Employment Sector
Employment Working Paper No. 83

Growth, Economic Policies and Employment Linkages: Israel

Roby Nathanson
Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on Social Justice for a Fair Globalization, and which has now been widely adopted by the international community.

In order to support member States and the social partners to reach the goal, the ILO pursues a Decent Work Agenda which comprises four interrelated areas: Respect for fundamental worker’s rights and international labour standards, employment promotion, social protection and social dialogue. Explanations of this integrated approach and related challenges are contained in a number of key documents: in those explaining and elaborating the concept of decent work, in the Employment Policy Convention, 1964 (No. 122), and in the Global Employment Agenda.

The Global Employment Agenda was developed by the ILO through tripartite consensus of its Governing Body’s Employment and Social Policy Committee. Since its adoption in 2003 it has been further articulated and made more operational and today it constitutes the basic framework through which the ILO pursues the objective of placing employment at the centre of economic and social policies.

The Employment Sector is fully engaged in the implementation of the Global Employment Agenda, and is doing so through a large range of technical support and capacity building activities, advisory services and policy research. As part of its research and publications programme, the Employment Sector promotes knowledge-generation around key policy issues and topics conforming to the core elements of the Global Employment Agenda and the Decent Work Agenda. The Sector’s publications consist of books, monographs, working papers, employment reports and policy briefs.

The Employment Working Papers series is designed to disseminate the main findings of research initiatives undertaken by the various departments and programmes of the Sector. The working papers are intended to encourage exchange of ideas and to stimulate debate. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO.

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2 See the successive Reports of the Director-General to the International Labour Conference: Decent work (1999); Reducing the decent work deficit: A global challenge (2001); Working out of poverty (2003).
4 See http://www.ilo.org/employment.
Foreword

Despite relatively positive economic performance in the years prior to the global economic and financial crisis, countries in the Mediterranean basin face important employment and labour market challenges. The unemployment rate especially amongst youth is one of the highest in the world and their labour markets are characterized by high incidence of underemployment, employment in the informal economy and poor working conditions. The gender gap, particularly the low labour force participation of women, is a major challenge. Limited opportunities for productive employment together with more demand for labour in European countries have resulted in labour migration from East and South Mediterranean countries towards the Northern shore of the Mediterranean. The recent global economic and financial crisis led to economic downturn at varying degree in different countries, however, it shed light on the structural challenges of unemployment, poverty and inequality.

In the current political, economic and social context giving effect to the ILO Global Jobs Pact adopted in the 98th Session of the International Labour Conference (June 2009) is of paramount in order to promote productive employment and decent work in these countries. The promotion of productive employment and decent work is high on the agenda of the Euro-Mediterranean Partnership and is an utmost priority in the countries of the region. At the first Euro-Mediterranean Employment and Labour Ministers Conference in 2008 Ministers highlighted the urgency of challenges relating to employment, investment in human capital, and decent work for all and committed themselves to a Framework of Actions which would “contribute to developing a genuine social dimension within the Euro-Med agenda”.

The European Union has long actively supported the uptake of decent work as a global goal. As part of the Renewed Social Agenda the European Commission has “reaffirmed its commitment to promoting the internationally-agreed Decent Work Agenda, including through cooperation with the ILO and other partners, and the mobilisation of all relevant policies”. Furthermore, cooperation to enhance the response to the economic crisis has been recently intensified between both institutions.

Against this backdrop, the International Labour Office (ILO) and the European Commission (EC Directorate-General for Employment, Social Affairs and Equal Opportunities) developed a joint action oriented research project on “Expanding the knowledge base on decent work in Mediterranean countries.” The research undertaken focused on three main themes: 1) economic growth and employment; 2) labour market policies and 3) labour migration. The findings from the research are of great interest for policymakers as well as researchers and are reproduced in a series of working papers. They open up new avenues for research under future programmes.

This paper on Israel’s employment and economic growth linkages, written by Roby Nathanson, Director of the the Macro Center for Political Economics in Tel-Aviv, brings to light current and emerging issues concerning growth, employment policies, and economic linkages in Israel within the framework of the pervasive world financial and economic crisis. The first part of the study provides a broad overview of the recent macroeconomic, employment and poverty trends in Israel. The section analyzes macroeconomic and employment linkages through growth-employment elasticities as well
as trade and employment elasticities. It also analyses the poverty and decent work deficits in Israel. The second part of the paper is devoted to economic and employment policies including labour market policies, sectoral development policies and growth policies. The final section deals with the impact of the economic and financial crisis, its effect on growth and trade as well as the policy responses that have been put in place.

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1. Introduction

During the turn of the century, Israel economy has been in a period of significant economic growth. The economic climate changed abruptly though in late 2000 due to the burst of the dot-com bubble and the commencement of the second Intifada (Palestinian uprising). These events generated a severe recession, which had severe effects on the labour market. The unemployment rate increased to 10.7% in 2003 and government deficit climbed. Measures were taken to accelerate Israel economy: introducing major cuts in social benefits and in government spending, as well as reforming capital and pensions markets and the tax system. These economic policies had a positive impact on economic growth during 2003-2004, leading to 1.4-1.5% Purchasing Power Parity ("PPP") GDP per capita growth in 2004 and in 2005. Later on, together with the improvement in the security situation and the recuperating global high tech industry, Israel economy reached record levels. This is expressed in the PPP GDP Per Capita growth of over 6% in 2006 and 2007, as well as in exports and import levels (respectively 51bn and 64.5bn USD in 2008), stability in the monetary system and robust GDP growth. The labour market has also improved, with participation rates climbing to 56.5% in 2008, and unemployment rate reaching a 20-year low (5.9% in the second quarter). However, with the global economic crisis, triggered by credit crunch in the financial system, prospects for both GDP growth and the labour market are low. Bank of Israel experts’ forecast suggests a negative GDP growth of -1.5% and an increase in unemployment rate to 7.6% in 2009.

In this research we start by mapping the growth, trade and labour market of Israel economy, including the analysis of the decent working conditions and poverty amongst the population. Then we examine various economic policies and policy changes in Israel, affecting the labour market and decent work. Being in the midst of the recent economic crisis it is still early to assess the full scale impact it had on the economy and labour market, yet we attempt to give it the most accurate evaluation, also considering the actions the government has set in place to deal with these effects.

It is important to take into account long-term sectoral changes, and the effects of the global market on Israel's economy and on its several industries. Our analysis utilizes data, reports and studies of the Central Bureau of Statistics, the Bank of Israel, current papers and articles from the academic literature (as specified in the bibliography), the Ministry of Industry, Trade & Labour, the Ministry of Finance, the National Institute for Social Welfare and the OECD. It has been our intent to incorporate throughout the study the current trends that are underway affecting decent work of the whole economy and in the sectors. Such a presentation requires an interdisciplinary view of Israel's labour market.

In our report we identify the sources of growth and employment, and perform empirical analysis to estimate the elasticity between growth and employment in agriculture, manufacturing and services. This empirical exercise is aimed at determining how growth is translated in terms of labour supply in several demographic groups using the analytical framework developed by Kapsos (2005). Our findings suggest greater responsiveness of workforce to changes in GDP in contrast with the rest of the world and European countries. Moreover, youth employment exhibits interesting characteristics that diverge from global trends.

The comprehensive overview of labour market involves examination of connections such as the relationship between global crisis and demand for jobs of various quality workers. In our study we pay attention to the differences in volume and quality of jobs involving different sectors of Israel society such as youth, female, migrant workers, immigrants, and minorities, namely ultra-orthodox Jews and Arab Israelis.

As mentioned the government with the support of the Bank of Israel has initiated macroeconomic policies. It is imperative to examine their impact in terms of quality of
jobs, decent work and employment in different sectors. We address the issue of the effectiveness of government policy in reducing the overall level of poverty and poverty among workers, in reducing inequality and in improving decent work. In the analysis we pay attention to Israel's particular characteristics such as its level of insertion into global trade, its level of dependence on global trade and its development trajectory.

2. Israel Economy and Labour Force

2.1 Economic Growth

Comparative Analysis of Israel and OECD

Throughout the first decade of the new millennium, Israel economy has seen substantial growth, though with some less successful periods of business cycles. The expansion and downturn periods in the domestic economy match the evolution of the global economy. One of the possible explanations is the great exposure of Israel economy to the world markets, through extensive trade.

The gross domestic product (GDP) has evolved concurrently with the economic cycle, experiencing economic boom during the turn of the century, followed by a sharp decline with the burst of the dot-com bubble. The subsequent prolonged period of economic growth can be seen beginning from 2003 with consistent economic growth. It is also evident that the structural changes put into effect in 2003 turned to be conducive to Israel’s economic growth as well. The global financial and economic crisis developing in the end of 2007 has had a dampening effect on the GDP levels and GDP growth as late as 2009. This supports the growing consensus among the economists and politicians that local economy has taken a lesser hit so far than other developed countries and the global economy.

These effects are apparent in evaluation of the volume of Israel’s Gross Domestic Product computed in terms of Purchasing Power Parity. The evolution of economic cycles and the effects of the two crises undergone by the global economy during the first decade of the 21st century until today are embedded in Israel GDP.

Table 1. Israel Purchasing Power Parity (PPP) GDP per capita (USD)

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<tbody>
<tr>
<td>GDP</td>
<td>17,475</td>
<td>18,090</td>
<td>18,354</td>
<td>18,934</td>
<td>20,446</td>
<td>22,397</td>
<td>22,575</td>
</tr>
<tr>
<td>GDP</td>
<td>23,034</td>
<td>22,497</td>
<td>22,820</td>
<td>23,153</td>
<td>24,680</td>
<td>26,226</td>
<td>27,382</td>
</tr>
</tbody>
</table>

Overall, GDP per capita in Israel has grown substantially over the past few years. It has increased from the level of 17,475 (USD, PPP), to 27,382 (USD, PPP) in 2008, which is close to the OECD average. These figures represent the favourable Israel GDP condition, ranking Israel at par with other developed countries.
In the year 2000, which was a period of rapid growth particularly in the High Technology being one of the stronger sectors of Israel’s economy, the annual growth rate was 8.9%. During the economic downturn of 2001-2002 the annual average decline in GDP was less than one percent. After this period the economy stabilized to the annual growth rate of close to 5%, including 2008.

Generally, Israel’s economy exhibits stronger performance during growth periods and mild decline during recession. However, as we can see, the GDP is more volatile than that of OECD, with greater gains and losses. For example, Israel’s economy enjoyed a relatively high pace of development prior to the 2000-01 crisis, but also lost much more in terms of GDP growth when the high-tech bubble burst in the economic downturn. Thus, withstanding milder losses in the current crisis seems even more surprising, judging by the history of economic development.
Impact of Economic Growth on Inequality

The original statement that inequality should rise together with economic growth dates back to the 1950s when Simon Kuznets (1955, 1963) formulated his hypothesis, describing the inequality curve: initially inequality shoots up and then gradually scales back. Kuznets relied on the data available for US, the UK and Germany. Because of incomplete data, the hypothesis has only been recently thoroughly empirically researched. However, Barro (2000) confirms Kuznets’ curve as an empirical regularity using panel regressions (estimation by seemingly unrelated (SUR) technique) of roughly 100 countries between the 1960s to the 1990s. According to his conclusions, growth tends to fall with greater inequality when per capita GDP is below around $2000 (1985 U.S.dollars) and to rise with inequality when per capita GDP is above $2000. Bruno et al. (1998) used time-series data to investigate the Kuznets hypotheses and found no instances where the prediction is confirmed.

In fact, over the last two decades in the twentieth century, overall inequality remained stable, as very few countries experienced a significant trend increase or decrease in relative poverty (Bruno, Ravallion and Squire, 1998). Actually, it is reported in several studies, that aggregate within-country inequality (defined as the contribution of within-country inequality to total inequality) has started to rise (Milanovic, 2002, 2005) between 1988 and 1993 but in the consecutive period between 1993 and 1998 this global inequality appears to have fallen. Extended by a couple of years, similar findings were confirmed by the World Bank (2005).

Using the Luxemburg Income Study (LIS) indicators we calculated the rate growth in relative poverty within the 30 industrial states that participate in the project. In 60% of the states there was a rise in the relative poverty (which is defined in the project as 50% of the median income) since the 1980's and until 2005 (the last year we had information about), and in 64% of the states the Gini coefficient had also risen in that same period.

The pattern of convergence emerges from the latest empirical evidence in studies of inequality across countries (Ravallion, 2000). Thus, in countries with high inequality, like Brazil the process of becoming more equal is underway, while low-inequality countries like India the process is reverse. However, these results do not imply that globalization is the cause of convergence. Follow-up research by Ravallion (2003) indicate that convergence is still present in a better constructed data set using an econometric method better suited to deal with measurement errors.
When trying to assess the impact of economic growth on inequality, we need to look at the state of the country’s development. The state of development plays a key role on the effect of growth on poverty and decent work, as analyzed in Barro’s research on inequality and growth (2000). In developing countries the effect is often negative, while in developed countries the outcome is typically positive for reducing inequality in these countries.

Israel can be seen as a developed country, which has some characteristics of a developing country. Some of these elements, detailed in later sections of the current research, include a relatively low participation rate in the labour force, a large amount of the population living under the poverty line, and a large number of sectors and groups which do not take an active part in the labour market and the economy.

Analysis of the overall inequality situation should therefore be assessed using the Gini coefficient. The Gini coefficient presents us with the measure of income allocation and should not be analysed separately from the relationship among the growth rate and the state of general development. According to the data, the inequality has remained stable: although economic growth changed dramatically in the early 2000, the reported Gini coefficient remained much unaltered.

**Figure 4. Israel Gini Coefficient 2000-2007(%) Before and After Transfer Payments Compared with GDP Annual Growth (%)**

### Sources of Growth Analysis

#### Growth Determinants

From 2003 until 2008 Israel’s economy has seen steady growth. The slowdown in the growth of productivity in 2007 was an indication that the cyclical component of growth, which is the result of the increase in the utilization of existing factors of production, has been exhausted. The transition to growth driven by the accumulation of factors of production, accompanied by slower growth of productivity, is part of a natural and predictable process. This transition is evidence of the completion of the cyclical phase of growth, which is the result of the reduction of the output gap originated in the early 2000s.
The reduction of the output gap was reflected in a number of phenomena. First, a sharp rise in investment in the business sector (See relevant figure in section C below – investment rate evolution). Second, the increase in labour share of income, which had declined in every one of the years 2003-2007. Third, the drop in the return on gross capital which had risen continuously during the entire period of growth as a result of the increase in the utilization of capital; and the steady decline in the rate of unemployment to a record level of 6.7% in 2007, in spite of the increase in the rate of labor force participation.

Most of the short-term fluctuations in GDP are the result of changes in demand. However, an overall view of the cycle clearly shows that supply factors, such as technological improvements, the increase in the quality of the labor force and the increased efficiency of firms in the economy during recessions, have a decisive influence on Israel’s GDP. Although it is difficult to identify the effect of these factors within a single year, the average rate of increase in total productivity since 1999, explains about 37% of the increase in business sector product since then. This is evidence of the importance of the increase in productivity essential for sustainable growth.

The issue of technological change is an important factor in economic analysis and policy making. One of the ways to determine the total factor productivity as it is known among economists is to use the simple multi-factor macroeconomic model for computation of Solow residual which is obtained after removing the effect of changes in factors of production (capital and labour) from the growth in GDP. Figure 5 shows the development of the measure for Israel’s economy since the 1960s up to 2008.

**Figure 5. Solow Residual for Israel Economy, 1961-2008**

![Graph showing Solow Residual for Israel Economy, 1961-2008](source: Bank of Israel Annual report, 2008.)

It can be seen that the periods in which it was higher than the average for the sample (i.e. 1.3 % annually) are ones in which the Israeli economy was in a boom (i.e. the 1960s apart from the short period prior to the Six Day War, the boom following the Stabilization Plan in the mid-1980s, the early years of immigration following the creation of the State, the hi-tech boom in 2000 and the exit from recession followed by a boom during the years 2004–2008).

