

Chapter 2

The Labor Market

The labor market continued to slump in 2003 as the recession persisted. Labor input in the business sector was flat, the unemployment rate climbed to 10.7 percent, and unemployment intensity worsened. Employment of Israelis in the business sector expanded by 2 percent after no change in 2002. Employment of foreign workers decreased steeply and perceptible numbers of foreign workers in the construction industry were replaced by Israelis. Labor input in the public services contracted slightly after many years of uninterrupted increase due to vigorous measures to reduce the share of government in economic activity.

Nominal wage per employee post declined by 2.1 percent and fell more rapidly in the public services, where a collective agreement stipulating a progressive wage cut was concluded. Labor productivity increased by 1.5 percent after two years of uninterrupted declines. As a result of this factor and the 2.4 percent real wage decrease in the business sector, unit labor cost fell steeply, attesting to greater business efficiency.

Labor relations in 2003 deteriorated in view of the pension-fund arrangements, the raising of the compulsory retirement age, and plans for far-reaching changes in the public services and government-owned companies. The effects of legislative changes that slashed transfer payments and toughened citizens' eligibility for them were perceptible during the year. The stringencies, although prompted by the need to reduce government expenditure and raise the participation rate, dealt the welfare of needy families a severe blow.

The labor market was affected by slack domestic demand that made added labor input in the business sector less necessary; an appreciable decrease in employment of foreign workers and the replacement of some of them by Israelis; and a perceptible slowdown in hiring in the public services and wage cuts for those already employed.

1. MAIN DEVELOPMENTS

Three main underlying factors affected the labor market in 2003. First, economic recovery in developed countries and improved domestic security induced economic growth, albeit slow, in Israel. However, the security and political uncertainty kept domestic demand sluggish and reduced the need for additional labor input in the business sector. Second, the employment of foreign workers decreased considerably and some

foreign workers were replaced by Israelis. Third, hiring in the public services slowed significantly and the wages of those already employed in the sector were cut.

Due to the lethargic demand for labor and an increase in the participation rate, the unemployment rate surged and, in a development conducive to an increase in employment, real business-sector wages decreased. The wage decline and the increase in labor productivity were reflected in a steep downturn in unit labor cost, attesting to business efficiency measures. The increase in unemployment, the decline in real wage,

Table 2.1
Principal Labor Market Indicators,^a 2003

					(percent)			
	Increase or decrease from same quarter in 2002 ^b				Increase or decrease from previous quarter ^c			
	I	II	III	IV	I	II	III	IV
Working-age population	1.9	1.8	1.8	1.7				
Participation rate in civilian labor force ^d								
Total	54.2	53.7	54.9	55.0	54.5	54.2	54.3	54.8
Men	60.0	59.5	60.6	60.4	60.5	59.9	59.8	60.2
Women	48.7	48.2	49.6	49.9	48.9	48.8	49.2	49.7
Civilian labor force	2.4	2.2	2.5	2.8	1.0	-0.1	0.6	1.4
Israelis employed, total	1.9	2.0	2.1	2.0	0.3	0.1	0.5	1.3
Full-time employees	3.4	-2.0	5.5	-4.4	-3.6	-3.2	6.9	-4.0
Part-time employees	3.5	7.4	-2.8	16.2	11.8	1.9	-7.8	10.4
Temporarily absent from work	-26.2	18.8	-7.8	18.7	-10.8	10.7	4.9	5.0
Public-sector employees	-0.9	2.0	3.4	-0.2	-0.9	2.0	0.5	-1.5
Business-sector employees (Israelis)	3.3	2.0	1.5	3.0	0.1	-0.5	0.7	2.7
Foreign workers in business sector ^e	-12.3	-12.0	-13.7	-15.9				
Business-sector employees (Palestinians) ^e	-12.7	125.7	42.0	19.2				
Average weekly hours worked per								
business-sector Israeli employee	0.7	-2.0	2.3	-3.9	-1.5	-0.4	1.4	-1.9
Israeli labor input in business sector	4.1	-0.1	3.8	-1.0	-1.4	-1.0	2.1	0.8
Business-sector labor input of								
foreign workers ^e	-17.4	-22.0	-28.7	-30.2				
Business-sector labor input of								
Palestinian workers ^e	-1.3	128.6	25.9	20.1				
Unemployment rate ^d	10.5	9.8	11.6	11.0	10.8	10.6	10.7	10.9
Number of unemployed persons	6.3	4.3	6.1	9.4	7.0	-1.8	1.9	2.7
Real wage per employee post, total	-6.5	-6.6	0.6	1.7	-0.8	-1.1	4.1	-0.1
Business sector	-6.4	-5.6	1.1	1.8	-0.2	0.3	2.7	-0.1
Public sector	-6.5	-8.7	-0.7	1.3	-0.5	-6.3	6.7	2.1
Business-sector unit labor cost					1.0	-1.1	-3.4	3.7
Net business-sector domestic product per hour worked ^f					-1.8	7.3	2.9	-5.6

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

^b Unadjusted data.

^c Seasonally adjusted data.

^d Actual level, not rates of change.

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

^e National Accounts data.

^f At constant prices.

and the steep decrease in transfer payments put further restraints on domestic demand and the need for additional labor in the short term.

The labor market stabilized and even recovered slightly during the year, especially in the second half, as economic activity reawakened (Table 2.1). Business-sector employment expanded mildly and the percent of employers offering work and the number of vacant posts increased. The unemployment rate climbed and unemployment intensity worsened, but these developments coincided with an increase in the participation rate. The nominal wage per business-sector employee post rose moderately and real wages accelerated, mainly due to negative CPIs.

During the year, and especially in the second half, the labor market stabilized and even recovered somewhat, in tandem with economic activity.

Table 2.2
Labor Market Indicators,^a 2000–2003

	(change over previous year, percent)			
	2000	2001	2002	2003
Population (annual average)	2.7	2.4	2.0	1.8
Immigrants who arrived in this period	–21.6	–27.6	–23.0	–30.8
Working-age population	2.9	2.6	2.2	1.8
Participation rate in civilian labor force, total ^b	54.2	54.3	54.1	54.5
Men	60.8	60.7	60.2	60.1
Women	48.0	48.2	48.4	49.1
Civilian labor force	3.8	2.8	1.9	2.5
Total employees	3.2	1.1	0.3	0.9
Israelis	3.9	2.1	0.9	2.0
Non-Israelis	–1.5	–6.6	–4.0	–8.6
Public-sector employees	2.9	4.4	3.1	0.7
Public-sector labor input	1.9	3.3	4.3	–0.9
Business-sector employees	3.3	0.0	–0.6	1.0
Israelis	4.3	1.3	0.0	2.5
Foreign workers	6.6	14.2	3.4	–13.6
Palestinians	–15.3	–49.0	–37.4	29.7
Share in business sector of foreign and Palestinian workers ^b	15.2	14.1	13.6	12.4
Business-sector labor input	4.4	–1.9	0.3	0.1
Israelis	5.9	–1.0	1.1	1.8
Foreign workers	6.2	14.4	2.0	–14.0
Palestinians	–15.8	–50.7	–34.3	30.8
Real wage per employee post	6.2	3.0	–6.0	–2.8
Business sector	6.6	3.3	–6.7	–2.4
Public sector	5.4	2.6	–4.3	–3.7
Minimum wage (real)	4.9	7.9	–3.1	1.4
Business-sector unit labor cost	–1.2	6.6	2.0	–3.6
Net business-sector domestic product per hour worked ^c	5.5	–1.9	–4.2	1.5
Unemployment rate, total ^b	8.8	9.3	10.3	10.7
Men	8.4	8.9	10.1	10.2
Women	9.3	9.9	10.6	11.3

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

^b Actual levels, not rates of change.

^c At constant prices.

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

Business-sector employment increased by 1.0 percent after having fallen by 0.6 percent in 2002 (Table 2.2). The government policy that aims to downscale the employment of foreign workers proved successful; the number of foreign workers in the business sector contracted by one-sixth (about 35,000 workers) during the year. However, foreign workers still account for a very large share in total employment—more than 10 percent. Employment of Israelis increased by 2.5 percent after no change in 2002. The increase encompassed most business-sector industries, especially those intensive in skilled labor. Employment in unskilled-labor-intensive industries, in contrast, hardly expanded with the exception of construction, in which many foreign workers were replaced by Israelis. Thus, persons with relatively poor skills have severe difficulties in finding work. Hours worked per person employed in the business sector declined, in contrast to the previous year, and total business-sector labor input was flat for the second consecutive year.

Public-service employment expanded by only 0.7 percent in 2003, much slower than the annual rates since the mid-1990s and the rate of population increase. This is a consequence of the 2003 economic recovery plan, which included decisions to restrain the growth rate of public-service employment, to impose layoffs, and to encourage early retirement. The early-retirement trend actually gained strength due to employees' concern about future deterioration in their retirement and pension terms. Hours worked per person employed decreased by 1.6 percent, causing labor input in the public services to dip slightly after lengthy rapid expansion. Employment plummeted in public administration, continued to increase moderately in education and health services, and expanded strongly in social and welfare services, perhaps due to the intensification of socioeconomic distress.

The participation rate increased by 0.4 percent in 2003 and came to 54.5 percent. Men's participation was almost unchanged after a steep decrease in 2002, even though the discouraged-worker phenomenon was much more in evidence. Women's participation rate, in contrast, increased by 0.7 percent on average, far outpacing the long-term trend, because the persistence of the recession and the steep decline in households' standard of living prompted many women to seek work outside the home (the added-worker effect).

The unemployment rate rose in 2003:I to 10.7 percent on annual average, the highest rate observed in Israel's history (with the exception of the early 1990s, the peak period of mass immigration from the former USSR). The moderate rate of employment growth in public services and unskilled-labor-intensive industries contributed 0.6 percentage point to the increase in the unemployment rate. Unemployment among the poorly schooled rose swiftly. Joblessness among men was almost unchanged and that of women climbed vigorously in view of the rapid increase in women's labor-force participation, especially in the second half of the year. Unemployment intensity worsened and the share of the chronic jobless increased perceptibly.

The employment rate—the share of employed persons in the working-age population, a function of the participation rate and the proportion of participants who are employed—was 48.6 percent in 2003, 0.1 percentage-point higher than in 2002. This is because the upturn in the unemployment rate offset almost all of the increase in participation.

Nominal wage per employee post declined by 2.1 percent overall, by 3.1 percent in the public services, and by 1.7 percent in the business sector. In 2002, real wages eroded due to the contraction of economic activity and the unexpected eruption of inflation, whereas in 2003 the decrease in nominal wage forced the real wage down by 2.8 percent as the Consumer Price Index rose by only a small increment on annual average.

The nominal wage in the public services decreased due to measures adopted during the year as part of the economic recovery plan, the collective agreement concluded between the Government and the New General Federation of Labor, and other factors. Wages were lowered progressively by an average of 4 percent through the middle of 2005; payment of vacation benefits, the Jubilee Grant, and the cost-of-living allowance were postponed to next year; the quota of overtime hours was cut; and the slowdown in wage creep continued. Layoffs and early retirement of relatively well paid employees also lowered the average wage, although nonrecurrent payments related to these measures had a temporary upward effect on wage. Moreover, the wage cuts and the restraint in public-sector employment may have had a moderating effect on business-sector wages.

