

## Chapter 5

### *The Labor Market*

- ◆ The labor market was affected by the surge in demand in 2007 and was characterized by the marked expansion of employment, the significant contraction of unemployment alongside the reduction of its depth, and a rise in the real wage.
- ◆ The improved chances of finding employment encouraged persons who had not been part of the labor force to join it; thus, the participation rate rose, and the number of discouraged workers fell.
- ◆ Employment expanded this year in industries that are human-capital intensive as well as in those employing less-educated workers, and wages rose in almost all industries. The unemployment rate among educated workers neared its 'natural' rate, and the situation of workers with 11–12 years of education improved, although the unemployment rate remained high for persons with a low level of education.
- ◆ Unit labor cost rose for the first time since the emergence from the recession at the beginning of the current decade. This was the result of the slowing of the growth rate of labor productivity, and attests to the fact that the economy is approaching capacity utilization of the factors of production.
- ◆ After an extensive decline in the cyclical component of unemployment, most of the remaining unemployment reflects a mismatch between the level of human capital required and that offered. The employment rate of persons with less than 12 years of schooling rose slightly, but they continued to leave the labor force despite the policy measures adopted to encourage them to move 'from welfare to work.'
- ◆ The government's policy in the labor market focused on implementing the labor laws, subsidizing employment, and increasing remuneration for work through the long-term reform of income tax. At the end of the year the earned income tax credit reform legislation was adopted, and will initially be introduced in certain regions. On the other hand, the policy regarding foreign workers weakened, and the number of these workers even increased in 2007. In spite of the measures introduced, the rate of government expenditure on active labor market policy is only 0.21 percent of GDP, compared with an average of 0.7 percent in the OECD countries.

## 1. MAIN DEVELOPMENTS

Rapid growth in 2007 was mirrored in the performance of the labor market.

Real wages increased moderately in the review year.

Unit labor cost increased for the first time since 2002.

Israel's rapid economic expansion continued in 2007 and this had a marked effect on the labor market. The increased demand for workers led to the expansion of employment in most of the principal industries. The labor supply also grew, and this was expressed in the labor force participation rate. The increased demand for workers exceeded the rise in their supply, so that the unemployment rate fell substantially this year, alongside an increase in the real wage. However, the rate at which the real wage rose in 2007 was moderate, due in part to the inflation surprise in the second half of the year.

Several factors moderated the upward pressure on the nominal wage, among them the employment of new labor-force entrants at a lower wage than that of longstanding, experienced workers, the reduction of the income tax rate which served to increase the net wage, the adverse effect of local-currency appreciation on the export industries, and the continued globalization process, which enabled greater resort to outsourcing and the recruitment of cheap labor abroad.

The slower rise in labor productivity, signaling the approach to capacity utilization of the stock of factor inputs, caused a trend shift in the decline in unit labor cost, and this rose for the first time since the emergence from the recession. In 2003-05 GDP growth was supported primarily by increased utilization of factor inputs together with the relatively moderate but accelerating expansion of employment and the gradual reduction of the unemployment rate, without any substantial wage pressures. In 2006 there was a turnaround—a move from the emergence from recession to sustainable growth—characterized by the acceleration of investment in the principal industries and the stabilization of unit labor cost. As stated, this trend reversed in 2007.

The rapid economic growth, which improved the chance of finding employment, led to the further contraction in the number of discouraged workers (for the second year in succession), and even to a decline in the depth of unemployment, for the first time since 1998. However, unemployment today is far deeper than in the past. The greater length of time spent in unemployment attests to its nature, which stems from the mismatch between the skills required by employers and those offered by unemployed persons. This is also indicated by the longer period in which a position remains unfilled (according to the Survey of Employers undertaken by the Ministry of Industry, Trade and Labor) as well as by the increase in the shortage of trained workers (according to the Bank of Israel's Companies Survey and the Manufacturers' Association's Survey of Expectations in Manufacturing).<sup>1</sup> The combination of the relatively low demand for unskilled workers and the presence in Israel of over 200,000 foreign workers (whose number, for the first time in many years, exceeded that of unemployed Israelis) adversely impacts on the employment possibilities of Israelis with a low level of education: their unemployment rate has remained very high

<sup>1</sup> Nevertheless, the decline in the unemployment rate, which eases pressure in the labor market (fewer unemployed persons per vacant post), can by itself prolong the time taken to fill a vacant post.

(despite its decline among persons with 9–10 years of education), their employment rate has not expanded appreciably, and even the policy measures introduced have not yet succeeded in preventing them from leaving the labor force. Persons with 0–10 years of education currently account for 19 percent of the population aged 25–64, and it is important to get them back into the labor force. This requires specific attention, including an activation strategy that encourages unemployed persons to actively seek work (assistance in the work-seeking process and monitoring the search), vocational training programs alongside the examination of their effectiveness, and the creation of the conditions for their employment, e.g., by subsidizing their employers. All this should be done in addition to encouraging persons to go out to work (earned income tax credit and the supply or subsidization of work-support services), putting the labor laws into practice, and significantly reducing the number of foreign workers employed in Israel.

To return less-educated persons to the job cycle, treatment on many fronts is needed: activation programs, training, employment subsidies, encouragement of labor force participation, enforcement of labor laws, and reduced employment of non-Israelis.

## 2. THE POPULATION

Israel's population grew by 1.8 percent in 2007, similar to the growth rates of the last few years, bringing it to 7,180,000 persons (Tables 5.1 through 5.3, and A.5.1). This was due mainly to natural increase, alongside a decline in the rate of immigration to Israel. The fertility rate of the total population rose moderately and averaged 2.9 children per woman (compared with 2.84 children per woman in 2006). This reflects primarily the increase in the overall fertility rate of Jewish women (an average of 2.8 children per woman compared with 2.7 in 2006), while the overall fertility rate of Muslim women remained the same as in 2006 (an average of 4.0 children per woman).

Israel's population numbered 7,180,000 in 2007.

Only 18,129 immigrants came to Israel in 2007, 6 percent less than in 2006 (Table 5.3), so that the number of immigrants this year is the lowest since 1988. 36 percent of the immigrants came from the former USSR, about 25 percent from France and the US, and about 20 percent from Ethiopia. Concurrent with the decline in immigration to Israel, the trend of emigration from Israel has strengthened in the last few years, so that the migration balance approached zero. This worrying intensification of the emigration trend impelled the Ministry of Absorption to propose an extensive program, called 'Returning Home for Israel's 60th,' under which various incentives are offered to returning residents.<sup>2</sup>

Immigration continued to decline in 2007 and was the lowest since 1988.

<sup>2</sup> The incentives include a health insurance arrangement (in contrast with the current situation, in which the Health Insurance Law denies a returning resident medical services for at least six months), grants for research scholars and physicians who settle in the Negev or Galilee, loans and aid for entrepreneurs, help in finding employment, customs and excise exemption on electrical goods, and exemption from taxes on any income from abroad.

**Table 5.1**  
**Principal Labor Market Indicators, 2007**

	(percent)							
	Change from same quarter in 2006 <sup>a</sup>				Change from previous quarter <sup>b</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>c</sup> total					56.2	56.5	56.5	56.0
Men					61.8	61.8	61.7	61.8
Women					50.9	51.5	51.5	50.6
3. Civilian labor force	3.0	3.0	3.5	2.5	1.3	1.0	0.4	-0.4
4. Israelis employed, total	4.2	4.1	4.9	3.7	1.3	1.3	0.8	0.1
4.1 Full-time employees	5.9	6.0	1.4	4.2	1.0	0.2	0.4	0.4
4.2 Part-time employees	-0.3	0.9	18.2	2.0	2.5	4.4	1.1	-2.0
4.3 Temporarily absent from work	6.6	3.5	-3.6	6.3	1.9	0.4	0.3	14.6
5. Public-sector employees (Israelis)	6.8	2.5	2.6	3.7	0.1	0.8	2.6	0.4
6. Business-sector employees (Israelis)	3.1	4.8	5.9	3.7	1.5	1.5	0.2	0.4
7. Foreign workers in business sector <sup>d</sup>	0.2	1.1	5.1	6.7				
8. Palestinian workers in business sector <sup>d</sup>	16.3	14.6	-5.2	-2.2				
9. Average weekly hours worked per business-sector Israeli employee	1.2	1.9	0.3	0.5	0.6	-2.0	0.5	0.8
10. Israeli labor input in business sector	4.4	6.7	6.2	4.2	2.1	-0.5	0.7	1.2
11. Business-sector labor input of foreign workers <sup>d</sup>	0.2	1.2	5.2	6.7				
12. Business-sector labor input of Palestinian workers <sup>d</sup>	20.1	22.4	-9.9	-0.5				
13. Unemployment rate <sup>c</sup>					7.8	7.5	7.2	6.8
14. Number of unemployed persons	-9.8	-9.3	-10.7	-11.4	0.3	-2.0	-3.6	-6.9
15. Real wage per employee post, total <sup>e</sup>	2.7	3.7	1.1	0.0	0.1	1.1	-1.4	0.0
15.1 Business sector	3.3	4.0	1.7	-0.5	1.0	0.0	-1.0	0.0
15.2 Public sector	1.2	3.0	-0.2	1.4	-0.8	3.3	-1.9	0.0

<sup>a</sup> Unadjusted data.

<sup>b</sup> Adjusted data.

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

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

<sup>e</sup> Including reported foreign workers and Palestinians.

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

**Table 5.2**  
**Labor Market Indicators, 2004–07**

	(change over previous year, percent)			
	2004	2005	2006	2007
1. Population (annual average)	1.8	1.8	1.8	1.8
2. Immigrants who arrived in this period	-10.2	1.3	-9.0	-5.9
3. Working-age population	1.8	1.8	1.8	1.8
4. Participation rate in civilian labor force, <sup>a</sup> total	55.0	55.2	55.6	56.3
Men	60.6	60.7	61.1	61.8
Women	49.6	50.1	50.4	51.1
5. Civilian labor force	2.6	2.3	2.5	3.0
6. Employment rate <sup>a</sup>	49.2	50.3	50.9	52.2
Employment rate among the 25–64-year age group	66.7	67.5	68.5	70.1
7. Total employees <sup>b</sup>	1.7	3.4	2.9	4.2
Israelis	3.0	3.9	3.2	4.2
Non-Israelis	-10.1	-1.8	-0.7	3.6
8. Public-sector employees <sup>b</sup>	-0.4	4.1	2.0	3.8
Public-sector labor input	-2.3	3.7	0.1	4.8
9. Business-sector employees <sup>b</sup>	2.5	3.1	3.2	4.3
Israelis	4.6	3.8	3.7	4.4
Foreign workers	-11.4	-6.7	-1.3	3.3
Palestinians	-3.7	24.1	1.7	4.9
Share in business sector of foreign and Palestinian workers <sup>a</sup>	12.1	11.5	11.1	11.0
10. Business-sector labor input <sup>b</sup>	1.1	2.7	2.6	5.0
Israelis	2.9	3.4	3.1	5.2
Foreign workers	-11.5	-6.3	-1.0	3.4
Palestinians	-0.8	20.5	-0.8	6.3
11. Real wage per employee post <sup>c</sup>	2.5	1.0	1.3	1.9
Business sector	1.5	1.5	1.7	2.1
Public sector	4.6	0.0	0.3	1.3
12. Minimum wage (real)	0.7	-1.6	3.0	4.5
13. Unit labor costs in business sector <sup>b,d,e</sup>	-3.3	-1.9	-0.6	2.9
14. Gross domestic product per labor hour in the business sector <sup>b,d,e</sup>	5.2	5.5	6.6	0.0
15. Unemployment rate, total <sup>a</sup>	10.4	9.0	8.4	7.3
Men	9.5	8.6	7.9	6.8
Women	11.4	9.5	9.0	7.9
16. Government expenditure on the active labor market policy (percent of GDP) <sup>f</sup>	0.28	0.24	0.26	0.21

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

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

<sup>c</sup> Including reported foreign workers and Palestinians.

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

<sup>e</sup> Based on gross product, not net product as in previous years.

<sup>f</sup> Including training, employment services, programs to integrate recipients of benefits into the work force, aid related to the employment of new immigrants, etc.