An exception is the period 1993–2006, which is classified as a recession in terms of total productivity but is in fact characterized by a high rate of growth in GDP. It is possible that this is related to the supply effects of the mass wave of immigration to Israel during this period. Thus, the period was characterized by growth in the supply of labor, the stock of capital and potential GDP; however, this was not accompanied by an increase in total productivity due to the slow and lagged adjustment process in the absorption of immigrants within the Israeli labor market.
For a closer look at the technological change in the industries in Israel we provide the following figure 6 with selected sectors, measured over the last decade in terms of labour and total factor productivity (Solow residual). The findings suggest that one of the most technologically competent sectors turns to be agriculture, which is both high in labour and total factor productivity. On the other hand, construction sector ranks the lowest among the industries. This sector is known to be highly inefficient in terms of using latest innovation technology and is characterized by low-skill intensive labour.

**Figure 6. Labour and Total Factor Productivity in Principal Industries**

*Annual Averages 1998-2008*

![Graph showing labour and total factor productivity in principal industries](source: Bank of Israel Annual report, 2008)

The following figure presents the fluctuations in labour productivity over the last 13 years. The traditional methodology for computation of the labour productivity rate is based on (constant 1995 prices) GDP per employed ratio. This rate exhibits significant procyclical property: labour productivity is lowest during recessions (2001-2002).

**Figure 7. Labour Productivity Rate (%), 1995-2008**

![Graph showing labour productivity rate](source: Authors’ computations, based on Central Bureau of Statistics data)
Table 2. GDP and Sources of Growth, 1999-2008 (Volume Rates of Change, Percent %)

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<tr>
<td>GDP</td>
<td>6.1</td>
<td>0.2</td>
<td>5.2</td>
<td>4</td>
</tr>
<tr>
<td>Business Sector Product</td>
<td>7.1</td>
<td>-0.7</td>
<td>6.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Imports</td>
<td>13.7</td>
<td>-2.5</td>
<td>7.7</td>
<td>2.2</td>
</tr>
<tr>
<td>Exports</td>
<td>18.4</td>
<td>-1.7</td>
<td>9.1</td>
<td>3</td>
</tr>
<tr>
<td>Total Sources</td>
<td>8.3</td>
<td>-0.6</td>
<td>5.9</td>
<td>3.4</td>
</tr>
<tr>
<td>Gross Domestic Investment</td>
<td>4.1</td>
<td>-6.5</td>
<td>8.6</td>
<td>3.8</td>
</tr>
<tr>
<td>of which Fixed Capital Formation</td>
<td>1.5</td>
<td>-5.1</td>
<td>7.3</td>
<td>5.1</td>
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</table>

Source: Bank of Israel, based on Central Bureau of Statistics data

Notwithstanding setbacks in labour productivity during the recession years in the late 1990s, overall labour productivity has grown, while GDP per capita shows no significant increase (see Figure 8 below). This finding may highlight the looming demographic problem of slowly growing GDP compared to population (and subsequent labour participation) growth.

Figure 8. GDP per capita and Labour Productivity
Real GDP (base year 1995), Quarterly, 1995-2009

When considering the effect of human capital on Gross Domestic Product we can also examine the Human Development Index, developed by the UN: Israel ranks 23rd, with a 2005 HDI value of 0.932, and a value of 0.946 in the Education Index. These measurements represent positive standing of Israel’s human capital among the developed countries, contributing to the GDP. On the other hand, despite the quality of the human capital, the relatively low participation rate produces pressure on the labour force.

Sectors Driving Growth

Analyzing the sources of GDP, it is easy to identify that the main sector driving the country’s growth is the services sector. Banking and finance, trade and commerce, transport and communications, government-supplied and personal services, public and private education, and state of the art health care comprise by far the greater part of GDP during the recent decades. From this standpoint, Israel economy has all the characteristics of a developed, post-industrial country, which enjoys highly skilled human capital involved in
knowledge intensive production as opposed to a low-skilled labour-intensive economy with industrial focus.

Figure 9. Added Value Contribution of Sectors to GDP
(Billions of NIS at Fixed 1995 Prices)

Source: Central Bureau of Statistics

Since the 90s and before the services sector has seen tremendous growth and greatly contributed to GDP. Two periods of different rate of growth can be evaluated: up to 2001 and after 2002 and to 2007. The first period development was slower than in the second judging by the steeper slope. It should be noted, that this sector is less immune to the crisis, which occurred in the 2000s compared to others. At the same time industry production and agricultural produce to a greater extent remained stable with a small dip in production in the early 2000s’ due to global crisis.

It is imperative to relate to Israel's Information and Communication Technology (ICT or Hi-Tech) industry, which represents one of the country's main economic growth engines. Yet this industry employs only 8% of the country's workers. Information technology boasts of the leading position in Israel economy (see the following figures).

Figure 10. Israel's Industrial Exports (Excluding Diamonds)
by Year and Industry Type

Source: Central Bureau of Statistics
An analysis by technological level shows that over the past decade high technologies represent approximately three quarters of the industrial exports. In 2008 the share of the High-Tech sector has been 74%. In the first four months of 2009, the share of the High-Tech sector increased, concurrent with a sharp decline in the overall industrial export as a result of the decrease in the global demand for goods and services.

**Evolution of the Investment Rate**

The investment rate in Israel has seen expansion during economic growth periods and contraction during economic downturn.

During 2008, gross domestic investment grew at a rate of 3.8%. Fixed capital formation grew by 5.1% in 2008, which is less than in previous years but still much higher than the average over the whole business cycle. The increase in investment led to a rapid increase in the stock of capital and a continuation of the increase in the proportion of investment in business sector product. Thus, the rate of increase in per capita investment is continuously higher than that in the developed countries and the gap created at the beginning of the decade narrowed considerably in recent years, as depicted by the figure below.
Judging from figures no. 13 and 14 below, the rate of overall capital formation has dramatically increased during the last decade. In 2008, nonresidential fixed capital formation, excluding ships and planes, grew by 7.7% due to the rapid growth in investment in machinery and equipment and transportation vehicles while the investment in non-residential construction fell by 0.9%. Investment in residential construction grew by 3.8%, which was a continuation of the upward trend since 2006.

The trend in investment also changed due to the economic slowdown in 2008. Thus, the investment in inventory (of raw material and finished goods) increased significantly during the fourth quarter with the decline in demand. Fixed capital formation, apart from ships and planes, has experienced a steady increase since 2003 until the second half of 2008. This was primarily due to the decreased imports of transportation vehicles.

The trends in other industries did not change significantly. The trend in investment was influenced in 2008 by a number of factors: the closing of the output gap as a result of the increase in employment and capital utilization, which meant that firms could increase supply only through the expansion of the capital stock; and the continuing downward trend in its price in all industries, apart from construction. On the other hand, the credit crisis and the increase in the risk premium and lower expected profits as a result of the global slowdown made investment less worthwhile and led to slower growth in investment. There was a connection between risk and investment seen during the economic slowdowns of 2002 as well as that of 2008. The risk premium rose steeply and as a result investment in the economy declined. At a later stage, the risk premium fell and investment again began to increase. This was true following the 2002 recession and is relevant again at the current economic crisis.
The graph below depicts the evolution of the business sector investment development since 1990. It is evident from the graph that despite temporary economic slowdowns and subsequent decrease in investments, overall the investment rate has seen significant growth.

**R&D Investment**

Israel currently has the world's highest rate of R&D investment as percent of GDP (4.5%; Sweden is next with 3.6%, OECD average is 1.8%). This is due to the central role the technology sector plays in the services industry.

Special emphasis should be put on the competitive environment in which Israel industry is active on the global scale. In 2007, an OECD study has examined the member states and a number of additional countries, including Israel. The research has shown that Israel business sector has supported 75.4% of the overall R&D investment, while the OECD average was 55%, and the European Union average was higher, at around 64%. Additionally, the rate of governmental R&D investment in Israel was merely 18%, a substantially lower figure than the average 28.5% in OECD countries, and 34% for EU states.
The above data present a decline in governmental R&D investment share out of the total business sector R&D in Israel contrasted with a rise in this channel of investment in other developed countries. The Ministry of Industry, Trade and Labour asserts that these data suggest a dangerous indifference of this country’s politicians to the future of Israel's R&D and warns of a substantial potential hit to the economy's growth engine. The chart depicts the economic crisis in development in the High Technology sector even prior to the current deteriorating financial situation, which has accelerated these processes. Israel has no abundant natural resources, no relative advantage either in manufacturing or sales of products, which are based on low-cost labour. Therefore, the differentiation strategy in the global market should be based on competitive advantage in the field on Information Technology, based on highly developed human capital, eventually leading to the economic growth.

**Foreign Trade and Foreign Direct Investments**

**Foreign Trade**

Foreign trade in Israel has moved consistently over the last decade in accordance with the state of the global economy. As the chart illustrates, it is clear that foreign trade has moved concurrently with the country’s economic growth. Israel is a small economy, and as such is directly affected by shifts in global demand for products and services. These movements are immediately translated in the volume of foreign trade to be carried out in and out of Israel. The following graph charts the rate of foreign trade as a percent of Israel’s GDP.
Foreign Direct Investments ("FDI")

In accordance with macroeconomic theory, international trade and GDP both have pro-cycle behaviour, while the FDI seems to have a life of its own: it reacts to business cycles with a certain delay. This lag may be caused by the span of time it takes investors to process changes, re-evaluate and execute their revised investment strategies.

It is clear from the charts below that though GDP per capita was already positive in 2004; it took until 2005 for Foreign Direct Investment flow to increase. It wasn’t until 2006 that the substantial boost in FDI kicked in. This was the case even though the country has been experiencing consistent growth ever since 2003 and in 2004 it has already seen an even higher growth rate of 5%.

The outstanding surge in FDI in 2006 is explained by an unusual investment event. In May 2006, Warren Buffet’s US-based Berkshire Hathaway acquired 80% of the stock of Israel-based Iscar Metalworking Companies for USD 4 billion. Earlier in 2004 Isaac Tshuva, an Israeli businessman who has the controlling interest in several trans-national investment and holding companies, bought the Plaza Hotel on Fifth Avenue for USD 675 million. These two deals, despite their outstanding value in Israel terms, are only two examples of the increasing involvement of Israel business people and firms in the global economy to an extent that would have been deemed inconceivable just 20 years ago.
Figure 18. Israel Foreign Direct Investment (FDI) Growth Rate (%), 1996-2008

Source: Central Bureau of Statistics

Figure 19. Israel Foreign Direct Investment (FDI) 1995-2008 (USD, Current Prices)

Source: Central Bureau of Statistics

Figure 20. Israel’s FDI Evolution Compared with Merchandise Trade and GDP per Capita, 2001-2006

Source: World Bank Database Group and UNCTAD
Growth-Employment Elasticities

Growth-Employment Evolution

The general trend of the growth rate in Israel market does not present a clear relationship between economic growth and employment rate. This is the conclusion to be reached when assessing the relationship between the unemployment rate over the past few decades and economic growth in Israel.

During spells of consistent GDP growth, unemployment kept on rising. Peaks of worst unemployment coincided with the influx of new immigrants in the early 1990s, which several years later joined the civilian labour force (see section 2.3.1, iii) and with business cycles of the 2000s. It remains to analyze the elasticities of economic growth relative to employment evolution in Israel, in order to gauge the sensitivity of the labour market to economic growth.

Figure 21. GDP Annual Growth and Unemployment Rate, 1970-2006 (%)

Source: Central Bureau of Statistics

Growth-Employment Elasticities

For the sake of clarity and simplicity of calculation, which retains explanatory power we referred to Kapsos’s (2005) study. The purpose of the exercise is to gauge the correlation between output and employment, but not causality.

In order to estimate labour elasticities comparable to those computed by the ILO for other countries we used the methodology demonstrated by Kapsos (2005). We chose to estimate the regression of the following form:

\[
\ln E'_t = \alpha + \beta ln E'_{t-1} + \cdots + \gamma ln Y_t + \epsilon_t
\]

Where the dependent variable is the log of employment; the independent variables include the lagged employment of one or two periods (generally 3 periods were tested, but proved to be insignificant in all specifications) in order to account for autoregression and also the log of GDP (indexed at the base prices of 1967), and finally the last term is the constant variance error with zero mean. This limited specification differs from the one proposed in Kapsos since it is based on the data for a single country, when in the original specification took into account cross-country effects. However, this specification still suffers from omitted variables, which could lead to incorrect results.
In all 10 different elasticities were calculated using the general specification above, each with the relevant pair of variables. Mostly all data were since 1967, but youth employment series and service sector contribution to the GDP have limited availability – only since 1995.

The first four were calculated for total, men, women and youth employment, with the independent variable as the log of GDP in constant prices.

Table 3. Employment Elasticities - Sex, 1969-2007

<table>
<thead>
<tr>
<th></th>
<th>1969-2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>0.101</td>
</tr>
<tr>
<td>Female</td>
<td>0.213</td>
</tr>
<tr>
<td>Male</td>
<td>0.334</td>
</tr>
</tbody>
</table>

Table 4. Employment Elasticities - Youth, 1995-2007

<table>
<thead>
<tr>
<th></th>
<th>1995-2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>0.357</td>
</tr>
<tr>
<td>Youth</td>
<td>0.233</td>
</tr>
<tr>
<td>GDP Growth (%)</td>
<td>4.08</td>
</tr>
</tbody>
</table>

As we can see, for every 1-percentage point of additional GDP growth total employment grows by 0.357 points. Regardless the periods of negative growth during the periods covered, employment elasticities remain stable. Little difference is reported between 1995-2001 and 2002-2007, even though labour responsiveness slightly increases overall and for all sub-groups. Notably, the results suggest similar labour force volatility to GDP growth compared to global estimates of total employment elasticity 0.3-0.38 as reported by Kapsos. Assuming separability of elasticity and productivity, we can derive relatively simple relationship between these measures: when employment elasticity is between 0 and 1, positive economic growth is also paired with productivity growth and vice versa, given the same range for employment elasticity, negative growth is aggravated by falling productivity.

As for demographic characteristics of employment elasticities, younger workers’ employment (aged 15-24) grows less with economic growth than the overall employment. That is, greater participation among youth is achieved with higher levels of GDP rate. However, comparison to global trends of -0.02 and 0.06 elasticities suggests pronounced vitality of Israel youth labour market: every additional percent of GDP growth produces 0.233 percent growth in youth employment.

Gender plays a diminished role regarding the elasticities: contrary to global gaps between working men and women in participation flexibility, Israel male and female labour force reacts almost similarly to growth shocks, whilst males’ employment reaction is stronger.

Israel economy shows diversion among its sectors, as evidently, we can judge from different growth rates in agriculture (0.17), industry –0.104 and services – 0.168%. Services comprise of commerce, transport, finance, personal, government, education and health contribute greatly to the GDP and has greater employment elasticity compared to other sectors. Employment in agriculture changes little with greater economic growth: it dwindles by minus 0.17 percentage points for every percentage of shekel, but still more than the comparable measure in the global statistics (Kapsos, 2005).
When the regression is run with respective employment variable, sector value-added elasticity shows lesser deviations. Still, services sectors is the most responsive to growth shocks with almost 0.168 percentage points change in employment for every percent of change in GDP. The pronounced importance of the services sector in the economy suggests also a structural weakness: service workers seem easier to fire and to hire in a changing economy.

Table 5. Sector employment elasticities and value added elasticities by economic sector, 1969-2007

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sector GDP elasticity</td>
<td>-0.17</td>
<td>0.104</td>
<td>0.168</td>
</tr>
<tr>
<td>Sector value-added elasticity</td>
<td>-0.120</td>
<td>0.128</td>
<td>0.37*</td>
</tr>
<tr>
<td>Average annual value-added growth rate (%)</td>
<td>2.63%</td>
<td>3.00%</td>
<td>4.48%</td>
</tr>
</tbody>
</table>

*Due to data availability, services value-added elasticity data is from 1995-2007 only

2.2 Trade and Work

Israel Trade Levels

Israel's trade levels have seen continuous growth over the past decade. As depicted in the figure below, it is evident that local trade levels follow GDP evolution, with trade levels rising during periods of economic growth and declining during economic slowdown.

The most frequently used indicator for measuring the importance of international business transactions in comparison with domestic transactions is the “Trade-to-GDP Ratio”, which is the sum of exports and imports divided by GDP. International trade trends tend to be more important for small countries (in terms of population size, such as Israel), and with neighbouring countries with open trade regimes, rather than for large and relatively self-sufficient countries (such as the US) or those that are geographically isolated and thus penalised by high transport costs.