Real wages per business-sector employee post declined by 2.4 percent. Downtrends were evident in most industries—2.6 percent in skilled-labor-intensive industries and

Table 2.3
Principal Labor Market Indicators,^a 2000–2003

	('000s, annual averages)							
					Change from previous year			
	2000	2001	2002	2003	2000	2001	2002	2003
Mean population	6,289.2	6,439.0	6,570.0	6,689.6	163.9	149.8	131.0	119.6
Immigrants who arrived in this period	60.2	43.6	33.6	23.2	–16.6	–16.6	–10.0	–10.3
Working-age population ^b	4,486.7	4,604.7	4,706.2	4,791.8	128.2	118.0	101.5	85.6
Civilian labor force ^b	2,435.0	2,498.9	2,546.7	2,610.0	89.9	68.3	47.8	63.3
Number of unemployed ^b	213.8	234.0	262.4	279.7	5.3	19.4	28.4	17.3
Employees, total ^c	2,513.4	2,540.9	2,549.4	2,572.5	78.2	27.5	8.5	23.1
Israelis	2,217.9	2,264.9	2,284.4	2,330.3	82.8	47.0	19.5	45.9
Non-Israelis	295.5	276.0	265.0	242.2	–4.6	–19.5	–11.0	–22.8
Foreign workers	197.5	226.0	233.5	201.5	12.9	28.5	7.5	–32.0
Palestinians	98.0	50.0	31.5	40.7	–17.5	–48.0	–18.5	9.2
Public-sector employees ^{c,d}	607.1	634.0	653.8	658.2	16.9	26.9	19.8	4.4
Business-sector employees ^{c,d}	1,906.3	1,906.9	1,895.5	1,914.3	61.3	0.6	–11.4	18.8
Nominal wage per employee post								
Total (NIS per month)	6,791	7,072	7,023	6,873	468	281	–48	–151
Public sector	6,434	6,676	6,750	6,539	393	243	73	–211
Business sector	6,953	7,257	7,155	7,035	501	305	–103	–120

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

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

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

^d Israelis and non-Israelis.

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

1.2 percent in unskilled-labor-intensive and other industries. Labor productivity increased by 1.5 percent, after two years of cumulative decline, but was still lower than the mid-1990s level. Due to these factors, unit labor cost declined by 3.6 percent but still surpassed the level recorded on the eve of the Intifada. These developments indicate that firms are taking accelerated efficiency measures that have probably not yet run their full course.

Labor relations deteriorated in 2003, mainly due to new pension arrangements, the raising of the compulsory retirement age, and the intent to bring about far-reaching structural changes in public services and government-owned corporations, including sharp cutbacks in personnel. Measures to reduce the incidence of tenure in the public services were taken and proposals to limit the right to strike were placed on the table.

Box 2.1

Government Labor-Market Policy in 2003

In 2003, the government continued to carry out a comprehensive plan to transform and elasticize the labor market as an integral part of its growth-encouraging macroeconomic policy. One of the main goals of the plan was to boost the employment rate, which stands at 69 percent of those of prime working age as against 76 percent in the Western norm; to raise the standard of living of households, especially those that lack breadwinners; and to reduce these households' reliance on transfer payments. In its main provisions, the plan prescribed cutbacks in public-service employment and wages coupled with the subsidization of further employment of Israelis in the business sector. To achieve its goal, the plan included an integrated set of measures to downscale the employment of foreign workers, to reduce the implicit disincentive to labor in various transfer payments, and to cut labor cost. Since active programs in the labor market were hardly implemented, there is concern that many workers will find it difficult to participate in the job market and will find their standard of living impaired, at least in the short term. The average employment rate increased slightly in 2003 after two years of declines. During the year, employment in the public services decreased slightly and the business sector took on an additional 50,000 Israelis while shedding 28,000 non-Israelis.

The government policy to reduce employment in the public services rested on two pillars: avoiding new hiring to the extent possible and reducing headcount by means of thousands of layoffs and early retirements. As a result, employment in 2003 was almost unchanged (a 0.7 percent increase on annual average) after two years of rapid growth (Table 1) and labor input decreased for the first time since the 1985 Economic Stabilization Plan. These measures, coupled with an agreement to reduce wages for two years,

may promote a stronger redirection of labor supply to the business sector. However, efficiency measures during a time of tightness in the labor market are bound to cause an increase in unemployment and, apparently, a cutback in service to the citizen.

Measures to reduce the employment of foreign workers—barring new workers, introducing portability of legal foreign workers among employers who hold hiring permits, and more vigorous enforcement of the law and punishment of violators—gathered momentum during the year. The imposition of a levy on employers reduced the economic utility of employing foreigners; however, even though foreigners are still much cheaper to employ than Israelis, an attempt to raise the levy did not succeed. Overall, the population of foreign workers fell by 36,000 during the year, about one-sixth of the number at the end of 2002, after peaking in early 2002. Some foreign workers, especially in construction, were replaced by Israelis. Notably, the number of foreign-worker employment permits is expected to decrease considerably in years to come.

Many legislative changes that slashed transfer payments were made in 2002 and their effects were strongly felt in 2003 (for details, see the corresponding chapter in *Annual Report 2002*). The measures, although prompted by the need to reduce government outlays due to the swelling budget deficit and the intent to raise the participation rate, weakened the social safety net. For example, income-maintenance and related benefits were reduced and the eligibility terms for unemployment compensation were toughened. Consequently, income-maintenance and unemployment-compensation payments contracted by more than 20 percent in real terms in 2003, even though poverty worsened and the numbers of unemployed and of households entitled to income-maintenance benefits increased. The May 2003 economic recovery plan signaled more of the same. First, it reduced child allowances and stipulated the introduction of a uniform allowance for each child in a staggered process by the end of the decade. Importantly, the plan also stipulates that the mechanism used to adjust wage-replacement allowances will be changed in 2006 so that allowances will be linked to the Consumer Price Index instead of the national average wage. The purpose is to sever the relationship between wage changes at the top of the income-distribution scale and the level of benefits. Since the real wage has been rising perceptibly over the years, the legislative changes will be severely harmful to the relative standard of living of benefit recipients. Indexation to the national median wage would probably be a more appropriate way to solve the problem.

To reduce labor costs and increase disposable labor income, a reduction in earned-income tax rates was implemented earlier than planned and the

Change in Numbers of Israeli and Non-Israeli^a Employees, by Industry,^b 2001–2003

	Annual average rate of change in 2001–2002 (%)		Rate of change in 2003			
			(percent)		(thousands)	
	Israelis	Non-Israelis	Israelis	Non-Israelis	Israelis	Non-Israelis
Public services	3.1		–0.5		–3	
Business sector	1.3	3.3	3.0	–10.9	50	–28
Construction	0.4	–5.8	9.9	–15.7	11	–13
Agriculture	–4.2	13.9	–9.0	–8.9	–4	–3
Hotels & catering	–1.5	–6.6	5.9	–7.2	5	–3

^a Non-Israelis: Foreign and Palestinian workers (both reported and unreported).

^b Last quarter of period compared to last quarter prior to period.

SOURCE: Based on Central Bureau of Statistics data.

wage ceiling for National Insurance contributions and health tax was restored, in a measure that affects only a small group of employees. In contrast, tax benefits for residents of peripheral localities were cut back and members' contributions to old pension funds were raised starting in 2004 as part of the set of measures designed to increase pension saving.

To encourage labor-force participation and employment in ways beyond the severe reduction in the employment of foreign workers, the slashing of wage-replacement benefits, and the lowering of labor costs, several complementary measures were taken. A wage subsidy for single parents who receive income-maintenance benefits was introduced (Box 2.2); training programs in construction were reinforced so that Israelis could replace foreign workers; and participants in the arrangement for full-time yeshiva students (in the spirit of the Tal Commission recommendations) were given labor permits. Preparations were made to establish in the near future, very belatedly, four pilot employment centers to integrate recipients of income-maintenance benefits into the labor cycle, after legislation concerning the operation of such centers was passed. Importantly, the small number and limited incidence of such programs have kept many unskilled workers out of the employment cycle.

2. THE POPULATION AND THE WORKING-AGE POPULATION

Only 23,000 immigrants came in 2003 and the proportion of immigrants in the population returned to the 1980s level.

The average permanent population increased by only 1.8 percent in 2003, approximating the growth rate in the second half of the 1980s, before mass immigration from the former Soviet Union. Therefore, the working-age population (aged 15 and over) expanded at the same sluggish rate. Only 23,000 immigrants arrived in 2003 as against 34,000 in 2002 and 66,000 on annual average in 1996–2000. The proportion of immigrants in the total population returned to the 1980s level. Immigration from the

FSU—Asian and European republics alike—continued to decline for reasons including the depletion of the pool of persons eligible to immigrate under the Law of Return, the improvement in Jews' economic situation in Russia, and sizable emigration from Russia to Germany and to the United States. (See the corresponding chapter in *Annual Report 2002*.) Immigration from Argentina surged in 2002 due to economic hardships but receded in 2003 after political stabilization and economic recovery in Argentina and absorption difficulties in Israel. Immigration from France was unchanged in 2003 after a decline in personal security instigated a strong increase in 2002.

The foreseen downtrend in immigration from the FSU has turned attention to Western Jewry. Since the Intifada began, it has been believed that the proliferation of antisemitic incidents around the world, particularly in Europe,¹ may cause immigration to increase. Since the beginning of 2003, all immigrants other than those from Ethiopia, who are given accommodations in 'absorption centers,' have received a package of absorption benefits, and the 2004 state budget includes a special resource allocation to encourage immigration from the West. However, it was also decided for fiscal reasons to reduce various benefits that immigrants received in the past.

3. THE LABOR FORCE

The labor force grew by 2.5 percent in 2003, far exceeding the growth rate of the working-age population. The participation rate rose by 0.4 percentage points, despite the strong upturn in the unemployment rate, and came to 54.5 percent, after a slight decrease in 2002.

The participation rate of men declined but the decrease slowed to 0.1 percentage point on annual average as against 0.5 percent in 2002. The unemployment rate of men leveled off. However, the discouraged-worker phenomenon escalated severely. The persistence of the recession and the decline in many households' standard of living, exacerbated by the contraction of real wage and the steep reduction in transfer payments, prompted many women to enter the labor market (the added-worker effect) even though they had little chance of finding work. Thus, the participation rate of women began to rise in late 2002 and continued to do so in 2003 by 0.7 percentage point on annual average, far exceeding the long-term trend and resembling the increase in the rate of women's unemployment. The participation rate of Jews climbed by 0.4 percentage points after two years of gentle decreases. The participation rate of Arabs was flat after a downtrend at the beginning of the recession. Notably, the proportion of discouraged workers continued to rise moderately in 2002, largely due to the lack of appropriate jobs in workers' areas of residence, and did so conspicuously among young men and Arab women. This indicator continued to increase in 2003, especially among men and Arabs.

The decline in many households' standard of living prompted women to enter the labor market even though their chances of finding work were paltry. Thus, their participation rate climbed by 0.7 percent, much more than the long-term trend.

¹ The Stephen Roth Institute for the Study of Contemporary Antisemitism and Racism, Tel Aviv University (2003), *Anti-Semitism Worldwide 2001/2 and 2002/3*; European Monitoring Centre on Racism and Xenophobia (EUMC), Center for Research on Anti-Semitism (2003), *Manifestations of Anti-Semitism in the European Union, Synthesis Report*, Berlin, March 2003.

Table 2.4
Labor Force Participation Rates in Israel, 2002

	(percent)							
	Men				Women			
	Total		Jews ^a		Total		Jews	
	A*	B*	A*	B*	A*	B*	A*	B*
Average participation rate		60.2		60.2		48.4		54.0
Age group								
15–24	24.6	29.7	23.3	26.5	22.3	32.7	20.8	38.1
Principal working age, 25–54	53.8	83.1	53.2	84.0	52.2	69.3	51.6	78.3
Pre-pension (women, 55–59; men 55–64)	9.6	65.9	10.1	70.2	5.5	53.0	5.7	59.9
Pension age (women 60+; men, 65+)	12.0	15.4	13.4	16.3	19.9	9.8	22.0	10.4
Principal working-age group								
Years of education								
0–8	9.0	63.0	5.4	61.1	10.3	22.4	4.9	44.8
9–10	10.5	82.5	8.5	84.2	8.3	46.6	34.5	65.8
11–12	32.8	87.3	33.2	87.8	33.0	68.2	27.4	74.8
13–15	23.9	83.6	26.8	83.6	24.5	80.2	26.8	81.7
16+	23.9	85.3	26.1	84.7	23.8	88.0	6.5	88.7
Number of children^b								
None	44.6	80.1	47.0	81.7	40.4	75.6	42.8	81.4
1 or 2	36.1	89.2	37.7	89.4	39.6	74.0	41.7	80.3
3 or more	19.4	78.8	15.3	77.8	20.0	47.2	15.5	64.4
With religious education^c			4.3	29.1				
In ultra-orthodox household			5.7	37.3			4.9	54.8
Non-Jews	17.4	78.9			16.3	22.9		
In development towns, north	5.6	83.2	6.2	83.5	5.7	75.3	6.3	77.8
In development towns, south	5.1	78.5	6.1	78.3	4.9	71.0	5.8	71.2

* A = share in population; B = participation rate.