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

**Table 5.3**  
**Principal Labor Market Indicators, 2004–07**

	(thousands, annual averages)							
					Change from previous year			
	2004	2005	2006	2007	2004	2005	2006	2007
1. Mean population	6,809.0	6,930.1	7,053.7	7,179.5	119.3	121.1	123.6	125.8
2. Immigrants who arrived in this period	20.9	21.2	19.3	18.1	-2.4	0.3	-1.9	-1.1
3. Working-age population <sup>a</sup>	4,876.0	4,963.4	5,053.1	5,142.4	84.2	87.4	89.7	89.3
4. Civilian labor force <sup>a</sup>	2,678.6	2,740.1	2,809.7	2,893.8	68.6	61.5	69.6	84.1
5. Number of unemployed <sup>a</sup>	277.8	246.4	236.1	211.8	-2.0	-31.4	-10.3	-24.3
6. Employees, total <sup>b</sup>	2,634.0	2,722.6	2,801.0	2,917.6	44.3	88.7	78.3	116.6
Israelis	2,400.8	2,493.7	2,573.6	2,682.0	70.6	92.9	79.9	108.4
Non-Israelis	233.2	229.0	227.4	235.6	-26.3	-4.2	-1.6	8.2
Foreign workers	195.8	182.7	180.3	186.2	-1.4	8.9	0.8	2.3
Palestinians	37.4	46.3	47.1	49.4	-24.9	-13.1	-2.4	5.9
7. Public-sector employees <sup>b,c</sup>	724.1	753.9	769.1	798.7	-3.1	29.8	15.3	29.5
8. Business-sector employees <sup>b,c</sup>	1,909.8	1,968.8	2,031.9	2,118.9	47.5	58.9	63.1	87.1
9. Nominal wage per employee post, (NIS/month) <sup>d</sup>	7,050.8	7,220.5	7,467.8	7,646.9	142.0	169.7	247.3	179.1
Public sector	6,823.3	6,910.9	7,081.6	7,215.0	274.5	87.6	170.6	133.4
Business sector	7,159.7	7,365.0	7,646.8	7,845.2	75.6	205.4	281.8	198.4

<sup>a</sup> Labor Force Survey data.

<sup>b</sup> National Accounts data, including data from education and health imputed to business sector, including reported and unreported foreign workers and Palestinians.

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

<sup>d</sup> Including reported foreign workers and Palestinians.

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

### 3. THE CIVILIAN LABOR FORCE

Due to the increase in participation rate, the labor force expanded more rapidly than the working-age population

The civilian labor force, which consists of employed and unemployed Israelis, expanded by 3.0 percent in 2007 to reach 2,894,000 persons (Table 5.3). The rapid expansion of the labor force, compared with an increase of only 1.8 percent in the working-age population, is explained by the 0.7 percent rise in the participation rate, among both men and women, to stand at 56.3 percent (Table 5.2). The male participation rate in Israel has been rising since 2004 (when the economy began emerging from the recession), and even accelerated in 2007. There was a trend switch in the male participation rate in recent years after this had been declining for a long time, and this has occurred in many of the OECD countries. There was also an acceleration in the female participation rate in 2007. The rise in the participation rate encompassed all regions other than Jerusalem, and was particularly apparent in the Central and Tel Aviv regions.

The increase in the participation rate in the last few years is the result of rapid economic growth and the improved chance of finding employment, reflected by the ongoing decline in the unemployment rate. The government's policy of bringing

persons ‘from welfare to work,’ including the Mehalev (Wisconsin) program and other schemes aimed at encouraging employment, contributed to the rise in the participation rate; the reduction of social benefits may also have played a part. In 2007 most of the increase in the participation rate stemmed from its rise among persons with 13–15 years of schooling, while in the other education groups the rate remained relatively stable. Whereas the involvement in the labor market of persons with a lower level of education—up to 10 years of schooling—rose hardly at all, it is worth noting that the participation rates of persons with 0–8 and 9–10 years of schooling has remained stable since the beginning of the current decade, compared with a protracted downward trend in the three previous decades.

The participation rate increased among persons with 13–15 years of schooling and was largely unchanged among the other schooling groups.

The improved chance of finding employment is expressed in the continued contraction of the number of discouraged workers—unemployed persons who have ceased looking for work actively and are not included in the labor force as officially defined but who would be interested in appropriate work if it was offered to them. The average number of discouraged workers was 14 percent lower in 2007 than in 2006, the decline being apparent primarily among men (about 17 percent, compared with 9 percent among women). Note, however, that the number of discouraged workers is still large, about 47,000 individuals (for purposes of comparison, the average number of unemployed persons was 212,000 in 2007). The number of discouraged workers declined in every education group (with the exception of those with 13–15 years of schooling), but especially among those with only 10 or fewer years of education. However, the contraction in the number of discouraged workers with a low level of education cannot be explained by their return to the labor force because their participation rate did not increase (Table 5.6). Persons with a low level of education have difficulty finding work, even in a period of economic expansion, as the employment possibilities available to them are limited, and many positions that are suitable for their qualifications are filled by non-Israeli workers.

The number of discouraged workers declined but remained large at about 47,000.

#### 4. EMPLOYMENT

The number of employed persons averaged 2,918,000 in 2007, after increasing by 4.2 percent over last year (Tables 5.3 and 5.4). This growth rate was higher than in previous years and was expressed by an additional 117,000 employees in the principal industries. Three-quarters of the incremental employment stemmed from the expansion of the business sector, where employment grew by 4.3 percent. An additional 29,500 persons found employment in the public services—up by 3.8 percent over 2006. As a result of the difference between the growth rates of these two sectors, the share of the business sector in total employment rose slightly (by 0.1 percentage points, Figure 5.1). Despite the government’s official policy, not only did the number of non-Israeli workers not contract in 2007, it even expanded; however, because of the growth of the business sector the share in it of non-Israeli workers was lower by 0.1 percentage points than in 2006 (Table 5.2 and Figure 5.3).

Employment in the principal industries increased by 117,000, with three quarters of the increase occurring in the business sector.



In both the business sector and the public services labor input rose more sharply than did the number of employees (Table 5.2), so that the number of hours worked per employee rose, for the first time since 2002.<sup>3</sup>

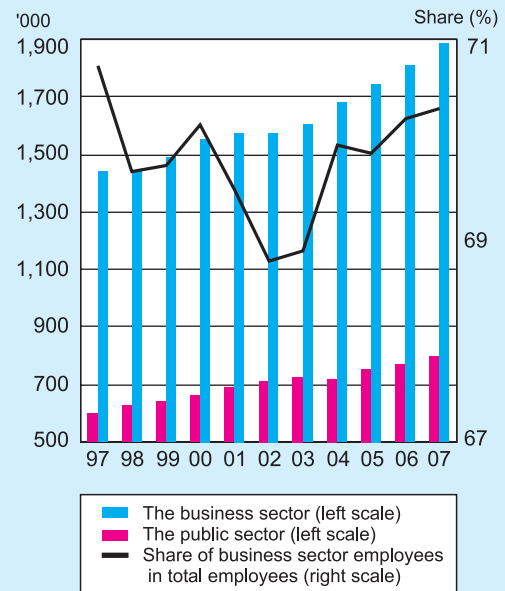
The number of workers in full-time posts increased at the same rate as did those in part-time posts, and the number of unwilling part-time workers declined.

Employment in full-time positions expanded by a substantial 4.4 percent in 2007, and the increment of part-time positions was similar—4.5 percent. Despite the relatively rapid expansion of employment in part-time jobs, explained by the growth of the service industries which are characterized by a large proportion of part-time positions in total employment, the number of persons usually working part-time involuntarily declined by 9.6 percent in 2007—although they still constitute 14.4 percent of all persons in part-time employment.<sup>4</sup>

In 2006:III, as a result of the Second Lebanon War, there was an exceptional rise in the proportion of employees temporarily absent from work. Even without that exceptional quarter, however, since mid-2004 there has been an upward trend in absenteeism, indicating an increase in employment security. In 2007 the number of persons temporarily absent from work rose by only 1.7 percent.

The large gap between the number of vacant posts and the balance of employment (the difference between posts filled and posts becoming vacant), as reported in the Ministry of Industry, Trade and Labor's Survey of Employers, expresses a high

**Figure 5.1**  
**The Number of Employees, by Sector, and the Share of Business Sector Employees in Total Employees<sup>a</sup>, 1997–2007**



<sup>a</sup> Among Israeli's employees only.

SOURCE: Central Bureau of Statistics.

<sup>3</sup> However, the changes in the average number of hours per employee were very small. Thus, in 2005 and 2006 there were slight declines of 0.4 and 0.6 percent respectively, while in 2007 there was an 0.9 percent increase as a result of additional hours in the hotels and catering services, agriculture, and commerce and repairs industries (3.1, 3.9 and 1.7 percent respectively). The decline in the average number of hours worked in the last few years goes against the theoretical model whereby during emergence from a recession labor input rises initially due to the increase in hours worked by existing employees, and only at a later stage are new employees added. This discrepancy may have resulted from the expansion of part-time employment (the correlation between the proportion of part-time jobs in total employment and the average number of hours worked per employee is high,  $-0.65$ ). This scenario is supported by the fact that the average number of hours worked by men in full-time positions has remained stable since 2003 (when the emergence from the recession began).

<sup>4</sup> This figure is similar to the OECD average, where 14.8 percent of all those in part-time employment would prefer to be working full-time.



**Table 5.4**  
**Employment and Labor Input, by Industry,<sup>a</sup> 2003-07**

Employment and Labor Input, by industry, 2003-07

	Employment								
	Thousands					Rates of change			
	2003	2004	2005	2006	2007	2004	2005	2006	2007
Total business sector <sup>b</sup>	1,862.3	1,909.9	1,968.8	2,031.9	2,118.9	2.6	3.1	3.2	4.3
Agriculture	68.4	73.8	76.5	71.7	71.1	7.8	3.8	-6.3	-0.8
Construction	207.9	193.0	183.3	187.7	202.7	-7.2	-5.0	2.4	8.0
Manufacturing	385.8	394.4	402.6	413.3	432.2	2.2	2.1	2.7	4.6
Commerce and vehicle repairs	331.9	340.6	349.2	349.4	370.4	2.6	2.5	0.1	6.0
Hotels and catering services	117.0	121.4	129.3	135.3	134.7	3.8	6.4	4.7	-0.4
Banking, insurance, and finance	78.0	79.1	82.1	87.4	95.0	1.4	3.8	6.5	8.7
Business services	346.4	359.9	375.2	394.7	416.8	3.9	4.3	5.2	5.6
Transport, storage, and communications	150.8	155.1	163.8	172.6	172.3	2.9	5.6	5.4	-0.2
Public sector	727.3	724.1	753.9	769.1	798.7	-0.4	4.1	2.0	3.8

Employment and labor input, by industry, 2007

	Employment						Labor input					
	Thousands			Rates of change			Thousands			Rates of change		
	Israelis	Foreign workers	Palestinians	Israelis	Foreign workers	Palestinians	Israelis	Foreign workers	Palestinians	Israelis	Foreign workers	Palestinians
	Thousands			Rates of change			Thousands			Rates of change		
Total business sector <sup>b</sup>	1,885.8	184.2	48.9	4.4	3.3	4.9	5.4	3.4	6.3			
Agriculture	43.3	23.9	4.0	-4.0	5.5	-0.5	-0.2	5.5	1.6			
Construction	150.2	29.8	22.7	11.8	-14.6	23.3	12.8	-14.6	25.6			
Manufacturing	421.6	2.1	8.5	4.9	3.9	-9.2	5.4	3.8	-7.8			
Commerce and vehicle repairs	358.2	5.2	7.0	6.4	4.4	-9.1	8.3	4.4	-7.4			
Hotels and catering services	122.1	11.2	1.4	0.0	2.5	-36.7	3.1	2.1	-35.9			
Banking, insurance, and finance	95.0	0/0	0/0	8.7			9.3					
Business services	375.3	37.0	4.5	5.9	2.8	4.9	7.0	2.8	7.1			
Transport, storage, and communications	171.2	0/0	1.1	-0.2		8.7	-1.9		12.0			
Public sector	796.2	2.0	0.5	3.9	0.0	0.0	4.2	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.

employee turnover.<sup>5</sup> In 2007 over 60 percent of total job separations were due to the employee's initiative, attesting to the tendency for employees to leave existing positions for more attractive ones, thereby improving their working conditions. This derives from the general improvement in the labor market and indicates a relatively high level of employee confidence.

The labor market developed dynamically and was typified by a high employee turnover.