The “Trade-to-GDP Ratio” is often called the “Trade Openness” ratio. However, the term “openness” may be somewhat misleading: a low ratio does not necessarily imply high (tariff or non-tariff) obstacles to foreign trade, but may be due to other factors, as mentioned above. In Israel this Trade Openness ratio does provide important insight in the economy’s development level. This is due to its small population (7.4 million as of May 2009) and proximity to European markets.

The indicator represents the combined weight of total trade in the economy, a measure of the dependence of domestic producers in foreign markets and of domestic demand on imports of goods and services.

Several notable papers (Dollar, 1992; Sachs and Warner, 1995; Edwards, 1992) have found that trade openness is associated with more rapid growth. Recently, the study by Dollar and Kraay (2005) using the GMM estimation of roughly 100 countries in the 1980s and 1990s confirmed these findings, concluding that a 100% increase in trade volumes resulted in a 25% cumulative rise in incomes during over a decade.

During the economic boom of 2000, the Trade-to-GDP Ratio in Israel has reached 75%, its highest level up until that point. The ratio subsequently declined sharply in 2001 to 69%, but has experienced consistent growth year after year until 2007, reaching 88%. 2008 was the first year since 2001 in which the Trade-to-GDP ratio has declined, reaching its 2004 levels of 83%. It is evident that Israel economy’s trade levels move in parallel to Israel economy and product.
Israel's trade level is correlated with the international and global trade levels. This can be clearly seen by comparing Israel’s Trade Openness Ratio with that of other European countries. Additionally, it is noteworthy that Israel’s trade level is characterized by a relatively high Trade-to-GDP ratio, especially since 2004. This is the result of 2003 reforms, which have given a strong boost to exports.

Israel relies heavily on trade to gain natural resources and other raw materials. Advanced tools and machinery; moreover, it has a sound export sector with almost every middle-size company developing international trade connections. Owing to its necessities and this entrepreneurial spirit Israel enjoys a relatively high Trade Openness Ratio among other developed countries, such as France and the UK. However, some countries with developed foreign trade, namely Denmark and Germany, have a similar Trade Openness Ratio to that of Israel.
Trade and the Labour Market

Building upon the conclusions of the previous section, one would expect that the labour market with such high trade levels to be huge. In reality, the participation rate is merely 56.5% while the trade openness has risen to 90.3% in 2008. However, both measures have seen expansion and an increase over the past decade.

Table 6. Trade and Labour Market Data Overview, 2008

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>7.4</td>
</tr>
<tr>
<td>Labour Force Size</td>
<td>2.8 mm</td>
</tr>
<tr>
<td>GDP Per Capita (PPP)</td>
<td>27,382 nis</td>
</tr>
<tr>
<td>Participation Rate</td>
<td>56.5%</td>
</tr>
<tr>
<td>Export to GDP Ratio</td>
<td>40%</td>
</tr>
<tr>
<td>Import to GDP Ratio</td>
<td>42%</td>
</tr>
<tr>
<td>Trade Openness Ratio</td>
<td>90.3%</td>
</tr>
</tbody>
</table>

Source: Central Bureau of Statistics

The participation rate in the civilian labour market as can be seen in the chart below has increased by almost 7% from around 50% in 2000 to 56.5% in 2008, while Trade-to-GDP Ratio has expanded by almost 20%: from 70% to 90% respectively. This disproportionate increase would suggest that trade effects on labour are positive and strong, but somewhat limited. Further investigation of trade and employment interaction is to be carried out in consecutive sections.
Trade and Employment

Trade-Employment Elasticity

Our calculations show that trade has become more important for employment formation during the last years. Using the similar methodology for employment elasticities influenced by GDP growth, we formulated a regression that estimates how trade openness would change overall employment. For every percentage point increase in trade openness we expect employment to rise by 0.24 during ’95-’01, that is until the high-tech bubble crisis and by 0.81 in the subsequent period until 2007. These numbers suggest that employment has become dependent on trade flows in and out of the country. Reforms aimed at fostering growing trade volumes would greatly increase employment in the labour market.

Table 7. Employment Elasticities of Trade Openness, 1995-2007

<table>
<thead>
<tr>
<th>Year</th>
<th>1995-2001</th>
<th>2002-2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment elasticity</td>
<td>0.247</td>
<td>0.814</td>
</tr>
</tbody>
</table>

Relationship between Trade Openness and Employment

Having checked the relationship between Israel trade levels and the participation rate of the population in the civilian labour force we move on to a correlation between unemployment and trade levels. The expectation is that the relationship turns out inverse, since greater trade volume implies more employment opportunities.

In order to determine the relationship between Israel trade volume and the number of job seekers (routinely computed as the rate of the population in the civilian labour force), we focused on the regression between trade openness, as referred in earlier sections, and unemployment rate. Again, the specification is similar to that of section 2.1.4, B, when the explained variable is the unemployment rate and the independent is Trade-to-GDP ratio. We found significant inverse relationship between the variables, which suggests that raising trade reduces unemployment.
Table 8. Job-seekers and Trade Openness, 2000-2008

<table>
<thead>
<tr>
<th></th>
<th>2001-2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment elasticity</td>
<td>-2.87</td>
</tr>
</tbody>
</table>

This econometric finding can be justified by the means of comparison as can be deduced from the graph 18 below.

**Figure 26. Unemployment Rate in Israel’s Civilian Labour Force and Trade Openness Ratio* (%) 1995-2008**

The substantial literature investigating the links between trade, trade policy, and labour market outcomes—both returns to labour and employment—has generated a number of stylized facts, but many open questions remain. Hoekman and Winters (2005) have surveyed the subset of the literature focusing on trade policy and integration into the world economy. Although in the longer run, trade opportunities can have a major impact in creating more productive and higher paying jobs, a great deal of the literature tends to take employment as given. A common finding is that much of the shorter run impacts of trade and reforms involve reallocation of labor or wage impacts within sectors. This reflects a pattern of expansion of more productive firms—especially export-oriented or suppliers to exporters—and contraction/adjustment of less productive enterprises in sectors that become subject to greater import competition. Wage responses to trade and trade reforms are generally greater than employment impacts, but trade can only explain a small fraction of the general increase in wage inequality observed in both developed and developing countries in recent decades. A feature of the literature survey is that the focus is almost exclusively on industries producing goods. Therefore the negative effect that trade openness has on employment is mainly in countries with large manufacturing sectors. Hoekman and Winters argue, that given the importance of service industries as a source of employment and determinants of competitiveness, future research should be conducted in order to examine the employment effects of services trade and investment reforms. It is important to point out, that as presented above, Israel’s services industry is the largest sector and has the largest number of employed persons.
In a more recent research Dutt et al. (2009) found, using cross-country data on trade policy, unemployment, and various controls, and controlling for endogeneity and measurement-error problems, a fairly strong and robust evidence for the Ricardian prediction that unemployment and trade openness are negatively related. This positive effect, which we have empirically found of trade openness on unemployment, is apparent for capital abundant countries, such as Israel, although it turns negative for labor-abundant countries.

The above research reports suggest that, being a services-oriented economy, where capital is abundant and labour force is relatively limited, the effect of trade openness on employment would, indeed, be positive, as evident by the data presented in the figures above.

Consequently, economic policies aimed at augmenting trade volumes have positive influence on employment by creating new work places and by reducing joblessness.

2.3 The Labour Market:

The Labour Force:

Participation Rate

The participation rate in Israel has been significantly lower relative to other developed countries during the past decade. The rate has been 56.8% in 2009 according to the CBS, as opposed to 72% in the US and 66.7% in OECD countries in 2007, according to the OECD. This is mainly due to a large part of the population in Israel, which does not partake in the work force for social and cultural reasons. The participation rate is a key measure to look at when evaluating decent work, as it often represents inherent impediments in the labour market. We believe this may very well be the case in Israel labour force.

The main trend of the participation rate for the overall population has been a steady upward trend (climbing from 54.3% in 2000 to 56.8% in 2009). The 2003 reforms in Israel social security and taxation scheme have focused on cutting social benefits and direct income taxation. These structural changes were done in an attempt to increase the participation rate in the civilian labour force, and indeed have boosted participation rates to new levels.

Figure 27. Civilian Labour Force, (thousands), 1995-2008

Source: Central Bureau of Statistics
Figure 28. Civilian Labour Force Participation Rate (%), 1995-2008

Source: Central Bureau of Statistics

Participation Rate by Sector

Breakdown by Sector

The participation rate in the services sector surpasses by far the participation rate in the industrial and agriculture sectors. The finding makes sense especially considering the commanding position of this sector in this economy as explained earlier in detail in section 2.1.3 A.

Participation rate is closely related to the discussion on decent work, since this rate plays a prominent role as an indicator for employment opportunity derived from ILO’s formal definition of decent work and suggested statistical measurements (Anker et al, 2002). More details on additional indicators can be found throughout the current paper, and specifically in the decent work section (see 2.5).

On the one hand, the relatively low participation rate compared with other countries would suggest a higher burden on the labour force. In fact, a straightforward conclusion suggests that close to half of the population is supported by the other working half. The immediate result is gradual aggravation in decent working situation, for instance longer working hours and lower productivity, in which the workers assume further weight and pressure than they would have, had the labour force participation rate been higher. On the other hand, for the past decade opportunities for decent work have been expanding thanks to the unprecedented economic growth in the services sector, which also harbours the largest percentage of labour. According to the data (figure 21) employment has been growing mainly in this sector and been stagnant in industrial and agricultural sectors, barely hovering at 13% and 2% respectively.

Figure 29. Employment by Sector, 1995-2007
(Employees of each Sector as a Percent of the Civilian Labour Force)

Source: Central Bureau of Statistics
**Geographical Location**

Economic gaps between regions in Israel are highly visible. Distances between most populated regions are only a few hours’ drive, and public transportation is existent, though inefficient. Freshman and Klapapish (2008) found that the regional unemployment rate showed convergence in all regions except the south. There are higher unemployment and lower participation rates in the northern and southern regions of Israel, with lower unemployment and higher participation rates along the coastal areas and the central region. Several explanations for economic backwardness of “the peripheral regions” have been suggested by the study, which include among others social and economic reasons: social segregation due to the higher rates of minority populations in the northern and southern regions, lower education attainment levels owing to unsatisfactory and ineffective spending on education, inefficient transportation and roads infrastructure. The central region enjoys the access to facilities and utilises a close-knit network of highways.

**Minorities within the Labour Force**

Minorities in Israel face both cultural and social barriers upon entering the labour market. The most significant minority group in Israel labour force, comprising about 20% of the population, is Israel Arabs. These Arab Israelis have historically shown low participation rates and higher unemployment rates than the rest of the population.

Actually, the participation rate among the minorities has been low: 42.6% in 2001 and 44.6% in 2009 (CBS). This phenomenon has several causes - one major reason is the low participation rates of Arab women due to cultural patterns, with a participation rate of only 21% in 2006. Female labour is uncommon within the Arab sector, especially in the Muslim and Druze populations. The level of education attainment is also a factor in the rate of participation, as participation rises with the level of education. However, it is still less significant than the social role of men and women: even the participation rate for highly educated women (16+) is still lower than that of men with elementary education attainment levels.

Additionally, the unemployment rate in the Arab sector is also higher than in the Jewish sector. For instance, in 2007 it was 8.9% for the Arab-Israelis while the national average was 7.3%. One of the main reasons for higher unemployment rates among Arab-Israelis is education attainment. On a broader scale in terms of overall development of the labour market, the demand for graduates of academic establishments has expanded while the demand for unskilled labour has gradually declined. Thus the Arab population finds it hard to cope with slacking demand for their skills. The reason of low education attainment of this minority is mainly due to the inferior state-funded public education system: in 2006, bagrut (high-school diploma) attainment rates in the Arab sector were 49.4%, whereas the corresponding rate in the Jewish sector was 64.3%.

It is important to note, however, that unemployment within the Druze population (a minority group within the Arab-Israel population) is lower than that of the Jewish sector. A study conducted by Nadj et al (2005) in the Ministry of Industry and Commerce found that in 2003 the rate of unemployment for the Druze population was 7.5%, compared to 10.5% for the Jewish population at the time. This is explained by the high rate of Druze men serving as military professionals and by the fact that Druze women who are unable to find work usually leave the labour force and choose not to participate in the labour market. Levi (2006) points out another reason for the high unemployment rates among the Arab minority, namely the discrimination in Israel labour market. Klinov and Mashmush found that the chances of a Jewish man to participate in the labour force are 23% higher than those of a minority man and this increases to 24% among women (without the effect of education).
Figure no. 30. Arab Males' Civilian Labour Force Participation

aged 15+ (100%= 437.1 K), 2007

Non-participant

38
%

Participant

62
%

Source: CBS Statistical Abstract of Israel 2008

Figure no. 31. Arab Females' Labour Force Participation aged 15+ (100%=425.9 K), 2007

Non-participant

79
%

Participant

21
%

Source: CBS Statistical Abstract of Israel 2008
Skilled Labour

**Education System**

The Israeli law designates an important role to the education system. The law regarding schooling provides free mandatory school for all citizens, aimed at receiving education through the end of high school. Public school is available and obligatory to the entire population of youngsters where basic education and skills are provided to all.

In the last few years of high school matriculation exams (“Bagrut”) are given to the students. This “Bagrut”, along with another exam consist of the requirements for admittance to universities. State universities receive funding and subsidies from the Government, offering relatively affordable student tuition, identical for all majors. Colleges are also available in Israel as a means for receiving higher education. These are private institutions, where the admission requirements are not as high as the universities, but without Governmental support, they typically have substantially higher tuition rates.

The percent of students that were entitled to a “Bagrut” diploma in 2006 was 53.4%, and 45.9% of all 12th graders met university entrance requirements. These figures in 1996 were 50.5% and 39.9%, respectively, which points to an apparent improvement in the high school education system.

Additional higher education institutions include other colleges, professional training institutes and instructional facilities. These also include programs offered by the Vocational Training Department in the Ministry of Industry, Trade and Labour, by the Small and Medium Enterprises Authority, the Ministry of Education and municipalities throughout Israel. Courses are offered by professional schools, technological colleges as well as by employers who are looking to absorb workers. Vocational training is offered in various training facilities in various subjects including business, technology, marketing, foreign trade, electronic trade,
computing and business establishment, among others. Business Schools and various Instruction Facilities offer optional government subsidized or fully funded courses for employed persons who are looking for extra training.

The following figure depicts the employed persons in the Israeli labour force by highest diploma attained.

**Figure 33. Employment by Diploma, 2007**
(Number of Employees with each Diploma in the Civilian Labour Force)

![Bar chart showing employment by diploma level in 2007](chart-image)

Source: Central Bureau of Statistics

**Figure 34. Employment by Education Level, 2007**
(Employee % in Civilian Labour Force, by Years of Schooling)

![Pie chart showing employment by education level in 2007](chart-image)

Source: Central Bureau of Statistics

**Skill Composition**

The evolution of the skill composition in the Israeli labour force is depicted in the following figure. It is evident from the graph that there is a wide distribution between the various skill levels. The evolution of the skill composition of the Israeli labour market over the past decade shows that there hasn’t been a significant change in the skill distribution.
Figure 35. Employment by Occupation, 2003-2007
(Number of Employees for each Occupation in the Civilian Labour Force)

Source: Central Bureau of Statistics

Figure 36. Employment by Education Level, 2003-2007
(Number of Employees for each Occupation by Years of Schooling)

Source: Central Bureau of Statistics
Labour Migration and Mobility

Labour Mobility

Changes in participation rate and unemployment rates can stem from various sources. These may include a) structural changes, such as policy decisions, which bring about changes in labour supply and demand, and b) shifts from employment to unemployment and vice versa, as well as c) shifts in and out of the labour force.

Klinov's research on Labour Mobility (dated December 2007) suggests that since 2003, in conjunction with the decline in unemployment, the shifts from employment to unemployment have declined, thereby implying greater job stability. In addition she found that people had joined the work force partially due to structural changes, thereby causing an increase in the unemployment rate. Also, there had been an increase in the duration of unemployment for each individual person.