^a Including non-Jewish immigrants.

^b Children under 14.

^c Religious education refers to men whose last place of study is a 'yeshiva' (religious seminary). Anyone who lives in a household whose head has received religious education is considered part of an ultra-orthodox household.

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

The employment rate—the share of employed persons in the population—is a function of the labor-force participation rate and the employment rate of participants. The employment rate in Israel's prime working-age cohort (25–54) was 69.2 percent in 2002, much lower than corresponding rates in OECD countries. Low employment rates are common among the poorly schooled, the ultraorthodox Jews, and Arab women—population groups that are also noted for low participation rates (Table 2.4). When employment rates are low, an economy cannot utilize its full productive capacity, the standard of living of households that lack breadwinners falls, and such households become more impoverished and dependent on transfer payments. The measures needed to raise the employment rate include pro-work policies, e.g., immediate implementation of the Tamir Committee recommendation to integrate long-term recipients of basic subsistence benefits into the work cycle, wage subsidies (Box 2.2), larger investments

in human capital and physical infrastructure, and continued reduction in the employment of foreign workers who displace unskilled Israelis in the job market.²

Box 2.2

Wage Subsidization and Labor-Cost Reduction for Low-Wage Employees¹

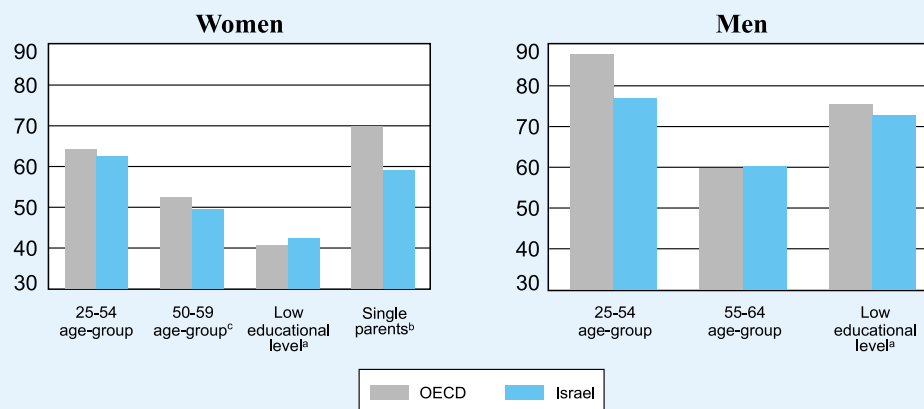
Non-participation in the labor force and part-time employment at low wage are common among the poorly schooled, the vocationally unskilled, heads of single-parent households, people approaching the end of working age (Figure 1), and persons with disabilities, and are among the most important reasons for reliance on transfer payments and high incidence of poverty among members of these population groups. (See the Economic Policy part of this Report.) Since the market wage available to such people is relatively low, and since accepting such a wage would force the people at issue to forgo some or all of the transfer payments and miscellaneous benefits for which they qualify, they have little incentive to accept a job and their poverty worsens.

During the past few decades, and with particular emphasis since the middle of the 1990s, Western countries have been introducing programs designed to subsidize wages and reduce labor costs, mainly for members of weak population groups. Examples are the Earned Income Tax Credit in the US (at a cost of 0.3 percent of GDP), the Working Family Tax Credit in the UK (0.6 percent of GDP) and the pilot Self-Sufficiency Project in Canada, all of which are meant for single-parent households. Similar programs provide low-wage workers with a tax credit or income supplements in order to give them a strong incentive to labor. Several programs require a minimum extent of employment to strengthen the worker's connection with the labor market, and some are time-limited in order to give participants an interest in gradually raising their income level.

Several countries (e.g., Belgium, Netherlands, and France) have reduced the social-insurance contributions of employers of low-wage workers in order to encourage them to hire such workers and increase their disposable income. This policy has run into several problems: many firms would have increased headcount in any case; the reduction of social-insurance contributions commensurate with monthly wage encourages part-time

¹ The box is based partly on OECD (2003), *OECD Employment*.

² For details, see D. Gottlieb, O. Peled, and N. Kassir, "A Program for the Reduction of Unemployment," Bank of Israel, July 2002 (Hebrew); the corresponding chapter in *Annual Report 2002*; and D. Gottlieb, *Principles for a War on Poverty Policy*, Bank of Israel, July 2003 (Hebrew).

Employment Rates in Israel and OECD Countries, 2001 (percent)

^a Aged 25-54 with no matriculation certificate.

^b Including men; about 10 percent of single-parent households in Israel are headed by a man.

^c In OECD countries this is the weighted average of the employment rates in Austria, the UK, Greece, and France, where the pensionable age for women is 60 (as in Israel). The figure is weighted according to the female population in the 50-59 age-group.

SOURCE: Israel—Based on Central Bureau of Statistics data; Selected countries—OECD *Employment Outlook* 2003; International Labor Office, *Year Book of Labor Statistics*; U.N. *Demographic Yearbook* 2000.

employment; and employers may not raise these workers' scanty wages for fear that they will forfeit the benefit by so doing, thereby reducing net wage.

To overcome some of the problems, the subsidies and tax benefits are sometimes focused on population groups that find it very difficult to join the labor market (single parents, the chronic unemployed, long-time recipients of income-maintenance benefits, etc.). The programs take account of problems of stigma, perseverance in the welfare system in order to take part in programs, and impairment to horizontal equality. Mechanisms have been developed to minimize the preference of benefit-recipients over other workers who may otherwise be crowded out of the labor market (the displacement effect). Notably, the OECD countries spend about 0.2 percent of GDP on focused wage subsidies, about one-fourth of total expenditure on active programs in the labor market.

It turns out that the wage-subsidy and labor-cost reduction programs do increase the participation rate, the employment rate, and the disposable income of weak population groups and lift many households and children, especially in single-parent households, out of the cycle of poverty. However, the quality of the jobs filled is generally poor; they provide neither employment security nor any likelihood of advancement. The programs, which are time-limited, have scanty long-term success because some participants drop out of the labor force when they end. These findings

illustrate the importance of help in hunting for suitable work and of vocational-training programs. Finally, successful wage-subsidy programs, such as tax-credit schemes, are expensive since studies have shown that, for the most part, only generous plans get results. However, such programs reduce expenditure for other transfer payments.

Israel currently has two active wage-subsidy programs²: supplemental income maintenance for low-wage workers, as part of the National Insurance income-maintenance benefit (the structure of the benefit is described in Box 2.1 in the corresponding chapter of Bank of Israel *Annual Report 2002*) and a wage subsidy for single parents. In 2002, 26,000 households—17 percent of households that receive income maintenance—received the supplement and the expenditure on this account was NIS 0.5 billion, only 0.1 percent of GDP. More than two-fifths of recipients of the supplemental benefit remain in the system for more than five years.

A one-year program that subsidizes the wages of single parents who receive income-maintenance benefits was activated in early August 2003. A single parent who increases his/her income for four months by NIS 1,200 per month, relative to the base wage, receives a grant in the sum of NIS 3,600, another NIS 3,200 for four additional months of work, and another NIS 2,800 for months 9–12. The employer receives a grant of NIS 1,000 per month, for up to one year, for employing a present or new worker full-time at the minimum wage at least. If the post is less than full-time, the benefit is reduced commensurably. The employer or the worker also benefits from participation in travel expenses. Single parents receive a subsidy for child upkeep in a daycare or family-care center and are eligible for vocational training. By the beginning of 2004, 9,000 single parents were referred to jobs and one-third of them began to work, but only about two-thirds increased their income enough to qualify for the grant.

In 2004, after a lengthy delay, four pilot district employment centers are to be established in different parts of the country. Each center is to provide essential services for income-maintenance recipients in its district (including assistance in arranging childcare), in order to place them in jobs. The law that regulates the centers' activities does not state explicitly that their services are to include wage subsidization, vocational training, participation in travel expenses, and other matters.

² Notably, in response to mass immigration from the Former Soviet Union, a wage-subsidy program was in effect between 1991 and 1995 (under the Encouragement of the Business Sector Law) for all additional persons hired by one employer. To this day, however, its contribution to increasing employment has not been examined in depth.

The tax system gives employers practical incentives to hire low-wage workers: a high tax threshold and a reduced rate of National Insurance contributions. Since Israel's minimum wage is high by international standards (see Box 4.3 in Bank of Israel *Annual Report 1999*), it limits the vast bargaining power of employers of low-wage workers but makes it difficult for them to do more hiring.

In sum, Israel's wage-subsidy programs for the poorly schooled and the unskilled are limited in scope and designed mainly for recipients of income-maintenance benefits—even though comprehensive programs for diverse population groups have proved themselves in Western countries. Thus, they should be put to greater use in Israel, and a diagnostic mechanism that can identify those incapable of working and in need of appropriate support should be devised.

4. EMPLOYMENT IN THE PRINCIPAL INDUSTRIES³

The growth of employment was 0.7 percent in the public services, much slower than in the past, and 1.0 percent in the business sector. The combination of stable labor input in the business sector, higher labor productivity, and a steep decrease in unit labor cost shows that firms have been streamlining.

Employment countrywide (including foreign and Palestinian workers) expanded by 0.9 percent in 2003 after no change in 2002 and hours worked per person employed declined by 1 percent. The growth of public-service employment slowed markedly to only 0.7 percent (Table 2.5). Hours worked per person employed in the public services decreased by 1.6 percent, for reasons including the cutback in overtime hours, and labor input contracted after many years of rapid increase. In the business sector, the economic slump in 2001 caused employment to level off and hours worked per person employed to decrease. Only in 2002 did it lead to a contraction of employment and a similar increase in hours worked per person employed. In 2003, business-sector employment expanded by 1.0 percent and hours worked per employed person decreased at a similar rate, for reasons including a steep cutback in the number of foreign workers who worked many hours per day. The combination of stability in business-sector labor input, higher labor productivity, and the acute decline in unit labor cost shows that business firms have been streamlining.

The factor of greatest influence on employment in 2003 was the continued activity recession and its underlying cause, security instability. With no political horizon in sight, domestic demand, including labor demand in the business sector, remained sluggish. The global economic recovery made a small contribution to the expansion of employment in export industries. Some of the dismissed foreign workers were replaced by Israelis, especially in construction. The decrease in real business wages and the measures taken to reduce labor cost and increase disposable income also abetted an expansion in employment. In the short term, however, labor demand was restrained by

³ The public services include public administration; education; health, social, and welfare services; some community, social, and personal services; and research and development. The classification of public services resembles that of general government in the next chapter.

