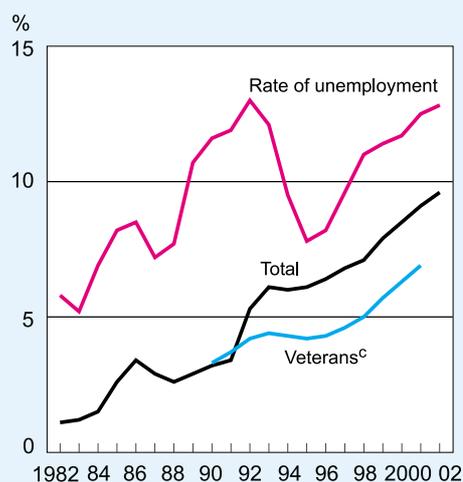
¹ Based in part on D. Romanov and N. Zussman (2001), “Changes in the Income Support System in Israel: Policy Implications,” Bank of Israel, *Economic Review*, 74, August (Hebrew).

³ See Box 1.2 in last year’s edition of this report.

above a disregard of 3 percent of the average wage for a one-person family and 17 percent for any other family combination, and the offset rate was 100 percent (60 percent for single-parent families).

In addition to the income support, families also benefit from reductions and exemptions from payments (municipal rates, rent subsidy, Broadcasting Authority license, bus fares, medications, physicians' fees, etc.), which could add up to another NIS 1,500 a month if fully utilized. Many recipients are home-owners, however, and are not eligible for the rent subsidy, which accounts for the lion's share of the associated benefits.

Figure 1
Share in Total Working-Age Families^a of Those Receiving Income Support, and the Rate of Unemployment among Persons with Low Educational Levels^b, 1982–2002



^a Families whose heads are aged up to 65 years.

^b With 0–12 years of education.

^c Not including households of immigrants from the former Soviet Union who immigrated in the 1990s.

SOURCE: Based on data from the Central Bureau of Statistics and the National Income Institute.

Since the introduction of the Income Support Law in 1982 there has been a rapid rise in the proportion of families receiving this payment, which is currently 9.6 percent (Figure 1)—a rate which cannot be fully explained by demographic trends (such as the influx of immigrants from the former USSR). There are two main reasons for this development. First, employment opportunities at a reasonable wage for the population of beneficiaries have contracted—because of structural changes, the exposure of industries to competing imports, and the increase in the proportion of non-Israelis employed in the business sector, which reduced the demand for unskilled workers. Second, the extent of associated benefits, as well as awareness of them, has risen.

In 2001 only some 26 percent of the families receiving income support had labor income, and for 40 percent of them this was less than NIS 1,500 a month. Since the probability of being poor declines sharply as the number of wage-earners in a family rises,² it is crucial to increase the participation

² K. Flug and N. Kasir (Kaliner) (2003), "Poverty and Employment, and the Gulf Between Them," *Israel Economic Review* 1, April, Bank of Israel and Am Oved.

rates of recipients of income support, while expanding the extent of employment of the wage-earners among them.

The need to prevent the continued rapid expansion of the number of families receiving income support, which was 142,000 in 2001, and to reduce these payments, which amounted to NIS 3.5 billion (one-fifth of all wage-substitute benefits), led to the adoption of vigorous measures in 2002 aimed at raising the participation rates of recipients, as well as to the introduction of changes in the Arrangements Law for 2003.

A significant cut in payments and associated benefits, together with annulment of exemption from the employment test for some recipients and reduction of the disregard rate, could encourage participation in the labor force and lead to the expansion of employment, thereby serving to increase a household's income from labor while reducing its dependence on transfer payments and improving its standard of living. Directing vocational training to recipients of income support and implementing a program to subsidize their wages (which also applies to unemployment benefit recipients only if an employer increases the number of his or her employees) supports this. Reducing the disregard, on the other hand, serves as a disincentive to work, and is hence not recommended.

Nevertheless, because of rising unemployment, especially among the less educated, who constitute the majority of recipients, and the extent of foreign workers employed, it is doubtful whether the proposed measures will lead to the absorption in the labor market of many recipients of income support in the near future. The welfare of income support recipients who have not managed to find work or are unable to work will decline. Thus, for example, at the beginning of 2003 the enlarged income support payments (and child allowances) of a couple with two children will be about 34 percent below its estimated poverty line income, i.e., a real erosion of 26 percent compared with the beginning of 2002 (when associated benefits were also granted without a means test).³

Research undertaken in other countries shows that programs to subsidize the wages of individuals with low earning ability serves to increase their participation rate.⁴ In the wake of the influx of immigrants from the former USSR, a program to subsidize wages was introduced in Israel in 1991–95 (Encouragement of the Business Sector Law), but unlike the program introduced in 2003, it did not focus on the unemployed and recipients of income support. Apart from this, its contribution to increasing employment has not been examined to this day.

³ Research and Planning Authority, National Insurance Institute (2002), *The Dimensions of Poverty and Inequality of Income Distribution in Israel, 2001; Principal Findings*, November (Hebrew).

⁴ J. Hotz and J. Scholz, "The Earned Income Tax Credit," in R. Moffitt (ed.), *Means-Tested Transfers in the U.S.*, University of Chicago Press (forthcoming).

The Employment Service, as presently constituted, is unable to supply the necessary assistance to the chronically unemployed (see Box 2.3), and as long as there is no extensive, nation-wide diagnostic network, such as the experimental one recommended by the Tamir Committee, it will be impossible to identify them and extend them the aid they require, including the possibility of differentiating the income support payment with earning ability.

In accordance with the recommendations of the Tamir Committee, four experimental employment centers are to be set up in Israel, each one of them being responsible for providing the necessary services to recipients of income support (and other long-term welfare benefits) in that region, in order to help them find employment. About 14,000 recipients living in the experimental regions will be required to report to the center, where they will be allocated a personal supervisor and an individual plan will be devised to help them find work (diagnosis, providing work-seeking skills, completing education, vocational guidance, placement, etc.). The centers will be run by the Employment Service, non-profit organizations, and businesses.

Programs aimed at easing the transition from welfare to work began to gain acceptance in western countries in the 1990s. The brief period since their introduction makes it difficult to assess their results, but in most cases they appear to have helped individuals find work, thereby increasing employment and raising wages while reducing the proportion of the population relying on government hand-outs.⁵ The rate of former recipients of income support who have remained in employment has declined in the long run, however, attesting to the difficulty of changing established patterns of behavior.

⁵ R. Moffitt "The Temporary Assistance for Needy Families Program," in R. Moffitt (ed.), *op. cit.*

4. EMPLOYMENT IN THE PRINCIPAL INDUSTRIES

The number of persons employed (including foreign and Palestinian workers) remained virtually unchanged in 2002, after its rise slowed by only 1.3 percent in 2001. The stability in the number of persons employed reflects a steep 3.1 percent increase in employment in the public services and a 1.1 percent decline in the business sector (Table 2.5). The average number of hours worked per public-services employee rose by 1.1 percent in 2002, so that labor input continued to grow rapidly, by 4.3 percent, compared with 3.3 percent in 2001. In 2001 the economic slump was expressed in the slower expansion of the number of persons employed in the business sector, alongside a sharp fall in the number of hours worked per employee, while in 2002 employment dipped but the number of hours per employee rose slightly. Thus, labor input declined by 0.4 percent, after falling by 1.6 percent in 2001.

The stability of the number of persons employed reflects a 3.1 percent rise in employment in the public services and a 1.1 percent reduction in the business sector.