<sup>5</sup> Thus, in 2007 the number of vacant positions in manufacturing averaged 13,436 each quarter, but the balance of employment in that industry averaged only 1,872 per quarter—the result of the fact that each quarter 29,565 posts were filled and 27,693 posts fell vacant. A similar situation of employee turnover emerges when the figures for vacant posts and the balance of employment in other industries are examined—transport and communications, business services, health services, and construction.

### a. By-industry developments

In the business sector, employment expanded markedly in financial and business services and commerce but stood still in hotel and restaurant services and transport, storage, and communication.

In the business sector employment expanded rapidly in the services—banking, insurance and finance, commerce and repairs, and business services at various levels of human-capital intensity (primarily in the sub-industries of R&D, security and cleaning services, and employee recruitment), while the average number of weekly hours worked per employee in these sub-industries rose (Tables 5.4 and 5.A.2.9). Against this backdrop, the stagnation of employment in the hotels and catering services<sup>6</sup> and transport, storage, and communications industries is notable. However, whereas in the hotels and catering services industry this stagnation was offset by the rise in the average number of hours worked per employee (up by 3.1 percent), in the transport, storage, and communication industry the average number of hours worked per employee fell by 1.8 percent, so that labor input declined. The hotels sub-industry was adversely affected by the drop in incoming tourism resulting from the Second Lebanon War; the number of persons employed in it contracted sharply in 2006:IV, remaining low in 2007:I (alongside an increase in the average number of hours worked per employee). However, as a result of the relatively rapid recovery of tourist entries and bed-nights, the number of persons employed in the hotels sub-industry began to rise once more in 2007:II (although the number of persons employed in it fell in 2007:IV, a seasonal decline after Q3 has also been evident in previous years). The stagnation in the transport, storage, and communication industry derived from the contraction of employment in the water- and air-transport sub-industry (which employs fewer than 10,000 employees); this may be the result of labor agreements with the port workers, which included early retirement inducements. However, according to National Insurance Institute data, the number of employee posts in the hotels and catering services, and transport, storage and communication industries actually rose (by 8.0 percent and 6.6 percent respectively). This may indicate the expansion in hours worked per employee and/or a rise in the number of non-Israelis employed in these industries.<sup>7</sup>

Employment in construction and manufacturing continued to expand.

The positive trend of the expansion of employment in construction continued and even intensified in 2007; labor input rose and product grew (Table 5.8). Employment in manufacturing also rose more rapidly than in the last few years, by virtue of the marked increase in sales both for export and for the domestic market. This expansion encompassed all levels of technological intensity, albeit to varying extents.<sup>8</sup> The

<sup>6</sup> The negligible 0.4 percentage-point decline in the number of persons employed in this industry stemmed from the 2.7 percent contraction of the hotels sub-industry, which was offset by the 0.9 percent expansion of the catering services sub-industry.

<sup>7</sup> The number of employee posts reported by the National Insurance Institute includes those of non-Israeli workers, but their number in the above industries is relatively small (Table 5.4).

<sup>8</sup> The number of persons employed in the high-tech and medium-high-tech industries rose by 6.0 percent, in the medium-low-tech industries it went up by 2.1 percent, and in the low-tech industries it rose by 4.8 percent.

number of persons employed in agriculture continued to contract in 2007, albeit at a moderate pace.

Employment in the public services expanded primarily as a result of the addition of new employees in public administration (4.0 percent) and education<sup>9</sup> (5.7 percent). The health services sub-industry expanded by 4.1 percent because of the steep rise in the number of persons employed in hospitals (10.8 percent), while the welfare and social services sub-industry contracted by 3.3 percent, and employment in community services dipped by 3.1 percent.

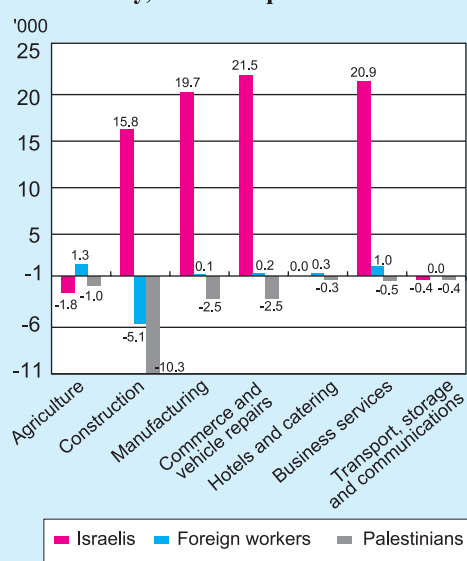
In general government, the main growth industries were public administration and education services.

### b. Employment of Israelis

In 2007 an average of 2,682,000 Israelis were employed, 4.2 percent more than in 2006. The number of Israelis employed in the business sector rose by 4.4 percent to reach 1,886,000, while in the public services employment expanded by 3.9 percent, and an average of 796,200 Israelis were employed. The average number of hours worked per employee rose in both sectors. Most of the increase, in both numbers employed and labor input, was in the construction industry (where Israelis replaced foreign workers) and in banking, insurance and finance services as well as in commerce and repairs, business services, and manufacturing (Table 5.4 and Figure 5.2).

The absorption of employees in the various industries is the result of the rapid economic growth and the continued expansion of most of the principal industries, based on the increase in demand for Israel's manufactured exports, the boom in the capital market, and the rise in wealth and the standard of living in Israel, which led to the expansion of consumption (thus, for example, private expenditure on the consumption of domestic services, with the exception of housing services, rose this year by 6.4 percent, at constant prices). As a result of the rapid absorption of employees, the rate of employment, defined as the proportion of the total working-age population in employment, rose by 1.2 percentage points. This stemmed

**Figure 5.2**  
Change in Number of Employees by Industry, 2007 compared to 2006



SOURCE: Central Bureau of Statistics.

<sup>9</sup> In education, the university and college sub-industry expanded by 6.5 percent, pre-elementary education grew by 10.5 percent, and elementary education rose by 8.2 percent.

Industries intensive in less-educated labor made a greater contribution to the falling unemployment rate than human-capital-intensive industries.

almost entirely from the increase in the employment rate among persons with 11–15 years of education; there was also a slight rise in the employment rate of persons with 9–10 years of education<sup>10</sup> (Table 5.6; for the effect of the business cycle on the employment, unemployment, and wage of groups with various levels of education, see Box 5.1). As a result of the extensive absorption of employees in the industries employing low-educated workers, the contribution of these industries to the decline in the unemployment rate was greater than that of the human-capital-intensive industries (Table 5.5).

### Box 5.1

#### Employment, Unemployment, and the Real Wage of Persons of Different Levels of Education, Across Business Cycles

Many studies have shown that patterns of employment and earning among unskilled workers are characterized by wide fluctuations across business cycles.<sup>1</sup> Most of the rise in the unemployment rate during a recession occurs among less-skilled workers,<sup>2</sup> while among persons with a high level of education it remains fairly stable. The real wage of unskilled workers displays a high level of procyclicality—a decline during a recession and an increase at times of economic growth—whereas the wage of skilled workers is inelastic downwards and may even rise during a recession; consequently, it is not always possible to identify cyclical fluctuations in the average wage.<sup>3</sup> The situation of unskilled workers is even worse, in fact, since because they are able to command only a low wage, their ability to save and smooth income is extremely limited, and they therefore tend to bear the full brunt of the business cycle.<sup>4</sup> Education, on the other hand, acts as ‘insurance,’ as it were, against unemployment and its repercussions—limiting cyclicity in employment and increasing wages.

The figures below describe the development of the unemployment and employment rates (the number of persons employed as a share of the total working-age population) of non-ultra-orthodox, non-immigrant Israeli Jews aged between 25 and 64,<sup>5</sup> divided into four groups by level of education. A light

<sup>1</sup> This subject was discussed in a study by Topel (1993). See also Hoynes (1999).

<sup>2</sup> See, for example, Mincer (1991).

<sup>3</sup> Rubinstein and Tsiddon (2001).

<sup>4</sup> See Krusell and Smith (1999, 2002).

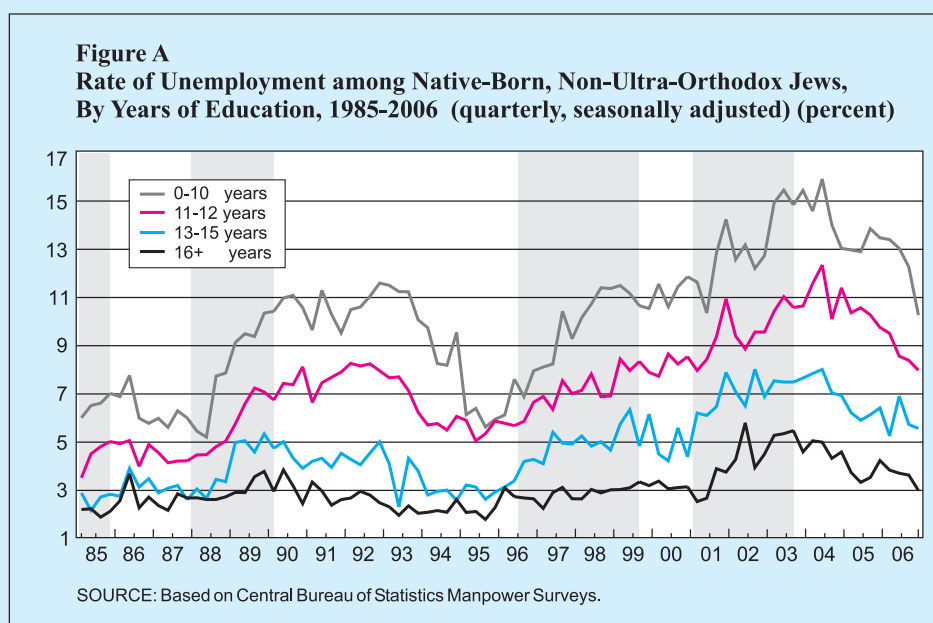
<sup>5</sup> An analysis based on the entire population of the same age yields similar results, but in order to neutralize the effect of the special characteristics of the Arabs, immigrants, and the ultra-orthodox we chose to concentrate on a more homogeneous segment of the population.

<sup>10</sup> However, the number of persons with 9–10 years of education declined, so that the rise in the employment rate stemmed from the reduction in the size of this group.

background denotes a period of economic growth and a dark one a period of recession.<sup>6</sup> Figure 1 shows that among unskilled workers not only is the level of unemployment higher, but the cyclical component of their unemployment is more significant. The standard deviation of the unemployment rate of persons with 0–10 years of schooling is three times as large as that of persons with 16 or more years of education. A strong cyclical effect on the unemployment rate of skilled workers was felt only in the recent recession, as that event stemmed inter alia from a crisis in the high-tech industry.

Figure 2 shows that cyclical fluctuations in the employment rate are also greater as the level of education of a group declines, but, in contrast with the other groups, among persons with 0–10 years of schooling the employment rate also declined during a period of economic expansion, starting in the 1990s. This is the result of the ongoing reduction in the participation rate of unskilled workers. Only in recent years has it been possible to discern a moderate upward trend in their employment rate, due to the improvement in their chances of finding work at a time of economic growth, on the one hand, and government measures adopted in order to return recipients of benefits to employment, on the other.

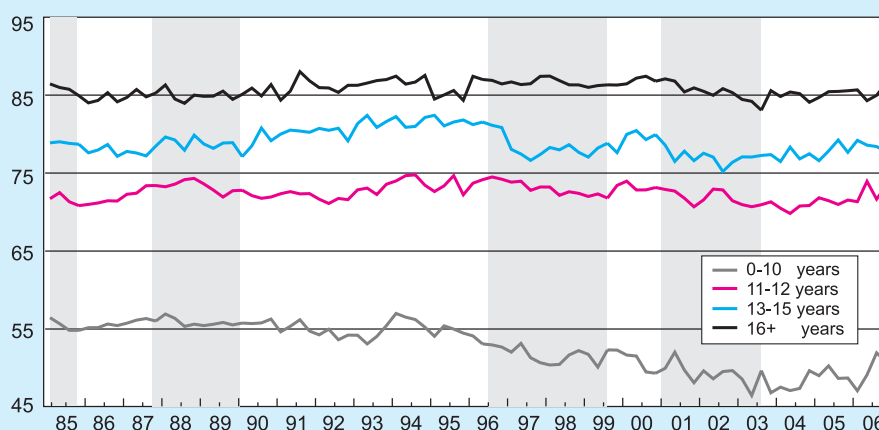
An analysis of the changes in the real wage of all four groups in the business sector<sup>7</sup> shows that there is a positive correlation with the growth rate of GDP,



<sup>6</sup> The account of business cycles in Israel is taken from studies by Melnick (2002) and Strawczynski and Flug (2007).