In regards to the demographic composition of the labour force, the only clear indication is that young workers, aged 18-34 are less prone to long periods of unemployment. Additionally, particularly stable groups that remain constantly employed are married persons, 35+ age group, and have 13+ years of education. Since 2003, job stability for non-educated workers has decreased, notwithstanding the diminishing number of foreign workers, who are employed in low-skill labour. Unemployment levels among women are slightly higher than of men, which may be explained by a high rate of shifts to and from participation in the work force.

There several possible avenues of change in unemployment rate: greater participation of women in labour force (increasing unemployment) and withdrawal of workers in the age group 15-24 (decreasing unemployment), and growing education level (decreasing unemployment). These changes add up to decreasing unemployment levels. The employment situation and decent work conditions have improved due to greater job security and longer tenure of work as well as shorter duration of unemployment spells.

Structural effects provide some of the reasoning for the changes in the work force as well. Persons receiving guaranteed minimal income were instructed in 2002 to report to Israel Employment Service, thereby increasing the participation rate as well as the level of unemployment specifically within the long duration segment. The largest group of this long duration segment is 35-44 year old men. The Wisconsin ("Mehalev" program) is another structural change, for details refer to the policy section.

Labour Migration

The issue of labour migration to and from Israel market is atypical to other countries. Unlike other developed countries, Israel neither has an easily accessible border with any of its neighbouring countries, nor does the immigration policy allow for effortless foreign migration. Therefore, migration of labour to Israel is limited, despite the advanced level of international trade.

Labour mobility to Israel can be characterized by three groups. The first one is a stream of (mainly Jewish) new immigrants. This immigration is mainly based on the "Law of Return", according to which every Jew has the right to immigrate to Israel. Details on the immigrants' participation and unemployment rates can be found in the next section, but in general these figures are more favourable than those of the general population. The number of new immigrants to Israel during the last decade has been in a consistent decline as depicted by the chart below.
The second group is made up of Arab workers from the Palestinian Authority. Some of which do and some of which do not have work permits. Due to the deterioration in security situation and the subsequent reluctance of the majority of the employers to hire these workers, the number of these workers is limited. The third group is composed of foreign workers, typically from developing countries, including Asian, African and Eastern European countries. The number of these foreign workers is somewhat limited mainly due to various procedural and policy rulings and barriers. Further information on these foreign workers (or “foreign wage earners”) is detailed in section IV.

**Immigration**

Between 1989 and 2007, Israel absorbed 1,040,188 immigrants, mostly from the former Soviet Union (19% of the Jewish population and 14.4% of the total population in 2007). The participation rate of immigrants in 2007, 60.4%, was much higher than that of the general population, 56.3%. The successful integration can be attributed to the higher levels of education attainment among Soviet Union immigrants, the lack of significant cultural barriers withholding participation and the high rate of educated and technologically trained individuals within the immigrant population.
**Foreign Wage Earners**

In the early 2000’s, 34% of foreign wage earners were employed in agriculture and only 14% in construction (CBS data). In addition, the aging population and the growing openness to globalization of Israel economy had created a market for caretakers for the elderly population (mostly from the Philippines).

During the 90s there was a major influx of foreign workers, as substitute for Arab workers from the Palestinian Authority. Many of these foreign workers were illegal, and did not possess proper government permits. Many businesses employed foreign labourers in sub-par conditions, denying them basic rights and lowering wages and benefits.

According to The Committee for Foreign Wage Earners’ Policy (2007), at the beginning of the 2001-2003 recession of Israel economy, the number of foreign wage earners had increased to over 250,000 (there are different estimates of the number of illegal labourers, ranging around 85,000). In 2003, Israel government established the “closed skies” policy, restricting the entry of foreign wage earners with permits and reducing the number of illegal foreign wage earners. The government ran massive enforcement operations and set up special enforcement units. In 2003, 21,000 illegal foreign wage earners were deported followed by 15,700 in 2004. This, along with a steady increase in the number of permits issued after 2004, has brought to an estimated decline in the number of illegal foreign labourers to a low of 80,000 in 2005, with a later rise to 90,400.

![Figure 39. Number of Foreign Wage Earners (Thousands), 1995-2008](image)

Source: Bank of Israel Data Series Database, 2009

**Impact of Military Service on Labour Market**

Military service for Jewish citizens at the age of 18 is mandatory. Therefore during their early adulthood a large percentage of the young population serves in the army, with enlistment rates standing at 52% of the relevant age group (18-year olds). The mandatory service period is three years for men and two for women. This has various effects on the labour market.

It may be anticipated therefore that participation rates for the young age group (18-24) would be significantly lower in Israel than in other developed countries. The characteristics of this age group in Israel are indeed quite different from those of parallel groups across the developed world, owing to the military service period. Recent years have seen a rise in participation rate for the young workers age group from 41.2% in 2003 to 42.7% in 2006, mainly since the economic upturn has opened many positions for non-skilled workers. These are particularly suitable for recently discharged military veterans within the relevant age group, and since enlistment rates for the military have dropped.
Another factor explaining relatively low participation rates for this age group is the ultra-orthodox population, whose 18-24 year old men do not participate in the labour force due to religious studies, which also release them of their army duty. This subsequently prevents many ultra-orthodox Jews from ever joining the work force, as they receive their military duty discharge due to religious studies being their full-time occupation.

When evaluating young workers and the ultra-orthodox population, we related to the impact of military service on the participation rate. There are several additional impacts this may have on the labour force. One of these is vocational training, since some soldiers acquire a profession during their military duty. This may very well have a positive effect on skilled workers composing the civilian labour force, following the soldiers' discharge. Another noteworthy social effect on workers’ skills and on the work force may be an adverse one. This is due to the fact that many released soldiers spend several years doing unprofessional work (i.e. security guards, waiters), which is sometimes related to the government programme to promote employment in “favoured” low-tech industries, according to that programme, workers receive subsidies and other benefits. Moreover it is culturally accepted to travel around the world following the release from the army. These effects may delay the vocational training or higher education to be postponed for several years. Thus it is advisable that adjustments to be made when evaluating Israel labour force in comparison to other countries.

_Employment:_

**Employment Rate**

**Unemployment Evolution**

At the first glance at the raw labour market data, the development of the labour force in Israel economy seems to have been growing relatively steady. This growth has been by almost a million workers over the last decade. However, the pace has been greater in the late 90s prior to the economic slowdown in 2001, picking up again several years later, along with the extensive economic growth that the country has been experiencing.

The unemployment rate is an important part of the decent working considerations. The reduction of unemployment improves the situation of the worker and her household, and provides her with job security. The duration periods of unemployment and of employment are important factors as well. Limited duration of unemployment and extensive period of work result in the desired job stability and security, which is essential for decent working conditions.

Unemployment levels in Israel have been relatively high in comparison with other developed countries. But in recent years, most likely in relation to the effect of the economic reforms instated in 2003, the unemployment rate has decreased significantly. During the current economic crisis the unemployment rates have been steady and did not increase as much as unemployment rates in other countries. Subsequently, the current unemployment rates in Israel are much in line with unemployment rates in other developed countries. In the first quarter of 2009 the unemployment rate in Israel was 7.6%, compared with 8.1% in the USA. European Union unemployment rate for 2008 was 7.3%.
Unemployment and Growth

Being a small open economy, the level of unemployment in Israel depends strongly on the business cycle of the global economy. A significant increase in unemployment rates occurred after the burst of the dot-com bubble (1998-2000) which coincided with the Second Intifada (2000). As mentioned, these events generated the recession of 2001-2003. Unemployment subsequently declined following Government measures starting in 2003 and the more favourable economic conditions. However, even at the height of the current economic crisis, the unemployment rate did not return to levels it reached in the previous crisis in the early 2000s.

The comparison of unemployment rates with GDP growth rates show that unemployment rates climb after a decrease in GDP growth rates throughout the entire period, with an expected close relation between high growth rates and low unemployment rates. This comparison also suggests that the minimal expected levels of unemployment are higher than the minimal levels seen in other industrialized countries, implying a lack of adjustment between labour demand and supply (i.e., high structural unemployment).
Segmentation of the Labour Market

Labour Market by Economic Sector

The graph illustrates the employed persons in the various sectors of the labour market. It is interesting to examine which the branches have with the largest numbers of employees. These branches include manufacturing, real estate, wholesale and retail and education, each having around 350-400 thousand workers.

The High Tech Labour Market

The origins of Israel's high tech industry are to be found in the local defense industry, and in the extensive migration from the former Soviet Union during the early 90s. Over the
years, Israel Defence Force’s leading R&D departments have served as breeding grounds for thousands of top-notch high tech personnel, many of whom have applied what they learned with respect to military technology in commercial environment.

In 2007, the product of the ICT industries sector was 17% of the business product in Israel, and employed 202,600 people. Israel’s dependence on foreign trade has motivated the government to encourage small start-ups to enter the export market by making various policy instruments available to high tech innovators. These include a range of government R&D subsidies and research grants available for high-tech, biotech and low-tech developments. The labour market of the sector is expanding: in 2005, high tech absorbed 60% (3,350 workers) of all the newcomers to the industrial sector. This should be compared with the 9% absorbed into traditional, low- and mid-tech industries. Importantly, high tech employees enjoy highly rewarding salaries and perks in comparison to workers in traditional industries. Industry benefits also include what appear to be better working conditions and greater employee mobility.

As pointed out previously, the High-Tech sector represents an important component of the Israeli economy and labour market. The graph below represents the share of the Information Technology sector in the Labour Market.

**Figure 44. Jobs in Information Technology (ICT)**

(Thousands; % of Overall Labour Force) 2001-2008

![Jobs in Information Technology (ICT) Graph](image)

**Manpower Workers**

Manpower companies’ (Temporary Work Agency – "TWA") employees

In the last two decades, Israel’s labour market has witnessed a sharp increase in the rate of workers employed through manpower companies. Manpower workers typically don’t have decent work conditions.

The Central Bureau of Statistics estimate for the number of manpower workers was 162,000 in 2007 (compiled through the number of workers receiving wage from manpower companies or subcontractors), while the Ministry of Industry, Trade & Labour estimated this number at 115,000 as of December 2007.

Indirect employment via TWAs is not only cheaper but it is a way to bypass standard employment restrictions in the public sectors. Budget constraints forbid government ministries and authorities to employ more people than the number stated in the budget law for a specific year. However, TWAs workers are considered the employees of the manpower contractor. Thus by hiring them, technically, the statutory limits are not being breached.
Employees that get their salaries via the employment agencies are normally paid only the basic salary without social benefits. Thus the business for which they work saves all other salary related payments even if the basic salary is not lower, as detailed by Nadiv (2005) in the "Licensed manpower contractors in Israel" report of the The Ministry of Industry, Trade and Labour.

**Wage Developments**

**Real Wage Development and Labour Productivity**

Wage levels are based on various parameters. They affect the worker and her household’s available income directly. It can be seen from the graph in the figure below that as a general rule wage development in Israel moves in conjunction with the growth in labour productivity levels.

**Figure 45. Labor productivity growth and gross wage increase (YoY), 1998-2007**

![Labor productivity growth and gross wage increase](source)


**Wage Distribution**

The average wage in Israel has constantly increased during the last 20 years: from NIS 5,272 in 1985 (in 2000) (2004 prices) to NIS 7,450 in 2007 - a 41% increase on average, also due to an increase in productivity of 22% between 1998 and 2007. Though the general trend of labour productivity has been coinciding with that of wage levels, in recent years there has been a gap in growth rates between wages and labour productivity. While labour productivity increased by 22% during 1998-2007, wages (2004 prices) rose only by 7.6%.
The following graph predicts the evolution of the average wage per work hour for a 40-year-old non-immigrant, Jewish employee. The analysis has been presented in a research by Friedman and Zussman (2008), who analyzed wage distribution and gaps in Israel’s labour market. The chart depicts the differences in wage development according to four education levels. The results of the analysis make it clear that differences in years of education are a prominent determinant for the employee’s hourly wage.

Job Quality Trends

Skilled and Non-Skilled Workers

Barro (2000) determined that there is a strong role for secondary schooling, rather than primary schooling, in enhancing economic growth. Empirical evidence has shown that this is the case in Israel as well, whereby the rate of participation in the work force rises with the level of education. Technological progress along with globalization and the ability to outsource low cost labour were a major cause for the increased demand for skilled labour.
This caused a surge in wages of skilled workers compared to the stagnant wages experienced by the non-skilled workers.

These effects have further reduced the position of non-academics in the labour market, leaving many unemployed or unemployable. According to the Ministry of Industry, Trade and Labour, the number of jobs in low-tech industries in Israel declined by 19.5% in the period 1995-2005. Moalem and Frish (1999) found that in Israel, 'highly skilled' personnel (academics and executives) earned an average 180% of the average wage in 1997, an increase from 155% in the 1970s. Alternatively, semi-skilled workers with little or no training or education earned an average of 55% of the average wage, falling from 70% in the 1970s. This widespread phenomenon has been documented by Juhn, Murphy, Pierce (1993) as well as Bound and Johnson (1992).

The data reveal that a dual labour market has existed in Israel for over two decades. This phenomenon is especially visible in the unemployment rate, labour force participation rates and the average wage, with clear disparities between academics and non-academics.

Figure no. 48. Unemployment Rate - Academics and Non-academics (1999-2005)

Demand for Labour

Before the economic crises in 2008, labour shortages were evident in Israel labour market - especially for High Tech wage earners and Low Tech industry wage earners. Technical training is very much in demand - according to estimates made for the TOB program in the Ministry of Education (a program for training high school graduates and non graduates in technical fields), there is a shortage of 5,000 employees each year in technical fields. This is in addition to many unskilled workers who are in demand in construction and agriculture, and are replaced by foreign wage earners (due to lack of willingness of domestic workers to take part in these fields of work). In pre-recession years, the main shortages of workers were recorded in the industry sector. This is visible in the graph below, as the most significant demand for skilled employees came from industry and construction employers (44% of all open positions).
Most of the workers in the industry sector are domestic (with almost no foreign wage earners), whereas in the construction sector most employees are foreign wage earners. This situation is due to the lack of appropriate training for local workers and the lower wage levels offered in this sector. The second major category in demand is salespersons and service providers. The liberalization of the economy in the past decades has affected mostly tradable goods industries, while non-tradable goods sectors were less affected; therefore the services sector did not decline significantly, and it has become a large domestic sector in constant need of workers. The low rate of academic positions in demand is due to the fact that most academic positions are not offered by the Public Employment Service but rather through other human resources systems such as job-finding companies and websites.

Considering the impact of public vocational training on labour shortages, in 2007 vocational training courses were given to only 4,336 persons, and most of these did not study the professions which are most in demand. In other words, public vocational training does not cater to the issue of labour shortages, as the allocation of courses does not meet the demands of the market. In addition, low-tech industry segments are not considered profitable career prospects by Israel youth, and so the demand for vocational training in these professions, as compared to high tech and services training, is relatively low.

### 2.4 Poverty

**State of Poverty**

Looking at the charts below, it is clear that the reforms in welfare and taxation system have influenced the poverty rate of households. The structural changes have indeed increased the participation rate in the work force and reduced unemployment. Nevertheless,
it is evident that though the poverty rate before transfer payments declined after 2003, the poverty rate after transfer payments increased. This was directly inflicted by the new policy changes enacted by the Finance Ministry.

**Figure no. 50. Poverty and Participation Rate in the Labour Force, 2000-2009**

*Source: CBS and The Extent of Poverty Report: National Insurance Institute, January 2009*

*A household is defined as poor if the available income per capita is less than 50% of the median available income per capita in the overall population.*

**Figure no. 51. Poverty and Unemployment Rate, 2000-2009**

*Source: CBS and The Extent of Poverty Report: National Insurance Institute, January 2009*

**Poverty Determinants**

The effect of the low participation rate is one of the main determinants affecting poverty. Poverty is determined directly by the age and education level of the head of the household, the size of the family and the number of workers in the household. According to Gottlieb et al (2008), the chances of households to suffer from poverty increase greatly when less than two workers are in the household.