Table 2.5
Employment and Labor Input, by Industry,^a 1998–2002

	Employment									
						Rates of change				
	1998	1999	2000	2001	2002	1999	2000	2001	2002	
	('000)					(percent)				
Total business sector ^b	1,771.2	1,844.0	1,922.8	1,928.5	1,907.3	4.1	4.3	0.3	-1.1	
Agriculture	84.7	88.5	90.0	81.0	81.7	4.5	1.7	-10.0	0.9	
Construction	252.5	244.1	236.1	220.3	203.8	-3.3	-3.3	-6.7	-7.5	
Manufacturing	409.9	400.7	403.3	388.9	372.6	-2.2	0.6	-3.6	-4.2	
Commerce and vehicle repairs	276.4	286.6	303.2	307.1	319.8	3.7	5.8	1.3	4.1	
Hotels and catering services	121.3	131.6	148.2	137.6	124.9	8.5	12.6	-7.2	-9.2	
Banking, insurance, and finance	72.8	73.9	73.6	75.2	76.2	1.5	-0.4	2.2	1.3	
Business services	234.1	247.8	286.3	302.8	308.5	5.8	15.5	5.8	1.9	
Public sector	571.6	590.2	607.1	634.0	653.8	3.3	2.9	4.4	3.1	

	Labor input									
						Rates of change				
	1998	1999	2000	2001	2002	1999	2000	2001	2002	
	('000)					(percent)				
Total business sector ^b	71,966.2	74,838.1	78,948.1	77,654.7	77,354.7	4.0	5.5	-1.6	-0.4	
Agriculture	3,776.0	4,003.7	4,038.4	3,721.1	3,673.3	6.0	0.9	-7.9	-1.3	
Construction	11,127.2	10,555.7	10,288.0	9,548.0	9,024.5	-5.1	-2.5	-7.2	-5.5	
Manufacturing	16,982.7	16,774.2	17,310.0	16,305.3	15,759.6	-1.2	3.2	-5.8	-3.3	
Commerce and vehicle repairs	11,251.4	11,736.7	12,442.0	12,378.3	13,023.8	4.3	6.0	-0.5	5.2	
Hotels and catering services	5,082.1	5,397.9	6,122.4	5,570.8	4,925.5	6.2	13.4	-9.0	-11.6	
Banking, insurance, and finance	2,730.0	2,810.2	2,773.2	2,813.2	2,950.7	2.9	-1.3	1.4	4.9	
Business services	9,265.0	9,826.9	11,640.9	11,973.3	12,343.2	6.5	18.0	2.9	3.1	
Public sector	18,005.0	18,713.5	19,069.1	19,702.4	20,550.4	3.9	1.9	3.3	4.3	

Employment and Labor Input, by Industry, 2002

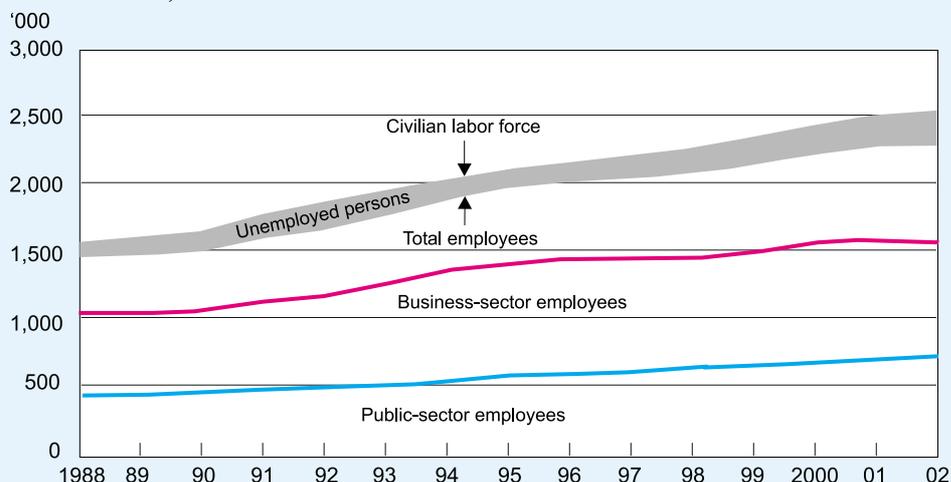
	Employment						Labor input		
	Foreign workers		Palestinians	Foreign workers		Palestinians	Foreign workers		Palestinians
	Israelis			Israelis			Israelis		
	('000)			(year-on-year rate of change)					
Total business sector ^b	1,637.2	240.6	29.5	0.0	-0.4	-40.4	1.1	-1.7	-40.4
Agriculture	44.9	32.8	4.0	-0.4	2.8	0.0	-3.7	1.5	0.0
Construction	118.7	72.1	13.0	1.5	-3.0	-55.2	4.4	-2.9	-55.2
Manufacturing	363.9	2.2	6.5	-3.7	0.0	-27.8	-2.8	0.0	-27.8
Commerce and vehicle repairs	311.8	8.0		4.2	0.0		5.4	0.0	
Hotels and catering services	86.5	34.5	3.9	-3.2	-16.3	-44.3	-6.0	-16.2	-44.3
Banking, insurance, and finance	76.2			1.3			4.9		
Business services	260.0	47.5	1.0	-0.5	19.9	-50.0	0.5	20.0	-50.0
Public sector	647.1	6.2	0.5	3.1	1.6	0.0	4.4	1.6	0.0

^a Including reported and unreported foreign workers and Palestinians.

^b Figures may not add due to the exclusion of 'miscellaneous.'

SOURCE: Central Bureau of Statistics and National Accounts data.

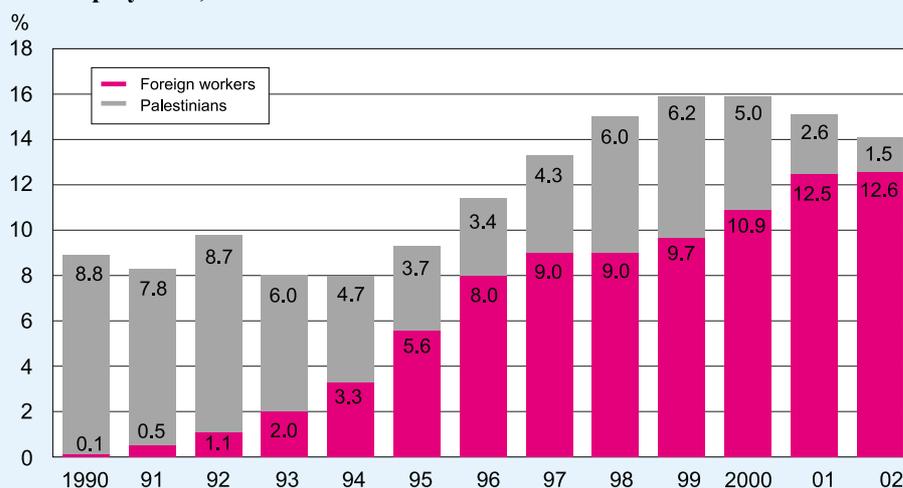
Figure 2.1
Employment in Public and Business Sectors, and Unemployed Persons, 1988–2002



SOURCE: Central Bureau of Statistics.

The main factors underlying the development of employment in 2001 were still in force in 2002. These included the recession, due to the terrorist attacks in Israel and the global slowdown, both of which served to reduce the demand for employees in the business sector, whether in industries supplying goods and services for the domestic market or in export-oriented high-tech industries. Another factor was the persistence

Figure 2.2
Share of Foreign Workers and Palestinians^a in Total Business-Sector Employment,^b 1990–2002



^a Reported and unreported foreign and Palestinian workers, as estimated by the Central Bureau of Statistics.
^b Including workers in health and education imputed to business sector.

SOURCE: Central Bureau of Statistics.

and exacerbation of the security unrest, leading to assessments that the conflict would not end in the near future. Firms which had previously avoided dismissing employees because of the associated compensation and the cost of hiring new employees once the recession ends, and which had simply reduced the number of hours worked per employee, decided at this point to downsize, bringing their workforce into line with the low level of demand expected to prevail in the near future. On the other hand, increased defense procurement, mobilization of military reserves, and greater demand for security guard services served to temporarily increase demand in other industries. Finally, the continued marked expansion of the number of persons employed in the public services dampened the effect of the recession on employment and prevented an even steeper rise in the unemployment rate.

The proportion of non-Israelis employed in the business sector fell to 14.2 percent in 2002, compared with a peak rate of 15.9 percent in 1999 and 2000 (Figure 2.2). This was due to the contraction of the employment of Palestinian workers and stability in the number of foreign workers. The proportion of non-Israelis is particularly high in construction, agriculture, hotels and catering, and care-giving, and by international standards their share in the labor force in Israel is very high.⁴

a. Employment of Israelis

The number of Israelis employed rose by 0.9 percent in 2002, the lowest rate since the recession of the late 1980s.

The number of Israelis employed rose by 0.9 percent in 2002, the lowest rate since the recession in the late 1980s, while the working-age population increased by 2.2 percent. Public-services employment expanded by a steep 3.1 percent, further to a similar trend in 2001, while business-sector employment remained unchanged. In the first half of 2002 the number of persons employed in the business sector stayed at the low level evident at the end of 2001, rising slightly subsequently. The number of persons employed in the public services continued to grow in 2002:I, after which it stabilized.

Employment of men did not change, whereas that of women expanded by 1.7 percent, mainly due to the large proportion of them in the public services, where employment expanded. The number of persons in full-time employment rose by 3.3 percent in 2002, and part-time employment declined by 2.6 percent—with a sharp drop among men and stability among women—in contrast to the rise in the share of persons in part-time employment in 2001 and previous recessions.