<sup>7</sup> The development of wages in the business sector differs from that in the public services because of differences in the passthrough mechanisms.

**Figure B**  
**Rate of Employment among Native-Born, Non-Ultra-Orthodox Jews,**  
**By Years of Education, 1985-2006 (quarterly, seasonally adjusted) (percent)**



SOURCE: Based on Central Bureau of Statistics Manpower Surveys.

but its intensity varies with level of education. The highest correlation was found with changes in the wage of persons with 11–12 and 13–15 years of education (0.37 and 0.31 respectively). The wage of persons in the most highly educated group—those with 16 or more years of education—was slightly less cyclical (a correlation of 0.22), and the lowest correlation, only 0.12, was found between economic growth and the wage of unskilled workers. The reason for the relatively low cyclicality of the wage of the most highly educated group is that demand for them is not weakening significantly even in a recession. By contrast, the low cyclicality of the wage of the least skilled workers can be explained by the fact that most of them earn a minimum wage. Although this rises at a time of economic expansion because it is linked to the average wage (sometimes with a lag, because it is updated once a year), but in the last few years this was frozen as part of the program of emergence from the recession. Note, however, that the minimum wage does not decline during a recession, so that the effect of business cycles on it is only partial (and consequently the standard deviation of the wages of persons with 0–10 years of schooling is also the lowest).

The differences between the various education groups in the development of employment, unemployment, and wages over business cycles are explained by the human capital theory—the complementarity between general and specific human capital. Investment in specific human capital is usually financed by the employer, as it is unique to the firm. This prevents him not only from dismissing

employees in whose training he has invested but also from reducing their wage, at times of a temporary lull in demand. On the other hand, the cost of dismissing unskilled workers, whose level of human capital is generally poor and who have not been given specific training, is relatively low. These workers are laid off during a recession and recruited once again at a time of economic growth, when demand picks up.

Additional explanations may be found in differences in the mobility rates and elasticity of the labor supply of skilled and unskilled workers, as well as in the character of the industries in which most of them are employed. Thus, for example, employment in manufacturing and construction fluctuates more widely, whereas in the public services, including the health and education services, and in the financial services the fluctuations are smaller, so that the stability of employment of skilled workers across business cycles may derive from the fact that they work in industries that are less subject to cyclicality.

An analysis of the cyclical shifts in the employment and unemployment of persons with different levels of education in Israel indicates that those most vulnerable to business cycles are the lowest strata of the labor market—persons with a low level of education, most of whom are employed on a temporary basis via sub-contractors and are not unionized. Since the wage of unskilled workers is low they cannot smooth earnings over time by saving, and it is therefore incumbent upon the government to intervene by improving their employment stability through strengthening their human capital. Herein lies the importance of vocational training programs suited for specific segments of the population, as well as of following them up and examining their effectiveness in improving the employment chances and earning ability of persons with a low level of schooling.<sup>8</sup> Furthermore, it is important for unemployed persons to receive adequate unemployment benefit for a reasonable period, thereby enabling them to seek work that is appropriate for their skills. This should improve the fit between an individual's skills and his/her job, enabling them to remain in employment and maximize their earning potential. In the last few years, however, government policy has gone in the opposite direction: because of continuous cuts in unemployment benefits and the increased stringency with which the criteria for eligibility for it are applied (curtailing the period during which it may be received and extending the required period of employment prior to its receipt), the terms for receiving unemployment benefit in Israel are among the strictest in the developed world. (For further discussion of the subject of the increased difficulty of youngsters to obtain unemployment benefit, see Bank of Israel, *Recent Economic Developments*, 116.)

<sup>8</sup> Recommendations for improving the existing vocational training system appear in Bank of Israel, *Recent Economic Developments*, 118.



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### c. Employment of non-Israelis

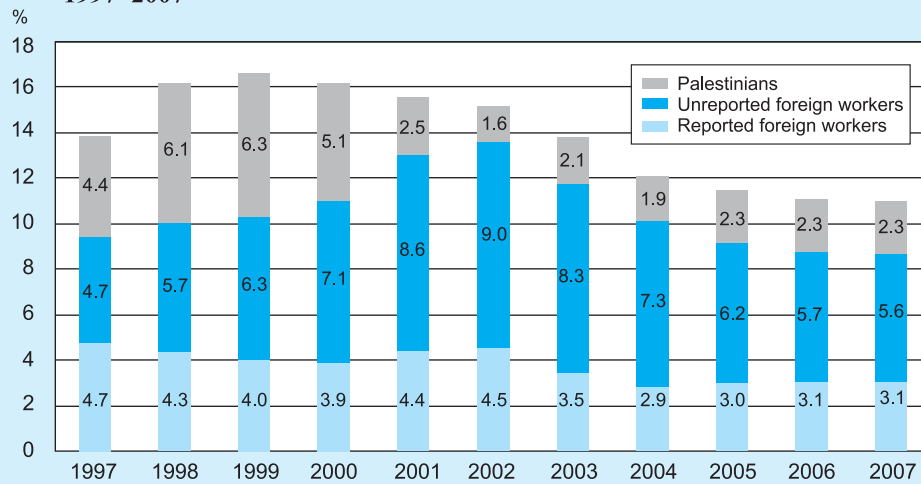
186,200 foreign workers and 49,400 Palestinians were employed in Israel in 2007 (Table 5.3). The number of non-Israelis rose by 3.6 percent, with a 3.3 percent increase in the number of foreign workers in the business sector and a 4.9 percent increase in the number of Palestinians (Table 5.4). Nonetheless, the share of non-Israelis in the business sector did not increase due to the sector's overall expansion (Figure 5.3). In 2007 there were extensive dismissals of foreign workers from the construction industry (a 14.6 percent decline), and these workers moved to other industries (Table 5.4). The calm security situation made it possible to expand the employment of Palestinians, primarily in construction.

The rise in the number of non-Israeli workers contradicts both the government's declared policy and the trend of reducing the number of foreign workers, as was the case in previous years, especially in 2003 and 2004.<sup>11</sup> (For the effect of the employment of non-Israelis on the employment and wage of Israelis, see Box 5.2).

<sup>11</sup> The acceleration of the pace at which illegal workers were deported in 2003 and 2004 came in the wake of the government's decision to cut the employment of foreign workers in Israel by reducing the number of permits issued, restricting the entry of new workers with permits (the 'closed skies' policy), and implementing more strictly the regulations regarding the deportation of illegal workers. In 2003 21,000 illegal foreign workers were deported from Israel; this number plummeted to 6,500 in 2005 and only 3,500 in 2006.

The increase in the number of non-Israeli workers clashes with the government's declared policy.

**Figure 5.3**  
**The Share of Foreign Workers and Palestinians in the Business Sector, 1997–2007**



SOURCE: Central Bureau of Statistics.

### Box 5.2

#### The effect of the employment of non-Israeli workers on the employment and wages of Israelis

An analysis of the substitution between Israeli and non-Israeli (i.e. foreign and Palestinian) workers in the industries that are characterized by a particularly high proportion of non-Israeli workers highlights the need for determined implementation of the government's policy of decreasing the number of non-Israeli workers and supporting the employment of Israelis. Consistent implementation of this policy will result in at least 50,000 previously unemployed Israelis replacing the non-Israeli workers. In addition the wages of low-skilled Israelis will rise, and the incidence of poverty among them will decline.

The main motive for international migration of workers, particularly unskilled ones, is their desire for a higher income and standard of living. The non-Israeli workers, most of whom are unskilled, come from countries with significantly lower income and per capita GDP than Israel.<sup>1</sup> As a result, non-

<sup>1</sup> Thus, while Israel's per capita GDP is about \$25,500 (adjusted for purchasing power), the per capita GDP in the source countries (like China, the Philippines and Thailand) ranges from \$5,000–\$10,000 and in the Palestinian Authority is less than \$1,500. The average wage per hour in these locations is less than one dollar.

Israeli workers are willing to work for a lower wage and for longer hours than Israelis. Furthermore, Israelis benefit from social welfare payments that in certain cases serve as a substitute for labor income.

The average wage of non-Israeli workers who were employed in Israel in 2006, primarily in construction and agriculture and as domestic care givers, was lower than the average wage of Israelis in these industries and even lower than the minimum wage. The large supply of non-Israeli labor reduces the employment possibilities for unskilled Israelis and leads to a decline in the equilibrium wage in those industries that employ foreign workers. This also affects the wages of unskilled Israelis in industries with a low proportion of foreign workers. Thus, for example, the employment of non-Israelis in the construction industry (which in many countries represents the upper benchmark of earning ability for unskilled workers) leads to lower wages for unskilled workers in physically easier and less dangerous occupations, such as cleaning and security. The willingness of foreign workers to work for low wages is also expressed in the high mediation fees they pay for the right to work in Israel.<sup>2</sup>

The employment of unskilled non-Israeli workers also increases the polarization in the distribution of income among Israelis. This works through two channels: First, there is substitution between unskilled non-Israeli workers and unskilled Israeli workers and complementarity between non-Israeli workers and skilled Israeli workers, particularly in the agriculture and construction industries.<sup>3</sup> Second, the employment of non-Israeli workers brings down production costs in the service and manufacturing industries whose products constitute a higher proportion of consumption for middle- and high-income earners than for low-income earners (this includes apartments, catering, cleaning, elderly homecare and other business services). On the other hand, the employment of non-Israeli workers also reduces the production costs of fruits and vegetables (for the local market), whose proportion of consumption is higher among low-income earners.

Due to the geographic proximity of the Palestinian Authority and the low wages of Palestinians employed in Israel (which in some cases are significantly lower than the Israeli minimum wage), their potential effect on the employment possibilities and wages of unskilled Israelis is particularly strong. Therefore, priority should be given to regulating the number of Palestinian workers in Israel, subject to political agreements, and to tightening the supervision of their employment conditions. However, it should be remembered that there

<sup>2</sup> For further details, see the 2002 report of the US State Department on the trade in human beings and a letter from the Ministry of Justice that appears in Rechlevski (2002) (Hebrew).

<sup>3</sup> This claim finds support in Zussman and Romanov (2003), Amir and Gottlieb (2005) and Gottlieb (2002) (Hebrew).

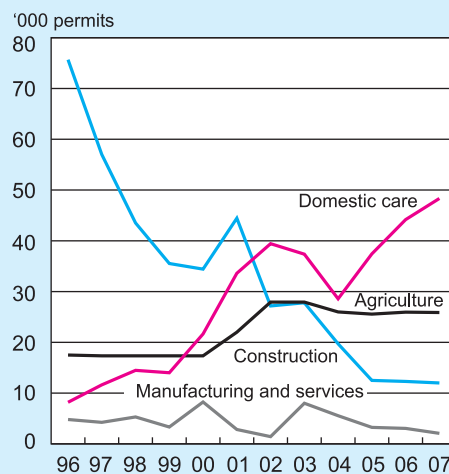
are reasons why the employment of Palestinian workers is preferred over the employment of foreign workers: Palestinian workers are daily commuters while the foreign workers may stay on in the country illegally and while the local consumption of foreign workers is limited, a not insignificant proportion of the consumption of Palestinians living in the Palestinian Authority is satisfied by imports from Israel.

### Recent policy with regard to non-Israeli workers

The non-Israeli workers employed in Israel accounted for some 11 percent of total employment in 2007 and about 13 percent of the labor input in the business sector. Most of them are employed as domestic care-givers (49,000 legal workers), in construction (56,000 legal and illegal workers) and in agriculture (28,000 legal workers).

In 2006, the government decided to end the employment of foreign workers in the construction, manufacturing and food and hospitality industries starting from 2010, which is a continuation of the policy to reduce the total number of permits (see Figure A). From 2010 onward, only the employment of experts, at particularly high wages, will be permitted in those industries. The reduction in demand for foreign workers will be accomplished by increasing the cost of employing them, allowing mobility between employers and increasing enforcement of the laws regarding their employment and working conditions. This will be achieved through, among other things, a transition to employing foreign workers through manpower agencies.<sup>4</sup>

**Figure A**  
**Number of Work Permits for the**  
**Employment of Foreign Workers,<sup>a</sup>**  
**1996-2007**



<sup>a</sup> In August 2007, about 26,500 permits were used to employ Palestinians, about 14,300 of whom were employed in construction, 8,000 in agriculture, and the rest in manufacturing, services and other industries.