Breakdown by age group has shown that together with the increase in the age of the head of the household comes an increase in the quality of life. Breakdown by education level shows that there is a strong negative correlation between the education level and poverty situation, especially for persons with less than 8 years of education. This effect coincides with the global and local trend by way of a diminishing demand for uneducated workers. The severity of poverty among uneducated workers has deepened over the years. Usually, social scientists refer to poverty as a “vicious circle” meaning that the chances of children from low income households to remain poor are high as well. It must be noted,
however, that these data regarding education level hold true among all sectors, excluding ultra-orthodox Jews, whereby high-education levels do not translate into low poverty rates.

Family size is negatively correlated with poverty; the larger the family, the bigger are its chances to be poor. This is even more apparent following the 2003 cuts in the social security benefits which were previously distributed according to the number of children.

**Poverty among Certain Groups**

Israel has a multi-cultural society, including Jews, Arabs and other minorities. Each group has sub-groups with similar cultural elements. These include ultra-orthodox and non-ultra orthodox among the Jews, Muslims, Christians, Druze, and more, within the Muslim population the Bedouins have unique cultural elements. Additionally Israel has immigration from various locations. This multi-cultural society has an effect on fertility rate, education and labour force performance. It is therefore important to distinguish between these groups in order to differentiate and analyze the poverty levels in each of them.

Poverty levels are especially high among ultra-orthodox Jews. The main causes, as portrayed by Gottlieb et al (2008), are high fertility rate, deficiency in male elementary school education material essential for future earning capabilities, low participation rate in labour force due to the relationship between the status-quo in which they are not drafted to the army but receive financial support for extensive learning of Judaic studies. Since 2003 there has been an increase in their poverty levels due to the policy changes by way of reducing social security benefits to families with a large number of children. The severity of poverty among ultra-orthodox Jews is more than double the rate of poverty within the rest of the Jewish population.

The Arab population's poverty level is greater than the poverty level among the Jewish population. It is mainly caused due to vocational reasons, including a high unemployment rate, limited percent of Arab women's participation rate in the work force for cultural reasons, and low wages to Arab employees. The population typically has low levels of education. The fertility rate is high, and a large percent of the population is distributed in villages far away from the urban centres of the country, where a great deal of the jobs are offered.

The rest of the population is characterized by a relative high percent of poverty amongst youngsters, especially in comparison with families with an older head of household. However, younger poverty is likely a temporary condition, since with age and professional experience they succeed in overcoming the burden of poverty.

As a conclusion, there is a notable adverse correlation between the severity of the poverty and the level of education. As far as family size is concerned, as a general rule, poverty increases together with the size of the family.

**The Working Poor**

**In-Work Poverty Determinants**

In recent years, the poverty rate for households has remained steady (20% after transfer payments and taxes in 2006, compared with 20.6% in 2005). However, the share of working families - families with at least one employed provider - within the segment of poor families increased from 38% in 2003 to 43.2% in 2006 (National Insurance Institute of Israel, 2007).

This trend indicates that the decrease in unemployment and the rise in labour force participation rates have not been translated into a decrease in poverty for the families whose
providers became employed. It is essential to examine the effect of employment on poverty in order to ensure poverty reduction and not merely employment.

The rate of poverty among households with only one supporter in 2007 was 23.5% compared with 2.8% for households with two supporters (National Insurance Institute data). Tzameret- Kercher et al (2007) asserts that one of the causes for this situation is the large gap between educated and non-educated workers. The low-income earners’ wages remain constant, while the high income earners’ wages have increased in the last decade by approximately 37%. This phenomenon is characteristic of labour markets in developed countries. Another reason suggested for the decline in real wage of unskilled workers may be the reduction in the rate of workers who participate in unions and collective bargaining.

**Poverty Employment Mapping**

Poverty among the working population is relatively limited. According to the Extent of Poverty Report, published by the National Insurance Institute, in 2007 the extent of poverty among households which are part of the working population before transfer payments is 18.2% and 12.2% after transfer payments have being taken into account. The same figures among the population in the working age which are not working are 91.2% (!) and 69.8%, respectively. The extent of poverty among households with one supporter is 35.2% and 23.5% after transfer payments. Among families with two supporters, these figures are 4.1% (!) and 2.8%, respectively. This data above led the Government actions, which focused their efforts on increasing employment and participation rates.

The rate of the poor households increased during the years 2002-2005 from 18.1% to 20.6%. In 2006 there has been a decline to 20.0%. This decline stemmed in part due to a decrease in the rate of poor households of which the head of the household was an elderly, due to an increase in the social security benefits for the elderly. Among these households the poverty rate declined from 25.1% in 2004 to 21.5% in 2006. The poverty rate in 2007 remained constant at a level of 19.9%. In 2007 the main improvement in the state of poverty roots from the labour force. The poverty rate among working families remained stable at 12.2%, while the poverty rate among families where there are no working supporters continued to elevate from 66.6% in 2006 to 69.8% in 2007.

The figure below depicts the extent of poverty in Israel in relation to the education level of the head of the household. The data points to a clear correlation between the level of education and poverty level. The higher the education levels, the less is the family likely to reach the poverty level.
In order to gauge the poverty incidence among workers in different economic sectors the following data were examined (see table 5): the average wage compared to the poverty line, defined as half of a household’s disposable median income. As evident from the table and graph below, lowest wages are reported in agriculture and restaurant services. This also has an effect on poverty, as close to half of the persons employed in these industries are under the poverty line. Nevertheless, these sectors have a relatively limited number of employees, accounting together for 7.3% of the general employed population.

Table no. 9. Average Wage per employee by Industry and Poverty Line, 2005-07

<table>
<thead>
<tr>
<th>Average wage per employee</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>Employed, thousands in 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poverty Line</td>
<td>1,804</td>
<td>1,990</td>
<td>2,093</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>7,324</td>
<td>7,576</td>
<td>7,749</td>
<td>2,720</td>
</tr>
<tr>
<td>Accommodation services &amp; restaurants</td>
<td>3,488</td>
<td>3,575</td>
<td>3,658</td>
<td>147</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4,801</td>
<td>4,927</td>
<td>4,992</td>
<td>51</td>
</tr>
<tr>
<td>Banking, insurance &amp; finance</td>
<td>13,597</td>
<td>14,966</td>
<td>14,906</td>
<td>85</td>
</tr>
<tr>
<td>Business activities</td>
<td>7,344</td>
<td>7,696</td>
<td>8,015</td>
<td>498</td>
</tr>
<tr>
<td>Community, social &amp; personal services</td>
<td>5,072</td>
<td>5,076</td>
<td>5,230</td>
<td>150</td>
</tr>
<tr>
<td>Construction (building &amp; civil engineering projects)</td>
<td>6,287</td>
<td>6,473</td>
<td>6,659</td>
<td>134</td>
</tr>
<tr>
<td>Education</td>
<td>5,746</td>
<td>5,868</td>
<td>6,004</td>
<td>361</td>
</tr>
<tr>
<td>Electricity &amp; water supply</td>
<td>16,816</td>
<td>18,346</td>
<td>18,281</td>
<td>17</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>9,915</td>
<td>10,377</td>
<td>10,694</td>
<td>353</td>
</tr>
<tr>
<td>Public administration</td>
<td>11,366</td>
<td>11,840</td>
<td>12,078</td>
<td>109</td>
</tr>
<tr>
<td>Transport, storage &amp; communications</td>
<td>8,676</td>
<td>8,891</td>
<td>8,931</td>
<td>154</td>
</tr>
<tr>
<td>Health, welfare &amp; social work services</td>
<td>6,231</td>
<td>6,329</td>
<td>6,492</td>
<td>281</td>
</tr>
<tr>
<td>Wholesale &amp; retail trade, &amp; repairs</td>
<td>6,470</td>
<td>6,617</td>
<td>6,794</td>
<td>380</td>
</tr>
</tbody>
</table>

Figure no. 53. Average wage per employee in selected industries with poverty line, 2007


2.5 Decent Work

Decent Work Overview

On the whole, the socio-economic policy and decent work conditions in Israel are relatively developed. However, though the social security system and labour laws are advanced, there are some components of working conditions that can be improved. Further suggested policy is detailed in the subsequent policy section, especially in regards with negative income tax, designed to improve the economic condition of the underprivileged working population.

There are quite a few criteria for measuring decent work. Many of these have already been discussed in other sections of this paper. These include participation and unemployment rates, vocational training, average earnings, social security benefits, unemployment insurance, gender employment equality, minorities within the labour force, trade unions and collective bargaining capabilities. Additional decent work measurements will be covered in this section and subsequently in the policy changes discussion. These include productive and secure work, employment stability, social protection, and temporary workers (manpower agencies).

Productive and Secure Work (Stability)

Work stability laws and work safety laws are both components of decent working conditions. Work Safety Laws in Israel ensure occupational injury insurance coverage as well.

According to a study on labour mobility by Klinov (2007), since 2003 there has been a positive effect on employment duration in Israel. She asserts that this has made work stability one of the main factors to the decrease in unemployment. This represents an
improvement in decent working conditions, whereby workers enjoy relatively high job security.

**Adequate Income Level**

**Minimum Wage Legislation**

The minimum monthly wage in 2008 was NIS 3,850, and the hourly wage NIS 20.70 per hour. The minimum wage is set by the government at no less than 47.5% of the average wage in Israel and is a gross wage (with minimum wages for work hours, work days, weeks etc.) The minimum wage is set on an annual basis.

According to the 2007 State Comptroller Report, the estimated rate of employees aged 18+ earning less than minimum wage was 8-11%. This rate is higher than the accepted rate for developed countries (2-3%). Labour legislation infraction is particularly prevalent in minority populations, where enforcement is even less strict. In 2006 the enforcement unit in the Ministry of Industry, Trade and Labour inspected 17,700 employees (and their employers) - 7.5% of the assessed total number of under-paid employees. However, the State Comptroller inspection found that only 11% the cases inspected (1,900 employees) dealt with minimum wage issues. The other cases were checked for compliance to minor labour legislation issues. This indicates that minimum wage enforcement is quite limited - 0.8% of enforcement potential – a rate which the State Comptroller saw as inappropriate considering the severity and extent of minimum wage violations. In addition, the State Comptroller Report found severe malfunctions in the enforcement process: 71% of the cases (22 cases) had remained unattended for an average of close to 15 months, without proper documentation to explain the cause of delay. Furthermore, a significant decrease in both convictions (30%) and average fine size (50%) was recorded between 2005 and 2006. The report concluded that enforcement of labour legislation was both inefficient and incomplete and posed no deterrence to perpetrators.

**Minimum Wage Enforcement**

Prior to 2007, the inspection and enforcement of labour legislation was poor, with only a small budget of NIS 203,000 allocated to these activities in 2006. Until the mid 80's Israel economy was highly centralized, i.e., most of the economic activity was under the control of the government, the Histadrut (General Federation of Labour) or the private business sector. Although Israel was a free market economy the high concentration of economic resources in a few hands, affected competitiveness in the international markets. After the stabilization program of 1985 the structural reforms of privatization and reduction of trade barriers generated the need for more flexibility in the labour market. Consequently the business sector was more motivated to breach labour legislation and disregard employee rights, exploiting the weaknesses of enforcement.

Moreover, this trend was intensified by the deterioration of collective agreements and their substitution by individual contracts and by the increasing weakness of social partners such as trade unions at the national and sector level.

In a plan presented in January 2007 by the Ministry of Finance ("The plan for the reduction of poverty and the narrowing of social gaps"), a special emphasis was put on enforcement of the minimum wage law. Major aspects of the plan include assigning 25 million NIS for additional enforcement positions, computerizing supervision and control procedures, outsourcing of enforcement activities and establishing procedures for rapid and effective treatment of complaints.

The plan brought a change in attitude by the authorities, with NIS 22.8 million assigned to enforcement in the 2008 budget. In general, public sector employees and employees of large corporations are not exposed to minimum wage violations, which are
more prevalent in small businesses. Foreign wage earners are also more exposed to violations than local employees.

**Social Protection**

**Social Security**

Israel social security system is relatively sophisticated. Further details are given in the policy section where the various social security and welfare schedules are described (Section 3.1.2 B).

**Enforcement Efforts and the Informal Sector**

Despite enforcement efforts, the rates of violation of labour legislation are high. In just a 3-day enforcement operation performed by the enforcement unit of the Ministry of Industry, Trade and Labour in September 2006, 92% of the employers inspected were found to be violating labour laws. A violation of employee rights detected by the Ministry’s inspectors can be dealt with according to two options: either by divestiture of the employers’ relevant license (e.g. manpower company license, overtime work permit) and/or by the extending fines and pursuing labour litigation. The solutions offered by Israel legislature and court system are insufficient. Davidov (2006) who analyzed the state of enforcement in Israel suggests allocating resources to appoint additional inspectors. He also calls to hold users of the work responsible for wrong-doing, for cooperation between inspectors and tax authorities, and for drastic reform in work permits given to migrant workers.

The “informal” sector may be in fact a large part of the actual work force, but it is difficult to gauge its size. Davidov asserts that when discussing this sector, it is advisable to realize that instead of relating to entire sectors as “informal”, which may very well be the case for the actual Israel labour market, this situation should be considered as an enforcement problem.

Davidov distinguishes between three types of enforcement problems in Israel market. First, employers are not following some specific labour law requirements. Second, workers are not declared and the exclusion from labour and employment protections is sweeping. Third, the entire business is not declared.

**Labour Courts**

Labour courts are in charge of dealing with severe labour disputes and violations. In 2007 there were 53 residing judges and 700 public representatives in the labour courts system. Labour judges are allowed to order both sides of a dispute to seek a mediation process by approved mediators. The compromises are then brought to a judge for validation.

Labour courts, in recent years, have been considered to be quite independent from the judicial system (especially the Supreme Court). The Committee for Investigating the State of Labour Courts reaffirmed the need for labour courts and called upon the government to strengthen the courts by denying the Ministry of Industry, Trade and Labour the right to take part in appointing judges. The high number of cases brought to labour courts derives from the poor cooperation between trade unions and the government.
**Working Hours**

When considering important decent work conditions, the average number of work hours plays an important role as well. The working hours of the employed have been gradually decreasing in the past couple of years. The number of weekly work hours for the total economy has declined from almost 38 hours to close to 36. This fall comes largely due to the dwindling hours in the services sector, which is the largest sector, encompassing the majority of the workers in Israel. The agricultural sector displays volatility in working hours ranging from 40 to 44 hours per week. Manufacturing remained stable during the years with only a slight decrease in the last couple years.

The figure below depicts the evolution of the overall working hours in Israel since 1995, as well as the variations by sector.

![Figure no. 54. Average Weekly Working Hours](source.png)

**Vocational Training**

Vocational training plays a prominent role as a decent work determinant. Training can provide workers with specialized skills, thereby increasing their productivity as well as their wage levels. Details of Israel’s education system as well as specialized vocational training programs can be found in section 2.3.1-C above.

Unfortunately, in Israel the vocational training programs are not widespread, and there is a lot of room for improvement. Overall, the share of vocational training within the labour force is small. Even if all participants are summed together and no duplicities are considered, this number only accounts for 2.8% of the labour force. This rate is very small and does not influence the labour market. Most training courses deal with training in fields that are irrelevant in Israel's labour market – the administrative assistants’ labour market is saturated while other areas of work, such as construction (the demand for skilled workers in this field is mostly illustrated by the number of foreign wage earners due to the lack of skilled and unskilled domestic personnel) and computer services (a 374% rise in demand for computer technicians and practical engineers was recorded in 2006 by the Ministry of Industry, Labour and Trade - the highest of any trade).

Due to changes in the definitions of the population entitled to vocational training because of the Mehalev program (Orot Letasuka), the composition of those undergoing vocational training has changed. 50% of the persons undergoing vocational training are currently not receiving any support from the government, while 44% are receiving welfare benefits and 6% are receiving unemployment insurance. The period of training is between 4 to 12 months, in which daily studies are conducted. Courses are offered by professional schools, technological colleges as well as by employers who are looking to absorb workers.
A total of 402 courses are offered in 300 subjects in order to enhance capabilities when joining the workforce.

**Collective Bargaining and Wage Formation:**

**Major trade unions and organized labour organizations**

Trade union presence in Israel is considerably more pronounced in the traditional industries. However, the proportion of organized labour is not that high even in the traditional and service industries. Cohen et al. (2007) found that this percentage has been 45% in 2000, and the proportion of Histadrut members among organized labour was 67% in 2000. This is due to the existence of sectoral unions, functioning outside the Histadrut umbrella. Participation in a trade union or other organized labour organization represents positive decent working condition. This is in part due to the bargaining power of a large group of workers.