The labor input of Israelis and its composition was influenced in 2001 by the deepening of the recession and the persistence and exacerbation of the security unrest. At the beginning of 2001 there were still hopes that it would soon be over, but these dissipated during the year, expressed *inter alia* in the marked and ongoing decline in the number of hours worked per business-sector employee (2.3 percent). The number of hours per Israeli employee in the business sector rose by 1.2 percent in 2002, so that labor input increased by 1.1 percent, compared with its 1.0 percent contraction in 2001. The number of persons temporarily absent from work plummeted in comparison with

⁴ See Figure 2.3 in last year's edition of this report.

2001, when it soared, although many men were called up for reserve duty in 2002. The decline in the number of absentees may be due to the dismissal of employees who were on enforced leave or at the end of the vacation to which many dismissed persons are entitled. In addition, employees may have refrained from taking leave for fear of losing their jobs or because of difficulties in financing a vacation due to the steep drop in their real wage.

Employment of Israelis in business-sector industries varied in 2002 (Table 2.5). Employment plunged in manufacturing and catering and hotels, continuing the contraction of 2001, but rose in construction, commerce and financial services, continuing their upward trend. Employment in business services, transport and communications declined, after expanding in 2001, while in agriculture, electricity and water it remained virtually unchanged. The drop in the employment of skilled personnel in the high-tech industry contributed 0.8 percentage points to the rise in the unemployment rate in 2002, while the low-skilled-labor-intensive industries contributed only 0.4 percent (Table 2.6).

The decline in employment in the industries which are skilled-labor-intensive contributed 0.8 percent to the rise in the unemployment rate in 2002, while the unskilled-labor-intensive industries contributed only 0.4 percent.

Table 2.6
Contribution to Change in Unemployment Rate,^a 1999–2002

	(change from previous year, percentage points)			
	1999	2000	2001	2002
Total	0.4	–0.1	0.5	0.9
Public sector	0.2	0.3	–0.4	–0.3
Business sector	0.2	–0.4	1.0	1.3
High-skill industries ^b	0.3	–1.0	–0.1	0.8
<i>of which</i> Nontradables	0.5	0.0	–0.2	0.1
Manufacturing	0.0	–0.4	0.2	0.3
Computer services	–0.2	–0.6	–0.2	0.4
Unskilled-labor-intensive industries ^c	0.4	0.2	0.7	0.4
<i>of which</i> Manufacturing	0.0	0.3	0.1	0.4
<i>of which</i> Textile and clothing	–0.1	0.2	0.1	0.2
Construction	0.7	0.4	0.1	0.0
Hotel and catering services	–0.3	–0.3	0.3	0.2
Other industries (not classified) ^d	–0.5	0.3	0.4	0.1
<i>of which</i> Manufacturing	0.4	0.4	0.2	0.2

^a The contribution to the rise in unemployment was calculated as the difference between the number of Israelis who would be employed if employment had expanded in line with the growth of the civilian labor force and its actual expansion (for by-industry breakdown, see Table 1.A.2.10).

^b High-skill industries include some manufacturing, computer services, banking, insurance, financial institutions, and other business activities. This classification differs from that in the section on manufacturing in Chapter 1.

^c Unskilled-labor-intensive industries include some manufacturing, commerce and repairs, construction, and hotel and catering services.

^d Other industries (not classified) include agriculture, water and electricity, transport, storage and communications, equipment rentals, employment agencies, security and cleaning, entertainment and other personal services.

SOURCE: Based on Labor Force Surveys of the Central Bureau of Statistics.

According to the manpower survey, the number of Israelis employed in manufacturing fell by 3.9 percent in 2002, further to the modest decline in 2001, and the number of hours worked per employee rose by 1.7 percent. The drop in employment encompassed most manufacturing industries, both traditional, unskilled-labor-intensive ones (e.g., textiles and clothing) and highly-skilled-labor-intensive ones (e.g., electronic components and communications equipment), which were adversely affected by the ongoing decline in world demand for their products, as well as some of the mixed industries. Note that because of the intensification of security activity domestic purchases by the military soared, preventing further dismissals in manufacturing.

The number of Israelis employed in the hotel and catering industry plummeted in 2002 too, and the number of hours per employee declined, mainly due to the contraction of incoming tourism in the wake of the intensification of terror attacks in Israel, the events of September 11 in the US, as well as assaults elsewhere. This trend was also affected by fears of an impending war in Iraq, the global slump, and the contraction of outside activities by Israelis because of fears of terrorist attacks.

Construction activity has been contracting since the second half of the 1990s, and the share of Israelis employed in the industry has fallen while that of non-Israelis has risen. Construction activity fell moderately in 2002 and the number of Israelis employed rose by 1.5 percent, alongside a sharp drop in the number of Palestinian workers and decline in that of foreign workers. Total labor input in the industry fell steeply in 2002.

The number of employees in business services fell by 0.5 percent in 2002, encompassing most of its component industries, after rising steeply in 2001. This occurred despite the notable rise in the employment of security guards. The number of persons employed in computer services plummeted due to the slump in the high-tech industry, and demand for the services of members of the professions (lawyers, accountants, architects, etc.) declined.

The rapid expansion of the employment of security guards began in 2001:IV, and peaked in 2002:II in the wake of the wave of terrorist attacks and the instructions issued by the security forces to heighten security. The number of security guards declined subsequently (Figure 1.42). The total annual average increment of security guards was 6,000, offsetting 0.2 percentage points from the rise in the unemployment rate.

The number of persons employed in transport and communications dipped by 2 percent in 2002, after an impressive increase in 2001. The number of persons employed in transport fell by 5 percent, because of the contraction of economic activity and tourism, while the rapid expansion of communications continued.

The downward trend in the employment of Israelis in agriculture persisted, mainly in field crops, alongside the rise in the number of foreign workers.

There was a marked rise in the number of persons employed in the public services in 2002:I, after which it stabilized. The annual average increment was 3.1 percent—less than the increase in 2001 (labor input grew by 4.4 percent in 2002, compared with

3.2 percent in 2001)—offsetting 0.3 percentage points from the rise in the unemployment rate.

A rapid increase in public-services employment, exceeding the increase in the civilian labor force, has characterized periods when business-sector employment rose moderately, and the unemployment rate might have soared (e.g., during the slumps of 1996–99 and 2001–02). Altogether, in 1996–2002 public-services employment grew by an annual average of 3.6 percent, 1.2 percentage points more than the population growth rate, and double that of business-sector employment, so that the share of persons employed in the public services rose, and stood at 25.5 percent in 2002 (28.3 percent of Israelis employed). The development of public-services employment is characterized by considerable by-industry variance: employment in public administration and education and health services grew by 3 percent a year (half of it in the local authorities), employment in the welfare and social services rose far more rapidly, while the annual growth rate of employment in community and social services was lower than that of the population. Note that the real wage per employee post in the public services rose by an annual average of 1 percent in 1996–2002 (far more steeply in public administration and education services), despite a wage policy advocating a freeze; the growth rate of business-sector wages was double that in the public services, however.⁵ The expansion of public-services employment might become permanent and this, together with the increase in the real wage, could prevent the public sector from cutting expenditure in the future if vigorous steps are not taken to prevent it.

There was a marked increase in the number of persons employed in public administration and the welfare and social services in 2002, with stability in the health services. Employment in public administration expanded by 4.1 percent, and in the local authorities it grew even faster (by 9.6 percent). About half the rise in employment in public administration is explained by the augmentation of the police force, primarily in order to combat terrorism and deport illegal foreign workers.

Employment in education services grew by 2.9 percent in 2002, two-fifths of the increment in Israelis employed, and is first and foremost the outcome of the notable rise in the number of pupils. In the last few years there has been a rapid rise of employment in pre-school education, where free education for the 3–4 age-group has been gradually introduced, placing special emphasis on the Arab sector, where attendance rates are low. Employment has also risen in elementary education, with the introduction of a longer school day, and in higher education, with the addition of colleges.

Although the number of persons employed in the public services soared in 2002, some of them are in effect imputed to the business sector (e.g., teachers in private schools and colleges), and it is impossible to make a distinction between them and public-services employees (even after imputing some education and health employment to the business sector, as is done by the CBS).

⁵ See also, *The Rise in the Real Wage in the Public Services in 1999–2001, and the Outlook for 2002*, Bank of Israel, press release, 18.02.2003 (Hebrew).