SOURCE: Ministry of Industry, Trade and Labor, Foreign Workers Department.

<sup>4</sup> This system has been in use in the construction industry since 2005 and will be introduced in the agriculture and nursing industries during 2008.

Government policy to reduce the number of foreign workers has not been reflected in recent government decisions. At the beginning of 2007, the quota of permits in the agriculture industry was raised by 2,500, as part of a policy to encourage agricultural exports (Government Decision #1537, April 1, 2007). In the long-term domestic care industry, in which quotas are not set, the number of permits reached almost 49,000 in October 2007. Despite the government decisions to reduce the number of foreign workers—both legal and illegal—less effort is being put into enforcement among both foreign workers and their employers. In addition, there are a number of legislative proposals before the Knesset that may lead to a sharp increase in the number of foreign workers.

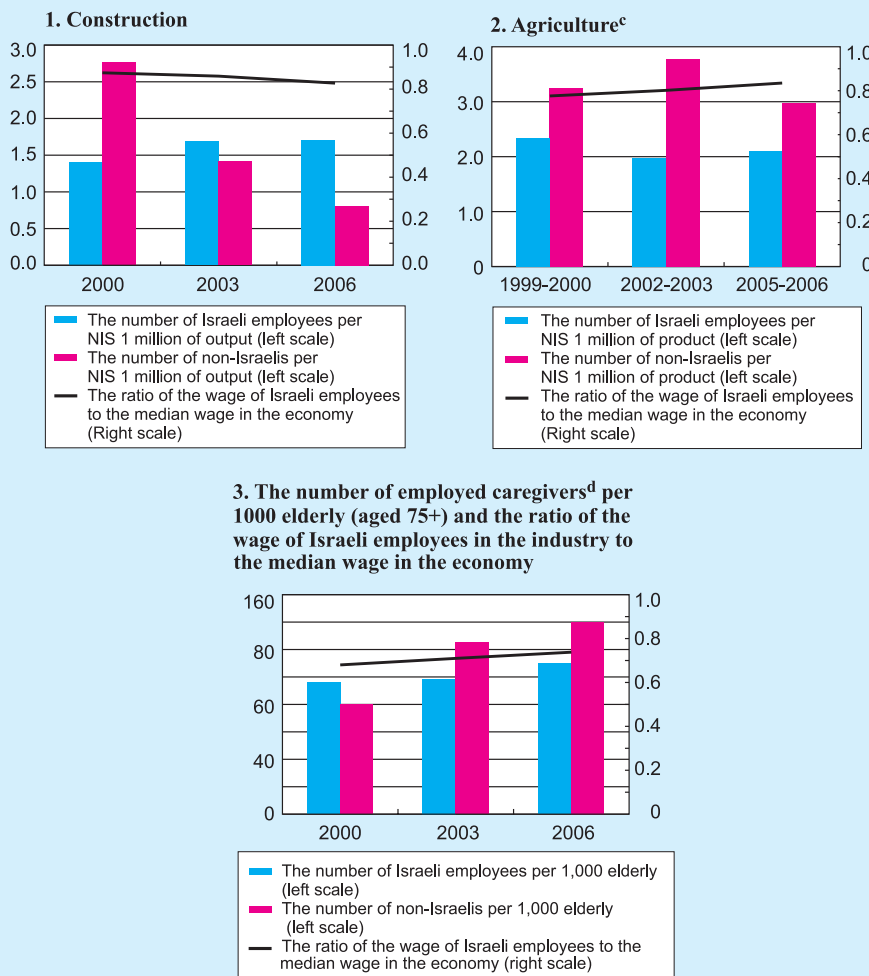
### **Developments by industry**

The continuous decline in the number of permits to employ foreign workers in the construction industry since the beginning of the decade and the sharp increase in the costs of employing foreign workers were accompanied by an increase in the number and proportion of unskilled Israeli workers in the industry and a minor decline in their wage relative to the median wage in the economy (Figure 2a). This is due to, among other things, the stagnation in the industry, which has led to a reduction in the number of total workers employed in it. A similar picture is obtained with regard to the number of salaried workers in “wet” work (plastering, paving, formwork, etc.) in the construction industry on its own. The reduction in the number of foreign workers employed in the industry and the increase of employment costs was accomplished through, among other things, the implementation of the recommendations of the Andoran Report (2004), which primarily called for the cancellation of the arrangement that ties workers to their employers and for their employment through manpower agencies, thus creating competition among contractors for the services of foreign workers. It should be mentioned that according to figures of the Central Bureau of Statistics, the number of illegal foreign workers in construction is still at high levels: more than 20,000 at the end of 2007, which represents 10 percent of the workers employed in the industry. Increasing the employment of Israelis in the industry and raising their wages will require that illegal foreign workers continue to be expelled from the country, that government decisions to reduce the number of permits for foreign workers be implemented with greater determination and that the enforcement of labor laws be intensified.

During the period 2000–06, the number of non-Israeli workers in the agriculture industry grew faster than the number of unskilled Israeli workers. Thus, the proportion of the latter declined. The number of non-Israeli workers per million shekel of output declined slightly (see Figure B2) due to the increase

in the industry's output, which was achieved through, among other things, technological improvements, such as the increasing use of marginal water as opposed to fresh water (see Figure B2). The employment of a large number of non-Israeli workers supports the economic activity in industries that make use of inputs that are in short supply, it encourages intensive agriculture (whose

**Figure B**  
**The Number of Non-Israeli and Low-Educated<sup>a</sup> Israeli Employees Adjusted by Activity in the Industry,<sup>b</sup> and the Ratio of the Wage of Israeli Employees to the Median Wage, 2000-06**



<sup>a</sup> With 0-12 years of education.

<sup>b</sup> At fixed 2006 prices.

<sup>c</sup> Average biennial figures, because of the fluctuations in the output of the industry arising from weather factors.

<sup>d</sup> In terms of full-time employment.

SOURCE: Based on Central Bureau of Statistics data.

environmental added value is low) and delays technological improvements that raise labor productivity.

The uninterrupted growth in the number of permits to employ foreign workers as caregivers in the long term care industry was accompanied by only a moderate increase in the number of Israeli care givers per 1,000 patients aged 75 and over and a slight increase in their wages relative to the median wage (Figure B3). However, there was a drop in the proportion of Israeli workers employed in the industry (both figures are expressed in terms of full-time positions). The significant increase in the proportion of foreign workers in the long term care industry is an indication of the potential increase in the employment of unskilled Israeli workers in the industry and in their wages, due to the increase in life expectancy and standard of living and therefore in the demand for domestic care services. The employment of foreign workers as domestic care givers is currently permitted only in the home of the patient but restrictions may be eased in the future, thus allowing their employment in institutions as well. Illegal employment in domestic help and in childcare is common among foreign workers in the long term care industry, which also limits the employment possibilities and income for Israeli workers, particularly unskilled ones.

In conclusion, there is significant substitution between Israeli and non-Israeli workers in the construction, agriculture and long term care industries and it is reasonable to assume that it also exists in other industries that employ non-Israeli workers. The increased cost of employing foreign workers in the construction industry, as part of the transition to employing foreign workers through manpower agencies, is an important step in encouraging the employment of Israelis and the increase in their wages. Increased determination to implement the government decisions to reduce the number of non-Israeli workers in the economy—whether legal or illegal—will make a significant contribution to encouraging the employment of unskilled Israelis, increasing their wages and achieving a more equitable distribution of income. The continued reduction in the number of non-Israeli workers, the increased cost of employing them and their replacement by Israelis will also make a significant contribution to the achievement of government objectives to increase employment and reduce poverty. This is consistent with the recommendations of the Interministerial Committee for Policy Formation Regarding non-Israeli Workers, headed by Zvi Eckstein, the Deputy Governor of the Bank of Israel.



## 5. UNEMPLOYMENT

The unemployment rate fell by an appreciable 1.1 percentage points in 2007, reaching an annual average of 7.3 percent of the civilian labor force—its lowest level since 1997. Israel's unemployment rate is similar to the average of the European OECD countries but is still significantly higher (by 1.6 percentage points) than the average in all the OECD countries.

The average unemployment rate fell to 7.3 percent.

The reduction of the unemployment rate was uniform for men and women. The male unemployment rate stabilized at 6.8 percent, while that of women reached 7.9 percent (Table 5.2). The decline in the unemployment rate together with the simultaneous increase in the labor force participation rate indicates that the rise in the demand for workers exceeded the increase in their supply. Consequently, according to the Ministry of Industry, Trade and Labor's Survey of Employers, demand for workers in the business sector expanded in 2007, reaching its highest level since 1997 (the first year the survey was undertaken).

The average number of persons unemployed in 2007 was 211,800, 10.3 percent less than in 2006. The unemployment rate fell in all education groups except for persons with 0–8 years of schooling (Table 5.6); however, the unemployment rate of persons with relatively low education (high school or less) remained high, also by international standards,<sup>12</sup> despite this year's marked decline.

The unemployment rate declined in all schooling groups but remained high among the less-educated.

Since 2003 there has been a continuous and accelerating reduction in the unemployment rate from its peak of 10.7 percent. The main question is, however, whether this trend can be maintained. In order to answer this, it is necessary to examine the changes in the unemployment levels of the various education groups. The unemployment rate of persons with 16 years or more of education reached the very low level of only 3.6 percent in 2007. The unemployment rate of persons with between 13 and 15 years of education also fell this year, and stood at 5.9 percent. Nevertheless, the absolute number of persons unemployed in these two groups fell by only 7 percent (5,400 individuals), and most of the expansion in their employment stemmed from the entry of new workers into the labor force. Note in this connection that even in the group of persons with a relatively high level of education there are some who have difficulty in finding employment. Thus, in 2006 27.6 percent of the persons who had been looking for work for a year or longer had 13 or more years of education; about half of them were at least 45 years old, and one third were Arabs or immigrants.

The unemployment rate of the group with 11–12 years of schooling plummeted but still remained high. However, most of the decline in the number of persons

<sup>12</sup> In 2006 the unemployment rate of persons with high-school education in Israel was 14.0 percent, compared with an average of 11.0 percent in the OECD countries, but the organization includes countries where the unemployment rate of low-educated persons is far lower—among them Ireland, Luxembourg, the Netherlands, and New Zealand (6.0, 5.0, 5.8, and 3.8 percent respectively). Note, however, that in these countries the participation rate of persons with a low level of education ranges from 62.2 to 69.2 percent, compared with only 47.9 percent in Israel (OECD, *Employment Outlook*, 2007).

**Table 5.5****Contribution to Change in Unemployment Rate, Israelis,<sup>a</sup> 2004–07**

	(change from previous year, percentage points)			
	2004	2005	2006	2007
Total	-0.3	-1.4	-0.6	-1.1
Public sector	0.8	-0.5	0.1	-0.2
Business sector	-1.2	-0.9	-0.7	-0.9
Human-capital-intensive industries <sup>b</sup>	-0.4	-0.4	-0.5	-0.6
Nontradables	-0.4	0.0	-0.2	-0.4
Manufacturing	0.0	-0.2	0.0	-0.2
Computer services	0.0	-0.2	-0.3	0.0
Low-educated-labor-intensive industries <sup>c</sup>	-0.3	-0.1	0.2	-0.7
Manufacturing	-0.1	0.3	0.2	-0.1
<i>of which</i> Textiles and clothing	0.0	0.0	0.1	0.1
Construction	0.2	0.2	-0.1	-0.4
Hotel and catering services	-0.3	-0.3	-0.1	0.1
Other industries (not classified) <sup>d</sup>	-0.6	-0.4	-0.4	0.4
<i>of which</i> Manufacturing	0.1	0.1	-0.2	0.0

<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 5.A.10).

<sup>b</sup> Human-capital-intensive 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> Low-educated-labor-intensive industries include some manufacturing, commerce and repairs, construction, and hotel and catering services.

<sup>d</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.