Trade union representation still dominates the public sector, banking and manufacturing, but low-wage traditional industries have become increasingly non-union. This trend is particularly visible in agriculture and construction as a result of the introduction of foreign wage earners, which has also caused profound changes in working conditions.

Cohen et al. distinguish between workers who are covered by collective agreements and those who are not, with the latter receiving much lower wages.

**Changes in collective bargaining power**

**Collective Bargaining and Wages**

Collective bargaining power of unskilled workers is limited, due to weak trade unions, lower rates of employees covered in collective agreements, import of foreign labour force and high unemployment rate among unskilled workers.

In Israel the decrease in the power of trade unions in the last two decades of the twentieth century, also brought a 35% decrease in coverage rates. The decline in coverage rates continued through the 2000's and wages are now mostly determined at the enterprise level. The business sector is more inclined to personal contracts and wage setting at the enterprise level. The public sector, however, mostly uses general and special collective agreements. Most government employees are employed under general collective agreement and some sectors (such as education and health) are under special collective agreements.

**General Collective Agreements**

Collective agreements often have substantial influence on the workers’ decent working conditions. In 2007, 381 collective agreements were registered at the Ministry of Industry, Trade and Labour, of which 25 were general agreements (between labour unions and employer unions) and 356 were specific agreements (between a labour union and a specific employer).

Although there is no data available on the prevalence of special collective agreements and general collective agreements, Cohen et al. found that 20% of employees were covered by a collective agreement without being members of a trade union, while 36% were covered and were also members of a trade union. This implies that a significant number of employees are covered by special collective agreements. See Appendix II for details of the latest Collective Agreement signed with the Histadrut.
Balancing Work and Family Life

There are many labour laws pertaining to vacation days, holidays, and official sabbatical days. The workweek has been reduced in many professions but not all of them to 5 days a week. The period of maternity leave has been expanded in May 2007 from 12 to 14 weeks. Men are entitled to paternity leave on special situations as well. Overall there has been an increase in the number of working mothers over the past decade.

3. Economic Policies

3.1 Labour Market Policies

Labour Law

Labour Legislation

Major aspects of labour legislation include: wage and benefits documentation, length of work week - 43 hours and work day - 8 hours, travel fares, overtime, vacation days, sick days, termination compensation, maternity (or paternity) leave, pension insurance, discrimination, gender equal pay, youth labour. See Appendix III for a more comprehensive list of labour law legislation.

Labour Enforcement

The Ministry of Industry, Trade and Labour is responsible for enforcement of labour laws. The chart below presents the enforcement data for 2007 and 2008. It is evident that an enforcement activity of the labour laws is being expanded, yet it is still very limited.

Table 10. Labour Law Enforcement Data, 2007-2008

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Complaints</td>
<td>1,349</td>
<td>1,785</td>
</tr>
<tr>
<td>New Employers Inspected</td>
<td>1,858</td>
<td>2,393</td>
</tr>
<tr>
<td>Actions Inspected</td>
<td>2,618</td>
<td>4,313</td>
</tr>
<tr>
<td>Fines - Number</td>
<td>459</td>
<td>1,436</td>
</tr>
<tr>
<td>Fines - Total Amount</td>
<td>3.9m NIS</td>
<td>13.9m NIS</td>
</tr>
<tr>
<td>Indictments</td>
<td>81</td>
<td>165</td>
</tr>
</tbody>
</table>

Source: Ministry of Industry, Trade and Labour Annual Summary of Activities, 2008

Foreign Workers Reform

As mentioned above, over the past decade, extreme measures have been put into place to deport illegal foreign workers, in order to encourage employment of Israel unskilled workers. However, the social benefits and conditions foreign workers who participate in the work force legally have deteriorated, partially due to the large supply of these workers.

One of the tough conditions foreign workers face when joining the Israeli labour market is high barriers to entry and large debts to the agencies transporting them to Israel. Apparently these manpower agencies require a one-time payment of around 10,000 USD, thereby indebting the foreign worker to the agency for a long period.
Recent policy reform in conjunction with the UN is expected to reduce these barriers for entry, bypassing these agencies and enabling legal transport of foreign workers without such high disbursement from the workers.

**Manpower Workers Policy**

In 2008, section 12A of the Manpower Employees Act, 1996, came into force, after being repeatedly postponed since its enactment in 2000. This section stipulates that an employee who has been employed by the same manpower company for a period of over 9 months will be considered an employee of his actual workplace (and not of the manpower company).

The potential impact of the implementation of the aforementioned ruling is twofold. On the one hand, the obligation to employ the TWA's workers as regular employees, which means to match their employment terms to the standard employees, could lead to massive dismissal. On the other hand, if the employee is valuable to the firm, the law forces it to become her de-facto employer, which can increase employment rates. In its annual report for 2008, the Bank of Israel indicates that public services employment has expanded by 3.1% (24,500 employees). The possible reason for that expansion, the report argues, is the implementation of this section.

**Labour Income**

**Taxation of labour income**

Israel has in place a progressive income tax schedule calculated by annual income, in which individuals pay tax on their income in accordance with the respective level of their salary, as a percent of their wage. This way, individuals pay income tax in accordance with their tax bracket, which is derived from their earnings. Whereby the higher their wage, the more tax they pay on every marginal addition to their salary. In 2003 a reform has been set in place by the Ministry of Finance to reduce the taxation gradually until 2010.

Some additional tax relief measures are set in place through tax reductions and credits. These include various parameters such as gender, family status, number of children, location, disability and other social standards. The tax system thereby provides additional aid to population from lower Social-Economic classes, such as in the periphery. For instance, in July 2009 additional tax credits were granted to working mothers in an attempt to encourage mothers to participate in the work force.

Recent years have seen a scheme of tax reductions on medium-high incomes in an effort to drive economic growth and ease the burden on middle income families.

Zussman and Romanov (2001) show that the current taxation scheme has a negative effect on the incentive to work among the low tax bracket employees and the population receiving guaranteed minimal income. The recipients of these benefits are typically persons with limited resources who are trying to fit into the work force. However, the current taxation scheme in fact has the effective tax at more than 100%. This is due to the taxation scheme as well as additional welfare benefits persons receiving guaranteed minimal income are eligible for. Therefore once they begin working, they lose eligibility to a large number of social benefits, which overall are higher than the expected wage. This is the reason for the growing number of the working poor who fall into a “poverty trap”.

One possible solution for this problem is a negative income tax schedule, providing incentives to work for persons who are receiving social benefits, thereby replacing the benefits received with negative taxation payments. Israel does not currently implement a negative income tax program nationwide, aside for several pilot programmes which have proven successful. The programme is expected to cover additional areas with low
participation rate and high poverty population density. However, among the mid to high tax brackets the incentive to work is more favourable, especially following the reduction in marginal tax rates in 2003.

Social Security

Overview

The collection and redistribution of social security was set in place in an attempt to narrow the socio-economic gap, and to provide government assistance to households and individuals who lack the ability to fully support themselves. Social security payments are also collected and distributed in accordance to social status.

A monthly amount is collected from all individuals above eighteen towards social security. Persons unable to participate in the work force (such as handicapped persons and the elderly), or those unable to earn enough in order to fully support themselves or their families, are eligible to receive guaranteed minimal income payment. They must fit various criteria to receive social security, typically including population of low socio-economic status, such as single mothers.

Other social security benefits include one-time payments to workers who are temporarily unable to attend their jobs, including reserve duty for men and maternity leave for women. The social security system is also responsible to provide unemployment benefits for a limited period to employees who recently lost their job (this benefit is not currently given to the self-employed).

Social Security Figures

For incomes of less than 60% of the average wage, 0.4% of the employee’s salary is deducted, and an amount equivalent to 3.45% of the employee’s salary is deducted from the employer. For wages over 60% of the average wage, 7% is deducted from the employee and 5.43% from the employer. The National Insurance Institute pays compensation in respect of unemployment, disability, retirement, military reserve duty, child allowances, maternity leave, and so on. Furthermore, there is a separate fee for national health insurance deducted only from the employee at a rate of 3.1% of his salary for wages under 60% of the average wage and 5% for higher wages.

Figure no. 55. Overall Value of Social Security Benefits Expenditure (in NIS mm) Evolution 1995-2008

Source: National Insurance Institute, 2009
Additional Payments

Annual military service - the employer usually pays the employee’s regular salary, including all social benefits, for the period of his/her military reserve duty. National Insurance reimburses the employer with the amount of the employee’s gross salary during his reserve duty.

Maternity Leave – there has recently been a policy change which expanded the period in which persons can take maternity leave from 12 to 14 weeks. An attempt to further expand the period to 16 weeks is being made. Policy change has also determined that either one of the parents can utilize the maternity leave, not necessarily the mother.

Unemployment Insurance and Benefits

Unemployment benefits are designed to support temporarily unemployed persons. It is not meant to provide support for an extensive period of time but rather to allow unemployed persons the time to look for work. The financial support offered by unemployment insurance is limited, especially for low-wage earners. Unemployment insurance at low-wage levels is 50%-60% of the previous wage (depending on the wage level), and at times are under minimum wage. Therefore, without other social benefits, unemployment insurance cannot guarantee an adequate standard of living for longer periods.

As a result of the changes enacted in 2002, the rate of unemployed persons receiving benefits (out of all unemployed persons) declined from 45% in 2001 to 23.5% in 2007, according to the National Insurance Institute’s Annual Survey. This decline was followed by a fall in the number of social security benefits receivers, rising from 141,800 in 2001 to 155,200 in 2003 but later declining to 120,200 in 2007. In other words, former benefits receivers had either become employed or ceased to receive any form of benefits. Another result was a decline in the rate of unemployment benefits receivers undergoing vocational training (out of all benefits receivers) from 13% in 2001 to 1% in 2006. The total expenditure on unemployment benefits also declined from NIS 350 million per month to NIS 145 million in 2007. Average amount of daily unemployment benefits per person was NIS 133 in 2007 (expected to be NIS 142 in 2009).

Negative Income Tax Program (EITC)

The Negative Income Tax Program or EITC (Earned Income Tax Credit) was set in place as an experimental measure dealing with in-work poverty. We believe this programme may play an important factor in dealing with decent work and poverty reduction in Israel. The programme was set in order to ensure basic social standards among the working poor, as well as to deal with distorted incentives in the labour market. These incentives often cause persons receiving social benefits in form of guaranteed minimal income to fall into a "poverty trap" whereby they lose all benefits if they choose to enter the work force, therefore effectively paying 100% income tax.

The Negative Income Tax Law, 2007 is meant to reduce the dependency of poverty stricken families with children on social benefits, and to provide benefit receivers with work incentives. The law offers payment for workers by number of children, the age of the recipient and income levels. The law is now being implemented in a pilot experiment in several communities across Israel. An estimate made by Glybchenko and Tzameret-Kertcher (2008) found that full implementation of the law will reduce poverty by more than 20% among poor families and by more than 8% among single parent families. The researchers also estimated that the law would bring an increase of over 2.3 hours per month in the average work period of married men and an increase of over 8.2 hours per month in the work period of married women. Although the results of the pilot experiment performed...
in specific communities are not yet available, it is plausible to predict that the law will change the poverty rate of workers and boost the number of workers.

"Orot Letaasuka"/ "Mehalev" Program (Israel Wisconsin Plan)

According to the current policy in Israel, households receiving guaranteed minimal income as social security have an incentive to remain unemployed. Since if they begin working they will lose their right for these benefits, and in effect will be paying 100% income tax.

The Mehalev (Wisconsin) plan was introduced in Israel in 2004 (after it was successfully implemented in Wisconsin, US) with the following objectives:

- Reducing the dependency on social benefits of certain segments of the population
- Encouraging entrepreneurship and employment
- Out-sourcing of certain governmental social services
- Regional and communal development
- Increasing labour mobility
- Lowering government expenditure on direct social benefits

The program has been operative since 2005 in four pilot areas and was conducted by private operators. The operative principles of the program are:

- Transfer of financial resources from social benefits to employment services
- Mandatory participation in a customized program in order to acquire skills
- A focus on the individual
- Flexible and diverse employment solutions
- One stop shop for all employment and welfare needs

Results of the program:

- In the first year of operation, over 10,000 placements (in which social benefits receivers were successfully integrated in the labour market) were made, and social benefit payments were reduced by 51% among the target population
- Many deficiencies were found, including the lack of special treatment of minority populations, disregard of religious needs and the lack of proper social support systems (kindergartens, public transportation, and the like)
- Improper treatment of handicapped populations and misplacement of workers who were fit to work

Due to public pressure, the Ministry of Industry, Trade and Labour nominated a special committee to assess the program and later recalled the program and changed several elements to better fit the target population. Among the alterations made:

- Removal of workers of ages 45+ from the program
- Forming special treatment routines for handicapped people, recent immigrants and academics
• Prohibiting the denial of benefits due to absence, sick days, etc.
• Incentives for employers

The new programme, named Orot Letaasuka, has been functioning better than the first one, showing a decline in the number of complaints, from 70 complaints on average per month for the Mehalev program to an average of 5 complaints in August and September 2007 and a similar number later. The reason for this decline, as explained by the programme's officials, is the removal of participants over 45 from the programme. By October 2007, 5,622 former participants over 45 were required to undergo one hour of training a week, and later transferred to the supervision of the employment service (also in the Ministry of Industry, Trade and Labour). 493 participants over 45 chose to stay in the programme.

3.2 Sectoral Development Policy

Capital Investment Stimulus Law

This legislation is intended to induce businesses, including international corporations, to invest in Israel and to support local companies, factories and branches. The law provides various grants, subsidies, tax reductions, loans, capital depreciation and other enticement plans for businesses. These are given especially in periphery and rural areas, in order to enhance economic activity.

This law has specific rulings for Government benefits in various sectors, including but not limited to manufacturing, agriculture, tourism, low and high technology. These benefits are designed to support financing of businesses in the various sectors. The financing and benefits include funding of manufacturing and agricultural machines, industrial factories, hotels, factories and other industrial buildings.

The activities of the Chief Scientist are also included under this ruling, whereby technology companies are being supported. These include new ventures as well as established ones, biotechnology, and other research and development activities.

It is evident from the figure below that over the past few years there has been a rapid growth in the industrial manufacturing. This growth has continued through 2008. From mid-2008 the industrial manufacturing has experienced a sharp decline, which continued through the first quarter of 2009.

Figure no. 56. Industrial Manufacturing Index

Source: Central Bureau of Statistics, 2009
Effect on Employment

The consequences of the capital investment stimulus law on employment, due to financing of new companies and factories, results in new positions and new hires. Such Government stimuli represent a positive factor for the employment rate. This is particularly true with the additional funds provided to factories in need, and the increased R&D investments due to the current global economic crisis.

The increased enforcement of immigration laws has reduced the number of Foreign Wage Earners, thereby increasing the wage of low level workers. This is a negative outcome for employers in sectors such as the agriculture. But it is a positive result for Israeli non-skilled workers, as their conditions are linked to those of these Foreign Wage Earners, which are willing to work for little compensation.

3.3 Growth Policy

Taxation Policy

In 2002-2003 the Ministry of Finance enacted extensive economic reforms in the taxation and social security system. It has lowered the tax rates on income from work, and cut social benefits concurrently. The tax reforms have also included taxation on financial income as well, introduced in Israel for the first time.

Aiming to focus the discussion on decent work conditions, we will refer to some of the adverse social aspects of these government acts. The reforms introduced significant cuts in welfare budgets, cutting benefits for almost anyone receiving welfare, from single mothers to families with a large number of children. The reforms included moving up the mandatory retirement age for both women and men to 67, and the willing retirement age to 67 for men and to 64 for women. Some of the changes enacted in social benefits during 2002-2003 include a longer work period required for unemployment insurance eligibility, as well as setting maximum periods for receiving unemployment, in addition to the reduction in these and other benefits. This move alone has denied benefits for 30% of previously eligible unemployed persons in 2003. Numerous social security benefits were cut including guaranteed minimal income, unemployment insurance, as well as benefits to the elderly and the disabled.

