

## Chapter 5

# The Labor Market

- ◆ Rapid economic growth affected the labor market in 2005, boosting employment, reducing unemployment, and causing a rise in wages.
- ◆ The rise in wages was accompanied by improved labor productivity and a drop in the cost of labor per unit of production, a continuation of the trend over the two preceding years.
- ◆ Hiring of workers in the business sector reflected heterogeneity in real activity: approximately 60 percent of new employees were in the trade and services sectors. In contrast, less than 10 percent of the new employees were hired by industry, which accounts for approximately one quarter of all business sector employment.
- ◆ Expansion in activity affected all sections of the population, but not to the same degree. Among highly educated people, the unemployment rate fell—approaching its natural level—which caused their wages to rise.
- ◆ Despite the recognition that helping economically disadvantaged people requires their inclusion in the labor force, some programs with this aim were cut back in 2005, while the policy of reducing employment of foreign workers was relaxed. Even so, a number of programs were formulated and put into operation, and are expected to yield results in the coming years.
- ◆ In order to promote the welfare of economically disadvantaged groups, policies designed to integrate them in the labor market should be continued and strengthened.

### 1. MAIN DEVELOPMENTS

Rapid economic growth, which began in the second half of 2003, led to positive trends in the labor market. Growth boosted employment, reduced unemployment, and caused a rise in wages.

The labor market's response to the acceleration of real activity starting in mid-2003 was slow, since uncertainty regarding the strength and durability of recovery made employers initially prefer increasing their production through greater utilization of the workers already employed. This led to steep rise in labor productivity in 2004. Other economies, such as the US and UK, behaved in much the same way. In the short term, high productivity facilitated emergence from the recession, and increased output with only a moderate rise in employment. In 2005, with the consolidation of growth, the

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The rise in labor productivity in 2005 stemmed from continued improvement in utilization of factors of production.

The rise in labor productivity in 2005 stemmed from continued improvement in utilization of factors of production. This was affected by a fall in the ratio of capital to labor in the business sector for the year, following a steep rise in the recession years. Economizing processes and technological improvement also contributed to the rise in productivity, although it is difficult to quantify their contribution. In addition, overall productivity has risen only moderately in the last decade, while the proportion of labor remuneration in GDP fell. Assuming that the level of investment in machinery and equipment in the Israeli economy is close to equilibrium, and that no steep changes in it are expected (see Box 1 in Chapter 2), it is likely that the effect of efficiency drives and technological improvements on productivity and GDP will be felt in the coming years.

The relatively moderate increase in wages reflects the high level of unemployment in the economy. This facilitates expansion in activity and employment, without generating substantial pressure for higher wages.

The rise in hourly wages in the business sector was less than the increase in labor productivity, which caused a decrease in unit labor cost, following the steep drop in 2003 and 2004. The relatively moderate increase in wages reflects the high level of unemployment in the economy, particularly among workers with less education. This facilitates expansion in activity and employment, without generating substantial pressure for higher wages. For this reason, although wages have been developing in line with the business cycle in recent years—falling sharply during the recession and rising over the past two years—unit labor costs have been continuously declining for three years. These developments made it possible for manufacturers to increase employment, without detracting from the profitability of production.

Hiring of workers reflected heterogeneity in real activity.

Hiring of workers in the business sector, which accounted for about 70 percent of new workers, reflected heterogeneity in real activity: 60 percent of them were in the services sectors (hotels and restaurants, and business services) and the trade sector. These sectors account for less than half of business sector employment. On the other hand, less than 10 percent of the new employees were in industry, which accounts for approximately one quarter of all business sector employment, and the number of workers in the construction sector fell.

In public services, employment expanded and wages remained unchanged. Over the three preceding years, policy was aimed at cutting wage costs and employment in the public sector. Noteworthy is the fact that employment in public services expanded in education and health, not in administrative sub-sectors.

Expansion in activity in 2003-05 affected all sections of the population, but not to the same degree.

Expansion in activity in 2003-05 affected all sections of the population; Employment rates rose for both well and poorly educated workers, and unemployment also fell among those with less education. The expansion of gaps in unemployment rates between the various groups halted in 2005, and wages of low-income earners also rose. At the same time, the gap in unemployment rates between groups and the non-uniform force of expansion in employment and wages show that demand for employees can be crudely separated into two categories: demand pressures for well educated and skilled workers, whose unemployment rate is low and close to its natural level, and

who are therefore in a strong bargaining position; and demand for workers with little education, whose supply curve is more elastic, and who are in a weak bargaining position. Low unemployment and higher wages among well-educated workers, and an analysis of the results of a survey of employers by the Ministry of Industry, Trade, and Labor, indicate increasing difficulty on the part of employers in recruiting employees with suitable qualifications.

Despite the recognition that helping economically disadvantaged people requires their inclusion in the labor force and reducing their dependence on welfare, the main measures adopted in Israel were scaling back transfer payments, starting in 2002 (which is expected to affect employment and welfare in the long term), and cutting the number of foreign workers in 2003 and 2004, while programs for encouraging employment lagged behind. Some programs aimed at integrating the unemployed in the labor market, such as those involving professional training and inducing single parents to join the labor market, were cut back in 2005, while the policy of reducing employment of foreign workers was relaxed. At the same time, a number of programs for including poorer segments of the population in the labor market, such as the “Mehalev” (an acronym for *Mehavtakhat Hakhmasah Leta’asuka Batukha*, From Income Supplements to Secure Employment) and “Tabat” (an acronym for *Tnufa Bata’asuka*, Momentum in Employment) programs, were formulated and put into operation, and are expected to yield results in the coming years. Trends in the labor market and policies adopted in recent years also led to an increase in 2005 in the proportion of families of workers among poor families, and in greater inequality in disposable income, although inequality in economic income remained unchanged, and economic income also rose among low-income earners.

In order to reduce the incidence of poverty by including economically disadvantaged people in the labor force, policies designed to make it easier for them to enter the labor market should be continued and strengthened. Resources should be invested in long-term implementation of these programs. Measures should be taken to improve the employment conditions of these groups, including a negative income tax. Their legal position vis-à-vis employers should be strengthened, while labor laws, including the Minimum Wage Law, should be rigorously enforced. At the same time, determined measures should be taken to reduce the number of foreign workers employed in Israel.

## 2. THE POPULATION

Israel’s population reached 6.91 million in 2005, an average of 1.8 percent more than in 2004 (see Tables 5.1 to 5.3 and 5.A.1). The population of working age rose by a similar rate. The overall fertility rate in Israel is 2.9 children per woman, amounting to 1.5 percent natural increase per year. This is higher than in developed countries, and

Despite recognition that helping economically disadvantaged people requires their inclusion in the labor force, the main measures adopted in Israel were scaling back transfer payments and cutting the number of foreign workers, while programs for encouraging employment lagged behind.

Policies designed to make it easier for economically disadvantaged groups to enter the labor market should be strengthened, and resolute measures to reduce the number of foreign workers employed in Israel should be continued.

Israel’s population reached 6.91 million in 2005.

**Table 5.1**  
**Principal Labor Market Indicators,<sup>a</sup> 2005**

	(percent)							
	Change from same quarter in 2004 <sup>b</sup>				Change from previous quarter <sup>c</sup>			
	I	II	III	IV	I	II	III	IV
1. Working-age population	1.8	1.8	1.8	1.8				
2. Participation rate in civilian labor force, <sup>d</sup> total					54.9	55.2	55.2	55.7
Men					60.4	60.6	60.8	61.0
Women					49.6	50.0	49.9	50.6
3. Civilian labor force	1.1	2.0	2.4	3.6	1.0	0.9	0.6	1.3
4. Israelis employed, total	3.1	3.8	3.6	5.0	1.7	1.1	0.8	1.4
4.1 Full-time employees	2.7	7.6	10.3	-6.1	1.8	3.1	-1.2	-2.7
4.2 Part-time employees	4.7	-7.0	-9.1	29.4	-0.1	0.3	5.1	10.4
4.3 Temporarily absent from work	-0.9	24.7	-3.1	4.5	-0.9	-2.9	3.1	-6.3
5. Public-sector employees (Israelis)	4.4	4.7	3.9	3.5	2.6	0.4	-0.5	1.0
6. Business-sector employees (Israelis)	2.5	3.4	3.5	5.7	1.1	1.7	1.2	1.5
7. Foreign workers in business sector <sup>e</sup>	4.9	4.9	-3.2	-0.9				
8. Palestinians workers in business sector <sup>e</sup>	8.6	55.8	18.0	20.1				
9. Average weekly hours worked per business-sector Israeli employee	0.7	1.0	2.6	-6.1	1.1	1.0	-1.5	-5.5
10. Israeli labor input in business sector	3.2	4.4	6.2	-0.8	2.2	2.7	-0.3	-4.1
11. Business-sector labor input of foreign workers <sup>e</sup>	6.9	50.8	16.7	12.0				
12. Business-sector labor input of Palestinian workers <sup>e</sup>	5.2	7.0	0.9	-0.9				
13. Unemployment rate <sup>d</sup>					9.2	9.1	8.9	8.8
14. Number of unemployed persons	-15.6	-13.5	-7.4	-8.9	-5.4	0.0	-1.5	-0.2
15. Real wage per employee post, total	-1.1	4.1	3.3	-1.2	-0.7	1.5	0.3	-2.4
15.1 Business sector	1.4	2.8	2.5	0.6	1.3	0.4	0.3	-0.6
15.2 Public sector	-6.4	7.2	5.3	-5.3	-5.3	-0.7	1.0	-3.3

<sup>a</sup> The numbers of foreign and Palestinian workers include both reported and unreported workers.

<sup>b</sup> Unadjusted data.

<sup>c</sup> Adjusted data.

<sup>d</sup> Actual level, not rates of change.

<sup>e</sup> National Accounts data.