The marked expansion of public-services employment offset 0.3 percentage points from the rise in the unemployment rate.

It is feared that the accelerated increase of employment in the public sector in recent years will become permanent and this, together with the rise in the real wage, will prevent the public sector from reducing expenditure in the future.

b. Foreign workers

The number of foreign workers remained unchanged in 2002, after an annual 16 percent increase in the two previous years.

The cost of employing foreign workers is 40 percent less than that of Israeli blue-collar workers, so that the unemployment rate among the latter is rising, their participation rate is declining, and their wage is being eroded.

The number of foreign workers remained unchanged in 2002, after an annual increase of 16 percent in the two previous years, and their number stood at 247,000. The quota of foreign workers in construction was reduced from 45,000 to 30,000, while in agriculture it was increased by 6,000 in April because of a temporary shortage of workers due to the closure imposed on the Territories. The number of valid permits (excluding in care-giving) was 57,000 at the end of 2002—some 8,000 less than at the end of 2001.

Since the cost of employing foreign workers is far lower than that of Israelis (Box 2.4), the employment of Israeli blue-collar workers in similar occupations—especially in those where the rate of foreign workers is high—was adversely affected, and as a result their unemployment rate rose, their participation rate fell, and the wages of those still in employment were eroded.⁶ This has far-reaching socio-economic repercussions, above all the expansion of poverty among the weaker strata of the population, alongside the negative economic implications of the protracted stay and even residence in Israel of foreigners.

Foreign workers are valuable as care-givers. The rise in life-expectancy and the aging of the population, together with the rise in the standard of living, have increased demand for care-giving services. The supply of public geriatric institutions is limited, and the cost of residence in a private old-age home is high. The provision of supervision and care by a live-in Israeli care-giver is the preferred solution for most households,⁷ but they cannot usually afford this, especially since many of the elderly are poor.

In 2002 the National Insurance Institute paid a care-giving allowance for some 112,000 elderly persons who live at home and depend on outside help for most daily tasks. The extent of the aid is low, however—a maximum of 15.5 hours a week.

One solution is to employ foreign care-givers (generally women from the Philippines), and this feature has expanded considerably since 1995. In 2002 there were 40,000 legal foreign care-givers (over 8,000 working for recipients of the care-giving allowance), and it is estimated that a similar number of workers are employed illegally. In contrast with other industries, in care-giving there is no quota for foreign workers.

The cost of employing round-the-clock foreign care-givers is far lower than that of Israelis, and less than the cost of keeping persons in need of care in institutions. Nonetheless, employing foreign care-givers creates several problems: greater resort to private welfare services partly relieves the government of its responsibility for this sphere; Israeli care-givers who provided home-help for persons in need of care—usually women with little education or new immigrants—could lose their source of income and even become unemployed, although manpower surveys for 1995–2002 indicate that the number of Israeli care-givers has doubled, and now stands at 36,000; many of the foreign care-givers have become cleaners or are employed in other services.

⁶ D. Gottlieb (2002), “The Effect of Non-Israeli Workers on Employment, Wages, and Inequality, 1995–2002,” *The Economic Quarterly*, 4 (Hebrew).

⁷ Y. Ophir, H. Deskel, and N. Dror (2001). “Foreign Workers as Care-Givers,” *Manpower Planning Authority, Discussion Paper* no. 7.01, March (Hebrew).

c. Palestinian workers

In the context of the exacerbation of the security situation, the contraction of employment of Palestinians in Israel continued in 2002, and their number stood at 30,000, compared with 50,000 in 2001, the construction industry accounting for half of this decline. The shortage of Palestinian workers was scarcely noticeable in 2002, for several reasons: they were employed mainly in construction, manufacturing, hotels and catering, and agriculture, which are all in recession, and in some of which foreign workers are employed. The cost of the latter is far lower than that of Palestinians (20 percent less in construction, for example, if the worker has a permit); the worsening of the recession has made it easier to employ Israelis at a cost which is not much higher than that of a Palestinian with a permit.

Against the backdrop of the exacerbation of the security situation, the employment of Palestinian workers in Israel continued to contract.

5. UNEMPLOYMENT

The unemployment rate has risen steeply since 2001:III, and in 2002:I it stood at 10.6 percent (seasonally adjusted). It moderated subsequently, so that the annual average was 10.3 percent, compared with 9.4 percent in 2001. This is Israel's highest unemployment rate since the manpower surveys were begun in the mid-1950s, except for 1991 and 1992, when the labor supply soared in the wake of the influx of immigrants from the former USSR. Note that in the year of the severe recession that preceded the Six Day War (1966–67) the unemployment rate was 10.4 percent (only 6.2 percent among the prime age population), after having tripled within three years, but it returned to its previous level soon afterwards. Israel's unemployment rate is significantly higher than that of other developed countries (an average of 6.9 percent in the OECD countries), and only Spain has a higher rate. The increase in Israel's unemployment rate in 2002 does not fully reflect the slump in the labor market, as the sharp rise in employment in the public services combined with the decline in the participation rate contributed 0.8 percent to moderating the further rise in the unemployment rate.

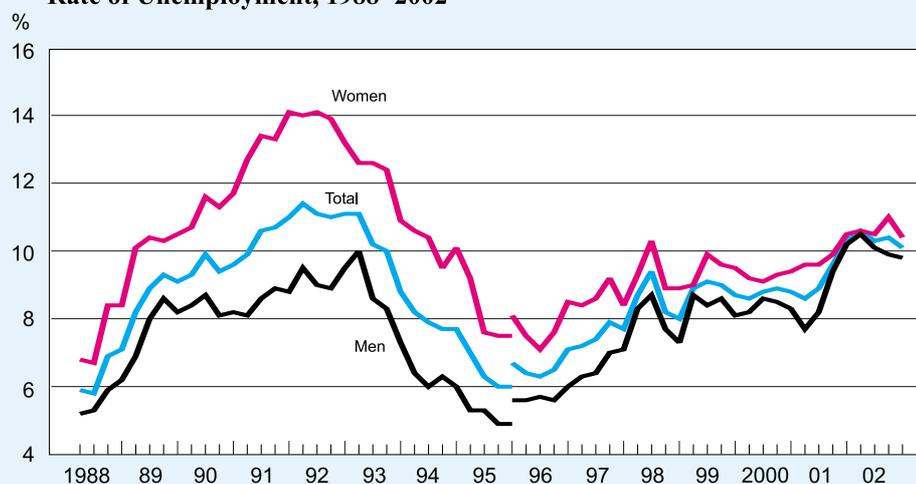
The unemployment rate rose by almost 1 percentage point in 2002 to reach an annual average of 10.3, Israel's highest since the severe recession before the Six Day War—with the exception of the start of the influx of immigrants.

A survey of employers undertaken by the Manpower Planning Authority of the Ministry of Labor and Social Affairs indicates the extent of the slump in the labor market and the decline in the chances of unemployed persons of finding work. The number of vacancies (excluding construction and agriculture, where jobs are filled primarily by non-Israelis) stabilized at a lower level than in 2001, and the number of vacancies per unemployed person was the lowest since the survey was first undertaken, in 1997.

The proportion of persons seeking work for less than two months declined in 2002, although in and after 2002:IV the share of persons—especially men—seeking work for over six months soared. Hence, the number of newly unemployed declined during the year, while the period of joblessness rose. The situation regarding the number of unemployed persons who have worked in the last twelve months is similar: in 2001 their number rose steadily, but declined from the beginning of 2002. This trend is

The number of the newly unemployed declined during 2002, while the period of unemployment grew longer, and there was a steep increase in new claims for income support.

Figure 2.3
Rate of Unemployment, 1988–2002^a



^a Quarterly data, seasonally adjusted; the Central Bureau of Statistics' definition of employment changed in 1995.

SOURCE: Central Bureau of Statistics.

reinforced by the Employment Service figures: the number of new work-seekers (including those dismissed from their jobs) declined, after reaching a peak at the end of 2001—a trend which can also be explained by the introduction of more rigorous requirements regarding eligibility for unemployment benefit—whereas the number of persons seeking work for a longer period rose, and there was a steep increase in new requests for income support.

In view of the deepening of unemployment, the human capital of persons out of work for a long period is eroded and their chances of finding work impaired. Along with a drop in the intensity with which they seek work, they are liable to accept positions that are not commensurate with their abilities, or to leave the labor market altogether.