Corresponding to the social security cuts, a reduction schedule in income tax has been set into place in several stages for the subsequent years. The reform reduced the marginal income tax for each tax bracket, thereby alleviating the tax burden from the working population. The tax reduction has benefited directly mainly mid to upper income wage earners.

These measures were taken in order to stimulate economic growth and encourage people to join the labour force.

Long-Term Growth Plans

The taxation and social security reforms described above were set into place as a multi-year fiscal reform designed to enhance the performance of the Israel economy in the long term. Other long term governmental plans designed by the Ministry of Finance exist for enhancing the energy sector, water and infrastructure, as well as for tax reform and other growth sources. The negative income tax program (EITC) described above in section 3.1.3 is one of them.

Additional long term policy plans include a scheme to enhance the economic activity in the areas outside of the technologically developed centre. These long term measures to
develop the “periphery” are intended to increase the population in the north and south of the country until 2020 by 370 and 336 thousand individuals, respectively. It also aims to increase the number of employed persons in the north and south of the country until 2020 by 220 and 136 thousand employees, respectively.

These goals will be met by providing support to the peripheral areas. These measures include supporting the education system, including budgetary preference, financial backing for municipalities in these areas. In addition the Government aims to provide enhancement and development of industries, develop infrastructure and mass transportation. Army bases will be transferred from the center of the country to the periphery. Various budgets and funds are being channelled towards the north and south of the country. Managers of local municipalities will receive additional training, and vocational training for youngsters will be extended. Tourism infrastructure will be supported and developed. These measures and more are planned as part of the long term plan for growth in the periphery.

**Trade Policy**

The Ministry of Trade and Labour oversees the trade policy and agreements. In general, Israel is situated in a central geographical location, between Europe and Asia, and has access to the Mediterranean Sea, with two major seaports: Haifa and Ashdod. Israel’s trade policy aims to include as many trade agreements and enable free trade whenever possible. These agreements enable free import, providing a full exemption or deduction of tariff taxation.

According to the 2007 Annual Report of the State Revenue Administration, the percent of export coming from countries Israel does not have trade agreements with was 40% in 2007. These countries include China, Russia, Japan, Hong Kong and India.

Israel has Bilateral and Trade Agreements enabling free trade with the World Trade Organization as well as with the following countries or trade regions: EFTA (Iceland, Norway, Switzerland and Lichtenstein), USA, European Union, Turkey, Jordan, Mexico, Canada, Egypt, Mercosur (Argentina, Brazil, Uruguay, Paraguay and Venezuela). See Appendix IV for a more detailed list of the trade agreements.

**Monetary Policy**

During the main part of the 2000s the Bank of Israel has performed a monetary policy focused on maintaining low inflation levels. The monetary policy in Israel typically deals with interest rate changes and their effect on inflation and the economy. The current interest rate in Israel is at an all time low, at a level of 0.5%.

The historical “crawling band” used to maintain a certain level for the USD/NIS currency market has been expanded in the 90s, and subsequently removed entirely. This was part of the Bank of Israel’s (“BOI”) policy of no intervention in the exchange rate. However, this has recently changed due to the recent economic crisis and the strengthening of Israel Shekel, which has had a negative effect on export. The Governor of the BOI has instated a policy by which the BOI supports the level of the Shekel, by purchasing large amounts of Dollars in the market, thereby providing consistent demand for Dollars in the Dollar-Shekel market. The BOI is currently purchasing 100mm USD in the market every day, and is yet to find an exit strategy from this scheme. This policy has indeed assisted the exporters, by preventing the Dollar from declining against the Shekel, thereby enabling an exchange rate which maintains export profitability.
4. Financial and Economic Crisis

4.1 Effects on Economy

Overview

The global crisis began in the second half of 2007 and intensified during 2008 and 2009. The crisis is still developing and the extent of its long-term impact on the real developments in the global and Israel economy is yet to be fully evaluated. The ramifications of the crisis on Israel are relatively moderate due to the unique conditions typical of Israel economy as compared to other countries.

These differences, as summarized by the Ministry of Finance, include a different macroeconomic situation as well as a housing market that did not suffer from an artificial bubble. Additionally, the ratio of finance to the value of properties provided in mortgages is low in Israel; Israel capital market has not reached the level of complexity of its American
counterpart and that of other countries. Finally, the level of leverage in Israel economy is relatively low.

Moreover, Israel has reached the global crisis well prepared and is in a sound condition after five years of rapid growth, low unemployment and a responsible fiscal policy. In addition, the stability of the economy has strengthened considerably, and this assists in softening the impact of external shocks. The increased stability of the economy derived from the government’s consistent fiscal policy, which led to a reduction in the budget deficit and as a result, to a decrease in the ratio of the public debt to GDP in recent years.

Nevertheless, a small and open economy such as Israel is no doubt affected directly by global developments. The global crisis has an impact on Israel economy through a number of channels: a reduced rate of growth in consumption (the wealth effect, due to a contraction in the public’s asset portfolio), a slower increase in investment, a lower rate of export growth, and rising costs of capital as corporations encounter difficulties in raising credit.

**Effect on Growth Rate, Businesses and Trade**

**Credit Markets**

One of the main effects of the economic crisis has been the access to credit. The credit shortage had a direct impact on businesses of all sizes and all industries. Thereby forcing corporations to either substantially cut costs or raise funds at extremely unfavourable prices, in order to remain operational.

These changes have reduced trade levels, and consequently growth rate. The deterioration in the economy has in turn caused the turnover of these companies to decline.

Therefore it is clear that the credit deficit has been affecting individual businesses greatly, and consequently trade levels and growth rate.

**Financial Markets**

Due to the turmoil in the financial markets, the savings and investments of the population have been at risk. The average investor has exposure to various financial instruments and securities, owing to the fact that his savings, retirement plans, and other financial investments are spread among different funds, securities and other instruments in the financial markets. The value of the markets declined substantially due to the effect of the economic crisis. This has caused deterioration in the financial situation of a large portion of the population, which is invested in the markets. And so, the pension funds, mutual funds and provident funds of a great deal of the population have been put in risk.

The global financial and economic crisis has also had an impact on several commercial banks all over the world, causing them to collapse. Fortunately, in Israel there was no fear of a disaster in the banking system, partially due to tight regulation. Consequently the crisis did not undermine the trust in the banking system.

**Labour Market**

The credit deficit had a direct impact on businesses, thereby forcing them to substantially cut costs in order to remain operational. One of the methods for cutting costs has been by laying off part of their employees. The deterioration in the economy has in turn
caused the financial turnover of these companies to decline. This further decrease in returns, has forced them to reduce costs time and again, often by firing more workers.

The credit deficit has been affecting individual businesses greatly, but the work force has taken a great deal of the hit, evident by the rising unemployment level. According to Ministry of Industry, Trade and Labour Policy Paper of May 09, during the preceding 6 months approximately 100,000 workers were laid off.

4.2 Policy Response to the Crisis

Acceleration Program

The acceleration program was offered by the Ministry of Finance in order to assist the economy in coping with the economic crisis. The program is intended to provide economic stimulus to the economy.

As a part of the acceleration program the Finance Ministry attempted to identify specific sectors in the economy that are considered to be growth generators, but have been suffering because of the global economic crisis. The Ministry has provided these sectors with focused aid and solutions to support their activity during the crisis. Two exemplary sections include strengthening the High Tech sector and the Real Estate sector.

High Tech: The Government has offered a program intended to help the high tech and biotechnology industries. Until February 2009 a total of 350mm NIS has been allocated to the Chief Scientist in order to invest in Israel R&D. The funds are intended to be used towards R&D investments, and are meant to give an immediate relief to the funding difficulties encountered by companies that are doing quality R&D.

An additional package of 250mm NIS will be allocated by the government towards setting up a fund specializing in biotechnology investments. Further capital for the fund will be raised by the private sector. The program was formed with the Ministry of Trade and Labour, the Chief Scientist and experts in high-tech investments. (Ministry of Finance)

Additionally, the Government offered hundreds of millions of NIS in aid to the residential construction sector, with the purpose of leading the initiation of 6,000 new construction projects. This was done with an aim to aid the residential real-estate sector, to ensure sufficient supply of residential housing, and protect jobs of thousands of workers in the real estate industry.

The aid given to the real estate sector includes providing credit, cancelling permit fees, alleviate real estate taxation, postpone and spread payments, as well as supply guarantees. The plan was formulated by the Finance Ministry in collaboration with the Housing Ministry, the Tax Authority, and Israel Land Authority.

Pension Funds Security Net

Despite the government’s reluctance, and due to the Histadrut Labour Union and other social organizations’ persistence, a security net has been set in place. The security net has been enacted in Israel Parliament in November 2008. The security net is intended to provide governmental guarantee the financial safety of the pension plans.

Prior to that, the Histadrut has asserted that a Security Net for the public’s Pension Funds must be set in place. This is due to the fact that these funds have lost more than 20 percent of their value in the market crash over the several months preceding the decision. It
was therefore critical to provide measures in order to ensure the safe retirement and financial security of the pension funds of entire population, particularly for persons closer to their retirement.

The decision regarding the safety net initially came following the release of the above-mentioned economic stimulus plan. The plan had ignored the union's demand for a security net for pension funds, causing the Histadrut to threaten a general strike of the entire public sector if the safety net is not set.

2009-2010 Budget and the “Package Deal”

The newly elected Government has passed budget for the years 2009-2010 in July 2009, together with a “Package Deal” signed by the representatives of the Government, the Histadrut Labour Union and the Manufacturers’ Association (representing the economic organizations and employers).

The essentials of the agreement can be found in appendix V:

1. Structural Reforms in Israel Real Land Administration, Israel’s Ports and Israel Electric Company (IEC)
   - Budgetary supplements, as well as Government financial backing to encourage economic growth. These include investments in R&D, increased capital investment, providing credit to robust corporations in need, support small businesses, support foreign trade and the periphery, support export and more
2. Additional steps for enhancement of local businesses and the periphery, providing financial assistance, increase in water taxation, and other changes
3. Workers’ contribution: Deduction of benefits from workers in the public service, as their contribution to the overall situation due to the impact of the economic crisis on the Government's budget
4. Labour Law Legislation
5. Employers' contribution: In the effort to add to the budgetary sources, the social security payments by the employers will increase temporarily from July 2009 to March 2011, by 0.4 percent up to 60% of the average wage tax bracket.
6. A committee will be set up to ensure implementation of the "Package Deal" in order to save the economy. The committee will include the Prime minister, Finance Minister, Chairman of the Histadrut (Labour Unions) and Chairman of the panel coordinating the Economic Organizations

Emergency Plan for Unemployment

The Ministry of Industry, Trade and Labour has prepared an Emergency Plan for Unemployment, intended to defeat the rising rates of unemployment caused by the economic crisis. These measures are intended to enhance business activity thereby reducing unemployment. Some of these suggestions are detailed below:

1. Initiate a fund dedicated to assisting factories experiencing temporary difficulties due to the economic crisis. The focus would be on factories in the periphery and in areas with high unemployment, which provides employment to a significant portion of the population. The fund will finance factories that can be strengthened by the additional resources. The credit provided to these corporations and factories will assist them to survive the current crisis and will ensure the continuing employment of low skilled workers
2. Increase investment in research and development (R&D) by 1.3 billion NIS. It is assumed that for every single Governmental Shekel granted, GDP growth is multiplied at a magnitude of at least five times the investment. The direct effect for employment is both by retaining current job positions and creating new jobs, affecting directly 11,560 jobs. The Ministry of Industry, Trade and Labour maintains, based on research reports, that the indirect effect of every such worker is 2-4 additional workers. In total this investment is expected to ensure 34,000-58,000 jobs. An additional 1.66 billion NIS, if made available is expected to support 74,000 new jobs including direct and indirect.

3. Vocational training programs for job seekers through the employment agency

5. Synopsis

5.1 Briefings and Interviews with National Stakeholders

Review

During the research interviews were conducted with the following official representatives:

1. Mr. Eli Ben Gera (Gera), Deputy Director of the Trade Union Department -The New Histadrut (Israel Labour Union).
2. Dr. Daniel Gotlieb (Gotlieb), Director of the Research Department - National Social Insurance Institute-Ministry Social Welfare.
3. Mr. Avi Barak (Barak), Director of the Industrial Relations Department - Manufactures Association of Israel .
4. Dr. Kranit Flug (Flug), Director of the Economic Research Department - Bank of Israel.

All the interviews where undertaken during August/September 2009 and focused on the following issues: growth, economic policies and employment linkages.

The method was to refer to keywords in an open dialogue. These include globalization, employment and labour market situation, decent work, trade and economic growth.

Gera stated that globalization is an irreversible fact having a substantial impact on these issues. Therefore the challenge of the Trade Unions is to face its challenges. The globalization process did contribute to economic growth in Israel but had a negative effect mostly in low tech and labour intensive sectors such as textile. On top of the free movement of goods and services the openness of the international markets generated also free flow of manpower. Consequently an increasing number of foreign wage earners infiltrated the domestic labour market with employment conditions, which clearly differ from the agreed industrial relations in the framework of collective agreements. The Government should therefore initiate active labour market policies to improve vocational training in professions where Israel has a comparative advantage to labour intensive sectors. Gera mentioned tourism as an important source of such employment. Recently the Histadrut signed with the government and the National Council of Employees (including industry, self employed and commerce a.o.) a “package deal”, which includes the introduction of laws aimed at improving labour rights. (See chapter 4.2.3). This package deal is valid during the budget years 2009/10. On the one hand the Histadrut agreed to reduce some salary benefits (half of the health leave for the year 2009 and 2010) in the public sector (this concession saved the budget 1.3 Billion NIS). On the other hand the Histadrut succeeded to improve the benefit
packages given to Government employees by way of law labour rights, including the legal right to oblige an employer to negotiate with an established labour council.

Moreover very severe penalties would be imposed on employers who delay salary payments.

Additionally a fund was established (financed 1/3 by holiday leaves, 1/3 by employees and 1/3 by the Government) to subsidize working places in sectors that suffered from the recent world economic crises. See Appendix V section E for additional labour laws under the “package deal”.

Gotlieb argued that the globalization has positive and negative effects. As to the positive impact, he mentioned the need of Israel to be a part of the international markets mostly because it has a relatively small economy, which is therefore highly dependent on world trade. Another advantage is the influx of knowledge and the need of reform, which was a necessity for Israel after a prolonged period of hyperinflation until the mid 80's. The capital market is open to foreign investments, which is clearly a stimulus for economic growth. The most outstanding negative effect according to Gotlieb is the influx of foreign wage earners since the beginning of the 90's. Those wage earners filled working places of Israeli low income workers. This trend generated a deterioration of working rights and collective agreements for lower income groups. Consequently, the number of the working poor and unemployed persons in lower income groups increased dramatically during the 90's. The labour market in Israel passed from a period of almost full employment (2-4 % unemployment rate during the 80's) to a period of relatively high unemployment during the 90's up until today (unemployment rates of 7-9%) Additionally, the unemployment benefits were systematically declined, as a tool to motivate low income wage earners to move away from the poverty trap and join the labour market. The impact of these measures, he claims, which were also followed by dramatic cuts in transfer payments (mostly from 2001 onwards), had only a limited impact on the reduction of the unemployment rates.

As to decent work, Gotlieb says that the cultural attitude in Israel is difficult to compare with, for example, northern European countries, which have a different ethnical code regarding labour relations. Therefore in Israel’s case there is a greater necessity for legal intervention (which is not always effective) in order to improve fair industrial relations even in fields anchored by law, like minimum wages.