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

**Table 5.2**  
**Labor Market Indicators,<sup>a</sup> 2002–05**

	(change over previous year, percent)			
	2002	2003	2004	2005
1. Population (annual average)	2.0	1.8	1.7	1.8
2. Immigrants who arrived in this period	-23.0	-30.7	-10.2	1.3
3. Working-age population	2.2	1.8	1.8	1.8
4. Participation rate in civilian labor force, total <sup>b</sup>	54.1	54.5	54.9	55.2
Men	60.2	60.1	60.6	60.7
Women	48.4	49.1	49.6	50.0
5. Civilian labor force	1.9	2.5	2.6	2.3
6. Total employees	0.2	1.2	1.9	4.1
Israelis	0.9	2.0	3.0	3.9
Non-Israelis	-5.0	-6.2	-8.3	6.4
7. Public-sector employees	3.1	1.5	-0.4	4.1
Public-sector labor input	5.1	-0.7	-1.6	5.0
8. Business-sector employees	-0.9	1.0	2.9	4.1
Israelis	-0.2	2.2	4.6	3.8
Foreign workers	1.5	-10.4	-9.4	3.0
Palestinians	-36.9	28.4	-3.7	24.1
Share in business sector of foreign and Palestinian workers <sup>b</sup>	14.0	13.0	11.6	11.9
9. Business-sector labor input	0.3	0.6	2.0	3.4
Israelis	1.0	1.6	2.9	3.1
Foreign workers	5.2	-25.6	-15.0	3.0
Palestinians	-34.4	31.5	-0.8	20.5
10. Real wage per employee post	-6.0	-3.0	2.5	1.2
Business sector	-6.7	-2.5	1.5	1.8
Public sector	-4.3	-4.1	4.6	0.0
11. Minimum wage (real)	-3.1	1.4	0.4	-1.3
12. Business-sector unit labor cost <sup>c,d</sup>	3.4	-4.3	-3.3	-1.9
13. Net business-sector domestic product per hour worked <sup>c,d</sup>	-4.7	2.1	5.6	3.0
14. Unemployment rate, total <sup>b</sup>	10.3	10.7	10.4	9.0
Men	10.1	10.2	9.5	8.5
Women	10.6	11.3	11.4	9.5

<sup>a</sup> The numbers of foreign and Palestinian workers include both reported and unreported workers.

<sup>b</sup> Actual levels, not rates of change.

<sup>c</sup> At constant prices.

<sup>d</sup> The calculation is based on gross product, and not net product as in past years.

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

**Table 5.3**  
**Principal Labor Market Indicators,<sup>a</sup> 2002–05**

	('000s, annual averages)							
	2002	2003	2004	2005	Change from previous year			
					2002	2003	2004	2005
1. Mean population	6,570.0	6,689.7	6,805.8	6,925.7	131.0	119.7	116.1	119.9
2. Immigrants who arrived in this period	33.6	23.3	20.9	21.2	-10.0	-10.3	-2.4	0.3
3. Working-age population <sup>b</sup>	4,706.2	4,791.8	4,876.0	4,963.4	101.5	85.6	84.2	87.4
4. Civilian labor force <sup>b</sup>	2,546.7	2,610.0	2,678.6	2,740.1	47.8	63.3	68.6	61.6
5. Number of unemployed <sup>b</sup>	262.4	279.8	277.8	246.4	28.4	17.4	-2.0	-31.3
6. Employees, total <sup>c</sup>	2,547.1	2,576.6	2,626.7	2,733.9	5.5	29.5	50.1	107.2
Israelis	2,284.4	2,330.2	2,400.8	2,493.7	19.5	45.8	70.6	92.2
Non-Israelis	262.7	246.4	225.9	240.3	-14.0	-16.3	-20.5	14.4
Foreign workers	232.4	207.6	188.5	194.0	3.5	-24.8	-19.1	5.4
Palestinians	30.3	38.8	37.4	46.3	-17.5	8.5	-1.4	8.9
7. Public-sector employees <sup>c,d</sup>	719.4	730.3	727.1	756.9	21.9	10.8	-3.1	29.8
8. Business-sector employees <sup>c,d</sup>	1,827.7	1,846.3	1,899.6	1,977.1	-16.4	18.7	53.3	77.5
9. Nominal wage per employee post, total (NIS per month)	7,071.7	6,907.6	7,049.7	7,234.7	-59	-164	142	183.9
Public sector	6,783.5	6,549.8	6,821.2	6,911.8	33	-234	271	88.5
Business sector	7,213.8	7,084.2	7,159.6	7,386.4	-97	-130	75	226.8

<sup>a</sup> The numbers of foreign and Palestinian workers include both reported and unreported workers.

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

<sup>c</sup> National Accounts data, including data from education and health imputed to business sector.

<sup>d</sup> Israelis and non-Israelis.

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

is closer to fertility rates in developing countries.<sup>1</sup> Fertility rates have not changed in the Jewish population over the past decade, while fertility in the Christian and Muslim populations and particularly in the Druze population has been falling.

Some 20,000 new immigrants arrived in Israel in 2005, the same low number as in 2004 and the 1980s (see Table 5.3). Approximately 1.2 million people have immigrated to Israel since the early 1990s, making up about 17 percent of the population. Immigration from Western Europe and South America increased in 2005, but the bulk of immigration—about 45 percent—is still from Eastern Europe. Worthy of note is the fact that figures for the beginning of the decade indicate a rise in emigration from Israel, with the balance of immigration nearing a negative figure.

In 1998, the Israeli government decided that the Falas Mura<sup>2</sup>—Jews who converted to Christianity in recent generations—were entitled to immigrate to Israel under the

<sup>1</sup> At the beginning of the decade, the average fertility rate was 1.6 children per woman in OECD countries, and 3.6 children per woman in developing countries.

<sup>2</sup> “Falas Mura” means “converted Falashas”.

20,000 new immigrants arrived in Israel in 2005, the same low number as in 2004 and the 1980s.

Entry into Israel Law, providing they undergo conversion to Judaism in Israel. The main reason for the lengthy delay in bringing the Falas Mura to Israel is concern that it will prove impossible to control the dimensions of such immigration, particularly its non-Jewish component, in addition to its high cost. In 2005, following public pressure and the deterioration of the living conditions of those remaining in Ethiopia, it was decided to increase the rate of Falas Mura immigration from 300 to 600 per month, and to bring the remainder of the group to Israel by 2007.

### 3. THE CIVILIAN LABOR FORCE

The civilian labor force, composed of Israeli workers and unemployed, numbered 2.74 million in 2005, 2.3 percent more than the average in 2004. The growth rate of the Israeli labor force in 2005 was higher than the growth rate of the working-age population, due to a 0.3 percentage point rise in the rate of participation in 2005, mainly among women. This increase was smaller than in the two preceding years. The increase in the rate of participation over the past three years was a result of improvement in the economic situation and the chances of finding employment (see Tables 5.1 through 5.3).

Continued growth in economic activity, combined with welfare cuts in recent years and more stringent criteria for receiving unemployment compensation and income supplements, including a requirement for active job seeking, were expected to cause a steep increase in the rate of participation in the labor force, but this did not occur. The rate has risen by 1 percentage point since the beginning of the decade, reaching 55.2 percent in 2005, but this is still far lower than the OECD average of approximately 70 percent. The average increase in the Israeli labor force participation rate in 2000-05 was about half the increase in the preceding decade (see Table 5.A.2 in the appendix). Low and declining participation rates are mainly typical of those with little education or religious education, and of Arab women. A breakdown of participation rates by level of education shows that in 2005, the weight of those with up to 12 years of education, whose participation rate is relatively low, fell, while the weight of those with over 12 years of education, whose participation rate is relatively high, rose. These changes followed the pattern since the beginning of the decade (see Table 5.6). The change in the relative weights of the different educational groups contributed to the rise in the participation rate in 2005.

Attention should also be paid to another group: people who have despaired and given up actively searching for employment, and are therefore not part of the labor force. They are able to work, however, and would do so if they could find jobs. This group grew by 60 percent to 64,000 in 2001-05. Those with less education (up to 12 years of schooling) accounted for more than 70 percent of this increase. Despite the fall in unemployment in 2005, there was no significant change in the number of those who have given up searching for employment, since the vast majority of this group

The growth rate of the Israeli labor force in 2005 was higher than the growth rate of the working-age population, due to a rise in the rate of participation this year.

Despite the fall in unemployment in 2005, there was no significant decrease in the number of those who have given up searching for employment, since the vast majority of them have low levels of education, and the unemployment rate in this group remains high.

has low levels of education, and the unemployment rate among those with low levels of education remains high, despite having fallen. Were those no longer searching for employment counted as unemployed, the unemployment rate would have soared to 12.5 percent in 2003 and 11 percent in 2005.

The failure of the participation rate to rise in 2005 and slackening pace of its increase throughout the current decade are due to the difficulties experienced by economically disadvantaged groups in finding employment.

The moderate rise in the participation rate in 2005, and the slackening in the pace of its increase in the current decade are due to the difficulties experienced by economically disadvantaged groups in finding employment. Among other things, these difficulties have been aggravated by globalization, which has intensified competition in conventional industries by exposing the Israeli economy to competing labor-intensive imports from countries with low wages, and by the large-scale entry of foreign workers employed at low wages. Poor enforcement of labor laws has also aggravated difficulties in joining the labor force experienced by those with low level of education. All these factors have led to a continuing drop in the relative demand for this group, reflected in the increased proportion of those with higher education in all sectors, as well as, to a lesser degree, the increased weight of education-intensive sectors in the Israeli economy. The same factors have weakened the bargaining power of those with low levels of education, while making the supply of their labor more elastic.<sup>3</sup> Another difficulty hampering the inclusion of those with low levels of education (up to 10 years) in the labor market is that they are 10 years older on the average than those with higher education. For these reasons, those with little education need support and advice in order to enter, and remain in, the labor market.

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Despite this trend, and the expressed belief that helping poor people requires their inclusion in the labor force and reducing their dependence on welfare, the main measures adopted in Israel were scaling back transfer payments, starting in 2002, and cutting the number of foreign workers in 2003 and 2004, while programs for encouraging employment lagged behind. This policy was implemented, despite the fact that active spending in Israel on encouraging employment is low by international standards: 0.2 percent of GDP, compared with 0.7 percent of GDP in OECD countries.<sup>4</sup> Furthermore, some of the government-initiated programs for integrating the unemployed in the labor market were scaled back in 2005: implementation of the Employment of Workers by Manpower Contractors Law was postponed again, this time to 2007 (for particulars about the law, see “The Amendment to the Employment of Workers by Manpower Contractors Law, and its Ramifications,” Bank of Israel Annual Report 2001, Chapter 2, Box 2). The number of participants in professional training courses fell, after dropping in 2004,<sup>5</sup> and the program for encouraging single

<sup>3</sup> For a discussion of these trends, see: Yossi Muallem and Roni Frisch (1999), “The Rise in Return for Education in Israel in 1976-99,” Bank of Israel Research Department; a series of articles for discussion in June 1999; and Karnit Flug, Nitza Kasir, and Sigal Ribon (2000), “Unemployment and Education in Israel: On Business Cycles, Structural Changes, and Technological Changes: 1986-98,” *Economic Quarterly* 3.

<sup>4</sup> According to the International Monetary Fund, March 2005, SM/05/74, Israel – Selected Issues.