After the unemployment rate of men rose sharply in 2001, catching up with the relatively moderate rise in that of women, it dipped in 2002, while that of women remained high (Figure 2.3). In the final event, the annual unemployment rate of men reached 10.1 percent, and that of women 10.6 percent. The participation rate of men declined more steeply in 2002, while that of women rose moderately, after rising steadily and rapidly for several years; this offset another 0.5 percentage points from the unemployment rate.

The rise in the unemployment rate in 2002 encompassed all education groups (Table 2.7), after the unemployment rate of persons with high-school education had risen moderately in 2001, and that of persons with higher education had not changed. The extension of unemployment in 2002 to 'stronger' population groups, which had not initially been affected by the recession, expresses the deepening of the recession in the labor market.

Table 2.7
Unemployment Rate, by Years of Education, 1998–2002

	(percent)				
	1998	1999	2000	2001 ^a	2002 ^a
Total	7.5	8.6	8.9	9.4	10.3
Years of education					
0–8	10.0	13.0	13.7	12.9	14.5
9–12	9.5	10.5	11.0	12.2	12.9
13–15	6.5	7.3	7.8	8.1	10.0
16+	4.1	4.2	4.4	4.5	5.8

^a A new method of extrapolation was introduced in 2001 in the Labor Force Surveys.

SOURCE: Labor Force Surveys of the Central Bureau of Statistics.

Box 2.2

Changes in the Unemployment Insurance Law in 1999–2002

In 1999–2002, in the wake of the continued steep increase in the number of persons receiving unemployment benefit and associated payments, and because of the need for fiscal restraint, several measures were introduced to encourage the return to work, *inter alia* by amending the Unemployment Insurance Law. This involved making it less easy to attain eligibility for unemployment benefit, cutting the maximum period in which the benefit could be claimed, and reducing the amount payable as a share of the individual's wage prior to becoming unemployed (the replacement ratio).

In 1999 a ceiling was set for unemployment benefit—the average wage in the first five months of unemployment, and two-thirds of this subsequently. This restriction reduced the replacement ratio of persons receiving a relatively high wage. In 2000 the maximum period during which unemployment benefit could be claimed was substantially reduced.

In the framework of the economic emergency package, in June 2002 unemployment benefit was cut by 4 percent (until the end of 2003), as were most national insurance allowances. In July 2002 the prior employment requirement for eligibility for unemployment benefit was increased to 360 days out of 540 days prior to the period of unemployment, instead of 180 out of 360 or 270 out of 540. According to estimates made by the National Insurance Institute, about 25 percent of all unemployment benefit recipients had not accumulated a long enough prior employment requirement, since many of them worked in occasional or seasonal jobs. The maximum period for payment of unemployment benefit to persons under 25 years old (without at least three dependants) was also reduced from 100 to 50 days. In addition, persons participating in vocational training courses were to receive only 70 percent of the unemployment benefit due to them.

Since the beginning of 2002 legislative changes have been made so that if an unemployed person under 40 claims unemployment benefit for a second time in four years (starting from the beginning of 2000) the accumulated period of payment will be restricted to 180 percent of one maximum period, and the amount paid during the period of unemployment which exceeds the maximum period will be 85 percent of the unemployment benefit to which the person would be entitled if it were his or her first unemployment period within those four years.

The assumption underlying these legislative changes is that unemployment insurance encourages unemployment, extends the period in which individuals are unemployed, and can also lead to abuse of the law. Although research¹ has shown that extending the maximum period of eligibility for unemployment benefit protracts the period of unemployment by 15–20 percent, the effect on the long-term unemployed is stronger. Extending the unemployment benefit period (e.g., income support) tends to make the period of unemployment longer. Increasing the replacement ratio slightly prolongs the period of unemployment, and this was also found to be the case for Israel.² The effect of prolonging the maximum period for unemployment benefit payment outweighs that of increasing the replacement ratio.

There are significant arguments against increasing the severity of the Unemployment Insurance Law. The dimensions and depth of unemployment are first and foremost the result of the labor market position; unemployment benefit constitutes an essential safety net for consumption smoothing as well as helping to utilize the earning potential of unemployed persons by giving them the time they need to find work that is commensurate with their abilities; unemployment benefit increases both the participation rate and the chances of finding a job, in contrast with frequent entries and exits from the labor market; most first-time unemployment benefit recipients do not claim a second time or claim income support, so that being unemployed appears to be a transitory state; other rules (e.g., the prior employment requirement) reduce the possibility of abusing unemployment benefit.

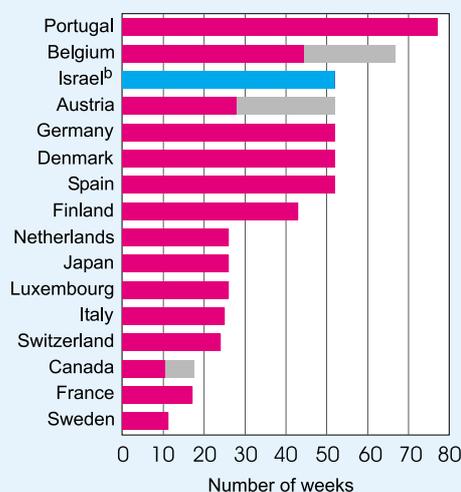
¹ US Department of Labor, Employment, and Training Administration (1999), *Dynamic Models of Unemployment Insurance Benefit Receipt: Survival Rate Analysis Report*, Unemployment Insurance, Occasional Paper 99–1.

² S. Ribon (1993), "Factors Affecting the Duration of Unemployment of Persons Receiving Unemployment Benefits," *Bank of Israel Economic Review* 67. Another study found that raising unemployment benefit expectations (i.e., the amount paid *times* the share of recipients among the unemployed) by 10 percent increases the long-term unemployment rate by 1–1.5 percent, see Y. Lavi and N. Zussman (2002), *The Effect of Labor Laws and the Disinflation Surprise on Determining Wages and Unemployment in the Business Sector in the 1990s: A Quantitative Estimate and Policy Proposals*, October (forthcoming, Hebrew).

Note that even before the legislative changes of 1999–2002 Israel's Unemployment Insurance Law was not generous by international standards; this applies in particular to the prior employment requirement, which is longer (one year) than in other countries, and constitutes a large share of the period in which it must be accumulated (eighteen months), as well as the shorter period in which the benefit is payable (Figures 1 and 2 respectively). The replacement ratio (66 percent) is similar to that in western countries.³

The proportion of unemployment benefit recipients among total unemployed persons depends not only on the prior employment period and the maximum payment period, but also on the extent to which the employment test is administered, and possibly also on social norms expressed in the inclination to claim unemployment benefit. An international comparison shows that in Israel the proportion of unemployed persons claiming benefit is relatively low (46 percent), and does not deviate from expectations in view of the strict eligibility conditions.

Figure 1
Length of Time in Work
Required to Qualify for
Unemployment Benefit^a in
Israel and Selected
Countries, 2002



^a The qualifying period varies with the number of dependents, age, etc. Rules applying to certain small groups have not been taken into account.

^b In Israel 360 days of work out of 540 days for which National Insurance is paid.

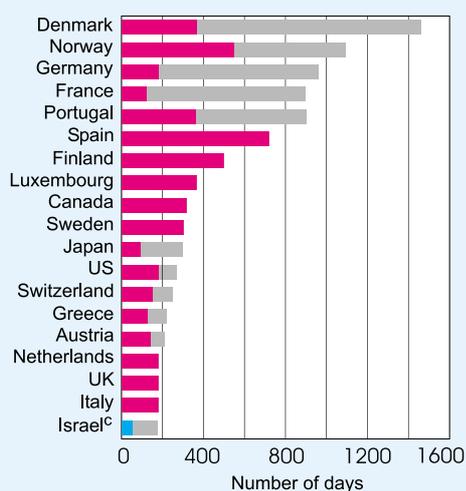
SOURCE: National Insurance Institute; and Social Security Programs Throughout the World, Europe, 2002

It can be assessed that the deterioration in the terms of the Unemployment Insurance Law at a time of rising unemployment, without the implementation of active measures in the labor market such as vocational training, wage subsidy, improved functioning of the Employment Service (Box 2.3), etc., alongside a reduction in the extent of foreign workers employed, will not increase employment, and might inflict damage on weaker sections of the population which anyway have difficulty finding work, especially in pockets of unemployment on the periphery. Dealing with the abuse of the Unemployment Insurance Law should focus on implementing the law, including the employment test.

³ See, *The Unemployment Insurance Law, an International Perspective*, Bank of Israel press release, 17.12.2002 (Hebrew).