Table 2.5
Employment and Labor Input, by Industry,^a 1999–2003

	Employment								
	‘000s					2000	Rates of change		
	1999	2000	2001	2002	2003		2001	2002	2003
	(‘000)						(percent)		
Total business sector ^b	1,845.0	1,906.3	1,906.9	1,895.5	1,914.3	3.3	0.0	−0.6	1.0
Agriculture	80.7	80.0	70.9	70.7	69.0	−0.9	−11.4	−0.3	−2.4
Construction	244.1	236.1	220.3	208.3	203.6	−3.3	−6.7	−5.4	−2.3
Manufacturing	400.5	406.0	391.5	373.4	362.8	1.4	−3.6	−4.6	−2.8
Commerce and vehicle repairs	297.4	316.2	320.1	331.8	332.3	6.3	1.2	3.7	0.2
Hotels and catering services	126.6	138.5	132.5	127.9	127.8	9.4	−4.3	−3.5	−0.1
Transport, storage, and communications	137.3	146.9	150.9	147.4	153.0	6.9	2.7	−2.3	3.8
Banking, insurance, and finance	73.9	73.6	75.2	76.2	77.5	−0.4	2.2	1.3	1.7
Business services	247.8	284.3	304.0	305.5	325.2	14.7	6.9	0.5	6.4
Public sector	590.2	607.1	634.0	653.8	658.2	2.9	4.4	3.1	0.7
	Labor input								
	‘000 hours					2000	Rates of change		
	1999	2000	2001	2002	2003		2001	2002	2003
	(‘000)						(percent)		
Total business sector ^b	74,883.1	78,207.3	78,682.7	76,912.6	77,008.4	4.4	−1.9	0.3	0.1
Agriculture	3,660.5	3,598.4	3,227.8	3,216.0	3,228.2	−1.7	−8.9	−1.9	0.4
Construction	10,555.7	10,288.0	9,548.0	9,224.5	8,802.3	−2.5	−7.2	−3.4	−4.6
Manufacturing	16,789.6	17,138.6	16,143.8	15,532.7	15,013.4	2.1	−5.8	−3.8	−3.3
Commerce and vehicle repairs	12,256.9	13,067.0	12,957.3	13,557.8	13,486.1	6.6	−0.8	4.6	−0.5
Hotels and catering services	5,137.2	5,658.1	5,342.6	5,063.1	5,029.0	10.1	−5.6	−5.2	−0.7
Transport, storage, and communications	5,721.9	6,260.9	6,238.6	6,050.2	6,235.3	9.4	−0.4	−3.0	3.1
Banking, insurance, and finance	2,810.2	2,773.2	2,813.2	2,950.7	2,981.9	−1.3	1.4	4.9	1.1
Business services	9,865.9	11,555.9	12,027.5	12,211.1	12,838.4	17.1	4.1	1.5	5.1
Public sector	18,713.5	19,069.1	19,702.4	20,550.4	20,361.7	1.9	3.3	4.3	−0.9
Employment and labor input, by industry, 2003									
	Employment						Labor input		
	Israelis	Foreign workers	Palestinians	Israelis	Foreign workers	Palestinians	Foreign workers	Palestinians	
		(‘000s)			Year-on-year rate of change				
Total business sector ^b	1,677.6	196.5	40.2	2.5	−13.6	29.7	1.8	−14.1	30.8
Agriculture	42.5	23.3	3.2	−5.3	2.2	6.7	−1.1	2.2	5.7
Construction	129.1	55.8	18.7	8.8	−25.2	24.7	6.2	−25.8	25.6
Manufacturing	355.7	1.6	5.5	−2.1	−27.3	−31.3	−2.5	−27.3	−30.8
Commerce and vehicle repairs	313.5	13.0	5.8	0.5	−7.1	−3.3	−0.1	−7.1	−3.3
Hotels and catering services	90.5	35.3	2.0	5.1	−11.3	0.0	5.4	−11.6	0.0
Transport, storage, and communications	152.1		0.9	3.5		80.0	2.8		82.4
Banking, insurance, and finance	77.5			1.7			1.1		
Business services	282.2	42.0	1.0	8.5	−5.6	0.0	7.3	−5.6	0.0
Public sector	652.7	5.0	0.5	0.9	−19.4	0.0	−0.6	−19.4	0.0

^a Including reported and unreported foreign workers and Palestinians.

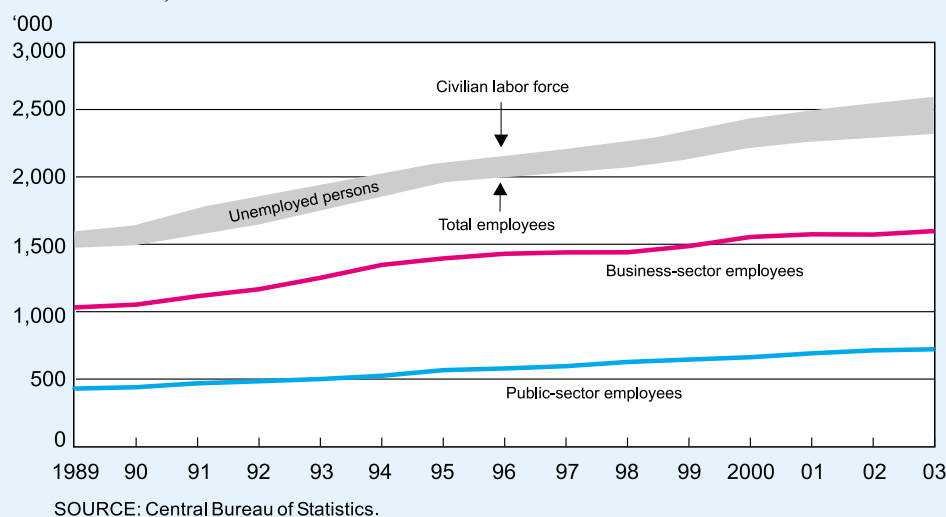
^b Figures may not add due to the exclusion of ‘miscellaneous.’

SOURCE: Central Bureau of Statistics and National Accounts data.

the absence of increase in household disposable income, the contraction of domestic demand, and the slowdown in growth of employment in the public services and the share of public services in economic activity.

The number of non-Israeli workers in the business sector fell by 8 percent in 2003 and ended the year at 12.4 percent of total business-sector employment. The rate in 2003 resembled that in 1996, a platform from which it rose steadily to 16.0 percent in 1999. The population of foreign workers declined by 35,000 and that of Palestinian workers increased slightly, after many years of contraction, due to improved security. The proportion of non-Israelis is particularly high in construction, agriculture, hotel and catering services, and caregiving, and is one of the highest in the world.

Figure 2.1
Employment in Public and Business Sectors, and Unemployed Persons, 1989–2003



a. Employment of Israelis

The number of Israelis employed increased by 2.0 percent in 2003, approximating the growth rate of the working-age population. Public-services employment expanded by only 0.9 percent after rapid growth rates in previous years, but business-sector employment rose by 2.5 percent after no growth in 2002 and slow growth in 2001. The growth of public-services employment was continuous until the fourth quarter; employment in the business sector recovered perceptibly in the second half.

Employment of men increased by 1.6 percent after zero growth in 2002, due to a steep increase in the employment of men in construction and business services and a slight downturn in the public services. Women's employment expanded by 2.5 percent, mainly due to rapid growth in the employment of women in business services and public services. Full-time employment increased by only 0.6 percent but the number of persons employed in part-time posts rose by a brisk 6.2 percent after having contracted

in 2002. The filling of part-time jobs may attest to the difficulty in finding full-time jobs in the midst of a recession, as some employers tend to be cautious about increasing labor output or even to eliminate jobs.

Labor input of Israelis in the business sector expanded by 1.8 percent in 2003. Unlike 2002, when employment was flat and hours worked per person employed increased perceptibly, employment expanded in 2003 and hours worked per person employed edged downward by 0.7 percent. The number of persons temporarily absent from work was unchanged, possibly due to the offsetting effects of increased taking of vacations, after avoidance of vacations during the previous recession years out of concern about being fired, and a steep decrease in the percent of men absent, apparently due to less army reserve duty.

Table 2.6
Contribution to Change in Unemployment Rate,^a 2000–2003

	(change from previous year, percentage points)			
	2000	2001	2002	2003
Total	–0.1	0.5	0.9	0.4
Public sector	0.3	–0.4	–0.3	0.4
Business sector	–0.4	1.0	1.3	0.0
High-skill industries ^b	–1.0	–0.1	0.8	–0.2
Nontradables	0.0	–0.2	0.1	–0.2
Manufacturing	–0.4	0.2	0.3	0.0
Computer services	–0.6	–0.2	0.4	0.1
Unskilled-labor-intensive industries ^c	0.2	0.7	0.4	0.2
Manufacturing	0.3	0.1	0.4	0.1
Textiles and clothing	0.2	0.1	0.2	0.0
Construction	0.4	0.1	0.0	–0.3
Hotel and catering services	–0.3	0.3	0.2	0.1
Other industries (not classified) ^d	0.3	0.4	0.1	0.1
Manufacturing	0.4	0.2	0.2	0.1

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

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

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

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

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

In most industries, employment of Israelis rose in 2003 after declining in 2002. A relatively strong upturn in employment in skill-intensive industries lowered the unemployment rate by 0.2 of a percentage point, whereas unskilled-labor-intensive and other industries contributed slightly to the increase (Table 2.6). On final reckoning, the business sector did not contribute to the upturn in the unemployment rate.

In most business-sector industries, employment of Israelis increased in 2003 after declining in 2002. The relatively swift upturn in employment in skilled-labor-intensive industries restrained the unemployment rate by 0.2 of a percentage point, whereas unskilled-labor-intensive and other industries raised the rate slightly.

According to the Central Bureau of Statistics Labor Force Survey, employment of Israelis in manufacturing increased by 0.6 percent in 2003,⁴ after a 3.9 percent decrease in 2002, and the number of hours worked per person per week declined by 0.7 percent. Employment in skill-intensive manufacturing industries expanded by 3.3 percent on the heels of a contraction in 2002, corresponding to the global high-tech recovery that included demand for Israeli exports. Employment in unskilled-labor-intensive manufacturing industries, which refer much of their output to the domestic market, decreased slightly despite the recovery in current private consumption.

Employment of Israelis in hotel and catering services increased by 5.1 percent, after two years of contraction, due to the relative improvement in security, the easing of the effects of the September 11, 2001 terror attacks in the U.S. and terrorism elsewhere, and the official end of the second Gulf War in the first half of 2003. Although inbound tourism increased considerably, the number of Israelis employed in hotel services was almost unchanged (for an average annual decrease of nearly 17 percent). In contrast, employment in restaurants and catering services expanded at a 7 percent average pace (4,000 employees), evidently due to an upturn in leisure activity and less use of foreign workers. Notably, the number of foreign workers in hotels and catering declined by about 4,000.

Some 19,000 non-Israeli workers left the construction industry and 11,000 Israelis joined, accounting for one-fourth of the increase in business-sector employment.

This is the first significant evidence of the replacement of non-Israeli workers by Israelis.

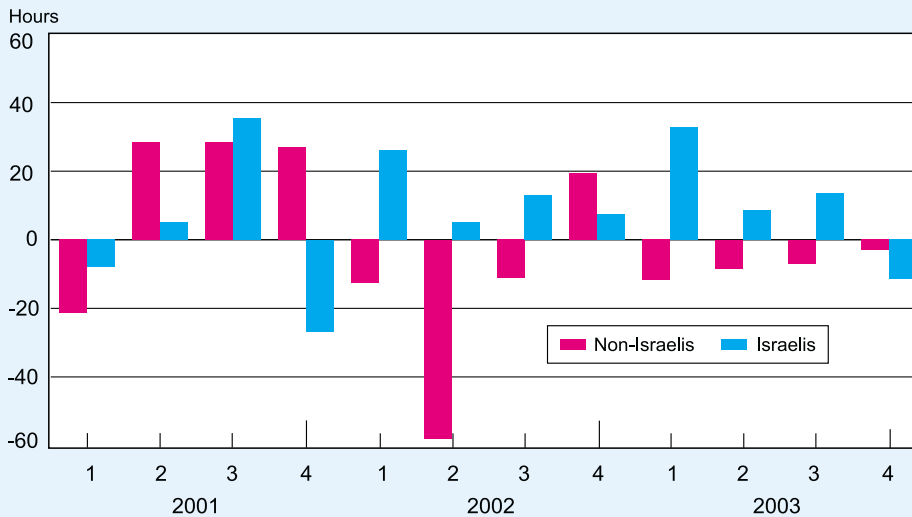
Construction activity continued to contract and the downtrend in the employment of non-Israelis gathered strength. On annual average, 19,000 foreign workers left the industry, 4,000 Palestinian workers joined, and 11,000 Israelis came aboard (an 8.8 percent increase). The influx of Israelis, accounting for about one-fourth of the increase in business-sector employment, kept the unemployment rate from rising by another 0.3 percentage point and provided the first significant evidence of the replacement of non-Israeli workers by Israelis (Figure 2.2).

Employment in banking, insurance, and financial services increased by 1.7 percent due to a 4.0 percent contraction in banking employment, occasioned by large-scale layoffs among other things, and increases in employment at insurance companies and provident funds, evidently due to the vigorous performance of the capital market and the provident funds' expansion into related fields of business.

The number of employees in business services increased by a brisk 8.5 percent. Employment by personnel companies fell precipitously, probably because labor demand was sluggish and fewer foreign workers were being employed. Employment in computer services and research and development was largely unchanged in 2003 after having suffered badly in 2002 due to the high-tech slump. Despite the relative easing of security tension, employment of guards and cleaning personnel continued to surge, possibly due to the replacement of foreign cleaning workers with Israelis. Employment of Israelis in real-estate brokerage and other business services (lawyers, accountants, etc.) also expanded strongly.