<sup>5</sup> The emphasis in the past two years was on courses training people in professions to replace foreign workers, with preference given to courses in which at least 50 percent of graduates were placed in jobs.

parent women to participate in the labor force was only partially successful. The weakening of the trend towards reducing employment of foreign workers has also affected the chances of those with low levels of education to find jobs.

At the same time, many programs that will probably bear fruit in the coming years were formulated or put into effect in 2005. In August 2005, four job placement centers for those receiving income supplements began operating in the framework of the Mehalev program (for an extensive description of the Mehalev program, see Box 1 below). In July 2005, implementation of a five-year support program for enterprises in outlying and development areas began, together with a special allocation for minorities in the central region and for ultra-Orthodox communities.<sup>6</sup> In the first stage, 11 enterprises that won the tender are expected to hire 1,100 new workers. Simultaneously, the Tabat program for encouraging participation and employment among poor groups was formulated, and \$21 million was allocated to it over four years.<sup>7</sup> There are grounds for hoping that these programs will contribute to an increase in the rate of participation in the labor force among poor groups, and improve their chances of finding jobs.

Programs for including economically disadvantaged segments of the population in the labor market, such as “Mehalev” and “Tabat”, were formulated or put into operation in 2005, and are expected to yield results in the coming years.

### Box 5.1

#### The Mehalev Program: from income support to employment support (the “Wisconsin Program”)

The number of non-employed and low-wage earners has been increasing in recent years. The growth in this population, which is characterized by dependence on welfare, social alienation and an inability to improve and exploit opportunities, led to the establishment of the Tamir Committee<sup>1</sup> in 2000. The Committee’s mandate was to design a policy towards the non-employed who receive

<sup>1</sup> The Committee, which was headed by Yosef Tamir, included representatives of the relevant government ministries, the Brookdale Institute and academia. For more information, see “The Recommendations of the Committee for Reform of the Policy towards the Non-Employed who Receive Ongoing Income Support – Intermediate Report” (August 2001).

<sup>6</sup> Under the program, the state’s share of the average monthly wage cost for additional workers will be 15 percent, up to a maximum of NIS 120,000 per worker for five years. Enterprises in preferred sectors will be entitled to support totaling up to NIS 60,000 per worker during the full period of the program, even if they pay wages of less than NIS 6,750.

<sup>7</sup> The government and the Joint Distribution Committee are financing the venture in equal shares. Approved programs include “Ma’avarim” (transitions) for integrating Jews and Druze from the rural sector; “Strive” for encouraging young people with less than 11 years of education who have been out of the labor force for a long time; “Eshet Hayil” (Woman of Valor) for encouraging women; “Avihail” for encouraging parents of Ethiopian origin, from the Caucasus, and from the Arab sector; “Geshet La’Haim” (Bridge to Life) for graduates of boarding schools from unstable family backgrounds; and others. For an extensive description of these programs, see “Tabat - Tnufa Bata’asuka (Momentum in Employment), 2006 work plan.”

ongoing income support by suggesting efficient ways of integrating them into the job market. This followed similar efforts in the West.<sup>2</sup> The conclusions of the Committee were of two kinds: First, this population suffers from a lack of education, professional skills and work experience and second, there are deficiencies in the structure and operation of the institutions for encouraging employment. These include the splitting of responsibility between a number of ministries and the lack of coordination between the various bodies.

The Committee recommended the institution of a new program for integrating recipients of income support within the job market which would also reduce government welfare expenditure. The program is called Mehalev (Hebrew acronym for “from income support to employment support”) and was approved in the Arrangements Law of 2004.<sup>3</sup> The goal of the Law is to reduce dependency on welfare and to provide welfare recipients with a better chance of integrating within the job market.

In February 2005, contracts for the operation of Employment Centers were signed with four companies, each of which was a partnership between an Israeli company and a foreign company, and in August 2005 the Centers began operating.<sup>4</sup> It was decided that the Centers would be located in four regions:<sup>5</sup> Jerusalem, Hadera and its environs, Nazareth/Upper Nazareth and Sderot/Ashkelon. The target population consists of recipients of (or applicants for) income support (or income supplements) who are looking for work and are living within one of the defined regions.

In accordance with the economic model, the companies initially received a grant for setting up according to their quote in the tender. In each quarter, an operating budget is transferred to them (also according to their quote).<sup>6</sup> The goal for each Center over a period of two years is to reduce the payment of income support in its area by 35 percent by the end of the contract. If the Center does not meet one of its quarterly targets, payments are delayed up to the amount of the shortfall. If the Center reduces income support payments beyond its target, the additional savings are divided between the company and

<sup>2</sup> In 1996, the US enacted revolutionary legislation to reduce unemployment and government spending on welfare. Several European states took similar action. For more, see "From Income Support to Employment Support", Ministry of Finance.

<sup>3</sup> For a discussion of the issues, see also Avishai Bainish's "Implementation of the Wisconsin Program in Israel – Legal Aspects", the Clinic for Employment Welfare in the Faculty of Law of the Hebrew University of Jerusalem, 2005.

<sup>4</sup> Originally, the Tamir Committee recommended that the Employment Service operate one of the centers and that it receive additional budget for that purpose; however, this was not actually carried out.

<sup>5</sup> See "The Expert Committee for Choosing Regions", The Ministry of Industry, Trade and Employment.

<sup>6</sup> It should be pointed out that the budget was adjusted for the growth in the number of participants at the beginning of the period in accordance with the conditions of the contract.

the State. In addition, the Center is eligible for a bonus for every file that stays closed for more than 6 months<sup>7</sup> and, if half of the closed files remain so for over 9 months, it receives an additional bonus.<sup>8</sup> One of the main goals is to remove or at least reduce the barriers faced by the participants in finding employment (through assistance with daycare, transportation, clothing, health services, etc.) and a separate budget is allocated to them for this purpose. The Centers are reimbursed for expenses on the presentation of receipts and any unutilized budget can be transferred to the next quarter. It is worth mentioning that the companies are not obligated to provide this assistance to participants and that they receive an additional bonus at the end of the contract in the amount of 5 percent of any savings they achieve. Therefore, any analysis of the operations of the companies should examine whether they tend to minimize employment support services in a way that is inconsistent with the improvement in the quality of job placements.<sup>9</sup>

Within each Center, there are personal counselors whose function is to create a program for each participant that will enhance his chances of employment until he is placed. The program includes, among other things, training courses to acquire professional skills as well as service in the community (through public bodies and non-profit organizations) for those who have not yet been placed. The goal of the community service is to strengthen employment habits and commitment among the participants.<sup>10</sup> It is worth mentioning that the Centers are obligated to clearly explain to each participant his rights and obligations and that the continuation of income support is conditional on his ongoing participation in the Center's program. This is intended to prevent exploitation of income support by individuals who are working unofficially.<sup>11</sup> Once each month, the Center reports to the National Insurance Institute on the implementation of the personal program of each participant and on that basis

<sup>7</sup> Of course, not because of a refusal to accept a job offer.

<sup>8</sup> The profit of the operator is calculated according to graduated levels and a company can reach up to about one half of the savings on a cumulative basis.

<sup>9</sup> Nonetheless, the administration responsible for implementing the program on behalf of the government has recently instructed the companies to make wider use of the employment support services and even obligated the provision of certain services from within this budget.

<sup>10</sup> No more than 9 hours per day (with a break of at least 12 hours between each day of community service). The community service can last no longer than four continuous months for each participant. The service cannot be a replacement for the work of a paid employee. The community service must be for the benefit of a non-profit body and can only involve approved one-time projects. There must be an employee present who supervises and assists the program participants. Travel expenses to and from the location are reimbursed. The government must approve the type of community service and its duration.

<sup>11</sup> This obligation applies to both spouses. Thus, if one of the spouses quits the program, the payment of income support is suspended to the household as a whole.

his eligibility for income maintenance is calculated for that month. According to the Law, the planner's decision can be appealed.<sup>12</sup>

Since the beginning of the program, there have been some 24,000 referrals to the Centers. Most of the individuals referred are over 40 which in itself makes it difficult to find them suitable work. On average, the referred individuals have not worked for three years or more before arriving at one of the Centers. One of the most difficult problems encountered at the Centers is the wide variety of populations that are being dealt with. This makes it difficult for a Center to concentrate on one population in designing programs for the participants. According to the figures of the companies for January, about 6,374 participants (37 percent) were working (in full or part-time jobs) of which about one-third were employed in manufacturing, cleaning and security. Another 1,954 were involved in community service. In January, the income support for 2,985 individuals was suspended. Of these 1,054 individuals were asked to report to the Centers but did not show up; 38 did report but refused the work offered to them; and 1,893 were absent longer than permitted or didn't follow the program set down for them. Since the beginning of the program until January, 485 appeals were submitted to the Appeals Committee. Of those, 20 percent have not yet been ruled on; 5 percent were found to be justified; 5 percent were found to be partially justified; 12 percent were withdrawn by the participants; and 58 percent were rejected.

Microeconomic research has shown that in certain circumstances the intervention of the government in creating subsidized employment in the private sector has a positive influence on the level of employment.<sup>13</sup> According to the theoretical models, assistance in job search leads to an increase in employment rates and also reduces government expenditure.<sup>14</sup> Research which has attempted to evaluate the US program showed that a reduction in welfare payments had been achieved but that the majority of participants were still under the poverty line. It even found that the phenomenon of the working poor had become more prevalent.<sup>15</sup> It has been found that the success of the program is also dependent on the positions that the Center offers to the participants and their stability.<sup>16</sup> At this stage, the program is operating in Israel according to a temporary order for

<sup>12</sup> The Appeals Committee consists of three members: the chairman who is a public sector employee and expert on employment, a social worker and an economist.

<sup>13</sup> See Natalya Pesserman and Aryeh Arnon, "Unemployment in Israel during the Period 1970–2003 and Possible Policy Measures", the Van Leer Institute, 2005.

<sup>14</sup> G.J. Van den Berg, B. van der Klaauw, and J.C. van Ours (2004), "Punitive Sanctions and the Transition Rate from Welfare to Work", *Journal of Labor Economics*, 22(1), 211-241.

<sup>15</sup> D. Smith Nightingale and K.S. Mikelson, "An Overview of Research Related to Wisconsin Work".

<sup>16</sup> D. Autor and S. Houseman, "Do Temporary Help Jobs Improve Labor Market Outcomes for Low-Skilled Workers? Evidence from Random Assignments", Working Paper 11743, National Bureau of Economic Research, 2005.

a three-year period (although the tenders are for two years). Since the program has only been operating since August 2005, sweeping conclusions cannot yet be reached. However, some preliminary comments and recommendations for improvement can be made. Three main issues have come to light during the implementation of the program: First, what is the program's effect on the unskilled who are already employed? Will the large-scale addition of unskilled individuals to the labor market harm the working conditions of those already working?<sup>17</sup> Is the community work done by the participants at the expense of others' source of livelihood?