Note, in conclusion, that the Arrangements Law for 2003 states that unemployed persons who participate in vocational training courses will receive unemployment benefit provided their maximum payment period has not ended. Formerly they received unemployment benefit throughout the training period, and it was not included in the number of days of eligibility for unemployment benefit. This means that recipients will prefer to embark on courses at the beginning of their period of unemployment, before attempting to find work utilizing their current human capital. In addition, for most unemployed persons the maximum period of eligibility is shorter than most courses, so that many may refrain from participating in them, even though the lengthy courses provide skills that are relatively valuable in the labor market; as a result their chances of finding work will decline.

Figure 2
Maximum Period in Which Unemployment Benefit is Paid^a in Israel and Selected Countries, 2002^b



^a The maximum period of entitlement depends on the qualifying period, and/or the number of dependants, and/or age.

^b The data for the US, Japan and Canada relate to 1999.

^c In Israel maximum entitlements are: 175 days, if the unemployed person is at least 45 years old, or at least 35 years old if he/she has three or more dependants; 138 days if he/she is at least 35 years old and has fewer than three dependants, or if he/she is less than 35 years old and has at least three dependants; 100 days if he/she is between 25 and 35 years old and has fewer than three dependants; 50 days if he/she is less than 25 years old and has fewer than three dependants; 70 days for a soldier in the first year after demobilization.

SOURCE: National Insurance Institute; and Social Security Programs Throughout the World, Europe, 2002

Box 2.3 Public Employment Services in Israel and Elsewhere

The Employment Service fulfills a pivotal role in improving the interaction between job-seekers and employers. Better matching between them raises output and wages, and the shorter period needed for this reduces the costs associated with unemployment. The public employment service is concerned primarily with the weaker segments of the population, which suffer more

than others from unemployment, and thereby contributes to reducing inequality in the unemployment burden. With the rise of unemployment in many western countries, including Israel, the importance of the organization has grown.

In recent decades many developed countries have made significant structural changes in the public employment service and its spheres of activity.¹ The main one has been to shift the emphasis from serving as an intermediary between employees and employers, to implementing proactive government policy in the labor market. Other important measures have included:

- Outsourcing part of the placement process, in order to make it more efficient: this has been taken furthest in Australia, where placement has been privatized. Other countries have liberalized the activities of private employment services. Research has shown that the chances of a public employment service making a successful placement are usually lower than those of a private employment service, except for the long-term unemployed.²
- Expanding the treatment of job-seekers on an individual basis: this includes in-depth interviews, vocational guidance, providing skills in writing C.V., setting employment objectives, etc. These activities were found to be effective, and their cost was generally low. They are very important for the long-term unemployed.
- Integrating various activities within a one-stop center, or instituting close cooperation between various agencies providing different services.
- Extensive computerization: providing user-friendly personal computers, not only at the employment service office but also in public institutions, shopping centers, etc., where it is possible to access detailed descriptions of vacancies available by various designations (profession, location, etc.). The internet also has an important role to play in this.

In the wake of these changes the OECD³ has recommended making the public employment services responsible for three areas: determining eligibility for unemployment benefit, placement, and referring suitable candidates to active labor market programs. In Israel the first two spheres are the responsibility of the Employment Service, while the third is that of the Ministry of Labor and Social Affairs (primarily the Manpower Training and Development Department).

¹ P. Thuy, E. Hansen, and D. Price (2001), *The Public Employment Service in a Changing Labour Market*, The International Labour Organisation, International Labour Office, Geneva.

² P. Gregg and J. Wadsworth (1996), "How Effective are State Employment Agencies? Job Centre Use and Job Matching in Britain," *Oxford Bulletin of Economics and Statistics*, Vol. 58, No.3.

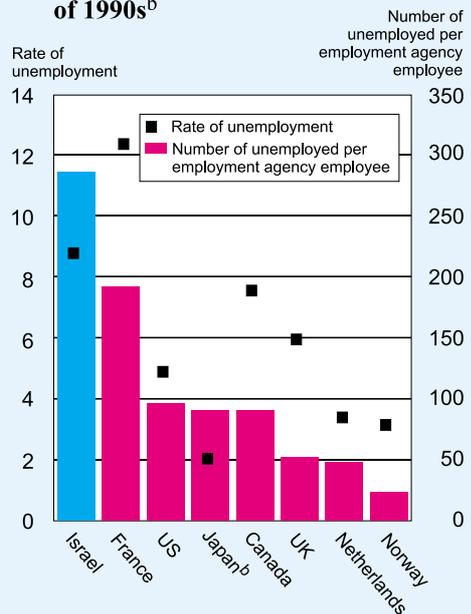
³ OECD (2001) *Labour Market Policies and the Public Employment Service*.

The process of weakening Israel's Employment Service has been continuing for several years, and was reinforced in 1991 by the annulment of the obligation of employers to refer all vacancies to the Service. The proportion of job offers directed to the Employment Service has been declining steadily since then (currently, only about a third of all vacancies are referred to it). The proportion of job-seekers who are helped by the Service and have found work through it is small. In the 1980s the adult section of the Service received one job offer for every two job-seekers, and by the 1990s there was one for every 10. The Service is perceived as being concerned with the weaker segments of the population, e.g., the long-term unemployed, and those who are often out of work, and this tends to deter job-seekers and employers from making use of it. This has given rise to a vicious circle, from which the Service finds it difficult to escape.

The ability of the Employment Service to devote the necessary time to dealing with job-seekers on an individual basis has declined as the resources available to it have been curtailed, so that its main function has become to provide authorization for recipients of unemployment benefit (and income support). The number of job-seekers per full-time Employment Service employee has doubled since the early 1990s, and in 2002 it stood at over 250, five times as many as in the 1980s. It may be assumed that reducing the frequency of the attendance requirement and computerization of the process could compensate for the contraction in labor input.

The number of job-seekers per Employment Service employee in Israel is far larger than the accepted figure in western countries, even taking Israel's high unemployment rate into account (Figure 1). The expenditure by Israel's Employment Service (as a

Figure 1
Number of Unemployed Persons per Employee in Employment Service Agencies^a and the Rate of Unemployment at the end of 1990s^b



^a Excluding head office staff of the Employment Service.
^b 1991.

SOURCE: Based on Ministry of Finance and Central Bureau of Statistics data; and Thuy et al (2001); *OECD Employment Outlook*, June 2001; International Labor Organization (2002), *Yearbook of Labor Statistics* 2001.

ratio of GDP) is lower than that of most of the OECD countries, and this is also the case with expenditure per unemployed person (as a ratio of GDP per employed person).

In order to improve the quality of placement, the Employment Service should establish an extensive set of procedures for dealing with job-seekers, bringing them together under one roof. These should include government units intended to provide employment solutions (e.g., public works and rehabilitation centers), increasing cooperation with the Manpower Training and Development Department and even incorporating it; increasing reliance on the computerized system in order to match job-seekers with job offers and monitor the quality of placements; establishing user-friendly computer terminals enabling job-seekers to look for work directly, according to various definitions; to increase efforts to identify job-offers; to apply the employment test more stringently, and possibly also to require unemployed persons to seek work elsewhere than via the Employment Service. Prior to making these improvements it is necessary to make the Service function more efficiently, adding resources where needed (and making the number of its employees more flexible in accordance with the extent of unemployment), adopting advanced management patterns, defining clear quantitative targets, and adhering to proper administrative procedures.

Experimental employment centers for income support recipients are to be established in 2003, in accordance with the recommendations of the Tamir Committee (2001), and in which the Employment Service will be incorporated (see Box 2.1). The results of the experiment will aid in formulating the changes needed in the Employment Service.

6. WAGES⁸

The average nominal wage per employee post in 2002 dipped by 0.4 percent, reflecting a 1.2 percent increase in public-services wages and a 1.0 percent decline in the business sector, after the nominal wage rose by 2.7 percent in both sectors in 2001. The wages of foreign workers are denominated in dollars, and hence the sharp local-currency depreciation in 2002 served to increase their wage and to moderate the decline in the nominal wage per employee post in the business sector. During 2002 the downward trend of the nominal wage was checked, and it even began to rise slightly. Note that the nominal wage per employee post in Israel has not declined since statistics were first gathered and recorded in the early 1960s. It has always risen, the only exception to this being during the severe recession of 1967.

⁸ The wage per employee post (as reported by the National Insurance Institute) is calculated as total wage payments *divided by* total employee posts, and is not weighted by the extent of posts. Note that some of the change in the wage per employee post is technical and derives from the change in the extent of the post, the composition of employment, etc.