⁴ The Manufacturing Survey data tell the opposite story: a 2.5 percent decrease in the employment of wage-earners and declines in most manufacturing industries. (See Chapter 1 in this Report.) The Manufacturing Survey data correspond partly to the employee post statistics reported by the National Insurance Institute.

Figure 2.2
Israeli and Non-Israeli Workers^a in Construction, Change in Hours
Worked per Thousand Sq. Meters Built, 2001–2003 (quarter-on-quarter)



^a Foreign and Palestinian workers, whether reported or not.

SOURCE: Based on Central Bureau of Statistics data.

Public-services employment increased by only 0.9 percent in 2003, far short of the average growth rate in 1996–2002 (3.4 percent) and the rate of population increase in 2003, and raised the unemployment rate by 0.4 percentage point. This is the result of government policy principles that found concrete expression in the May 2003 economic recovery plan: (1) a moratorium on new hiring in central and municipal government (except the defense system) until the end of 2006, equivalent to an annual 1 percent lowering of the personnel ceiling; (2) closing the loophole of using the office-purchases budget line for the hiring of temporary help; and (3) layoffs and encouragement of early retirement of thousands of workers in public services and government-owned corporations, a trend that gathered momentum due to concern among employees about a future worsening of retirement and pension terms.

Hours worked per person employed in the public services slipped by 1.5 percent due to the cutback in overtime hours and an increase in the proportion of employees in industries that have a shorter average workweek. Overall, labor input in the public services was almost unchanged after steady increases since the 1985 Economic Stabilization Program.

Public administration employment at the state level decreased by a steep 5.7 percent after stability in 2002 and rapid growth since the second half of the 1990s. Employment in municipal administration contracted at a similar rate for reasons including municipal recovery plans. Health services employment inched upward by only 1.6 percent, as efficiency measures in the health system reduced employment in hospitals and the growth of employment at medical clinics and institutes slowed considerably. Employment in education services grew by only 1.3 percent after several years of

Employment in the public services expanded by only 0.9 percent—far below the average annual rate since the mid-1990s and the rate of population increase this year—and contributed 0.4 percentage point to the increase in the unemployment rate. This is the result of government policy principles that found concrete expression in the May 2003 economic recovery plan.

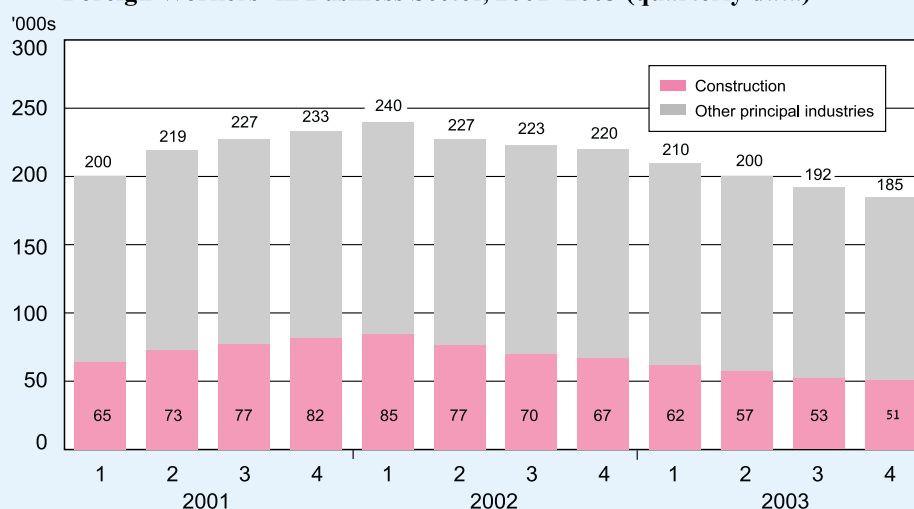
relatively rapid expansion. Employment in social and welfare services continued to increase rapidly, possibly due to the widening of socioeconomic distress. Services of Israeli home-caregivers increased vigorously in 2003, apparently because fewer foreign workers were employed in caregiving for the elderly.

b. Foreign workers

Vigorous measures to reduce the employment of foreign workers reduced the number of such workers in the business sector by one-seventh relative to 2002, to 202,000 on annual average.

The employment of foreign workers plummeted in 2003 after rapid increases from the early 1990s to the beginning of 2002. The number of foreign workers declined in 2003 by one-seventh relative to 2002 and came to 202,000 on annual average. During the year, their population contracted by 36,000, one-third of which in construction (Figure 2.3). The number of foreign workers in hotel services (mainly in Eilat and at the Dead Sea) decreased steeply and the same seems to have occurred in catering services. Some 61,000 permits for foreign workers were issued in 2003 (excluding those for caregivers), almost unchanged from 2002, but this figure is expected to decline to 48,000 in 2004, mostly due to a cutback of 10,000 permits in construction. The number of foreign-worker permits for caregiving decreased by several thousand—the first downturn after several years of steady increase, for reasons including tougher terms of eligibility for the employment of non-Israelis.

Figure 2.3
Foreign Workers^a in Business Sector, 2001–2003 (quarterly data)



^a Reported and unreported workers.

SOURCE: Based on Central Bureau of Statistics data.

Vigorous and, as stated, successful actions were taken in 2003 to reduce the employment of foreign workers. A ‘closed skies’ policy was introduced: new foreign workers, i.e., anyone other than those whose employers held valid foreign-worker employment permits, were barred, and border control was toughened perceptibly. Fewer

inbound passengers were turned away, indicating indirectly, perhaps, that the policy of deterrence is reducing attempted unlawful entry to Israel. To thwart the entry of additional foreign workers, a portability policy was introduced: employers who hold valid permits for the employment of non-Israelis were allowed to employ foreign workers whose employment permits had expired. Large-scale enforcement and punitive measures were invoked: the numbers of employers inspected, investigation files opened, fines imposed (although few were collected), and indictments presented all increased significantly. The immigration police were given greater powers and punitive measures against scofflaw employers were stiffened.

In 2003, employers were subjected to a duty of 8 percent of the wages of their foreign workers (except for caregivers). A proposal to increase the duty gradually over the next few years was not approved, even though foreign workers are still more than 20 percent cheaper than Israelis. (See Box 2.4 in the corresponding chapter in *Annual Report 2002*.) Due to the heightened enforcement actions against foreign workers and their employers, coupled with the increase in the cost of employing them, the number of foreign workers who were expelled from the country or left of their own accord increased perceptibly in 2003.

To encourage Israelis to replace foreign workers, training programs for Israelis in construction trades were given larger budgets in 2003. As noted, Israelis replaced many foreign construction workers during the year. The planned establishment of pilot employment centers to place income-maintenance recipients in work may have a favorable effect on the employment of Israelis in industries in which the use of non-Israelis is on the decline.

Foreign workers began to enter agriculture in the first half of the 1990s, when security events drove down the employment of Palestinians, and they quickly found work even on farms that had not used Palestinians previously. The quota of foreign workers in agriculture was raised by 6,000 in 2002 after several years without change, bringing the number of non-Israeli farm workers in 2003, nearly all of whom were foreigners (mostly from Thailand), to 26,000. The number of permits for foreign workers in agriculture is expected to be cut back by 2,000 in 2004. Foreign workers account for one-third of total agricultural employment and are as numerous as Israeli employees. They are brought to Israel in an organized manner by the Moshav Movement and, for the most part, receive appropriate terms of employment. Therefore, there are few illegal foreign workers in agriculture.⁵

Income from agriculture has been trending down for quite some time because the strong expansion of supply of agricultural produce has surpassed the increase in demand—a state of affairs that causes income to decline rapidly even relative to input prices. Consequently, self-employed farmers (including kibbutz members) have been flowing out of the industry and finding employment in other sectors. The number of

⁵ A. Cohen (1999), “Thai Workers in Israeli Agriculture,” in L. Achdut and R. Natanzon (eds.), *The New Workers: Workers from Foreign Countries in Israel*, Friedrich Ebert Stiftung and Kav Adom, Hakibbutz Hameuhad (Hebrew).

Israeli agricultural employees in high-skill positions has been at a standstill and their wages relative to persons employed in other industries have been declining.⁶

As far back as 1995, a commission established to make recommendations on national agricultural and rural-sector policy in 1995–2000 recommended the gradual disemployment of foreign workers in agriculture because their employment was creating social problems and harming Israelis' employment and wages. Notably, however, this measure would raise labor cost, which accounts today for about one-fourth of purchased agricultural inputs, and would make agricultural produce for the domestic market and for export more expensive. Since these products have relatively low demand elasticity, their price to the Israeli consumer would skyrocket and domestic demand for them would hardly decrease. However, there is concern about severe damage to agricultural exports, which would become less competitive in global markets. Although only one-fourth of agricultural output is for export, the proportion of foreign labor in export-oriented crops is especially high. Attentiveness to the economic welfare of Israel residents generally and Israeli farmers particularly is part of agriculture policy, along with preservation of natural resources and the environment (Box 1.4), settlement of the country and its outlying areas, control of national land, and so on. Thus, to ease gradually the dependency on foreign workers and to rely on Israeli labor—a cause consistent with the rural-settlement ethos—complementary measures to help the farmers are needed: more research and development, more agricultural training services, introduction of labor-saving and labor-productivity enhancing technologies, encouragement of capital investment in rural areas, and subsidies for nonagricultural projects such as tourism and recreation.

In sum, it would be proper to reduce the employment of foreign workers in agriculture by cutting back on the number of permits and raising the cost of their employment, but it should be done gradually and requisite budgets for support of the farmers should be made available as it is done.

c. Palestinian workers

The improvement in security in 2003 led to an increase of 9,000 Palestinian workers employed in Israel, bringing their number to 31,000. This is still very low relative to the level in 2001, by which time the intifada was already in full swing. According to the Palestinian Central Bureau of Statistics (PCBS), employment in Israel of workers from the Palestinian Authority (PA) areas was still growing in the second half of 2002 but has been almost unchanged since then. The downscaling of employment of foreign workers increases demand for Palestinian labor, but movement restrictions in the PA areas and the construction of the separation fence impede the entry of residents of these areas who wish to work in Israel. If and when the security situation improves and the political process moves ahead, requests from employers and others for a larger number of employment permits for Palestinian workers will become more numerous.

⁶ For a description of major developments in agriculture, see A. Kislev (in press), *Foreign Workers and Restructuring in Agriculture*; Ministry of Agriculture and Rural Development (2003), *Economic Report on Agriculture and the Rural Sector*, 2002 (Hebrew).

5. UNEMPLOYMENT

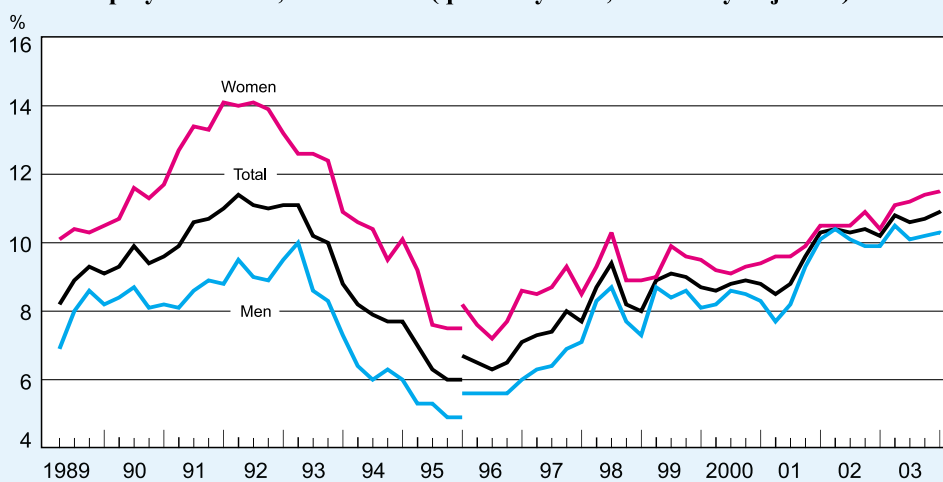
The unemployment rate continued to surge in the first quarter of 2003 and leveled off at 10.7 percent in annual terms, as against 10.3 percent in 2002—the highest rate observed in Israel since the first Labor Force Surveys in the mid-1950s (with the exception of the early 1990s, when mass immigration from the former Soviet Union peaked) and far above the average unemployment rate in the OECD countries (7.1 percent).