Second, is the program sufficiently concerned about maintaining the rights and welfare of the participants? Also in this context, does the community work perhaps create a class of "workers without work" at wages that don't even come close to minimum wage. Out of concern that the participants' rights are being infringed upon, various social organizations that are opposed to the program are working to protect the participants. Two non-profit organizations have jointly founded a project called "With a Hand on the Heart"<sup>18</sup> which offers a sympathetic ear to the participants and tries to monitor the program. The figures on the project show that some 800 of the participants claim that they were not made sufficiently aware of their rights.<sup>19</sup> An additional problem arises from the obligation of all the participants to report to the Centers based on the definition of who is employable according to the tests of the National Insurance Institute. Apparently, these tests do not identify with full accuracy the partial handicaps, whether physical, mental or emotional, which rule out placement in a regular job. In order to deal with the population suffering from special difficulties, a government committee has been established which is headed by the Director General of the Ministry of Industry, Trade and Employment and is composed of representatives from various government bodies (the Ministry of Finance, the Ministry of Health, the National Insurance Institute and the Employment Service as well as an occupational doctor). This is an internal committee that operates as part of the program with the goal of identifying special populations and finding specific ways of dealing with them. The Committee also invited the social welfare organizations to present their views.

The third issue involves the nature of the monetary incentives the operator faces. Are the rights of participants harmed because the Center's compensation is determined more by the reduction in the number of income support recipients than by the number of placements and their quality? On the one hand, this incentive

<sup>17</sup> R. Solow, "Guess who Pays for Workfare?" *Work and Welfare*.

<sup>18</sup> This is a joint project of the Commitment for Peace and Social Justice organization and the Community Advocacy organization.

<sup>19</sup> This figure does not include all the participants in the program since there are those who turned to other social organizations with similar claims.

is likely to expose income support recipients who work unofficially; on the other hand, it may encourage too drastic a policy in suspending the income support of individuals who are unable to participate in the program or whose abilities and skills are not suited to the personal program that was designed for them.<sup>20</sup>

In summary, the Mehalev program is meant to be a test case for the operation of a new service that will shift potential wage earners from dependence on income support to employment. The program has been operating for too short a time to make final conclusions with respect to its functioning. At present, it appears that the program is working to achieve its goal though it has encountered a number of problems that must be solved. In any case, the program has wide-ranging social and economic implications and, if successful, will contribute to the welfare of weaker segments of the population in addition to reducing government expenditure.

<sup>20</sup> According to the Law, the job referral and/or the personal program must be suited to the participant's health and physical fitness.

#### 4. EMPLOYMENT

Expansion in the business sector was fueled by economic growth, while public sector employment expanded after two years of growth slower than the rate of population increase.

Employment in the economy (Israelis, foreigner workers, and Palestinians) grew 4.1 percent in 2005, amounting to 107,000 new jobs. This was the highest rate of increase in the past five years. Employment rose by similar rates in the business sector and public services.<sup>8</sup> Economic growth boosted employment in the business sector, while higher employment in public services followed two years in which public service employment grew at a lower rate than the population. Labor input in the business sector rose moderately, compared with the rise in the number of employees, due to a fall in the average number of work hours per employee in this sector, most of which was in the fourth quarter of the year. In public services, the increase in labor input was greater than the increase in the number of employees, with a rise in the number of work-hours per employee in this sector (see Table 5.4).

The business sector accounted for 70 percent of all new workers (see Figure 5.1). These jobs demonstrated the great heterogeneity of growth in 2005: 60 percent of new jobs were in service industries—hotels and catering, and business services—and the trade industry, all of which account for less than half of total business sector employment. Most growth in the business services industry was in research and development, indicating that expansion in this area is expected to continue. On the other hand, less than 10 percent of the new employees were in manufacturing,

<sup>8</sup> Public services include sub-sectors in which most employees work in the public sector. Because available data are limited, no more accurate distinction can be made between employees in the public and private sectors.

**Table 5.4**  
**Employment and Labor Input, by Industry,<sup>a</sup> 2001–05**

	Employment									
	'000s					Rates of change				
	2001	2002	2003	2004	2005	2002	2003	2004	2005	
Total business sector <sup>b</sup>	1,844.1	1,827.7	1,846.3	1,899.6	1,977.1	-0.9	1.0	2.9	4.1	
Agriculture	70.8	69.9	68.4	74.0	76.6	-1.3	-2.1	8.1	3.6	
Construction	219.7	207.6	203.7	192.7	188.3	-5.5	-1.9	-5.4	-2.3	
Manufacturing	403.7	387.8	384.5	394.7	401.8	-3.9	-0.9	2.6	1.8	
Commerce and vehicle repairs	319.9	331.6	334.3	343.8	357.5	3.7	0.8	2.8	4.1	
Hotels and catering services	138.9	134.6	131.0	136.3	148.1	-3.1	-2.7	4.0	9.4	
Banking, insurance, and finance	75.2	76.2	78.0	79.1	82.1	1.3	2.4	1.4	3.8	
Business services	320.6	320.5	342.9	356.3	371.8	-0.0	7.0	3.9	4.3	
Transport, storage, and communications	150.9	147.4	150.9	155.2	163.8	-2.3	2.3	2.9	5.6	
Public sector	697.5	719.4	730.3	727.1	756.9	3.1	1.5	-0.4	4.1	

**Employment and labor input, by industry, 2005**

	Employment						Labor input		
	'000s			Rates of change			Israelis	Foreign workers	Palestinians
	Israelis	Foreign workers	Palestinians	Israelis	Foreign workers	Palestinians			
Total business sector <sup>b</sup>	1,742.3	189.0	45.8	3.8	3.0	24.1	3.3	3.0	20.5
Agriculture	50.0	23.3	3.3	2.0	6.4	7.5	1.7	6.4	4.4
Construction	127.1	41.77	19.4	-1.2	-12.8	20.3	-2.0	-12.8	16.4
Manufacturing	391.7	1.2	8.9	1.3	-16.1	34.6	1.4	-15.8	28.0
Commerce and vehicle repairs	337.2	11.2	9.1	3.8	2.9	15.4	2.8	2.9	10.2
Hotels and catering services	115.1	30.8	2.2	11.2	2.2	24.2	9.9	2.2	18.4
Banking, insurance, and finance	82.1			3.8			4.9		
Business services	335.3	35.6	0.9	4.8	0.7	-6.2	4.2	0.5	-7.4
Transport, storage, and communications	162.6		1.2	5.5		11.2	4.8		8.4
Public sector	751.4	5.0	0.5	4.1	0.0	0.0	4.3	0.0	0.0

<sup>a</sup> Including reported and unreported foreign workers and Palestinians.

<sup>b</sup> Figures may not add due to the exclusion of 'miscellaneous.'

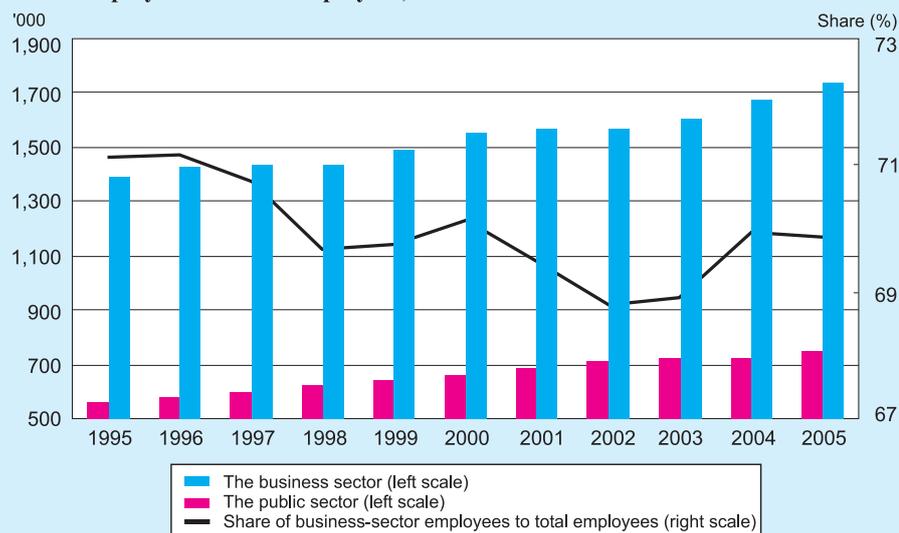
SOURCE: Central Bureau of Statistics and National Accounts data.

which accounts for approximately one quarter of all business sector employment. The number of workers in the construction industry fell, corresponding to a decline in construction activity.

The greater weight of service industries in the business sector employment, with a corresponding drop in the weight of manufacturing employment, are long-term phenomena characteristic of developed economies. Indeed, during the preceding business cycle in 2000-05, manufacturing and construction were the only sectors in which output and labor input fell. Output and labor input in all other sectors,

The greater weight of service industries in business sector employment and a corresponding drop in the weight of manufacturing employment are a long-term phenomena characteristic of developed economies.

**Figure 5.1**  
**The Number of Employees, by Sector, and the Share of Business-Sector Employees to Total Employees, 1995–2005**



SOURCE: Central Bureau of Statistics.

particularly services and trade, continued to rise (see Tables 5.4 and 5.8). Labor input in trade and services industries rose during the most recent business cycle, despite a drop in the average number of work hours per employee in these sectors over the entire cycle (see Table 5.A.9). This indicates expectation on the part of employers of continued expansion in activity, which motivates them to hire new workers, without reaching full utilization of the workers they already employ.

A survey of employers by the Ministry of Industry, Trade, and Labor shows broad improvement in demand for workers, encompassing most industries in the business sector.<sup>9</sup> The number of available jobs has risen continuously since mid-2004, and the number of jobs filled rose substantially. It appears that workers also feel more confident, since they are leaving jobs on their own initiative, as shown by the accelerated employment cycle (the number of jobs filled and left). Furthermore, the average length of time that a job remained open rose. In some industries (construction, transportation and communications, business services, and community services), the number of available jobs rose steeply. These findings indicate an increasing difficulty on the part of employers in recruiting workers with suitable qualifications.

Employment in public services grew in 2005, after an effort was made to reduce wage costs in the sector during the three preceding years. The rise in public sector

<sup>9</sup> In the first half of 2005.

Employers are finding it increasingly difficult to recruit workers with suitable qualifications.