Any further reduction of the unemployment rate will depend primarily on the transition of persons with 11–12 years of schooling from unemployment to employment via the expansion of service industries that are intensive in less-educated labor and the replacement of non-Israeli workers.

unemployed was in this group, and the number of new participants in the labor force from this group was significantly lower than the number of persons finding employment. The unemployment rates of the groups with a low level of education remained very high, even after four years of economic expansion (Table 5.6). Whereas the unemployment rate of persons with 9–10 years of schooling has fallen by 4 percentage points since 2003, the situation of persons with 0–8 years of schooling has not improved substantially. Although the number of persons in those two groups who are unemployed has dropped, this is not as a result of the transition to employment but rather because of the contraction of these groups within the working-age population and their exit from the labor force. This analysis appears to indicate that the pace at which the unemployment rate declines will slow in the near future, and that any further reduction of the general unemployment rate will depend primarily on the transition of persons with 11–12 years of schooling from unemployment to employment. Since

**Table 5.6**  
**Israelis' Participation, Employment and Unemployment Rates, by Educational Level, 2002–07**

	(percent)					
	2002	2003	2004	2005	2006	2007
<b>Rate of participation<sup>a</sup></b>						
Total	54.3	54.8	55.2	55.2	55.6	56.3
Years of education						
8-0	22.8	22.7	23.7	23.5	23.0	23.1
9-10	39.2	39.0	38.0	37.9	38.5	38.5
11-12	54.8	54.1	54.1	54.2	54.6	54.7
15-13	64.5	65.6	66.0	65.6	65.8	66.4
16+	77.0	77.0	77.1	77.3	77.1	77.0
<b>Employment rate<sup>a</sup></b>						
Total	48.7	48.9	49.5	50.2	50.9	52.2
Years of education						
8-0	19.5	18.9	19.9	20.0	19.3	19.4
9-10	33.4	33.0	32.3	32.9	33.5	34.2
11-12	47.9	46.7	46.8	47.7	48.5	49.6
15-13	58.7	59.9	60.3	60.7	61.4	62.5
16+	72.5	72.4	73.1	73.9	74.0	74.2
<b>Unemployment rate<sup>b</sup></b>						
Total	10.3	10.7	10.4	9.0	8.4	7.3
Years of education						
8-0	14.5	16.6	16.1	15.0	15.9	16.0
9-10	14.7	15.3	15.1	13.1	12.8	11.3
11-12	12.5	13.6	13.5	12.0	11.2	9.4
15-13	9.1	8.7	8.7	7.4	6.6	5.9
16+	5.8	5.9	5.3	4.3	4.0	3.6

<sup>a</sup> Percent of the working-age population.

<sup>b</sup> Percent of the civilian labor force.

SOURCE: Central Bureau of Statistics Labor Force Survey.

those concerned have a relatively low level of education (considering the modern environment), the expansion of their employment can come from either the further expansion of the low-educated-labor-intensive service industries or the replacement of non-Israeli workers in existing positions.

One of the indices of the improved chance of finding work, the depth of unemployment, declined in 2007, for the first time since 1998 (Table 5.A.2.7), but the proportion of persons seeking work for over six months has nonetheless remained high: 38.7 percent of all unemployed persons. The proportion of those seeking work for over a year is more than twice as great today as it was at the beginning of the decade (for further details about the depth of unemployment, see Box 5.3). The high level of the depth of unemployment in the context of its falling rate expresses the greater significance of the unemployment deriving from the mismatch between the

Although the depth of unemployment diminished, its continuing high level reflects the upturn in unemployment deriving from mismatch between the skills of the unemployed and employers' requirements.

skills of the unemployed person and employers' requirements. Additional indications of this are to be found in the greater period of time during which a position remains unfilled,<sup>13</sup> as is indicated by the Ministry of Industry, Trade and Labor's Survey of Employers, the intensification of the severity of the skilled-labor-shortage constraint, making this labor shortage the dominant supply constraint in all the principal industries according to the Bank of Israel's Companies Survey, and the rise in the proportion of manufacturers reporting difficulties in recruiting trained workers, according to the Association of Manufacturers' Survey of Expectations in Manufacturing.<sup>14</sup>

### Box 5.3

#### The depth of unemployment

About ten years ago, in 1997, the percentage of unemployed persons who had been looking for work for over a year stood at only 6 percent of all unemployed persons. Since then Israel's unemployment rate has risen constantly, peaking in 2003, while at the same time unemployment has deepened, so that within just six years the share of unemployed persons seeking work for over a year has risen threefold. Some economists have explained this by the institutional change that occurred in 2002,<sup>1</sup> when recipients of income support who were not registered work-seekers were required to resume reporting to the Employment Office, thereby being officially registered as unemployed. Despite the gradual decline in the unemployment rate since 2004, the depth of unemployment continued to grow (Figure 1). In 2007 the first decline in the depth of unemployment was recorded. Time will tell whether this is a lagged response to economic growth and a trend shift or merely an occasional deviation.

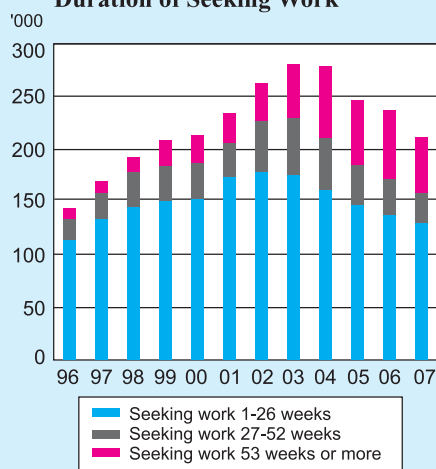
The increased depth of unemployment could signal a change in the character of unemployment—a switch from frictional unemployment, which is relatively short-lived and primarily expresses the replacement of employees, to unemployment that derives from a mismatch between employers' requirements

<sup>1</sup> Klinov, R. "Shifts in Transition Rates Between Employment and Unemployment," unpublished.

<sup>13</sup> There are, of course, other explanations for the longer period of time until a position is filled: as a result of the decline in the unemployment rate fewer unemployed persons compete for each vacant post, and also as long as the general situation in the labor market improves unemployed persons tend to seek work that is better suited to them and is more attractive; these factors can also prolong the search process.

<sup>14</sup> According to the survey findings, the proportion of manufacturers reporting 'considerable difficulties' in recruiting trained workers rose from an average of 16.3 percent in the first three quarters of 2006 to 23.7 percent in the equivalent period in 2007 (up by 45 percent). Concurrently, the proportion of companies reporting 'slight difficulties' fell from 21.3 to 13.7 percent.

**Figure A**  
**Distribution of the Unemployed by**  
**Duration of Seeking Work**



SOURCE: Central Bureau of Statistics Manpower Surveys 1996-2007.

and the skills of work-seekers. The switch to demand for workers with specific skills creates a 'hard core' of unemployed persons who are less employable, i.e., who encounter difficulties in finding work. Table 1 presents the changes in the probability of being unemployed for a year or more among different groups of unemployed persons, and their share in total unemployed persons. The data refers to 2001<sup>2</sup> and 2006, when the total number of unemployed persons was similar (234,000 and 236,000 respectively).

The table shows that the share of persons seeking work for a year or more rose considerably in all the

groups of unemployed persons, so that the increased depth of unemployment cannot be attributed to changes in specific groups of unemployed. The share of persons unemployed for a long time who had 0–10 years of schooling and among men rose twofold or more within five years, and among Arabs it rose threefold. The employment of Israeli Arabs was adversely affected as a result of the extensive employment of foreign workers (as explained in Box 2 in the chapter on employment and wages in Bank of Israel, Annual Report, 2004), and this could explain why they remained unemployed for a longer period. The depth of unemployment increased more moderately among new immigrants and young people, as these groups tend to acquire human capital more quickly; the increase was also more moderate among persons with 11–12 years of education. The share of each group in total unemployment remained fairly stable; however, there was some substitution between younger unemployed persons (aged 45 or less) and older ones, a decline in the share of new immigrants who were unemployed, and a rise in the share of unemployed Arabs.

An analysis of the data on persons seeking work for a year or more should take into account the fact that they are based on the memories of the individuals concerned, so that some measurement error may have crept in. Furthermore, the drop-out rates from the labor force are particularly high among persons who

<sup>2</sup> Before the sharp increase in the depth of unemployment.

table chapter 5 box 3

## Distribution of the Unemployed, by Various Characteristics

	2001			2006		
	Number of unemployed	Share of total unemployed	Share of those looking for work 52 weeks or more	Number of unemployed	Share of total unemployed	Share of those looking for work 52 weeks or more
Years of education						
0–10	51,186	21.9	20.3	49,856	21.1	48.4
11–12	104,122	44.5	17.1	106,592	45.2	27.3
13–15	51,698	22.1	12.7	48,206	20.4	24.5
16+	26,574	11.4	14.6	30,736	13.0	27.9
Age						
15–24	67,746	29.0	10.2	67,698	28.7	18.4
25–44	109,958	47.0	15.7	102,170	43.3	30.6
45–64	54,660	23.4	25.6	63,416	26.9	45.8
המגדר						
Men	120,956	51.7	16.6	118,502	50.2	34.1
Women	113,024	48.3	16.4	117,530	49.8	28.5
Immigrants	48,264	20.6	13.2	36,714	15.6	20.3
Arabs	29,816	12.7	17.0	38,268	16.2	62.5

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

have been unemployed for a long time,<sup>3</sup> skewing the figures, if the drop-outs have fewer years of education and are older than the average.

Long-term unemployment has negative implications at both the individual and the national levels. It is generally accepted that the chances of finding employment decline the longer a person has been looking for work, primarily because of the erosion of the unemployed person's human capital (Pissarides, 1992). The lower probability of finding work may also derive from the weakening of the effort the unemployed person<sup>4</sup> invests in looking for work as well as from the employers' lack of interest in taking on workers whose connection with the labor market has been loose for a long time.<sup>5</sup> During a period of economic expansion, when demand for labor increases, the share in total unemployment of persons who

<sup>3</sup> Thus, for example, the share of discouraged workers grew with the job-seeking period ("The Phenomenon of the Discouraged Worker in Israel," Bank of Israel, Recent Economic Developments 120, pp. 28–30.

<sup>4</sup> Since most persons who have been unemployed for a long time have a low level of education and few skills, the employment they can find is generally low paid, and does not constitute much of an incentive to look for work.

<sup>5</sup> A survey undertaken by the Institute of Manpower Studies (1987) revealed that employers tend to discriminate against persons who have been unemployed for a long time only because they do not have up-to-date labor experience. About one third of the employers who participated in the survey admitted that they refused even to interview candidates who had been unemployed for a long time.

have been unemployed for a long time may rise as unemployed persons with the skills required by the labor market find employment. If employers do not want to employ them the vacant posts will remain unfilled for a longer period<sup>6</sup> as a result of the increase in the unemployment component deriving from the mismatch between skills required in the labor market and the skills of the long-term unemployed. During a recession, when the unemployment rate rises, the concentration of unemployment in the hard core (outsiders) should lead to the weakening of the pressure to reduce the real wage<sup>7</sup> and hinder the action of one of the mechanisms enabling emergence from a recession—the reduction of unit labor cost, which causes a rise in manufacturing profitability and the expansion of supply.

In view of the above, government policy with regard to persons unemployed for a long time should focus on three spheres: 1. Aiding, providing incentives, and increasing the efficiency of the search for work; 2. Investing in the human capital of unemployed persons by means of training programs, thereby bringing their skills up to date and into line with the demands of the market; 3. Subsidizing their employment in the business sector to provide them with experience and work habits, and to give them the chance of establishing contact with potential employers. All these elements are to be found in the Mehalev/Lights to Employment program, which was intended to help persons whose connection with the labor market was the loosest (recipients of income support). The program had beneficial results (see section 7 of this Chapter), and hence it is desirable to expand it in its present form to the rest of the country. Concurrently, it is possible to examine implementing the measures involved to the wider population of unemployed persons.

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<sup>6</sup> See for example Budd, Levine and Smith (1988a).

<sup>7</sup> Several studies have shown that the pressure of unemployment against wage increases from persons unemployed for a long time is lower than that from persons unemployed for a short period. See, for example, Layard and Nickell (1985), Budd, Levine and Smith (1988b).



## 6. WAGES

Real wage per employee post rose by 1.9 percent, led by business services, construction, and manufacturing.