The Employers Survey, conducted by the Personnel Planning Authority at the Ministry of Industry, Trade, and Employment, shows that the chances of the unemployed finding work increased during 2003 due to the recovery of labor demand in the business sector. The proportion of employers offering work and the number of vacant posts rose during the year, even though there were fewer vacancies in 2003 all told than in 2002. The employment balance—the number of workers hired *less* the number laid off—also improved although it remained negative.

The proportion of persons seeking work for less than two months declined slightly in 2003 and that of jobseekers for more than half a year rose briskly, especially among women in both cases. This indicates that there were fewer newly unemployed but that unemployment intensity worsened. Further evidence is the decline in the proportion of unemployed who had worked in the previous twelve months. For these reasons, coupled with the proportional increase in chronic joblessness among the unemployed, the number of income-maintenance claims rose perceptibly.

The unemployment rate continued to surge and came to 10.7 percent, and unemployment intensity worsened. However, the jobless were more likely to find work as the year passed, due to the recovery of labor demand in the business sector.

Figure 2.4
Unemployment Rate, 1989–2003^a (quarterly data, seasonally adjusted)



^a The CBS definition was changed in 1995.

SOURCE: Based on Central Bureau of Statistics data.

The unemployment rate of men surged in the first quarter of 2003, declined afterwards, and was almost unchanged at 10.2 percent on annual average (Figure 2.4)

even though the participation rate of men dipped by 0.1 percentage point. The unemployment rate of women continued to rise in 2003 and came to 11.3 percent on annual average as against 10.6 percent in 2002, due to a 0.7 percentage-point increase in women's participation rate. The unemployment rate of Jews surged from 9.8 percent to 10.6 percent whereas that of Arabs fell by nearly 2 percentage points to 11.3 percent, even though their participation rate was unchanged.

Table 2.7
Unemployment Rate, by Years of Education, 1999–2003^a

	(percent)				
	1999	2000	2001 ^b	2002	2003
Total	8.9	8.8	9.4	10.3	10.7
Years of education					
0–8	13.7	13.2	12.9	14.5	16.6
9–12	11.0	11.5	12.3	12.9	13.9
13–15	7.8	6.9	8.1	9.1	8.7
16+	4.4	4.5	4.5	5.8	5.9

^a The corresponding table in the *Annual Report, 2002* contained incorrect data.

^b A new method of extrapolation was used in the Labor Force Surveys in 2001.

SOURCE: Labor Force Surveys of Central Bureau of Statistics.

The unemployment rate of persons with secondary and less schooling rose strongly and that among skilled persons was unchanged. This is consistent with the sluggish expansion of employment of Israelis in unskilled-labor-intensive industries, despite the contraction of employment of foreign workers.

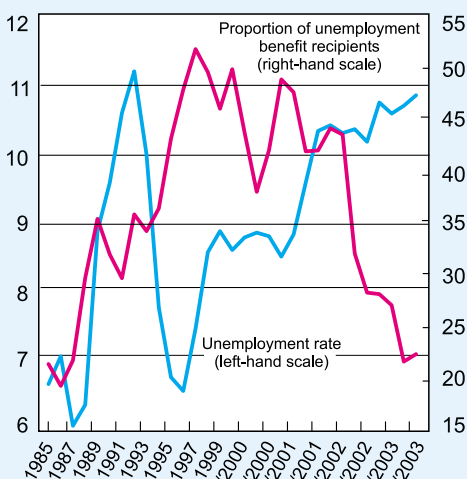
The unemployment rate of persons with secondary and less schooling rose strongly and that among persons with more than secondary schooling was unchanged, after strong increases in unemployment among all schooling cohorts in 2002 (Table 2.7). This is consistent with the sluggish expansion of employment of Israelis in unskilled-labor-intensive industries, despite the contraction of employment of foreign workers.

The economic plan unveiled in the middle of 2002 resulted in many amendments of the Unemployment Compensation Law that were detrimental to the jobless (for details, see Box 2.2 in the corresponding chapter of *Annual Report 2002*). Among other things, the qualifying period for unemployment compensation (the minimum term of employment preceding joblessness) was extended to 360 days of work during the 540 days preceding joblessness instead of 180 days out of 360 or 270 out of 540. The new standard is one of the strictest in the West.⁷ The persistence of the recession and the increases in the rate and intensity of unemployment severely reduced the likelihood that jobless persons would qualify for compensation and increased the likelihood of their becoming unemployed again. Indeed, Figure 2.5 shows that the ratio of unemployment-compensation recipients to total jobless fell steeply during 2002 and came to less than one-fourth at the end of 2003 as against about half in 2000.

Although the Unemployment Insurance Law is an insurance law to a certain extent, the expenditure for unemployment compensation and the contributions to National

⁷ In another restriction of eligibility for unemployment compensation, applied at the beginning of 2002: the duration of benefits for persons under age forty who re-apply for unemployment compensation within four years (as measured from the beginning of 2000) shall not exceed a cumulative period of 180 percent of one maximum term of receipt of compensation.

Figure 2.5
Proportion of Total Unemployed Persons Receiving Unemployment Benefit, and Unemployment Rate, 1985–2003 (percent)



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

Insurance for unemployment compensation are rarely in balance. The main consideration that should guide the lawmakers is how to improve the performance of the labor market: unemployment benefits allow jobless persons to seek work that corresponds to their qualifications in order to fulfill their earning potential. Therefore, it may be advisable to ease, not to toughen, the terms of the qualifying period and to extend the maximum benefit term. It would also be proper to apply the employment tests stringently in order to prevent abuse of the law.

The Economic Arrangements Law for 2004 reduced the frequency with which unemployment-compensation claimants have to visit the Employment Service. Few countries require physical visits to labor exchanges (UK and Spain, for

example); others keep records by telephone (as in several states in the US and in Canada) or by mail (e.g., Scandinavia and Portugal).⁸ Reporting is usually fortnightly or monthly. Frequent record-keeping by the employment services may shorten the duration of joblessness by inflicting a cost on the jobless, inhibiting unlawful receipt of benefits, and facilitating closer monitoring of job-hunting actions. At this time of surging unemployment, however, Israel's employment service has not been able to keep up with its workload (Box 2.3 in the corresponding chapter of *Annual Report 2002*). Therefore, the action that was taken will let the Employment Service staff devote more time to job placement and make it easier for the jobless to seek work by other means, even though it will weaken the enforcement of the employment test to some degree.

Box 2.3 Nonfinancial Costs of Unemployment¹

Joblessness is a major factor in the decline of personal life satisfaction, i.e., happiness. The unemployed lose income and are exposed to nonfinancial

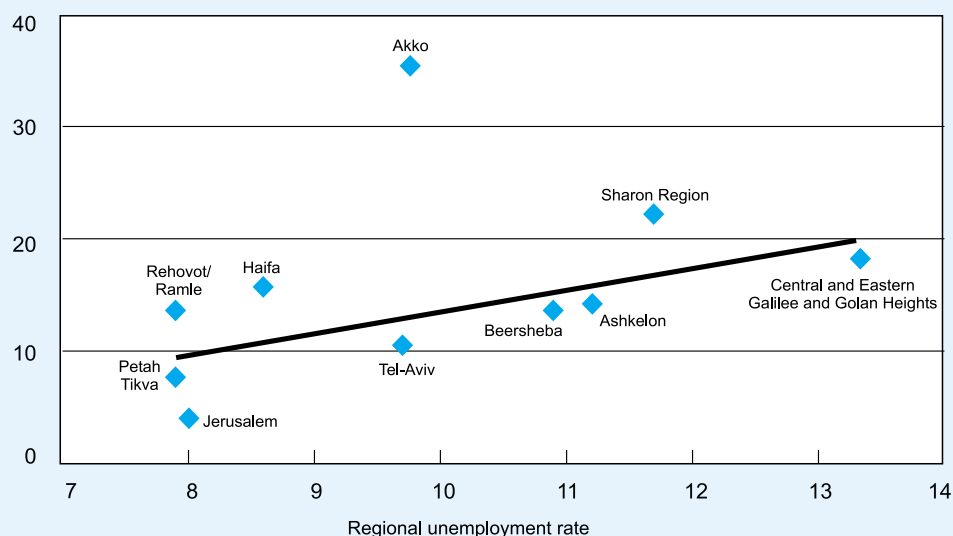
¹ The box is based on N. Zussman and D. Romanov (2004), *The Happiness of a Nation – Israelis' Satisfaction with Their Lives* (Hebrew), Bank of Israel, Research Department, Discussion Paper No. 2004.03.

⁸ OECD (2001), *Labour Market Policies and the Public Employment Service*.

costs such as an assault on self-image and social status and the loss of contact with co-workers. These costs are manifested in higher rates of suicide, mortality, and morbidity; weakening of marital relations; higher crime rates, etc.

In 2002, the Central Bureau of Statistics conducted its first-ever Social Survey among Israelis aged 20+, including questions about various important matters in individuals' lives. One question concerned life satisfaction. By taking the contribution of personal income to happiness as a given, one may quantify in financial terms the effect of other indicators of people's lives on their happiness (in Hedonic Price terms), including the harm to happiness caused by unemployment.

Difference Between Life Satisfaction of Employed and Unemployed Persons, by Regional Unemployment Rate (percent)



After taking account of the loss of the income of the unemployed, on the one hand, and the increase in their leisure time, on the other hand, we estimate that the indirect nonfinancial costs of unemployment to jobless persons who worked full-time before becoming unemployed, at the national average wage, are equal to NIS 3,000 per month, about one-fourth of the total cost of unemployment in terms of happiness. Studies abroad² point to a much higher share. These findings undermine the common argument that unemployment is essentially voluntary; they emphasize the need to invest heavily—in efforts

² Winkelmann, L., and Winkelmann, R. (1998), "Why Are the Unemployed So Unhappy? Evidence from Panel Data," *Economica*, vol. 65, no. 257.

and in budgets—in job-placement programs for the unemployed, as in the spirit of the Tamir Committee recommendations, or in wage subsidies (Box 2.2). It is preferable to adopt these solutions than to raise the level of unemployment benefits; higher benefits would accomplish relatively little for the welfare of the jobless and might even create disincentives to labor. In any case, however, unemployment benefits must assure the jobless a reasonable standard of living relative to their pre-employment standard. Israel's unemployment benefits do not always meet this condition.

When unemployment rises, the employed become more fearful of losing their jobs and their life satisfaction falls. The survey shows that people who are seriously afraid of being fired are much less happy than people who have employment security. Almost one-fifth of employed Israelis were afraid of losing their sources of livelihood in 2002. In recent years, unemployment levels have increased, the power of labor unions has declined, and the proportion of temporary employment by means of personnel companies has risen. All these circumstances have been severely detrimental to employment security.

Examination of the marginal effects of characteristics of the jobless on their life satisfaction reveals several findings that resemble those obtained abroad.³ Unemployed men are less happy than unemployed women, and recent-immigrant and well-schooled unemployed are less happy than nonimmigrant and poorly schooled unemployed. The least happy jobless persons are those in their forties. Younger and older people are less troubled by unemployment—the former because they view joblessness as a passing phase and the latter because many members of their age cohort are also unemployed. As the current recession drags on, the plague of unemployment is also making inroads in the middle-aged and well-schooled cohorts, making its adverse impact more severe.

An increase in a regional unemployment rate widens the satisfaction gap between the employed and the unemployed (see figure). While employed persons in high-unemployment regions are not as happy as those in strong job markets, the slim chances of finding work in such areas do even greater damage to the happiness of the unemployed, although one might imagine that the 'fraternity of the jobless' might ease the pain slightly. The widening of satisfaction gaps between employed and unemployed persons in high-unemployment areas, e.g., the northern and the southern parts of Israel, may exacerbate tensions within these regions and, therefore, warrants spot intervention and systemic care.

³ Praag, B. M. S., and Ferrer-I-Carbonell, A. (2002), *Life Satisfaction Differences between Workers and Non-Workers: The Value of Participation Per-se*, Tinbergen Institute, Discussion Paper 2002-018/3.