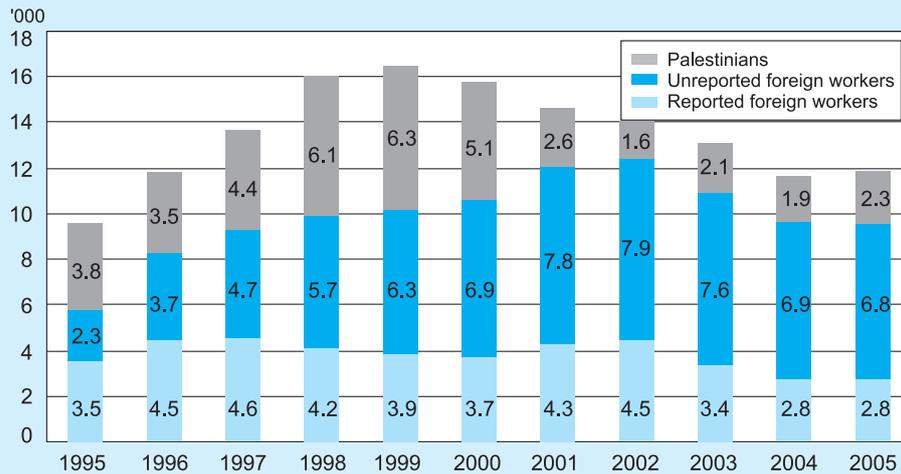
employment was not in administration sub-sectors (cutbacks even caused a fall in employment in the local authorities); It was in education and health. Half of the approximately 12,000 new employees in public services were in education, in stark contrast to the Dovrat report’s recommendation that employment be scaled back in this sub-sector and the Ministry of Education’s unsuccessful attempts to fire 4,500 teachers during the year. A closer look at the expansion of manpower in education shows that most new jobs in this sector were in pre-high-school and non-university higher education, in line with trends in these two groups over the past decade. In the health industry, employment expanded in non-hospital entities. However, limited data make it impossible to distinguish between expansion of employment in education and health financed by the public sector and privately financed expansion.

The rise in public sector employment was not in administration sub-sectors; it was in education and health.

Some 11.9 percent of employees in the business sector in 2005 were non-Israelis. Most of these were foreign workers from countries with low labor costs, and the remainder consisted of Palestinian workers (see Figure 5.2). The number of foreign workers rose despite government policy, following a steep decline in 2003 and 2004, and the proportion is still high by international standards. This situation is disturbing, given the high level of unemployment among Israelis with little education. As a result of the relatively calm security situation and relaxation of security restrictions, the number of Palestinian workers rose substantially in 2005, reaching approximately 50,000.

11.9 percent of employees in the business sector in 2005 were non-Israelis.

**Figure 5.2**  
**The Share of Foreign Workers and Palestinians in the Business Sector, 1995–2005**



SOURCE: Central Bureau of Statistics.

### a. Employment of Israelis

The number of employed Israelis rose 3.9 percent to 2.493 million in 2005, continuing a steady rise in the employment rate among Israelis (the employment rate among the working age population) since mid-2003. The number of Israelis employed was up 3.8 percent in the business sector and 4.1 percent in public services (see Tables 5.2 and 5.4). The rise in employment among Israelis in 2005 was accompanied by a 0.3 percent decrease in the number of work hours per employee. This decrease was entirely in the business sector, and mostly in the fourth quarter of the year.

Expansion in activity affected all sections of the population, but not to the same degree. Approximately 80 percent of new employees had higher education, even though their proportion in the working population was only 50 percent.

The rise in employment in 2005 was accompanied by no change in the weight of part-time jobs, even though seasonal employment and a high rate of part-time jobs are typical of the trade and services sub-sectors, which accounted for most of the rise in employment this year (see Box 2 below for an extensive discussion of the question of part-time jobs). The number of employees earning less than half the nationwide average wage also dipped slightly. Expansion in activity affected all sections of the population, but not to the same degree. Approximately 80 percent of new employees had higher education, even though their proportion among the working population was only 50 percent. The employment rate rose mostly among workers with higher education, and the weight of this group in the population also rose.

The dominant factor affecting employment among Israelis in all sectors was the extent of real activity.

The dominant factor affecting employment among Israelis in all sectors was the extent of real activity; changes in employment of non-Israeli workers probably also had some effect, mostly in construction, agriculture, and services, in which foreign workers are extensively employed (see Table 5.8 and 5.4). It appears that, despite the ongoing recession in the construction industry, there is a shortage of workers in it. The Ministry of Industry, Trade, and Labor's survey of employers showed that available jobs shot up 40 percent between the second quarter of 2004 and the second quarter of 2005. Government programs for replacing foreign workers in the construction industry with Israelis by training and subsidizing of Israeli workers were implemented either partially or not at all. Few Israeli workers were hired in the sector.

The changes in the number of foreign workers are also expected to affect Israeli workers in the welfare and household help sub-sectors. An examination of the effect of employment of foreign workers on employment of Israelis in the welfare (carers) sub-sector showed a drop in the number of Israeli carers, and a corresponding increase in permits for foreign workers in this sub-sector.<sup>10</sup> The fall in the number of Israelis working in welfare in 2005 follows a continual increase since 2002. The number of Israelis in the household services sub-sector rose in 2005, following a steep increase in 2004, probably as a result of enforcement and deterrence measures aimed at decreasing the number of illegal foreign workers employed in the sub-sector.

<sup>10</sup> There are no direct figures available for the number of foreign workers working in the welfare sub-sector.

**Box 5.2****Proportion of employees in part-time posts and its significance**

The increase in the rate of employment in 2003 and 2004 was accompanied by an increase in the proportion of part-time posts and in 2005<sup>1</sup>, this proportion stabilized. Since in general the income from a part-time post is not sufficient to support a worker's family, there are those who claim that this improvement in employment is problematic and that the growth in part-time posts indicates a worsening of the situation of individuals who were "pushed" into the labor market as a result of cuts in welfare benefits or the nature of growth during those years. This approach differs from that which predominates in developed nations according to which part-time posts are viewed as an essential component in the flexibility of the labor market which opens up employment possibilities for groups with no possibility or desire to work full-time. These groups include women, students and the elderly. Thus, for example, in the summation of the meeting between the labor ministers of the OECD countries in Paris in September 2003, emphasis was placed on the importance of flexibility in the labor market and the creation of part-time posts as a way of integrating additional populations within the workforce.

The proportion of part-time posts in the total number of posts in Israel is not significantly larger than in the OECD countries. Thus, the proportion of employees in part-time posts in Israel during the period 2001–04 was 15.1 percent while the average in the OECD countries was 14.2 percent.<sup>2</sup> Furthermore, during the last decade, the proportion of part-time posts in the OECD countries has grown by 2.5 percentage points (in the G7 countries by 3.6 percentage points) as a result of the policy measures taken in order to facilitate the creation of part-time posts, while in Israel the proportion has remained stable. The proportion of part-time posts is therefore not particularly high in Israel and is not characterized by an unusually high growth rate.

The proportion of employees in part-time posts among various population groups in Israel does not indicate any problematic concentrations. The groups that are characterized by a high proportion of part-time posts are in fact those which would be predicted by economic theory (Table 1). Thus, the proportion of employed women in part-time posts is three times higher than for men and they constitute 74 percent of the total employees in part-time posts. As expected, the proportion of employed women in part-time posts is particularly high among mothers with children of up to one year of age. The proportion is also high

<sup>1</sup> The analysis does not include 2005 since detailed figures are not available for that year.

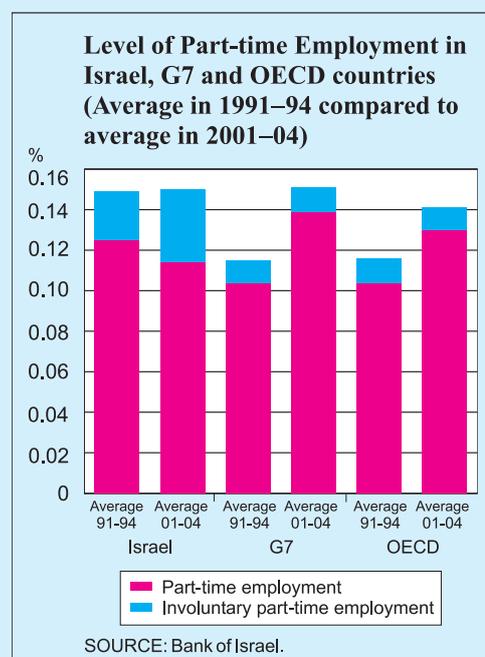
<sup>2</sup> The definition of a part-time post in Israel is different from the accepted international definition. For purposes of comparison, Israel's proportion of part-time posts was calculated according to the international definition which is based on the number of individuals who *generally* work in a post that involves less than 30 hours of work per week.

among employees over 60 although in the 51–60 age group it is no different than among younger groups. The proportion is also high among students who constitute some 16 percent of the total number of part-time employees. In contrast, the proportion of fathers with children up to the age of 18 who work part-time is, as expected, particularly low. The stability in the proportion of employees in part-time posts during the last decade characterizes all the segments of the population and does not show any changes among the various groups (apart from the increase among Arabs which is apparently related to the increase in employment among Arab women and to somewhat of a decline among the elderly).

Although the figures on the proportion of part-time employees in Israel do not indicate any particular problem, the question of whether employment in a part-time post is out of choice or not reveals a different situation.<sup>3</sup> The proportion of employees in part-time posts involuntarily in Israel is higher by three-fold than in the OECD countries. Furthermore, while in these countries the proportion of employees in part-time posts involuntarily has remained constant during the last decade, in Israel it has risen by about one-half, from 2.4 to 3.6 percent of total employees (Figure 1).

The rise in the proportion of employees in part-time posts involuntarily during the present decade followed a period of stability during the 90s. Although the phenomenon encompassed all the segments of the population, it was especially noticeable in certain groups, particularly those which have always been characterized by high rates of involuntary part-time employment, i.e. women, the young, Arabs and particularly individuals with little education. In 2000, the proportion of employees in part-time posts involuntarily within the total number of part-time employees was 18.4 percent. This proportion gradually rose to 26.7 percent in 2004. The majority (81.4 percent) of the employees in part-time posts involuntarily are women. Comparing the group with 16 years

<sup>3</sup> Employees who are forced to work part-time are defined as individuals who would like to work in a full-time post but are forced to make do with a part-time post. It should be mentioned that the subjectivity of the answers is problematic when making international comparisons.



of education to the rest of the population sharpens the picture. Thus, although the proportion of employees in part-time posts involuntarily among those with higher education (16 or more years of study) rose by 8 percentage points from 2000 to 2004, which is similar to the average rate of increase in the population as a whole and among those with 9–12 years of education, the rate of all highly-educated employees in part-time posts (whether voluntarily or not) fell by half a percentage point. This is in contrast to the increase of 1.2 percent in the proportion of part-time employees in the total population in this business cycle. This reflects the fact that only individuals with higher education have the ability to move from part-time to full-time posts. Among other groups as well, such as the above 60 group and students, the proportion of employees in part-time posts involuntarily rose between 2000 and 2004. However, the low proportion of employees in part-time posts involuntarily in these groups and the low proportion of these groups within the total of part-time employees (see Table) is an expression of the approach that stresses the advantages of market flexibility which has been adopted by the OECD countries.