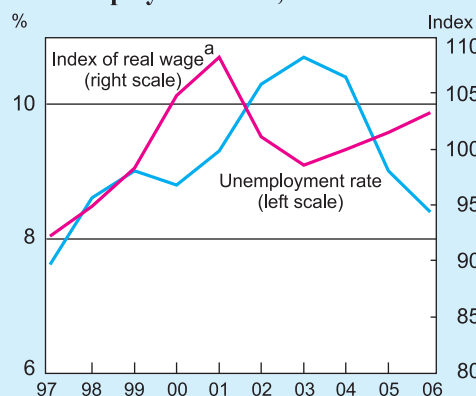
The real wage per employee post rose by a moderate 1.9 percent in 2007 (Table 5.7), as a result of the nominal 2.4 percent increase which was partially eroded by the unexpected acceleration of inflation in the second half of the year. Most of the rise in the real wage stemmed from its increase in the business sector (2.1 percent), led by business services, construction, and manufacturing. In the construction industry the wage of Israelis rose more rapidly than that of foreign workers. In the financial services the real wage was stable, despite the continued extensive recruitment of personnel in the industry. It is possible that the wage of new entrants may have brought the average

wage down. The wage per employee post in the commerce and hotels and catering industries rose at the same rate as that in the economy as a whole, and more steeply than in previous years. The rise in the real wage in these industries was apparently influenced mainly by the hike in the minimum wage, since they are low-paid low-educated-labor intensive. In the transport, storage and communication industry the real wage fell slightly, and this is consistent with the stagnation of employment in this industry; in the electricity and water industry the real wage declined, by half a percent.

The minimum wage was raised in April 2007 (for the first time since June 2006) to NIS 3,710 a month—a nominal increase of 3.5 percent.<sup>15</sup> The next raise, which was to have been implemented in June 2007, was deferred to December, and then once again to July 2008.

A relatively moderate increase in the nominal wage during a period of economic expansion is difficult to explain, but there are several factors which might have served to dampen wage increases: first, many employees entered the various industries in 2007, some of them new workers, with limited work experience. The wage of new entrants is lower than that of experienced employees, so that it may have pulled the

**Figure 5.4**  
**Index of Real Wage per Employee Post in Business Sector<sup>a</sup> and the Unemployment Rate, 1997–2007**



<sup>a</sup> 2004 = 100.

SOURCE: Central Bureau of Statistics.

<sup>15</sup> As a monthly average, the minimum wage was 5 percent higher in nominal terms in 2007 than in 2006 because in 2006 the minimum wage was raised twice, in April and June.

**Table 5.7**  
**Change in Real Wage per Employee Post,<sup>a</sup> 2003-07**

	(percent, at constant prices)				
	2003	2004	2005	2006	2007
Total	-3.0	2.5	1.0	1.3	1.9
Israelis	-3.1	2.3	1.1	1.3	2.1
Public sector	-4.1	4.6	0.0	0.3	1.3
Business sector, total	-2.5	1.5	1.5	1.7	2.1
Israelis	-2.7	1.0	1.5	1.6	2.2
Agriculture, total	-0.9	0.6	0.7	1.6	1.7
Israelis	-0.9	-0.3	-0.1	0.5	0.6
Manufacturing–Israelis	-0.2	2.2	2.6	2.5	2.7
Electricity and water–Israelis	-2.7	0.4	6.4	6.8	-0.5
Construction, total	-3.5	1.6	-1.0	0.7	2.8
Israelis	-3.1	-0.8	-0.7	0.8	3.4
Commerce and repairs–Israelis	-2.7	0.2	1.0	0.2	1.9
Hotel and catering services, total	-0.1	-0.4	-0.4	0.5	1.5
Transport, storage and communications–Israelis	-2.6	-0.7	0.2	0.3	-0.2
Financial services–Israelis	-3.4	10.3	3.0	7.9	-0.1
Business services–Israelis	-4.2	3.0	4.6	2.7	4.9

<sup>a</sup> Real wage per employee post according to National Insurance Institute reports. Includes registered Palestinian and foreign workers, unlike otherwise indicated.

SOURCE: Labor Force Surveys of Central Bureau of Statistics.

average wage<sup>16</sup> down. Second, as a result of the reduction of the income tax rates, in the framework of the long-term reform, the net wage rose more rapidly than the gross wage. Thus, for example, as a result of the changes in income tax, which went into effect in January 2008, the net wage of employees earning NIS 3,500 or more a month increased, and the maximum benefit—an additional 4.2 percent of the net wage—was received by persons earning a monthly wage of between NIS 12,000 and NIS 14,000. Third, local-currency appreciation, which had an adverse effect on the tradable industries, also including the high-tech industry, served to moderate wage hikes even

The high level of new hiring, the cut in income-tax rates, the appreciation of the NIS, and the globalization process held the increase in wages down.

<sup>16</sup> Data from the social survey of 2005 indicate that only 9.5 percent of persons employed less than one year as associate professionals and technicians in manufacturing earned a wage that was over NIS 7,500, compared with 42 percent of persons who had been employed in similar positions for between 1 and 4 years. 85.4 percent of the new skilled workers in construction earned less than NIS 5,000 a month, compared with 65 percent of those who had been working for between 1 and 4 years. Similarly, 82.3 percent of sales and service workers in the hotels and catering industry who had been working for less than one year earned less than NIS 4,000 a month, while among employees in equivalent posts who had been working for between 1 and 4 years the proportion of persons earning less than NIS 4,000 a month was only 57.6 percent. In the insurance and finance services industry new entrants did not earn more than NIS 6,000 a month, while 23.8 percent of employees who had been working for between 1 and 4 years received a monthly wage of NIS 6,000 and upwards. A rough calculation shows that the wage of new entrants in the business sector is 30 percent lower than that of experienced workers, so that had it not been for the exceptional expansion of employment in 2007 the average wage would have risen by an additional 0.7 percentage points.

**Table 5.8**  
**Change in Output, Labor Inputs and the Real Wage, by Industry, 2007**

	Share of employees with more than 12 years' education <sup>a</sup>	Change from 2006			Change from 2000			(percent)
		in real wage			in real wage			
		in output	in labor input	per employee post	in output	in labor input	per employee post	
Agriculture	0.28	-6.2	2.1	1.7	20.8	-10.4	7.2	
Manufacturing	0.49	5.1	5.1	2.7	11.7	3.3	8.6	
Electricity and water	0.59	5.3	-7.2	-0.5	24.3	-14.7	9.8	
Construction	0.25	4.5	8.4	2.8	-3.6	-17.2	-0.2	
Commerce and vehicle repairs	0.37	7.5	7.8	1.9	34.1	13.4	-4.4	
Hotels and catering services	0.33	2.2	2.2	1.5	-3.9	-3.9	-5.9	
Transport, storage and communications	0.40	5.1	-1.8	-0.2	34.1	11.2	-7.1	
Financial services	0.68	9.3	9.3	-0.1	28.1	28.1	8.1	
Business services	0.69	8.3	6.6	4.9	34.0	32.5	6.4	

<sup>a</sup> Data for 2006

SOURCE: Central Bureau of Statistics.

among the strata of persons earning a relatively high wage. Note, in addition, that in an era of globalization a rapid rise in wages can cause business activity to be moved to countries where labor is cheaper (outsourcing), particularly in industries where there is restricted use of physical capital, such as human-capital-intensive business services. This substitution can undermine workers' bargaining power and curb their wage demands. The decentralization of labor agreements and the decline in the strength of the General Federation of Labor (Histadrut) in recent decades has also served to weaken workers' bargaining power.

The real wage rose by only 1.3 percent in the public services, due mainly to the 1.9 and 2.0 percent wage hikes in the health, social and welfare, and community services. In public administration the wage rose by one percent, and in education, by 1.3 percent. However, several wage agreements with various sectors within the public services could lead to marked wage increases in the near future. According to an agreement reached in principle by the head of the Histadrut and the Director-General of Wages and Labor Agreements in the Ministry of Finance, employees in government ministries, local authorities, public-sector corporations, and administration employees in universities will receive an additional 5 percent over the course of 2 years, starting in January 2008. In May 2007 an agreement was signed in principle between the government and elementary school teachers according to which the wage of the latter will increase by an additional 26 percent on average,<sup>17</sup> over the course of 6 years,

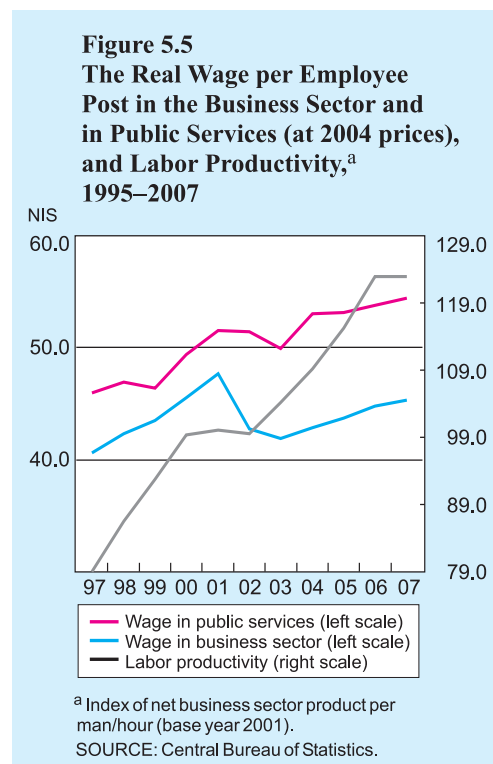
<sup>17</sup> According to this agreement, the average wage of elementary school teachers should rise from NIS 7,200 a month to NIS 9,000 and NIS 9,500, and the wage of newly employed teachers will go up from NIS 2,800 a month (about NIS 3,600 a month after the income supplement) to about NIS 5,300.

General government  
wages may rise in  
the near future in  
accordance with wage  
accords concluded in  
2007.

in return for an increase in the hours worked per post from 30 to 36 hours a week. Since the beginning of the current school year this reform has been implemented in about 300 schools, and experienced teachers have been included in the reform in these schools on a voluntary basis. After a lengthy strike an agreement was also reached with the secondary school teachers, according to which they would receive an immediate 10 percent pay rise and, if they agreed to implement extensive reforms, an additional 26 percent wage increase, also to be spread over 6 years. According to the agreement reached with the senior university cadre at the end of a prolonged strike, their wage will rise by 24.2 percent in three stages between January 2008 and December 2009 to compensate for its erosion. This is in addition to the wage increment granted throughout the public services and the broadening of the basis for acquiring seniority which went into effect in January 2008. A wage agreement with the physicians is currently under review.

Unit labor cost has declined since 2002, but at a rate that has slowed over the years (Table 5.2 and Figure 5.5). This decline was due to the fact that labor productivity rose faster than wages, a process that is characteristic of the stage of emergence from a recession and a shift to economic growth. Initially the expansion of supply was made possible by the greater utilization of existing factors of production, while employment expanded gradually and the unemployment rate remained relatively high. The combination of all these elements served to counteract the upward pressure on wages. At a more advanced stage of growth the factor utilization approached its full

extent, and it was necessary to add new factors of production: investment in the principal industries increased, and the pace at which employment expanded accelerated, as did that of the decline in the unemployment rate. Given this situation, the moderation of the rate at which productivity rises is a natural result of the absorption of new employees, whose labor productivity is lower than that of experienced employees. As the economic growth process progresses, the decline in the rate at which productivity increases, on the one hand, and the rise in wages, on the other, cause unit labor cost to stabilize. These trends were in evidence already in 2006; in 2007 the rate at which the real wage rose in the business sector accelerated, alongside the stabilization of labor productivity—two trends which led to a rise in unit labor cost, for the first time since 2001.



The stabilization of productivity caused a rise in unit labor cost.

The compulsory-pension reform, to be enacted gradually from 2008 onward, will probably increase the cost of labor.

A major reform which will considerably increase labor costs in Israel is the introduction of a compulsory pension arrangement. Under this arrangement, pension provision becomes compulsory for both employer and employee, and temporary workers will also be eligible for pensions. The Histadrut and the Manufacturers' Association have reached an agreement whereby every employer in Israel will provide their employees with a pension. This agreement became a binding regulation on 30.12.2007, by means of an expansionary order issued by the Minister of Industry, Trade and Labor. Under the agreement, pension provision will be made for every employee who is not covered by any other collective agreement and has been employed in a given post for at least six months. Only 2.5 percent of the employee's salary will be required to be set aside in 2008 (one third by the employee and two-thirds by the employer), and each year the provision will increase by 2.5 percent of the employee's salary, so that it will reach 15 percent in the year 2013. The provision will be compulsory up to the level of the average wage. The Ministry of Finance is planning to anchor the compulsory pension arrangement in law, in order to intensify its implementation. The introduction of the compulsory pension law is highly significant, as about one million employees in Israel—mainly those earning a low wage, temporary workers, those working for sub-contractors, etc.—have no pension arrangement. This also accounts for the massive repercussions of this law for the economy.