6. WAGES⁹ AND LABOR RELATIONS

The nominal average wage per employee post declined by 2.1 percent in 2003—3.1 percent in the public services and 1.8 percent in the business sector. The real wage decreased by a severe 6.0 percent in 2002, due to the persistence of the labor-market slump and the unexpected inflation spike, and by 2.8 percent in 2003 (Table 2.8) amidst negligible price increases. The rates of real wage decline in 2003 were 3.7 percent in the public services, much as in 2002, and 2.4 percent in the business sector, much less than a year earlier. Real wages increased in the second half of 2003 due to negative CPIs and a slight upturn in nominal wage.

Table 2.8
Change in Real Wage per Employee Post,^a 1999–2003

	(percent, at constant prices)				
	1999	2000	2001	2002	2003
Total	2.5	6.2	3.0	–6.0	–2.8
Israelis			2.6	–5.9	–2.9
Public sector	0.0	5.4	2.6	–4.3	–3.7
Business sector, total	3.6	6.6	3.3	–6.7	–2.4
Israelis			2.7	–7.0	–2.6
Agriculture, total	2.7	5.3	8.3	–5.5	–1.2
Israelis			5.4	–3.8	–1.5
Manufacturing	5.2	4.3	3.2	–4.2	–0.4
Electricity and water	2.3	7.6	2.5	–3.2	–2.7
Construction, total	3.9	6.3	4.3	–5.1	–4.0
Israelis			0.3	–4.7	–3.5
Commerce and repairs	–0.4	6.1	2.2	–6.3	–2.5
Hotel and catering services	1.2	4.0	–0.1	–6.4	1.1
Transport, storage and communications	0.6	1.5	0.9	–5.1	–2.3
Financial services	3.9	12.0	1.7	–6.8	–3.4
Business services	10.3	14.2	3.6	–8.6	–3.2

^a The real wage per employee post, according to National Insurance Institute reports, includes reported foreign workers and Palestinians, unless stated otherwise. In the wake of the change in definitions in 2002, business-sector industries (excluding agriculture), are: up to 2002, Israeli and reported foreign workers, in 2003, Israeli workers only.

SOURCE: Central Bureau of Statistics.

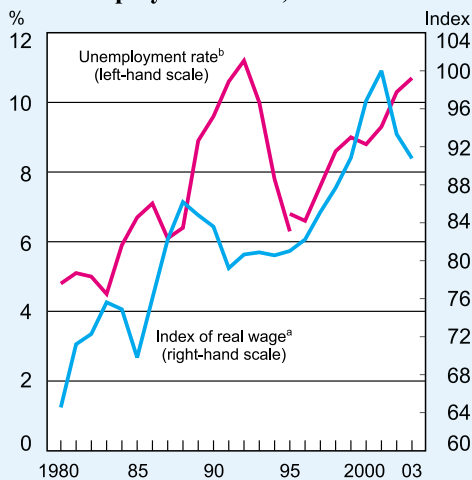
The real wage per business-sector employee post declined by 2.4 percent after a much steeper decrease in 2002. Wages in the public services fell by 3.7 percent, due to the economic recovery plan and the collective agreement concluded between the Government and the Histadrut.

The nominal wage per employee post in the public services fell by 3 percent, after a 1.1 percent increase in 2002, due to a series of measures in the mid-2003 economic recovery plan and the collective agreement concluded between the Government and the Histadrut. Among other things, on July 1, 2003, the wages of employees in the

⁹ The wage per employee post (as reported by the National Insurance Institute) is calculated as total wage payments *divided by* total employee posts and is not standardized to the extent of posts. Note that some of the change in the wage per employee post is technical and derives from the change in the extent of the post, the composition of employment, etc. Furthermore, although self-employed income and income from other sources (employment-related pension, social benefits, capital income, etc.) are essential for comprehensive analysis of the patterns of labor-market participation, data about them become available at a considerable lag.

public services and state-owned business corporations were lowered progressively by 4 percent on average for a two-year period. Vacation bonuses and the Jubilee Grant were deferred to 2004 (for a total gross saving of NIS 1.3 billion) as was a Cost-of-Living Allowance for general-government employees (2.0 percent on account of the portion of wage between the minimum wage and NIS 7,700). These measures will save the state budget about NIS 2 billion per year (gross). The policy of slowing wage creep remained in effect; wage creep in Israel, estimated at 2.5–3 percent per year, is an important element in wage increases at a time of low inflation. Mass early retirement of longstanding public-service employees, most of whom received relatively high wages, also lowered the total payroll even though nonrecurrent payments related to retirement had a temporarily upward effect. Layoffs, some pursuant to collective agreements (e.g., at government ministries, municipal authorities, and the teachers' unions), had much the same effect. Notably, since the cutback in overtime hours resulted in a 1.5 percent decrease in hours worked per Israeli public-service employee, the nominal wage per hour worked in the public services declined more gently than the wage per employee post.

Figure 2.6
Index of Real Wage per Employee
Post in Business Sector^a and
Unemployment Rate, 1980–2003



^a 2001 = 100. Excluding Palestinian workers.

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

SOURCE: Central Bureau of Statistics.

The wage cut and the restraint of employment growth in the public services may have a moderating effect on business-sector wages, if only in the short term, by increasing the supply of labor that is directed to the business sector. Studies in Israel¹⁰ have found that wage volatility in one industry easily spills into other industries and that the transmission between general-government wages and wages in various business-sector industries acts at a lag of one year to eighteen months. In the long term, the typical wage ratios between various industries and sectors have been preserved. These correlations, however, have weakened during the past decade due to the declining strength of trade unions and the reduced incidence of industry-level

The wage cut and the restraint of employment growth in the public services may have a moderating effect on business-sector wages, if only in the short term, by increasing the supply of labor that is directed to the business sector.

¹⁰ L. Achdut and V. Sola (1999), *Interrelations among Industries in Israel's Wage System: Analysis of Time Series, 1997–1998*, New General Federation of Labor [the Histadrut], Social and Economic Research Institute, and Friedrich Ebert Stiftung, Discussion Paper 5 (Hebrew); D. Elkayam (1989), "Factors that Influence Labor Supply and Labor Demand in the Business Sector, 1962–1984," Bank of Israel Survey, 64 (Hebrew); Y. Artstein (2001), "Labor-Market Elasticity in Israel," in A. Ben-Bassat (ed.), *From Government Involvement to Market Economy—The Israeli Economy 1985–1998, Essays in Memory of Prof. Michael Bruno*, Am-Oved Publishers Ltd. and the Maurice Falk Institute for Economic Research in Israel (Hebrew).

and occupation-level wage accords. Even enterprise-level agreements seem to be less frequent and use of the opposite instrument, personal labor contracts, is on the increase. The decline in the inflation environment evidently helped these processes to accelerate. In sum, the reduction of public-service wages and employment may have a limited effect on corresponding developments in the business sector, but since the wage cut is time-limited its effect will be even weaker.

The ongoing decline in nominal business-sector wages—3.1 percent over the past two years, in cumulative terms—attests to the slump in the labor market and the surplus in labor supply. In view of sluggish demand for their products and services, employers continued to reduce not only labor input, for the third consecutive year, but also labor cost. Employees lose bargaining power at times of surging unemployment and this effect, coupled with greater elasticity in the labor market, exerts downward pressure on wages.

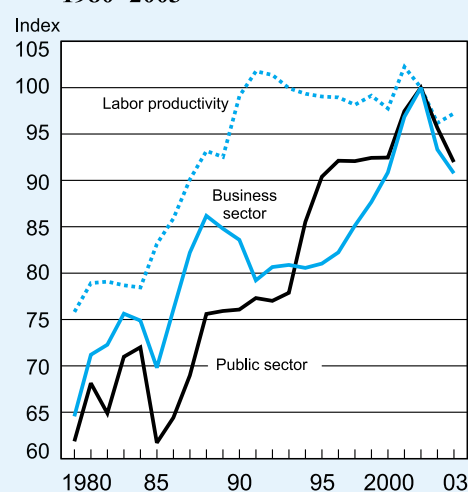
Labor input in the business sector was almost unchanged in 2003 but business-sector product expanded by 1.8 percent. Thus, labor productivity (net domestic product of the business sector per hour worked, in constant prices) increased by 1.5 percent after a cumulative 6 percent decline in 2001–2002. Nevertheless, since labor productivity remained lower in 2003 than in the second half of the 1990s, firms may continue to streamline. Labor productivity increased appreciably in most industries and conspicuously in manufacturing, trade, hotel and catering services, and transport and communications.

The combination of higher labor productivity and lower real wages in the business sector led to a 3.6 percent decline in unit labor cost after two years of steady upturns. Since the 2003 level is still higher than that immediately preceding the beginning of the Intifada, presumably firms will continue to act to improve their profitability.

In view of a provision in the 2002 Economic Arrangements Law that suspended adjustments of the national average wage (as determined under the National Insurance Law), the minimum wage was also left unchanged for 2003. In the aftermath of the COLA given in January 2003, however, the nominal minimum wage was adjusted by 2.1 percent and the wage decline in some traditional industries and in social and welfare services was restrained.

Labor productivity increased by 1.5 percent after two years of declines. Business efficiency measures coupled with real wage erosion in the business sector lowered unit labor cost by 3.6 percent—leaving it, however, at a much higher level than on the eve of the Intifada.

Figure 2.7
Index^a of Real Wage per Employee
Post in the Business and Public
Sectors, and Labor Productivity,^b
1980–2003



^a 2001= 100. Business-sector net domestic product per hour worked.
^b At constant prices.

SOURCE: Central Bureau of Statistics.

The real wage per Israeli employee business-sector post contracted by 2.6 percent in 2003 (approximately 1.9 percent per hour worked). The contraction was evident in most industries and was conspicuous (–2.5 percent) in skill-intensive industries that maintain relatively high wage levels. Since the number of employee posts fell more steeply in these industries than in others, the recomposition of business-sector employment helped to accelerate the decline in real wage per Israeli employee post. Were it not for the recomposition of employment, the real wage would have declined by 1.4 percent.

In construction, the real wage per Israeli employee post decreased by 3.5 percent due to the replacement of foreign workers with blue-collar Israelis, who are paid less than white-collar Israelis. Notably, the real wage of foreign workers in construction declined by 1.6 percent, but this was due to appreciation of the NIS against the dollar (since the foreigners' wages are dollar-denominated); in dollar terms, wages increased by 3.1 percent, attesting to surplus demand for foreign labor.

In electricity and water, the wage per Israeli employee post continued to decline, possibly due to early retirement of relatively well paid employees in government-owned corporations. In several subindustries in wholesale and retail trade, the continuation of perceptible wage decreases and contraction of employment pointed to efficiency processes, since industry product expanded. Similar developments occurred in the banking system, which had awarded sizable wage increases in previous years. In business services, wages in computer services withered due to excess labor supply and firms' reluctance to invest in mechanization and computerization during the recession. The wages of persons employed in architecture and engineering services declined slightly due to the contraction of construction activity.

In manufacturing, real wages per Israeli employee post edged down by 3.4 percent after a 4.2 percent decrease in 2002.¹¹ The decline in 2002 occurred mainly in skilled-labor-intensive and in mixed industries; in 2003, real wages continued to contract in high-tech manufacturing industries (by 1.9 percent), including electronic components, in which wages had advanced in 2002. In contrast, real wages in mixed and traditional industries increased slightly (by less than 1 percent in each industry), apparently due to a recovery in their activity and the adjustment of the minimum wage. In hotel services, the downtrend in real wages per Israeli employee post slowed due to the extension of the collective agreement in the hotel industry, signed in early 2002, that lowered nominal labor cost by 7–8.5 percent. Wages in restaurant and catering services increased slightly due to an increase in away-from-home activity.

Several measures were introduced in 2003 to reduce labor cost (in addition to those pertaining to the public services) and increase disposable wage income. A reduction of earned-income tax rates, recommended by the Rabinovitch Commission, was moved up and the wage ceiling for National Insurance contributions and health tax was restored

Real business-sector wage contracted in most industries and did so conspicuously in those intensive in skilled labor.

Several measures to cut labor cost and increase disposable wage income were taken, foremost earlier implementation of a reduction in tax rates on earned income.

¹¹ In contrast, the Manufacturing Survey shows that the monthly labor cost per employee in manufacturing increased by 2 percent and that labor cost per hour increased commensurably because hours worked per employee were unchanged.