#### Workers in Part-Time Jobs as Percent of Total Employees

	Percent of part-time workers within subgroup		Part-time workers in subgroup as percent of total part-time workers	
	2000	2004	2000	2004
Total	14.0	15.2	100.0	100.0
Men	6.0	7.1	23.7	26.0
Women	24.0	25.0	76.3	74.0
Aged 20–25	19.3	25.2	17.3	18.0
26–60	12.1	12.9	69.6	69.6
60+	34.1	36.6	13.1	12.4
Arabs	9.1	10.3	6.8	7.5
Years of education 0–8	16.5	19.1	7.5	6.6
9–12	10.2	12.1	31.1	32.1
13–15	16.2	16.9	29.1	28.8
16+	15.8	15.3	26.5	27.0
16+ who are neither ultra-orthodox nor new immigrants	16.0	15.1	21.2	24.9
New immigrants	13.4	15.5	17.4	7.6
Married, with spouse employed	12.4	12.5	44.8	41.2
Married, with spouse unemployed	14.2	15.5	21.4	21.9
Unmarried	16.8	19.5	33.8	36.9
Mothers	24.3	23.7	61.3	57.3
Mothers of babies under 1 year	26.6	27.6	8.2	8.5
Student	31.0	36.4	16.9	16.3

Although even now the employees in part-time posts involuntarily constitute only one-quarter of total part-time employees, one cannot ignore the rapid increase in this group in recent years. The concern over the increase in the number of part-time employees in Israel is amplified by the fact that among employees in part-time posts involuntarily, the proportion who remain in a part-time position for 12–18 months is higher than among other part-time employees (75 percent as opposed to 65 percent) and the tendency to leave employment is lower by about one-third. Therefore, some of those employees who wish to move to a full-time position are prevented from doing so by some barrier. This situation is similar in nature to unemployment since it results from a shortage in demand for workers and indeed a significant relationship was found between the rise in the rate of unemployment and the increase in the proportion of employees in part-time posts involuntarily.<sup>4</sup> The sharp increase in the proportion of employees in part-time posts involuntarily is a reflection of the Israeli labor market's difficulty in creating full-time posts for workers in general and for weaker segments of the population in particular. The problem can be attributed to the recession during the period 2000–02 or to the government policy of lowering welfare payments though an unambiguous conclusion would require an in-depth econometric investigation.

<sup>4</sup> For further discussion, see Cohen, Shtier and Nativ, “Involuntary Part-Time Work and Unemployment in Israel”, 1997–79, *The Economic Quarterly*, October 2000.

## b. Employment of foreign workers

The higher number of foreign workers in 2005 is attributable to economic growth, which boosted demand for them, combined with a relaxation of the policy aimed at reducing their number.

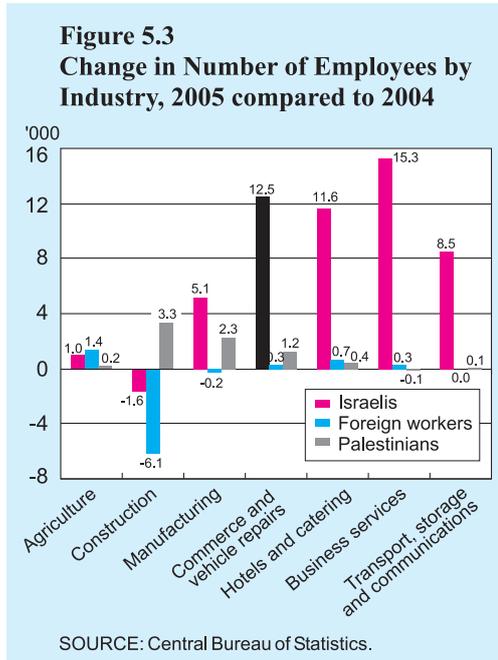
The number of foreign workers in the Israeli economy, not including workers from the Palestinian Authority (PA), rose 2.9 percent to 194,000 in 2005, after a 20 percent plunge over the two preceding years. The increase took place despite a government decision to decrease this number (see Table 5.2 and Figures 5.2 and 5.3). The higher number of foreign workers in 2005 is attributable to economic growth, which boosted demand for them, combined with a relaxation of the policy aimed at reducing their number. Increased employment of foreign workers in Israel is reflected in a rise in the number of foreign workers residing in Israel illegally.<sup>11</sup> The number of these workers, who entered Israel either as tourists or under employment licenses that have since expired, is approximately 130,000.

<sup>11</sup> The increase in the number of workers classified as illegal residents in Israel was also influenced by the rise in the number of legal employees in the welfare sub-sector for whom no national insurance payments were made in respect of their employment. At this stage, a lack of data makes it impossible to distinguish between this group and illegal workers.

The 194,000 foreign workers in 2005 outnumbered the 161,000 unemployed Israelis with up to 12 years of education. Employment of foreign workers pushes these Israelis out of the labor market, and detracts from the employment terms of those remaining in it. Government policy in recent years aimed at reducing the number of foreign workers was weakened in 2005. The number of permits for foreign workers was not cut, except for the construction industry. No steps were taken to make hiring them more expensive,<sup>12</sup> and enforcement actions to reduce the number of illegal residents slackened. According to figures from the Ministry of the Interior population administration, 6,500 foreign workers illegally residing in Israel were deported to their countries of origin in 2005, compared with 18,500 in 2004. Implementation of expulsion orders issued by the Ministry of the Interior was scaled back. A return to the policy of reducing employment of foreigners in Israel, combined with making their employment more expensive, is a key element of policy aimed at increasing employment and wages of Israelis with little education, in order to promote their welfare and reduce poverty among them.

Organized employment of foreign workers in Israel began in 1993 under a “linking arrangement,” whereby the granting of a work permit to a worker before entering Israel, and during his employment, depended on a single employer and a defined job. In 2004, the “Committee for Arranging Employment of Foreign Workers” formulated a new arrangement, based on corporations that supplied workers to employers. This arrangement was designed to foster long-term employer-employee relations, guarantee the foreign workers’ rights,<sup>13</sup> make it easier for an employee to switch from one employer to another, and ensure an orderly departure by employees at the end of their employment period, while safeguarding their social rights. At the same time, this arrangement still chained the employee to the manpower agency, and allowed only limited and partial mobility between employers. Furthermore, the arrangement created another level of intermediary liable to make hiring workers more

Government policy in recent years aimed at reducing the number of foreign workers was weakened in 2005. The number of permits for foreign workers was not cut, no steps were taken to make hiring them more expensive, and enforcement actions slackened.



A new arrangement governing employment of foreign workers, based on corporations that supply workers to employers, went into effect in 2005, initially in the construction industry, with the intention of applying it later to other sectors.

<sup>12</sup> The Ministry of Finance’s proposal to increase the tax on employment of foreign workers was not accepted, and enforcement of the existing tax was particularly poor.

<sup>13</sup> Every corporation was required to pay a NIS 10,000 license fee, and NIS 500 for each request for a worker, whether employed or not. The employer deposits NIS 700 per month in a compensation fund, and undertakes to pay for 236 hours per month. Salary slips issued to foreign workers are continually monitored.

expensive, without increasing their wages (see Bank of Israel, Annual Report 2004, Research Department Chapter 2 for an extensive description of this arrangement and its ramifications). The arrangement went into effect in May 2005, initially in the construction industry, with the intention of applying it later to other sectors. About 40 corporations with 10,500 foreign workers applied for licenses. At the same time, the number of permits for foreign construction workers dropped by 22 percent to only 15,000, following a 32 percent slide in 2004.<sup>14</sup> The decrease in the number of permits, combined with arrangement of foreign workers in the construction industry through corporations, led to higher wages in the industry.

In the social welfare sub-sector, the number of permits for foreign workers rose 8.4 percent to 33,000, following a steep 20 percent drop in 2004. There is no quota for permits in this sector; the number is determined according to need. The conception is that senior citizens are better off being cared for in their home environment, which also involves less spending from the state budget than hospitalization in a geriatric institution. The biggest source of financing for welfare workers is the National Insurance Institute (NII), which pays for 75,000 such workers, including 8,000 foreign workers.<sup>15</sup> One of the problems in this sub-sector consists of social welfare workers leaving their employers to work without permits at higher wages. This harms the needy person, and leads to the entry of additional foreign workers on the same permit. Only determined enforcement measures and suitable salary terms for workers in the sub-sector can prevent this from happening. 26,000 permits for foreign workers were issued in agriculture and 3,000 in manufacturing during the year. Foreign workers were hired for most of the jobs authorized in these permits.

### c. Employment of Palestinians

Approximately 50,000 Palestinians worked in Israel in 2005, slightly more than in 2004. The number of Palestinian workers reached a peak of 120,000 in 1999 (see Table 5.2 and Figure 5.2). After that, when the second intifada broke out, and due to security-related events, the number plummeted to 30,000 in 2002, and has since risen, with fluctuations, depending on the security situation. Approximately 74 percent of the Palestinian workers employed in Israel work in construction, trade, and services. The number working in services rose as a result of growth in the sub-sector, and also rose slightly in construction in order to replace foreign workers, whose numbers in construction fell.

All additional Palestinian workers in 2005 were from the West Bank (Judea and Samaria), while the number of workers from the Gaza Strip fell to less than 2,000 before

The number of Palestinian workers in services rose as a result of growth in this sub-sector, together with a smaller increase in the construction industry in order to replace foreign workers.

<sup>14</sup> Including workers employed under the new employment agreement.