## 7. THE GOVERNMENT'S LABOR MARKET POLICY

In 2007, as was the case in previous years, the government's labor market policy was directed towards enabling non-employed persons to shift 'from welfare to work,' by encouraging them to participate in the labor force, maintaining workers' rights, increasing remuneration for work (reducing income tax rates and introducing an earned income tax credit law, this will begin to be implemented in 2008, although the money will be paid retroactively for months worked in the 2007 tax year), and subsidizing employment. These measures are consistent with the employment target set for 2010—an employment rate of 72 percent for persons aged between 25 and 64 (this rate was 70.1 percent in 2007). However, government expenditure on active labor market policy, which was very low in previous years in comparison with the OECD countries, plummeted in 2007 and stood at only 0.21 percent of GDP (Table 5.2). The steep decline in the proportion of actual vis-à-vis planned expenditure (0.27 percent of the approved budget) stemmed from under-utilization by the Vocational Training Department (which utilized only 85 percent of its annual budget) and the Personnel Planning and Placement Department in the Ministry of Industry, Trade and Labor<sup>18</sup> (which utilized only 82 percent of its budget).

Government expenditure on active labor market policy was only 0.21 percent of GDP in 2007.

<sup>18</sup> Most of the under-utilization in this unit derived from under-expenditure regarding the Mehalev program—instead of the NIS 240 million allocated to it, only NIS 132.5 was actually spent.

The Mehalev program, which began operating in August 2005, has had results and, according to findings presented in the report issued by the National Insurance Institute and the JDC-Brookdale Institute,<sup>19</sup> the situation of participants in the program has improved considerably. Fifteen months after the program was first implemented the rate of employment among participants (the experimental group) rose by 14.1 percentage points, compared with an increase of only 3.8 percentage points in the control group (individuals with similar characteristics who did not take part in the program). The proportion of persons in full-time employment rose from 21.3 to 36.2 percent in the experimental group, compared with a rise from 11.1 to 21.0 percent in the control group. The average monthly wage of employed persons in the experimental group went up by about NIS 400 more than that of persons in the control group, largely due to the greater extent of the average post in the experimental group.

At the beginning of 2007, in accordance with the recommendations of the Tamir Committee, the Knesset approved a series of exemptions with regard to the extent to which special groups (such as single parents and parents of large families) participated in the program. However, in July 2007, as a result of further investigation, it was decided that persons aged 45 and up be excluded from the program and transferred to the care of the Employment Service. The extent to which persons with an academic degree, new immigrants, long-term recipients of income support, and disabled persons were obliged to participate was reduced, and they were required to attend the program center for only one hour a week. The decision to exclude persons aged 45 or more from the program altered it drastically, as this age-group accounted for about half the participants. The change was accepted despite the new findings, also presented in the aforementioned report, indicating that the improvement in the employment situation was above average in the 45–54 age-group. The name of the program was also changed, to Lights to Employment,<sup>20</sup> though in effect it adopted the principles formulated at the end of 2006 by the Ministries of Finance and Industry, Trade and Labor, namely, emphasis on appropriate referrals to employment instead of saving money on benefits, by making it more worthwhile for agencies implementing the program to find work for their clients rather than depriving them of benefits, rewarding employers for taking on new workers, and rewarding participants in the program for accepting long-term employment by providing them with vocational training or subsidizing their training program and giving them a grant for remaining in a job for at least one year, ‘the 13th salary.’<sup>21</sup> Furthermore, it was decided that recipients of income support—rent subsidy, reduction in municipal taxes, etc.—who joined the program and started working would continue to receive that support. In October 2007 an increase of over 20 percent was approved in the extent of funding provided to services supporting employment and

In 2007, persons aged 45+ were excused from the Mehalev (“Wisconsin”) program even though the employment situation of participants in the 45–54 cohort showed above-average improvement.

<sup>19</sup> Assessment study of the Mehalev Program, Report no.4.

<sup>20</sup> The new program replaced the Mehalev Program in August 2007, when the latter had 10,590 participants, 5,622 of whom were aged 45 or more. On 1 October they were transferred to the responsibility of the Employment Service, but 493 participants aged over 45 decided to remain in the program.

<sup>21</sup> This decision was ratified by the Knesset’s Labor, Welfare and Health Committee on 5.12.2007. In the first week of December 2007, 364 requests were submitted for perseverance grants.



vocational training.<sup>22</sup> At the end of November an order was introduced extending the Lights to Employment program to new areas—Netanya, the Basma Regional Council (Ma'awiya, Barta'a and Ein A-Sala), and Ein Ma'ahal from December 2007. The order brought an additional 4,700 recipients of income support payments aged up to 45 into the program.

The earned-income credit will be piloted in 2008 in trial areas.

In order to complete the encouragement of employment by means of positive incentives, an earned income tax credit law was approved in December 2007. Initially the law will be implemented in areas where the Mehalev/Lights to Employment program has been in operation and will be extended to the rest of the country in the course of two years. Under the law, workers aged 23 who are parents of children aged less than 18, and earn at least 45 percent of the minimum wage (currently NIS 1,725) but not more than NIS 5,000, will be eligible for a monthly increment of between NIS 275 and NIS 400. A family in which both parents work, and their joint income does not exceed NIS 10,000, will be entitled to this benefit for each wage-earner; workers aged 55 or more will receive a monthly payment of up to NIS 275, even if they do not have children under 18. The grant will be paid four times a year directly into the account of the eligible persons.

The extent of employment via sub-contractors has expanded considerably in Israel since the early 1990s. The backdrop to this phenomenon consists of pressure for increased efficiency and lower labor costs in the business sector and the demand for a cut in the number of public service employees. Israel's wage structure favors employment via sub-contractors, as in most labor agreements wage increments such as seniority are not included in the basic wage, and hence the resort to sub-contractors reduces employers' labor costs considerably. The use of sub-contractors is particularly widespread in spheres which do not require investment in human capital and are characterized by a low wage and inferior working conditions. Moreover, persons who work for sub-contractors are not unionized and are unable to stand up for their rights,<sup>23</sup> which are infringed even in work undertaken on behalf of the government.<sup>24</sup> In order to boost implementation, the government decided in February 2007 to set up a new administrative entity to license and implement the labor laws, and funds were allocated for augmenting personnel in the Department of Labor Law Implementation in the Ministry of Industry, Trade and Labor. During June that ministry reached an agreement with the Ministry of Finance, the Histadrut, and the employers regarding several measures intended to regulate and heighten implementation of the labor laws.

Measures to toughen enforcement of labor laws were taken in 2007.

<sup>22</sup> NIS 12,000,000 was allocated for vocational training activities for participants in the program (the government funded 70 percent of the expenditure), and another NIS 3,000,000 was intended for training participants in supporting and protected employment.

<sup>23</sup> Persons working for sub-contractors are entitled to all the basic labor rights, including the minimum wage, hours of work and rest, annual leave, etc., and are eligible for a vacation supplement, sick pay, and overtime pay.

<sup>24</sup> In a campaign undertaken by the Ministry of Industry, Trade and Labor aimed at implementing the law, 24 sub-contractors who provided workers in the areas of security, cleaning services, and welfare to about 150 government sites were investigated, and 280 incidents in which the labor laws were infringed were brought to light.



These included making the employer financially and criminally responsible for any infringement of the labor laws, placing the responsibility for the terms of employment of workers on the shoulders of the entity requiring the service, and annulling any association with sub-contractors found to have violated workers' rights.

In the public services it is obligatory to issue a tender in which sub-contractors who provide services are required to disclose the wage they pay their workers and append confirmation from the Department of Labor Law Implementation in the Ministry of Industry, Trade and Labor that in the three years prior to the tender they have not been convicted or fined for any breach of the labor laws.<sup>25</sup> In 2007 charges were brought in some 50 cases against personnel and services sub-contractors for violating the labor laws, and the licenses of 52 companies bringing foreign workers into Israel were revoked. In the framework of a special campaign undertaken by the Department of Labor Law Implementation in the Ministry of Industry, Trade and Labor, legal proceedings were begun in 415 cases against employers of teenagers.

In order to attain the objectives in the sphere of employment, direct intervention was adopted. This included subsidizing the employment of new workers from the ultra-orthodox and Arab segments of the population, as well as that of disabled persons, and encouraging employment in peripheral areas. Since 2005 the Ministry of Industry, Trade and Labor has conducted a program aimed at encouraging employment in areas of national priority, and over 5,600 new employee posts have been created in Galilee, the Negev, and the border areas near Sderot and around the Gaza Strip. The next stage of the program, which went into effect in September 2007, is expected to add another 1,585 employee posts. Furthermore, employers in national priority areas have been guaranteed up to 20 percent of the cost of the average wage of incremental employment in plants employing ultra-orthodox persons and Arabs with academic qualifications. In order to enable disabled persons to find employment, the government will subsidize the adjustment of the work environment to their needs, thereby reducing the cost to employers of their employment.

After years in which there has been a drastic decline in the number of persons participating in vocational training courses, this trend was checked in 2007 and there was even a slight 2 percent rise in comparison to 2006. However, in view of the high unemployment rate among persons with a low level of education it would seem that the level of investment in vocational training is not enough and should be expanded.<sup>26</sup> In the framework of the subsidization of work-supporting services, NIS 442,000,000 was spent in 2007 on subsidizing day-care centers for the children of working women.

A committee headed by Israel Makow was set up to examine ways of strengthening the periphery and the traditional manufacturing industries. The committee submitted an ambitious program which shifts the emphasis away from encouraging direct

The number of vocational-training participants stopped falling in 2007.

<sup>25</sup> The following violations make a candidate ineligible to participate in a government tender: failure to pay the minimum wage, obliging an employee to work on his day of rest, failure to pay for overtime, illegally employing or illegally acting as an intermediary for employment.

<sup>26</sup> For a discussion of the improvement of the vocational training system, see Bank of Israel, Recent Economic Developments, 118.

competition in labor-intensive products with countries where labor costs are low towards encouraging the traditional industries in areas in which Israel has an international advantage, namely, developing new products, improving existing products, developing materials, and enhancing manufacturing processes. The program presents the necessary conditions for strengthening the periphery: developing a rapid and accessible transport system and raising the standard of living in the periphery by means of community, social, and cultural development, and improving the education system. At the present stage, in April 2007 a team was set up in the Ministry of Industry, Trade and Labor to foster employment and development in the Negev. The team's task is to initiate new programs and projects designed to attract investment, develop sources of employment, and encourage the establishment of business ventures in the Negev region, creating an employment track and setting up special employment sources for the Bedouin, establishing new centers of manufacturing and employment (such as the high-tech science park in Beersheba,<sup>27</sup>) and a manufacturing area at the Lehavim junction (in cooperation with the Rahat municipality), and the establishment of an applied bio-tech research center in the Negev.

A sub-committee headed by Benny Pepperman was set up within the Ministry of Industry, Trade and Labor for the purpose of helping Ethiopian youngsters find employment. The committee recommended the implementation of three programs aimed at youngsters between the ages of 18 and 35: a program for youngsters about to be demobilized, a program for youngsters in the intermediate age-group, whether employed or not, and a program for students in their final year of studies and for persons with tertiary education. The committee recommended that a program be implemented over the course of three to five years, at a total cost of about NIS 72,000,000, but to date only limited action has been taken to help young Ethiopians find work.<sup>28</sup>

<sup>27</sup> The US company KUD, which specializes in setting up industrial parks, has already begun to build it, in conjunction with the Ben Gurion University of the Negev and Beersheba municipality. The budget intended for development the infrastructure of the science park is estimated at NIS 51,000,000.

<sup>28</sup> In December a course was opened with the intention of training 25 Ethiopian youngsters, thereby enabling them to find work in the high-tech industry; this was done in cooperation with the Vocational Training Department of the Ministry of Industry, Trade and Labor, and the Training Unit of the Matrix Company.