Table 2.8
Change in Real Wage per Employee Post,^a 1998–2002

	(percent, at constant prices)				
	1998	1999	2000	2001	2002 ^b
Total	2.2	2.6	6.2	3.0	-5.7
Israelis				2.6	-5.4
Public sector	0.4	0.1	5.3	2.7	-4.2
Business sector, total	3.0	3.6	6.6	3.2	-6.3
Israelis				2.7	-5.8
Agriculture, total	3.1	2.7	5.3	8.3	-4.8
Israelis				5.4	-3.9
Manufacturing	5.5	5.2	4.3	3.2	-4.6
Electricity and water	2.8	2.3	7.6	2.5	-3.2
Construction, total	2.3	3.9	6.3	4.3	-4.4
Israelis				0.3	-4.5
Commerce and repairs	2.7	-0.4	6.1	2.2	-6.5
Hotel and catering services, total	0.6	1.2	4.0	-0.1	-6.1
Israelis				-0.4	-6.1
Transport, storage and communications	1.4	0.6	1.5	0.9	-5.4
Financial services	-2.6	3.9	12.0	1.7	-6.9
Business services	4.2	10.3	14.2	3.6	-9.0

^a The real wage per employee post, according to National Insurance Institute reports, includes reported foreign workers and Palestinians, unless stated otherwise.

^b Data on wages of Israelis relate to the first 11 months of 2002. Rate of change calculated as the change from the previous year.
 SOURCE: Central Bureau of Statistics.

In real terms, the average wage per employee post declined by 5.7 percent in 2002 (Table 2.8)—a fall not seen since the 1980s—by 4.2 percent in the public services and 6.3 percent in the business sector. Towards the end of the year the rate at which the real wage declined slowed, largely due to the moderation of the increase in the CPI.

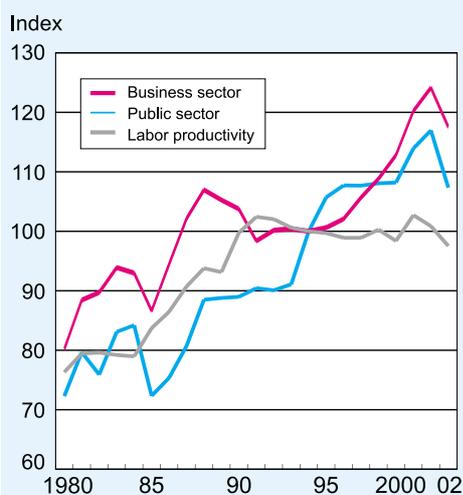
Wage drift in the public services (promotion, bonus for length of service, etc.) is estimated at 2–3 percent a year, so that the moderate rise in the nominal wage per employee post in this sector in 2002 reflects the absence of a valid cost-of-living agreement (COLA) and signed wage agreements with some employees, as well as the accelerated recruitment of new employees at the lower echelons of the wage scale. The shift in the composition of public-services employment did not affect the average wage in 2002.

The slight dip in the nominal wage in the business sector reflects the effect of the deepening recession and further increase in excess labor supply. Employers reached the conclusion that the recession would continue, and sought to adjust their labor force to the low level of demand, as well as refraining from raising wages and sometimes even worsening terms of employment. Naturally, the bargaining position of employees was weakened. The heightened connection between conditions in the economy in general and the development of wages is consistent with the trend towards a more flexible labor market—a lower level of unionization alongside a rise in the share of plant agreements and personal contracts, greater employment via private employment agencies, increased competition in the goods market in Israel, etc.

The average number of hours worked per business-sector employee rose by 0.7 percent in 2002, but the marked real contraction of business-sector product caused labor productivity (net domestic product per hour worked, at constant prices) to decline by 3.7 percent, further to its 1.8 percent dip in 2001. There was a marked drop in labor productivity in the financial and business services, as well as in commerce and hotels and catering, in which labor input did not decline, despite the fall in by-industry product. Labor productivity went down by 0.9 percent in manufacturing due to the marked fall in product, which was not fully offset by the contraction of labor input. Labor productivity rose in transport, communications, and agriculture because of the rise in product, alongside the contraction of labor input.

The sharp erosion of the real wage in the business sector moderated the 1.3 percent rise in unit labor cost, compared with its 6.6 percent increase in 2001. Since in the long run the real business sector wage is determined on the basis of labor productivity,⁹ (Figure 2.4), the process of adjusting labor input and wages by firms to falling demand appears not to have been concluded.

Figure 2.4
Index^a of Real Wage per Employee Post in the Business and Public Sectors and Labor Productivity^b, 1980–2001



^a 1994=100.

^b Business-sector net domestic product per labor hour, at constant price.

The sharp drop in the real wage in 2002 is explained not only by the deepening recession, expressed in the decline of the nominal wage, but also by the fall in labor productivity, the unexpected inflation, and the absence until the end of the year of a valid COLA that would compensate—if only partially—for the rise in prices. In 2001:IV 12-month inflation expectations were slightly above 1 percent (they rose to 2–3 percent only at the beginning of 2002, after the steep reduction of its key interest rate by the Bank of Israel in December 2001). The CPI, on the other hand, rose by 6.5 percent in 2002, and since the second half of the 1990s unexpected inflation has explained 30 percent of the change in the real wage.¹⁰

There was no change in the minimum wage in 2002, after the average wage per employee post (in accordance with the National Insurance Law) was frozen for

a year under the Arrangements Law for 2002. The average wage is the basis for calculating the minimum wage and some social security benefits. In real terms, the

⁹ Y. Lavi and N. Sussman (2001), “The Determination of Real Wages in the Long Run and its Changes in the Short Run: Evidence from Israel, 1968–88,” Bank of Israel, Research Department, *Discussion Paper* no. 2001.04.

¹⁰ *Ibid.*

The steep drop in the real wage in 2002 is explained by the deepening recession, expressed in a decline in the nominal wage, as well as by the reduction of labor productivity, the unexpected inflation, and the absence of a valid COLA until the end of the year.

annual average minimum wage was eroded by 3.1 percent, after rising by a steep 7.9 percent in 2001. Many employees earn the minimum wage, or a wage that is linked to it, so that its erosion helped to moderate the rise of the real wage in 2002, although this was limited because of incomplete compliance with the law.

The change in the by-industry composition of business-sector employment contributed 0.3 percent to the decline in the real wage in 2002; in manufacturing this contribution was only 0.1 percent, compared with 1.6 percent in business services. The contribution of the change in the composition derived from the decline in the share of persons employed in the industries in which wages are relatively high. The effect of the intra-industry composition of employment during a recession is not clear. On the one hand, more employees were fired, usually those with less seniority (although the proportion of more senior employees fired has risen of late),¹¹ while on the other, the extent of new workers recruited—most of whom are at the bottom of the wage scale—declined.

The dip in the real wage per employee post in the business sector was led by the financial services (6.9 percent) and business services (9.0 percent). The 11.1 percent decline in the real wage in the computer services industry, which was adversely affected by the steep drop in activity of the high-tech industry in Israel and abroad, was notable. The wages of persons employed via employment subcontractors also plummeted, and since many of them earn the minimum wage,¹² its erosion affected their real wage. In the security guard and cleaning industry the real wage declined only moderately, probably due to the increased demand for security guards.

In manufacturing the real wage went down by 4.6 percent; in unskilled-labor-intensive industries it declined more moderately (3.3 percent), in the mixed industries it went down more steeply (4.9 percent), as was the case in skilled-labor-intensive industries other than electronic components (4.7 percent), due to the sharp drop in demand for their products. The electronic components industry is exceptional in that wages remained virtually unchanged in 2002: at the beginning of the year indices of activity in the industry (sales, employment, etc.) were at a low point, but improved consistently later in the year, although their average levels were still below those of 2001. The Survey of Manufacturing indicates that in most industries labor costs (wages and associated costs) per hour worked declined at the same rate as the hourly wage, but in the high-tech industry labor costs declined far more steeply, indicating that employers reduced various additional benefits.

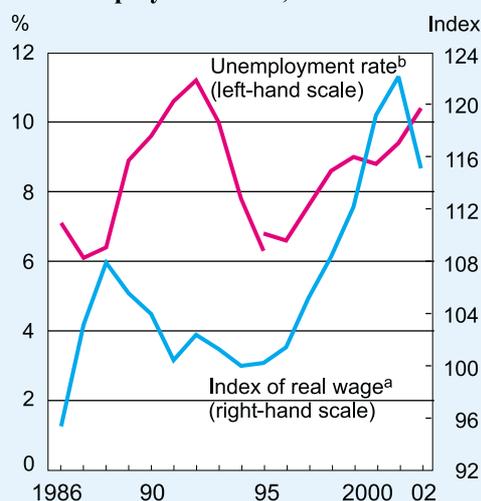
In catering and hotels the real wage fell by 6.1 percent, *inter alia* due to the collective agreement in the hotel industry signed in the wake of the crisis in tourism and which led to the reduction of nominal labor cost by 5–7 percent.