<sup>15</sup> In this case, welfare benefits are not given in kind. The NII pays money directly to the welfare company, and the amount paid is in effect deducted from what the senior citizen and his family pay for the foreign worker.

the disengagement. After the disengagement, entry of Palestinian workers from Gaza into Israel was banned. Some 8 percent of the Palestinian labor force was employed in Israel in 2005, compared with 20 percent in 2000.<sup>16</sup> Palestinian workers are also divided into “official” and “unofficial” workers; the latter receive no social benefits whatsoever. At the beginning of the decade, it was found that the salaries of Palestinians employed in Israel were 80 percent higher than those of Palestinians employed within the PA and those with permits earned 20 percent more than those without them. The security situation in recent years, which affected economic activity in the PA, caused a steep increase in unemployment to over 40 percent, a 10 percent slide in the average wage in the PA, and a cut in the number of Palestinian workers employed in Israel. These trends are expected to widen the wage gap between Palestinians employed in Israel and those employed in the PA, and have a decisive effect on the amount of disposable income and extent of poverty among the Palestinians.

8 percent of the Palestinian labor force was employed in Israel in 2005, compared with 20 percent in 2000.

## 5. UNEMPLOYMENT

Unemployment averaged 246,000 in 2005, 9.0 percent of the civilian labor force, which was 1.4 percentage points lower than in 2004. The unemployment rate fell during all of 2005, continuing the downtrend in 2004. It reached 8.8 percent in the fourth quarter, after a two-year climb culminating in 10.7 percent unemployment in 2003 (see Tables 5.1 and 5.2, and Figure 5.4). As noted above, the rate of participation in the labor force rose slightly during 2005; the fall in the unemployment rate represents mostly a rise in employment in the Israeli economy.

The unemployment rate fell during all of 2005, continuing the downtrend in 2004, after a two-year rise.

The decline in the unemployment rate was much steeper among women. Unemployment reached 8.5 percent for men and 9.5 percent for women (see Table 5.2). At 8.5 percent for 2005, the unemployment rate among those who immigrated to Israel after 1990 was lower than the rate for veteran residents for the first time (see Table 5.A.4). The large proportion of new immigrants with academic and technical professions (approximately 30 percent<sup>17</sup>), and the rising demand for workers in these professions, contributed to a relatively sharp decrease in unemployment among immigrants.

Starting in 2002, the criteria for receiving unemployment compensation were made more restrictive, and the amount of compensation was cut (see Chapter 4 in the Research Department’s section of the Bank of Israel report for 2003 and 2004). The 10-monthly unemployment compensation average dropped 0.2 percent, following a 39.5 percent cut in the two preceding years. Changes in recent years have made Israel’s criteria for receiving unemployment compensation among the strictest in Western countries.

<sup>16</sup> The World Bank: “West Bank and Gaza Update,” November 2005, “The Palestinians Economy and the Prospects for its Recovery,” December 2005.

<sup>17</sup> According to Ministry of Immigrant Absorption figures.

**Table 5.5**  
**Contribution to Change in Unemployment Rate, Israelis,<sup>a</sup> 2002–05**  
(change from previous year, percentage points)

	2002	2003	2004	2005
Total	0.9	0.4	-0.3	-1.4
Public sector	-0.3	0.2	0.8	-0.5
Business sector	1.3	0.2	-1.2	-0.9
High-skill industries <sup>b</sup>	0.8	-0.1	-0.4	-0.4
Nontradables <sup>c</sup>	0.1	-0.3	-0.4	0.0
Manufacturing	0.3	0.1	0.0	-0.2
Computer services	0.4	0.1	-0.0	-0.2
Unskilled-labor-intensive industries <sup>d</sup>	0.4	0.0	-0.2	-0.1
Manufacturing	0.4	0.1	-0.1	0.3
Textiles and clothing	0.2	0.0	0.0	0.0
Construction	0.0	-0.3	0.2	0.2
Hotel and catering services	0.2	0.1	-0.3	-0.3
Other industries (not classified) <sup>e</sup>	0.1	0.2	-0.6	-0.4
Manufacturing	0.2	0.1	0.1	0.1

<sup>a</sup> 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 6.A.10).

<sup>b</sup> 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.

<sup>c</sup> High-skill nontradable industries are banking, insurance, financial institutions and other business activities.

<sup>d</sup> Unskilled-labor-intensive industries include some manufacturing, commerce and repairs, construction, and hotel and catering services.

<sup>e</sup> 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 Central Bureau of Statistics.

It should be kept in mind that unemployment compensation plays an important role in preserving the elasticity of the labor market, since it enables a worker to spend a reasonable amount of time searching for a job suitable to his qualifications.

The proportion of hardcore unemployed is still high, despite a slight decrease in 2005. This high proportion is a result of a rising trend since the mid-1990s, which became more pronounced in the current decade. The proportion of those seeking work for over six months rose from about 22 percent of all unemployed in 1995 to about 28 percent at the beginning of the current decade, and about 40 percent in 2005 (see Table 5.A.7). The unemployment rate is very heterogeneous between employed people with different levels of education. The unemployment rate was 13.1 percent

The proportion of hardcore unemployed is still high, despite a slight decrease in 2005. This high proportion is a result of a rising trend since the mid-1990s, which became more pronounced in the current decade.

**Table 5.6**  
**Israelis' Participation, Employment and Unemployment Rates, by Educational Level, 2001–05**

	(percent)				
	2001	2002	2003	2004	2005
<b>Rate of participation<sup>a</sup></b>					
Total	54.1	54.3	54.8	54.9	55.2
Years of education					
8-0	23.8	22.8	22.7	23.8	23.5
9-10	39.9	39.2	39.0	38.0	37.2
11-12	54.7	54.8	54.1	54.1	54.2
15-13	65.3	64.5	65.6	66.0	65.6
16+	74.6	77.0	77.0	77.2	77.3
<b>Employment rate<sup>a</sup></b>					
Total	49.1	48.7	48.9	49.2	50.2
Years of education					
8-0	20.8	19.5	18.9	19.9	20.0
9-10	34.2	33.4	33.1	32.3	32.9
11-12	48.2	47.9	46.7	46.8	47.7
15-13	60.0	58.7	59.9	60.3	60.7
16+	71.3	72.5	72.4	73.1	73.9
<b>Unemployment rate<sup>b</sup></b>					
Total	9.3	10.3	10.7	10.4	9.0
Years of education					
8-0	12.8	14.5	16.6	16.1	15.0
9-10	14.2	14.7	15.3	15.2	13.1
11-12	11.8	12.5	13.6	13.5	12.0
15-13	8.1	9.1	8.7	8.7	7.4
16+	4.5	5.8	5.9	5.3	4.4

<sup>a</sup> Of the working-age population.

<sup>b</sup> Of the civilian labor force.

SOURCE: Central Bureau of Statistics Labor Force Survey.

among those with 9-10 years of education, compared with 4.4 percent among those with 16 or more years of education (see Table 5.6). The gap in unemployment between different education groups has widened over the past decade. In 2005, however, the unemployment rate fell mostly among groups with less education, while the weight of these groups in the population fell. Similar trends over the whole decade, including

2005 in particular, were evident in the contribution of various economic sectors to unemployment, when broken down into levels of expertise required in them.<sup>18</sup> (See Table 5.5, and also Table 5.A.10 for a more extensive description of industries).

## 6. WAGES

The real wage per salaried position in the Israeli economy was 1.2 percent higher on average in 2005 than during the corresponding period in 2004. This increase was due to a 1.8 percent rise in the business sector, accompanied by no change in public services wages (see Table 5.7 and Figure 5.4). The rise in real wages reflected a 2.6 percent increase in nominal wages, deflated by the average rise in prices during the period.

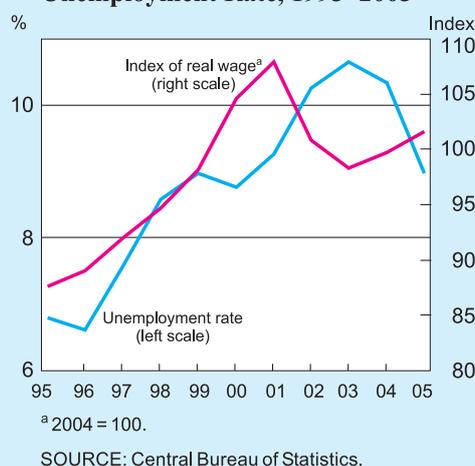
Wages in the public sector were affected by repeal of the tax “for encouraging growth” in July. This tax, which averaged 4 percent, was deducted from wages for two years; had it not been repealed, wages in the public sector

would have been eroded. The rise in public sector wages was moderate, compared with work hours per employee in the sector. This indicates streamlining, especially in public administration, in which personnel was also cut back. Wage increases were greater in health services, welfare and social care, and community and social services, and personnel in these areas also expanded. Unchanged wages in public services, following a steep two-year decline, was also affected by the restriction of cost-of-living increments to a partial one for 2001-2002 only, a slower rate of promotion, the failure to sign a wage agreement for 2002-2005,<sup>19</sup> strict observance of the wage

<sup>18</sup> Industries with a low level of expertise made a cumulative 4 percent contribution to the unemployment rate during the decade, while employment changes in advanced industries caused a cumulative 2 percentage-point drop in unemployment over the decade. The same held true for 2005: Advanced industries contributed to a 0.4 percentage-point fall in the unemployment rate, while traditional industries did not affect this fall. In this category of industries, the effect of growth in employment in tourism, which reduced unemployment, was offset by the small increase in employment in traditional industries.

<sup>19</sup> The last wage agreement signed in the public sector was for 1999-2001, and the wage increase for this period has also not been agreed. Negotiations for a final agreement for this period, and for a wage agreement for 2002-06, are expected in the coming year.

**Figure 5.4**  
Index of Real Wage per Employee Post in Business Sector<sup>a</sup> and Unemployment Rate, 1995–2005



The rise in public sector wages was moderate, compared with the rise in work hours per employee in the sector. This indicates streamlining, especially in public administration, in which personnel was also cut back.

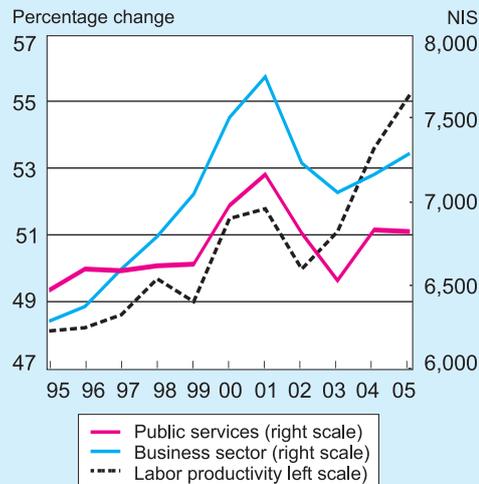
The moderation in public sector wage increases, following a steep two-year decline, was also affected by the limited extent of the cost-of-living increment, a slower rate of promotion, the failure to sign a wage agreement, strict observance of the wage and benefits framework, and programs that encouraged the retirement of workers who have worked in their jobs for many years.

and benefits framework in the sector, and programs that encourage the retirement of workers who have worked in their jobs for many years (see Box 2, “The Fall since 2000 in the Age at which Civil Service Workers in the Civil Services Retire, Chapter 6). Also, new rules were established in 2005 for evaluating academic degrees, which are important for promotion and wages in the public sector.<sup>20</sup> In view of the slowing of price rises in recent years, it is proper that automatic wage rises be scaled back in future wage agreements in the public sector, while the proportion of wage benefits designed to encourage productivity and efficiency in this sector should be increased.