(a measure that pertains to a very small group of workers). In the opposite direction, it was decided as part of the pension-savings reform to increase employee and employer contributions to old pension funds by 1.5 percentage points in a staggered four-year process starting in 2004. Employees who are covered by budgetary-pension arrangements will pay one percent of their wage into the scheme in 2004 (and 2 percent in 2005 and subsequent years). To blunt the increase in labor cost that these measures will create, there is an intention of reducing employers' National Insurance contributions during the next two years at a staggered cumulative rate of 1.5 percentage points. However, tax benefits for residents of peripheral localities and the health-tax reduction for defense-system employees were reduced severely.

The compulsory retirement age for pension purposes will be raised each year by four months until it reaches sixty-seven for men and sixty-four for women. In the future, however, a public commission will be established to examine women's retirement age among other issues. (See also Chapter 3 in this Report.) Notably, the public commission for the examination of the retirement age (July 2000) recommended an increase to age sixty-seven for both men and women, in consideration of people who work in burnout-intensive occupations and are vulnerable to layoff at advanced age.

The deterioration in labor relations in 2003 traces not only to the new pension arrangements but also to plans to restructure the public services and government-owned corporations, including layoffs and worsening of employment terms for those remaining. According to the plans, government units will be closed and merged; patterns of activity in electricity, marine ports, land-line communication, and postal services (among others) will be modified and opened to competition; state-owned entities and corporations will be privatized. Although comprehensive efficiencies are definitely needed in the public services and in entities related to them, they should be implemented—to the extent possible—gradually and in dialogue with labor and its elected representatives in order to attain the largest possible degree of consensus.

In addition to wage cuts and personnel reductions (including layoffs) in the public services, attempts were made in 2003 to limit the institution of tenure, e.g., by extending the probationary period and making greater use of non-tenured hiring. The downscaling of tenure in the public services may improve the performance of the services and allow greater flexibility in aligning employment with needs. However, tenure helps workers to amass seniority and specific experience that may enhance the quality of the work performed. Importantly, the reduction of tenure for public employees, the worsening of budgetary-pension terms, and the shift to accrual pension may ultimately prompt labor to seek compensation in the form of a wage increase, since these are interlocking tools.

Another aspect of the protracted slackening in employer-employee relations was an additional deferral, to 2007, of the implementation of the section of the law that transforms people hired by labor contractors into employees of their real employers after nine months on the job. Notably, the public services are the largest employers of this form of labor, directly and indirectly. (See Box 2.2 in the corresponding chapter of Bank of Israel *Annual Report 2001*.)

The deterioration in labor relations in 2003 traces mainly to the new pension arrangements and the raising of the compulsory retirement age, and also to plans to restructure public services and government-owned corporations, including layoffs. Although comprehensive efficiencies are definitely needed in the public services and in entities related to them, they should be implemented—to the extent possible—gradually and in dialogue with labor and its elected representatives.

Labor disputes often inflict considerable costs on the parties involved and the public at large, especially in the public services, which usually are the sole providers of vital services, and especially in Israel, which has been suffering from a plague of strikes in general government (Box 2.4). Legislative and institutional arrangements pertaining to the right to strike may have a crucial effect on the intensity of labor disputes and the accords signed in their aftermath. Thus, it is important to examine the ramifications of proposals to limit the right to strike in the public services and at large, e.g., binding arbitration (and even the prohibition of strikes in vital services), compulsory voting before a strike, extension of the cooling-off period before a strike, and shorter notification by employers about lockout.¹²

Studies in the US and Canada¹³ show that binding arbitration has a rather significant and positive effect on reducing the probability of strikes relative to a policy of almost unlimited right to strike. Binding arbitration reduces the loss of labor days and the cost of a strike relative to a situation in which the government must negotiate with public employees or the opposite, a far-reaching right to strike. Binding arbitration leads to larger wage increases than those attained under an unlimited right to strike. Thus, it mitigates the intensity of labor disputes but increases employers' wage expenses. Few developed countries have binding-arbitration arrangements. (The US and Canada are among them.) In Israel, the Institution for Agreed Arbitration is seldom employed, even though under certain circumstances binding arbitration is imposed if one of the sides so demands. Compulsory voting before a strike greatly reduces the probability of a strike and shortens the duration of strikes that erupt but has no effect on wage. Cooling-off periods before strikes—in the public services and in the business sector—do not make strikes less frequent; in fact, they may prolong the strikes and result in subsequent wage cuts.

Box 2.4 **Labor-Dispute Intensity in Israel**

Labor-dispute intensity is largely a function of the state of the economy, institutional and legal arrangements (e.g., the right to strike), government policy, structure of the political system, and other factors. In long-term international comparison, the frequency and intensity of sanctions and strikes in Israel—measured in the number of events, the proportion of workers

¹² A committee was established recently to examine the structure and performance of the labor courts; its terms of reference include the integration of labor courts into the general justice system. The implication of these measures may transcend the field of labor relations.

¹³ Gunderson, M., and Melino, A. (1990), "The Effects of Public Policy on Strike Duration," *Journal of Labor Economics*, vol. 8, no. 2; Currie, J., and McConnell, S., "Collective Bargaining in the Public Sector: The Effect of Legal Structure on Dispute Cost and Wages," *The American Economic Review*, vol. 81, no. 4, 1991; and *The Impact of Collective Bargaining Legislation on Disputes in the U.S. Public Sector: No Policy May be the Worst Policy*, NBER Working Paper no. 3978, 1992; Cramton et al. (1999), "The Effect of Collective Bargaining Legislation on Strikes and Wages," *The Review of Economics and Statistics*, vol. 81, no. 3.

taking part in them, days of work lost (standardized to the number of employees), the number of workers involved in a given strike, or the number of days of work lost per striker—is far above the Western average.

Several factors may explain the profusion of labor disputes in Israel in recent decades. (a) A large majority of labor disputes have involved public employees, and Israel has a relatively large share of employment in the public services and government-owned corporations. Workers in these enterprises are unionized and are not susceptible to layoffs; the employer has no competition in the products market. Greece and France, however, also have large-scale public services but less tempestuous labor relations. (b) Public-service workers generally and those in vital services particularly have almost unlimited striking privileges. (c) Due to high inflation rates in the past, Israel has partial wage-indexation arrangements (a COLA mechanism) and labor negotiated with management at frequent intervals to obtain compensation for wage erosion and to increase its overall remuneration. Studies¹ show that inflation volatility makes strikes lengthier and more frequent because severe uncertainty widens the expectation gap between labor and management and requires the sides to feel each other out in diverse scenarios.

Membership in labor unions is more prevalent in Israel than in most developed countries but not exceptionally so, and the coverage rate of collective agreements is actually rather low.² Thus, there is no clear and unequivocal correspondence between the ostensible strength of Israel's labor unions and the intensity of labor disputes. Israel's labor-relations system is in the midst of a changeover from the cooperative model practiced in many Western European countries, in which labor organizations negotiate with the government and private employers at the national level and the sides even conclude a social covenant, to the British/American model, based on negotiations at the level of individual unions and enterprises. It is not clear whether this process, coupled with proposed legislative changes that erode the right to strike, will reduce the intensity of labor disputes, since thus far labor organizations have sometimes had the power to temper workers' demands.

¹ Gramm, C. L., et al. (1988), "Inflation Uncertainty and Strike Activity," *Industrial Relations*, vol. 27, no. 1.

² The proportion of employed persons who belong to the Histadrut and that of persons covered by collective agreements fell from 80–85 percent in the early 1980s to 40–45 percent and 56 percent, respectively, in 2000. The decline accelerated when the State Health Insurance Law was enacted in 1995. For international comparisons, see Cohen, Y. et al. (2003), "Unpacking Union Density: Membership and Coverage in the Transformation of the Israeli IR System," *Industrial Relations*, vol. 42, no. 4; ILO, *World Labour Report 1997–1998*.

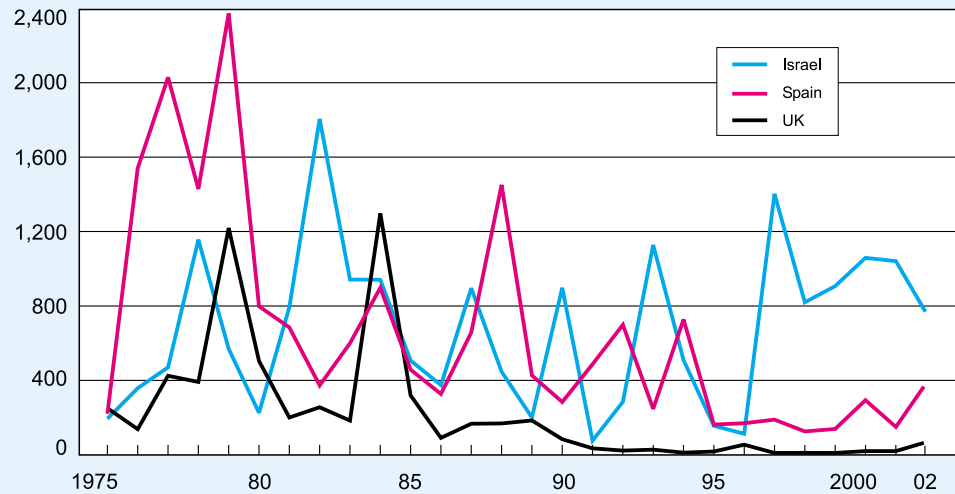
In the past two years, the focal issue in labor disputes in Israel has been the intent to restructure and reorganize the public services and government-owned corporations. An interesting comparison of the implications for the labor-relations system of processes similar to those taking place in Israel could be made with Britain in the 1980s.³ At that time, the British markets were opened to competition; the power of monopolies was reduced; privatization and outsourcing gathered momentum, especially in the public services; and part-time and temporary employment became much more common. The labor-relations system underwent immense change: the ripple effect of negotiations ebbed (less use was made of expansion orders and similar measures) and negotiations moved to the individual enterprise level; employers no longer had to recognize the union of employees' choice; unions were exposed to lawsuits for strike damage; the closed-shop rule was abolished and workers were allowed to cross picket lines; strikes without majority vote were banned; employers were allowed to fire striking workers under certain circumstances; and unionized workers were entitled to funding for legal proceedings against works committees from public funds. As a result of these measures, the unionization rate fell from a peak of 50 percent in the late 1970s to 40 percent a decade later and wage-income inequality increased steeply. Thus, it is no wonder that labor relations in Britain deteriorated during those years (see figure). Today, Britain has one of the lowest rates of labor-dispute intensity in Europe.

Spain has the highest labor-dispute intensity in Europe, even though labor unions there are weak and fractious and the labor-relation system is well regulated.⁴ This is partly related to underlying factors that have been prevalent in Israel for years: strikes were an inseparable part of negotiations conducted by large unions, general strikes were widespread, due to the labor movement's opposition to government socioeconomic policy and to a greater elasticity in the labor market, and cooperation between labor organizations and the government was limited. Expansion of the circle of strikers was also abetted by social solidarity. In recent years, labor disputes have diminished due to an increase in the importance of plant-level agreements, non-union labor has expanded, and mediation mechanisms have been established. However, in Spain, unlike Israel, the proportion of public-service workers in strikes has been small.

³ Metcalf, D. (1993), *Transformation of British Industrial Relations? Institutions, Conduct and Outcomes 1980–1990*, London School of Economics, Centre of Economic Performance, Discussion Paper no. 151.

⁴ Rigby, M., and Aledo, M. (2001), "The Worst Record in Europe? A Comparative Analysis of Industrial Conflict in Spain," *European Journal of Industrial Relations*, vol. 7, no. 3.

Annual Working Days Lost Due to Sanctions and Strikes, per 1,000 Employees; Israel,^a the UK,^b and Spain, 1975–2002



^a Excluding strikes in which fewer than 10 working days were lost; Israeli employees only.

^b Excluding strikes in which fewer than 10 employees were involved during one or more working day, unless more than 100 working days were lost; excluding political strikes. Before 1992, excluding employees in agriculture.

SOURCE: Based on International Labor Office, *Year Book of Labor Statistics*, various years, and Central Bureau of Statistics data.

In view of the experience in other countries, one may conjecture that future structural changes in Israel's public services and government-owned corporations may aggravate labor unrest in the short term. In the long term, however, labor-dispute intensity will probably decline due to greater elasticity in the labor market and heightened competition in services delivered today by government-owned corporations.