The number of strikes and days of work lost declined in 2002, apparently because of the continued recession and intensification of security incidents. The labor disputes which erupted related to the marked erosion of the real wage, as the signing of the

¹¹ S. Handles (2003), “Dismissal from Work: New or Veteran Employees?” Ministry of Labor and Social Affairs, Manpower Planning Authority, *Labor-Market Information Pages*, January (Hebrew).

¹² See Box 2.2 in last year’s edition of this publication.

Figure 2.5
Index of Real Wage per Employee
Post in Business Sector^a and
Unemployment Rate, 1986–2002



^a 1994 = 100. Excluding Palestinian workers.

^b In 1995 the Central Bureau of Statistics' definition changed.

SOURCE: Central Bureau of Statistics.

COLA has been delayed, and no agreement has yet been reached regarding 1999–2001 (except with the Union of Teachers, High-School Teachers, etc.). During 2002 collective agreements were reached between the government and some unions regarding such topics as payment of teachers in the public school system in areas where a long school day is in force, wage-increments of various kinds for members of the teachers unions, public-sector nurses, etc.

In the framework of the measures intended to cut public-services expenditure, the government decided to cut the overtime quota of employees, which constitutes a substantial component of the wages of some of them; this has not yet been implemented, however. The wage of senior public-services employees which is linked to the average wage, was frozen for 2002–03, but this did not apply

to the wage of other senior officials which is linked to the CPI, because of the terms of their employment contracts. An attempt to reach an agreement regarding a general wage freeze (excluding those covered by signed labor agreements) failed.

In November 2002 a COLA was signed for the business sector, and an order extending it to the public services was signed at a later date. According to this, employees would receive a COLA increment of 90 percent of the rise in the CPI in 3003 less 4.25 percentage points, up to a monthly wage ceiling of NIS 7,700. Thus, the COLA amounted to 2.0 percent, and will be paid in installments: 2.1 percent as of January 2003, up to a ceiling of the minimum wage (a similar one-off grant was made in December 2002), and 2.0 percent as of January 2004, up to a ceiling of NIS 7,700. Thus, the compensation for the rise in the CPI is extremely partial. In 1990–97 this compensation covered 40 percent of the rise in the CPI.¹³ The COLA signed in August 1998, which was in effect until January 2001, set an updating formula similar to the current one, and the compensation was negligible because of the moderation of the rate of price increases. Note that in the past the under-compensation implicit in the COLA was taken into account when signing wage agreements.

During 2002 the transition from a pay-as-you-go (unfunded) to a pay-as-you-earn (funded) pension went into effect regarding new recruits to the public services, after a

¹³ Y. Artstein (2001), "The Flexibility of Israel's Labor Market," in A. Ben-Bassat (ed), *From Government Intervention to a Market Economy: The Israeli Economy 1985–99*, Am Oved and the Falk Institute of Economic Research in Israel (Hebrew).

The number of strikes and days lost declined in 2002, apparently due to the continued recession and exacerbation of the security situation.

During 2002 the transfer of new public-services recruits from an unfunded pension scheme to a funded one went into effect. The agreement has far-reaching implications for the labor market too, including a worsening of terms of employment of new recruits, but improves occupational mobility between the public and private sectors.

similar arrangement had been introduced for employees of the local authorities and other public entities. An unfunded pension is financed by the employer; the salary determining the pension is that paid to the employee prior to his or her retirement, and the annual accrual rate is generally 2 percent. A funded pension is financed by both the employer and the employee; however, the determining salary is in accordance with the wage earned by the employee throughout his or her working life, (*plus* wage components for which pension contributions are made), and the accrual rates decline with age (only in the new pension funds). The arrangement is intended above all to prevent the constant rise in the government's actuarial commitments due to the unfunded pensions, but also has far-reaching implications for the labor market. On the one hand, it worsens the terms of employment of some new recruits to entities where an unfunded pension arrangement was formerly in place, though on the other, it increases occupational mobility between the public and the private sectors. Till now employees who had not accumulated sufficient years of employment in the public services were not entitled to receive an unfunded pension upon retirement, so that some of them refrained from moving to the private sector, while under a funded pension arrangement pension rights are retained.

Box 2.4

Measures to Increase the Cost of Employing Foreign Workers

The increased employment of foreign workers is first and foremost the outcome of the low cost of employing them (wages and associated costs), which is less than that of employing Israelis. In construction and agriculture, where foreign workers account for 40 percent of all persons employed in the industry, the gross wage per hour worked of a legal foreign worker was 30 percent less than that of employing an Israeli blue-collar worker in 2001.¹

From the employer's standpoint, the cost of employing anyone includes not only his or her gross wage, but also associated costs, such as national insurance and welfare contributions. The national insurance contribution paid by employers of foreign workers is 0.84 percent, because they are insured only in some categories, compared with a contribution of 4.93 for an Israeli employee. The labor laws, including those regarding social benefits, apply to all employees. In effect, employers of foreign workers tend not to pay social benefits. The employer's contribution for an Israeli worker who belongs to the builders' union is 18 percent, and in agriculture it is estimated to be similar.

¹ Note that employers of foreign workers are liable to bear the costs of recruiting them, bringing them to Israel, and financing their stay in the country, which are sometimes equivalent to wage-hikes, so that the wage differences could be smaller.

Because of the differences in the gross wage per hour worked and associated costs, the cost per hour of employing a legal foreign worker in construction and agriculture is 40 percent less than that of employing an Israeli blue-collar worker.

The employment of foreign workers has a deleterious effect on the employment and wage of Israeli blue-collar workers, even crowding some of them out of the labor market. The policy of reducing the employment of foreign workers must include the reduction of the number of permits issued for foreign workers and the deportation of foreign workers without permits (who constitute two-thirds of all foreign workers), on the one hand, and an increase in the cost of employing them, on the other.

At the end of 1996 the recommendations of an inter-ministerial committee (the Gal-Yam Report) on employing foreign workers were submitted. It recommended *inter alia* that a fee be charged for permits to employ foreign workers, and that an annual employment impost be imposed for each foreign worker, that a banker's guarantee be required from employers to ensure that all their obligations were discharged in accordance with the terms of the permit, that the foreign workers be obliged to make a monthly deposit which would be returned to them upon leaving the country at the end of the permitted period, after deduction of 15 percent for taxes and fees, and that the tax-credit points allotted to foreign workers for residence be reduced. The committee also recommended that employers' legal obligations, including those arising from Israel's labor legislation (particularly the Minimum Wage Law and the Hours of Work and Rest Law), be enforced more strictly, and that employers of foreign workers without permits should be fined and even deprived of the right to obtain permits to employ foreign workers for a prescribed period. To date these recommendations have not been effectively implemented, and the number of foreign workers has risen continuously.

In the wake of the report of the inter-ministerial committee on foreign workers and the establishment of an immigration authority (Rachlevsky Report, July 2002), it was decided to set up an immigration authority which would be responsible for dealing with the subject of foreign workers. Since November 2002 hardly any new permits for foreign workers have been issued and the efforts to deport those already in Israel but without permits have been stepped up, following the augmentation of the relevant departments of the police force. Although the number of foreign workers has not declined, the extent of enforcement activities among employers (reports, fines, etc.) has risen appreciably. In addition the tax-credit points granted to foreign workers for residence have been canceled, and a procedure

whereby employers submit foreign workers' pay-slips to the Employment Service's payment department in order to ensure compliance with the labor laws has been established. Since 2003 employers have been charged a fee of NIS 500 for each request to employ a foreign worker, as well as an impost of NIS 4,000 (NIS 1,000 in agriculture) for each permit issued for a foreign worker (except for care-givers). This amount constitutes less than 10 percent of the average annual wage of a foreign worker, so that the cost of employing them is still much lower than that of Israelis.

Currently, foreign workers are restricted by their permits to remain with their legal employers, and upon leaving them their permits are revoked. As a result, the employers benefit from economic rent due to the quotas: they do not have to compete for the legal foreign workers, and hence can employ them without providing them with appropriate conditions. Hence, it is necessary to grant the permit to the individual foreign worker, subject to the limitations of his or her industry, which should be enforced.