Hourly wages in the business sector rose by 1 percent,<sup>21</sup> less than the 3 percent rise in gross labor productivity in the sector. This reduced unit labor costs by 1.9 percent, on top of a cumulative 7 percent drop in 2003-04. These developments reflect the high level of unemployment in the Israeli economy, which makes it possible to expand activity and employment without generating significant upward pressure on wages, particularly among workers with little education. Utilization of labor and capital also rose during this period, which kept labor productivity relatively high. It should be noted that while wages have behaved in a pro-cycle manner in recent years, falling steeply during the recession, and rising over the past two years, the cost of labor per unit of production has been falling continuously for three years. These developments enabled manufacturers

to raise salaries over the past two years, while increasing employment, without detracting from the profitability of production, since wages per unit of production paid by manufacturers fell. At the same time, the rate of decrease in the cost of labor per unit of production slackened during the past three years. Only continued streamlining

**Figure 5.5**  
**The Real Wage per Employee**  
**Post in the Business Sector and**  
**in Public Services (at 2004 prices),**  
**and Labor Productivity,<sup>a</sup>**  
**1995–2005**



<sup>a</sup> Net business-sector domestic output per man/hour, at constant prices.

SOURCE: Central Bureau of Statistics.

Hourly wages in the business sector rose by less than the rise in labor productivity in the sector. This reduced unit labor costs.

The falling cost of labor enabled manufacturers to raise salaries over the past two years, while increasing employment, without detracting from the profitability of production, since wages per unit of production paid by manufacturers fell.

<sup>20</sup> The rules include defining the type of connection with the institution, examinations required under the curriculum, a high standard for curriculum and teaching staff, and local examination in the subject studied.

<sup>21</sup> The hourly wage from the employer’s perspective: This wage is calculated as the employer’s total labor cost, divided by the number of his employees’ work hours, using the cost of labor per unit of production for the calculation.

is capable of keeping this cost from rising, given the fall in the unemployment rate and the nearing of the Israeli economy to full employment (see Table 5.2 and Figure 5.5).

A comparison of wage increases in different industries in 2005 highlights the high degree of correlation between the rate of salary increase among workers in an industry and the proportion of highly educated workers in it.

The rise in real wages per employee in the business sector moderated during 2005. Among other things, this was due to a steeper rise in prices, and a fall in the number of work hours per employee during the year. Wage increases in the business sector in 2005 were primarily in the water and electricity industry (6.7 percent), business services (5.1 percent), and to a lesser extent in manufacturing (2.0 percent) and financial services (2.4 percent) following a steep rise in 2004 (see Table 5.7). Rising wages in these industries were driven by growth in activity and labor input in them. However, activity and employment also expanded in other sub-sector, such as trade, accommodations, and tourism services, to an even greater extent, with only slight wage increases. Nor can the changes in the average number of work hours per employee explain the gap in wage development between the various industries.

Nevertheless, a comparison of wage increases in 2005 highlights the high degree of correlation between the rate of salary increase among workers in an industry and

**Table 5.7**  
**Change in Real Wage per Employee Post,<sup>a</sup> 2001–05**

	(percent, at constant prices)				
	2001	2002	2003	2004	2005
Total	3.0	-6.0	-3.0	2.5	1.2
Israelis		-5.9	-3.1	2.3	1.3
Public sector	2.6	-4.3	-4.1	4.6	0.0
Business sector, total	3.3	-6.7	-2.5	1.5	1.8
Israelis		-7.0	-2.7	1.0	1.8
Agriculture, total	8.3	-5.5	-0.7	0.6	1.4
Israelis		-3.8	-0.8	-0.3	1.3
Manufacturing	3.2	-4.2	-0.2	3.9	2.0
Electricity and water	2.5	-3.2	-2.7	8.1	6.7
Construction, total	4.3	-5.1	-3.5	1.6	-0.1
Israelis		-4.7	-3.0	-0.8	0.2
Commerce and repairs	2.2	-6.3	-2.7	0.2	1.2
Hotel and catering services, total	-0.1	-6.4	0.7	-0.4	0.3
Transport, storage and communications	0.9	-5.1	-2.6	-0.7	0.0
Financial services	1.7	-6.8	-3.3	10.3	2.4
Business services	3.6	-8.6	-4.2	3.0	5.1

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

SOURCE: Labor Force Surveys of Central Bureau of Statistics.

the weight of highly educated workers in it (see Table 5.8). For example, the three industries with the steepest wage increases—electricity and water; business services; and banking, insurance, and financial institutions—are also the three industries in the business sector with the highest proportion of highly educated workers.<sup>22</sup> Worthy of note is the fact that electricity and water and banking sub-sectors feature strong labor unions, whose workers have a great deal of bargaining power. The financial services sector was also characterized by many labor disputes in 2005, which were related to privatization, mergers, and the recommendations of the Bachar Committee. These led to generous wage agreements and grants in the industry. In manufacturing, wages rose steeply in advanced areas, and more moderately in traditional industries.

**Table 5.8**  
**Change in Output, Labor Inputs and the Real Wage, by Industry, 2005**

	Share of employees with more than 12 years education <sup>a</sup>	Change from 2004			Change from 2000		
		in output	in labor input	in real wage per employee post	in output	in labor input	in real wage per employee post
Agriculture	0.29	-8.7	3.5	1.4	17.7	-4.2	4.5
Manufacturing	0.48	3.6	1.9	2.0	-6.3	-3.9	2.6
Electricity and water	0.54	7.2	5.8	6.7	14.7	9.0	3.5
Construction	0.26		-3.5	-0.1		-22.9	-2.8
Commerce and vehicle repairs	0.36	-0.6	3.0	1.2	-9.7	9.0	-6.1
Hotels and catering services	0.36	11.7	8.0	0.3	12.1	-5.8	-7.1
Transport, storage and communications	0.39	10.2	4.8	0.0	17.6	4.2	-7.5
Financial services	0.65		4.9	2.4	8.7	11.2	-0.4
Business services	0.71	5.8	3.7	5.1		18.1	-1.1

<sup>a</sup> Data for 2004

SOURCE: Central Bureau of Statistics.

On the other hand, in industries with a low proportion of highly educated workers, such as trade, hotels and catering, transportation, and communications, wage increases were particularly small, despite large expansion in activity and employees. A fall in activity eroded wages in the construction industry. The freeze in the minimum wage over the past two years, following a cabinet decision on the matter in the 2002 Economic Arrangements Law, also helped restrain wage increases in traditional industries.<sup>23</sup>

In industries with a low proportion of highly educated workers, wage increases were particularly small, despite large-scale expansion in activity and employment.

<sup>22</sup> Classification of industries by composition of personnel is taken from Labor Force surveys for 2004.

<sup>23</sup> The minimum monthly wage is expected to rise 3.5 percent to NIS 3,450 in April 2006.

Moderate wage increases in sub-sectors with a lower proportion of highly educated workers kept the cost of labor down in 2005.

Income tax rates are expected to fall below the average in the developed countries.

Growth in employment and higher wages in 2005, combined with falling income tax rates and a slight increase in allowances, caused a rise in per-capita disposable income, mainly in the top income deciles.

Given the vulnerability of low-income earners in the labor market, resources should be invested in strengthening this group, and integrating it in the labor market.

It appears that two trends can be distinguished in the demand for workers in the Israeli economy: (a) demand for highly educated and trained workers, among whom unemployment is low and close to their natural unemployment rate, and bargaining power is high, led to wage increases in sub-sectors in which they are employed; and (b) demand for workers with low levels of education, among whom unemployment is high, and whose supply curve is relatively elastic, which kept their wages from rising, despite increased demand and employment. Moderate wage increases in sub-sectors with a lower proportion of highly educated workers is what kept the cost of labor down in 2005.

Another phase in legislative changes aimed at cutting income taxes took effect in 2005. It was decided to move the final stage in this process forward to the beginning of 2006, and to increase the size of the cuts, while extending the process until the end of 2010.<sup>24</sup> At the end of the process, the maximum income tax rate will be 44 percent, compared with 49 percent in 2005. This will put income tax rates below the average in the developed countries.<sup>25</sup> Together with cutting income taxes, other changes were made in direct taxes on labor. These changes included eliminating the income tax credit point for non-working spouses, increasing deductions for those with unfunded civil service pensions, changes in salary deductions for the NII and health tax, and others. In addition to changes in direct taxation, cuts in allowances outlined in 2002-03 in the framework of various budgets and the economic recovery plan continued in 2005. While total allowance payments rose 0.5 percent in real terms in 2005 as a result of an increase in old-age pensions, other allowances were cut. Starting in 2002, allowances have fallen by over 10 percent in real terms.<sup>26</sup>

Growth in employment and higher wages in 2005, combined with falling income tax rates and a slight increase in allowances, caused a 1.6 percent real rise in per capita disposable income, mostly in the top deciles (see Table 5.A.13 in the appendix,<sup>27</sup> and the NII poverty report of January 2006). An examination of all the changes made in recent years shows that the contribution of taxation and allowances to the narrowing of inequality was reduced, particularly in households headed by a breadwinner, while the proportion of working families among poor people rose in 2005. Given the vulnerability of low-income earners in the labor market, resources should be invested in strengthening this population by instituting a negative income tax, formulating a job placement program for groups with special characteristics, and strictly enforcing labor laws, including the Minimum Wage Law.

<sup>24</sup> People with incomes lower than the tax threshold were granted an increase in net pay through reductions in their payments to the NII and health tax. In order to avoid reducing the NII's revenues, the rates of these deductions were increased for those earning high incomes.

<sup>25</sup> See "Income Tax Rates on Israeli Wages from an International Perspective," 2004 Bank of Israel report, Volume II of the Research Department, Chapter 3.

<sup>26</sup> Allowance rates are expected to rise 2.7 percent in 2006, and updating of the minimum wage is also expected.

<sup>27</sup> According to the table, net income of those earning more than four times the average wage rose by an average of 2.5 percent during the past two years, as a result of changes in direct taxes. The average increase in net income for those earning around the average wage was only 0.8 percent.