Barak stated that the globalization had enormous adverse effects on the domestic industries. At the beginning of the process during the late 80's there was even strong opposition formed by the Manufactures Association against opening the domestic market to foreign competition. Over the course of the years the trend has forced a great number of industries in traditional sectors (e.g. textile, metallic equipment) to close or transfer their plants to low paid labour intensive markets. Moreover the globalization generated pressure on the price level and earnings, these were additional factors driving the subsequent layoffs. The development of the High Tech industries since the mid 90's did generate economic growth and increase of working places mainly in the services sector. However without an improvement of comparative advantages in the traditional manufactures it will be difficult to generate the number of working places needed in the future to prevent a further increase in unemployment. As to the economic crisis, Barak stated that Israel was less affected because the macro economic conditions allowed the economy to well digest the slowdown. The High Tech industries should be considered in the future as the major source of income. There is a need to reallocate the labour force through vocational training schemes and proper labour conditions to sectors with a clear comparative advantage. Working women should also be preferred in those programs since they seem to be more efficient than man. As to decent work, Barak stated similar to Gotlieb that the cultural background and ethical codes in Israel do not allow industrial relations comparison to European standards, meaning that there is an increased necessity for laws and regulations to guarantee fair labour conditions.
Flug asserts that globalization is an economic need through which the volume of trade generates economic growth. There is a need for industries to compete. This might have a negative effect on the labour market in the short term. However, in the long term the economy will be in a far better shape. The labour market situation has suffered from the recent crisis and has generated an unemployment rate of 8% after reaching a low of 6% by mid 2008. In the future there might be a recovery, but as we have concluded (see the following section), the main problem remains the low participation rate compared to other developed economies. The reason for this situation relies on the sectoral structure of the Israeli society including religious ultra-orthodox and Arab women characterized for low participation rates. One way to improve the situation is by stimulating labour schemes suitable to the cultural conditions in these specific sectors (i.e. working from home or close to home in Arab villages). This could also fit the needs of the High Tech sector for example. The sectors which could potentially foresee an increase of working places in the future may very well be the services and tourism industries. However, Israel will still have to face big challenges associated with the expansion of these industries.

As to decent work, Flug points out that most of the labour conditions are already regulated by law (e.g. the minimum wage legislation). However, he asserts that there is room for improvement through a better implementation of the existing rules.

Summary

Out of the interviews we have concluded the following:

1. Globalization is an inevitable process. However it has negative and positive effects, and the challenge is to adjust the domestic labour market to the needs of the global economy.

2. Many of the traditional industries had to adapt to new conditions, including moving away from Israel, closing plants or importing cheap labour (which was not mostly the case in industry).

3. There is a constant increase in unemployment compared to previous decades. The future of the labour market might rely on the ability to generate jobs in new sectors and services, thereby concentrating on an effort to increase the participation rate.

4. The labour conditions of foreign wage earners are worse than those of the domestic workers. Therefore there is a pressing need to improve labour conditions (including social rights) of foreign wage earners and monitor their labour conditions.

5. Decent work conditions also have to do with cultural background and ethical habits. In their absence, there is an increasing need to generate new laws and regulations ensuring their implementation. Recently a “package deal” was signed between the Histadrut (labour union), the Government, and the employers and manufacturers associations’. This might give hope for a better situation in the future.

5.2 Conclusion

The resulting characteristics of the Israeli employment growth model are the following:
**Growth**

The Israeli economy has benefited from opening to trade and to migration. It became more sensitive to foreign business cycles. Yet the economy specializes on positively enhancing its orientation for more high tech manufacturing and services.

The growth was fuelled by investments in high tech manufacturing and services. This orientation resulted from the opportunities carried by the immigrants’ flows, especially due to the influx of immigrants coming from the Soviet Union in the late 80s and early 90s.

**Labour Market and Decent Work**

The labour market is segmented, with a relatively low participation rate in labour force, a large amount of the population living under the poverty line, and a large number of sectors and groups which do not have an active part in the labour market and the economy. The growth model induced a more intensive demand for skilled workers and an evolution of wages benefiting to the employers in regards of productivity; the more highly skilled, the more improved are the workers’ wages.

The higher unemployment of unskilled workers roots in the competition introduced by the foreign wage earners. An important effect on the decrease of the unskilled relative wage is related to the large number of foreign wage earners willing to work for little income, some of which are part of clandestine migration. Additional causes are weak law enforcement, the development of the TAW (Temporary Work Agencies) workers, and the limited amount of collective agreements.

**Government Actions**

The main measures of the recent economic policy were tax cuts and social benefits reduction. These changes have begun in the early 2000s and some are still coming into effect today as part of the long term government reform. The resulting growth and underemployment decrease did not reduce the poverty rate, after transfer payments.

The labour markets policies were in a vicious trap because the weak labour laws enforcement and the loss of eligibility to social benefits for workers even in vulnerable situation. Two programs were launched by the Israeli Government in the aim to reduce the work discouragement of the potential low paid employees: the negative income tax program (earned income tax credit) and the “Israel Wisconsin Plan”.

Over the long term, these programs, as well as additional periphery and low classes enhancement programs are expected to have a positive effect on the economy. The aim of these programs is to increase participation in the labour force, reduce unemployment, and subsequently reduce poverty, which is widespread among the population not participating in the labour force.

Facing the global financial and economic crisis, the Israeli Government afforded incentives and credit facility to high tech industries as well as to various other industries, including corporations and factories in need. This orientation would facilitate preventing deterioration in low-skill workers unemployment caused by the crisis. However, one may expect from this response to crisis no impact on poverty and inequality reduction. The “package deal” was an attempt to provide incentives for employers and workers, allowing the Government to pursue reforms in agreement with the workers, unions and economic organizations, together with improving the conditions of the labour force, corporations and the overall economy.
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### Appendices

#### Appendix I: Growth–Employment Elasticities

1969-2007 Elasticities:

Dependent Variable: LNTOT  
Method: Least Squares  
Date: 08/31/09   Time: 04:49  
Sample (adjusted): 1969 2008  
Included observations: 40 after adjustments

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R-squared 0.998953  
Mean dependent var 7.429468  
S.D. dependent var 0.342346  
Akaike info criterion -5.993535  
Schwarz criterion -5.824647  
F-statistic 11453.90  
Prob(F-statistic) 0.000000

Female employment and total GDP at constant prices: (1969-2007)

Dependent Variable: LNFEMALE  
Method: Least Squares  
Date: 08/31/09   Time: 04:51  
Sample (adjusted): 1970 2008  
Included observations: 39 after adjustments

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R-squared 0.998887  
Mean dependent var 6.514666  
S.D. dependent var 0.470734  
Akaike info criterion -5.993535  
Schwarz criterion -5.824647  
F-statistic 16155.65  
Prob(F-statistic) 0.000000

Male employment and total GDP at constant prices: (1969-2007)
Dependent Variable: LNMALE
Method: Least Squares
Date: 08/31/09   Time: 04:52
Sample (adjusted): 1970 2008
Included observations: 39 after adjustments

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R-squared    0.973888     Mean dependent var 6.935765
Adjusted R-squared 0.972438 S.D. dependent var 0.245797
S.E. of regression 0.040807 Akaike info criterion -3.486125
Sum squared resid 0.059947 Schwarz criterion -3.358159
Log likelihood 70.97945    F-statistic 671.3497
Durbin-Watson stat 2.189528 Prob(F-statistic) 0.000000

1995-2007 Elasticities:

Dependent Variable: LNEMPL
Method: Least Squares
Date: 07/20/09   Time: 00:22
Sample (adjusted): 1 13
Included observations: 13 after adjustments

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R-squared    0.971974     Mean dependent var 7.688695
Adjusted R-squared 0.969426 S.D. dependent var 0.105401
S.E. of regression 0.018430 Akaike info criterion -5.009049
Sum squared resid 0.003736 Schwarz criterion -4.922133
Log likelihood 34.55882    F-statistic 381.4904
Durbin-Watson stat 1.446632 Prob(F-statistic) 0.000000

Youth employment and total GDP at constant prices: (1995-2007)

Dependent Variable: LNEMPL_Y
Method: Least Squares
Date: 07/20/09   Time: 00:26
Sample (adjusted): 1 13
Included observations: 13 after adjustments

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**Dependent Variable:** LNEMP_AGRI  
**Method:** Least Squares  
**Date:** 08/31/09   **Time:** 04:54  
**Sample (adjusted):** 1968 2008  
**Included observations:** 41 after adjustments

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### Employment in manufacturing and total GDP at constant prices: (1969-2007)

**Dependent Variable:** LNEMP_MAN  
**Method:** Least Squares  
**Date:** 08/31/09   **Time:** 04:55  
**Sample (adjusted):** 1969 2008  
**Included observations:** 40 after adjustments

<table>
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R-squared   0.940429  Mean dependent var  4.126860
Adjusted R-squared  0.937293  S.D. dependent var  0.204300
S.E. of regression  0.051159  Akaike info criterion -3.037385
Sum squared resid  0.099457  Schwarz criterion -2.912001
Log likelihood  65.26639  F-statistic  299.9447
Durbin-Watson stat  1.592464  Prob(F-statistic)  0.000000

R-squared   0.983600  Mean dependent var  5.791176
Adjusted R-squared  0.982233  S.D. dependent var  0.178699
S.E. of regression  0.023819  Akaike info criterion -4.542011
Sum squared resid  0.020425  Schwarz criterion -4.373123
Log likelihood  94.84023  F-statistic  719.7014
Employment in services and total GDP at constant prices: (1969-2007)

Dependent Variable: LNEMP_SERV  
Method: Least Squares  
Date: 08/31/09   Time: 04:55  
Sample (adjusted): 1969 2008  
Included observations: 40 after adjustments

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R-squared: 0.998498  
Adjusted R-squared: 0.998373  
S.E. of regression: 0.014840  
Sum squared resid: 0.007928  
Log likelihood: 113.7662  
Durbin-Watson stat: 1.908841  
Prob(F-statistic): 0.000000

Employment in agriculture and the sector’s net added value at constant prices: (1969-2007)

Dependent Variable: LNEMP_AGRI  
Method: Least Squares  
Date: 08/31/09   Time: 04:56  
Sample (adjusted): 1968 2008  
Included observations: 41 after adjustments

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R-squared: 0.998498  
Adjusted R-squared: 0.998373  
S.E. of regression: 0.014840  
Sum squared resid: 0.007928  
Log likelihood: 113.7662  
Durbin-Watson stat: 1.908841  
Prob(F-statistic): 0.000000

Employment in manufacturing and the sector’s net added value at constant prices: (1969-2007)

Dependent Variable: LNEMP_MAN  
Method: Least Squares  
Date: 08/31/09   Time: 04:57

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R-squared: 0.998498  
Adjusted R-squared: 0.998373  
S.E. of regression: 0.014840  
Sum squared resid: 0.007928  
Log likelihood: 113.7662  
Durbin-Watson stat: 1.908841  
Prob(F-statistic): 0.000000
Sample (adjusted): 1969 2008
Included observations: 40 after adjustments

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Mean dependent var: 5.791176
Adjusted R-squared: 0.984190
S.D. dependent var: 0.178699
S.E. of regression: 0.022469
Akaike info criteri on: -4.658680
Schwarz criterion: -2.867499
Log likelihood: 97.17360
F-statistic: 810.2473
Prob(F-statistic): 0.000000

Employment in services and the sector net added value at constant prices: (1995-2007)

Dependent Variable: LNEMP_SER
Method: Least Squares
Date: 07/20/09  Time: 00:58
Sample (adjusted): 1 13
Included observations: 13 after adjustments

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Mean dependent var: 7.153498
Adjusted R-squared: 0.870852
S.D. dependent var: 0.143264
S.E. of regression: 0.051485
Akaike info criteri on: -2.954414
Schwarz criterion: -2.867499
Log likelihood: 21.20369
F-statistic: 81.91701
Prob(F-statistic): 0.000002

Dependent Variable: LNEMPL
Method: Least Squares
Date: 09/02/09  Time: 04:19
Sample (adjusted): 2 13
Included observations: 12 after adjustments

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R-squared: 0.993824
Mean dependent var: 7.704339
### Dependent Variable: LNEMP_Y

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**Sample (adjusted):** 2 13  
**Included observations:** 12 after adjustments

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**R-squared** 0.707837  **Mean dependent var** 5.842590

### Dependent Variable: LNEMP_SER

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**Sample (adjusted):** 2 13  
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**R-squared** 0.992754  **Mean dependent var** 7.173635
Appendix II: Collective Agreement

The most recent agreement between the Histadrut (Israel's largest labour union) and the Government, approved by the State Wage Officer, signed in April 2008 (valid through 31.12.2009) specifies:

- A 1.5% wage increase (calculated from the base salary by an average of the past 12 months) by 31.11.2008 and another 1.5% increase by 30.11.2009. This is followed by a 2% raise as of 1.12.2009
- Additional wages set by seniority
- A one-time bonus paid in May 2008 (calculated by base salary)
- Pension allocations and social benefits (depending on the period of joining the public service - some employees are covered by government pension funds while other are covered by private ones)
- An agreement settling retired public employee's pension rights
- The reinstatement of seniority levels for retirement benefits (seniority levels were previously considered in retirement benefits, this was annulled and now reinstated)

This agreement covers all employees in the local authorities, religious authorities, employees of the higher education institutions (other than professors - these have special collective agreements), employees in medical services, the port and airport authorities, fire fighting services and the post company.
Appendix III: Labor Laws

i. All important aspects of wage and benefits must be documented in a contract within 30 days of hiring - Employee Notice Law, 2002.

ii. The minimum monthly wage in 2008 was NIS 3,850, and the hourly wage is NIS 20.70 per hour. The minimum wage is set by the government at no less than 47.5% of the average wage in Israel and is a gross wage (with minimum wages for work hours, work days, weeks etc.) The minimum wage is set on an annual basis - Minimum Wage Law, 1987.

iii. The Labour and Rest Hours Law of 1951 set the work week length at 45 hours and the work day length at 8 hours. A collective agreement from 2000 (which is used as an extension to the law) later emended the work week length to 43 hours. Amendments to the law in 1974 set a limit of 12 hours of permitted overtime hours (which were not allowed at all in the original law) per week.

iv. The employer must compensate a worker for travel fares of up to NIS 21.14 per day - Collective Agreement, 1976

v. Overtime wages should be no less than 125% for the first two hours and no less than 150% after the third hour - Hours of Work and Rest Law, 1951.

vi. An employee is entitled to 12 business days of leave per year (if he works 6 days a week; for a 5-day week, 10 days of leave). After the 5th year of employment he is entitled to 16 days, 18 days for the 6th, 21 for the 7th and an extra day for each year up to a maximum of 28 days a year - Annual Leave Law, 1951

vii. An employee is entitled to 18 sick days a year, with the right to accumulate up to 90 days. From the second day onward, the employee is entitled to 37.5% of his/her wage and from the 4th day onwards to 75% of the wage - Sick Pay Law, 1976.

viii. Any employee who has worked in the same workplace for over a year is entitled to termination compensation in value of one monthly wage for every year he or she has worked for the current employee - Severance Pay Law, 1963.

ix. Women are entitled to 14 weeks of maternity leave after birth. Wages for this period are not paid by the employers, but received from the National Insurance Institute. Men are entitled to paternity leave on special occasions. After these 14 weeks, women are entitled to take an unpaid vacation of 1/4 of the time spent with the employer, but of no more than 12 months - Women Employment Law, 1954.

x. Pregnant employees are protected from work termination - Women Employment Law, 1954.

xi. As of 1.1.2008, every worker over 21 (20 for women) is entitled to pension insurance (a maximum bracket of the average wage), to be mutually financed by the employer and the employee. This compulsory regulation will only apply to workers who do not yet have a pension fund of any kind or that are entitled to one by a collective agreement. The insured wage will be the wage defined by the standards of the Severance Pay Law (see p. 34). The highest wage level applicable
for pension insurance is the national average wage. This mandatory insurance will apply until retirement age by law. The employee will have the right to choose his/her pension fund manager (pension funds are managed by private investment management companies, insurance companies or trade unions) within 60 days of the beginning of employment. Pension insurance will include coverage for both death and disability. The employee will be able to change fund managers at any time during the plan. Pension funds are financed both by the employee’s wage and by employer contributions.


xiii. Female employees’ rights to equal pay for equal work with the same employer are ensured - Male and Female Workers (Equal Pay) Law, 1996.

xiv. Youth Labour Law, 1953 - regulates the work conditions of individuals under 18.

Appendix IV: Trade Agreements

Israel's International Trade and Economic Agreements

August 2007

<table>
<thead>
<tr>
<th>Free Trade Area Agreements</th>
<th>Protection of Investments</th>
<th>Avoidance of Double Taxation</th>
<th>Agreements on R&amp;D</th>
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(1) Under Negotiations  
(2) Initiated  
(3) To be ratified  
(4) Awaiting re-establishment  
(5) Re-initiated  
Source: Ministry of Industry & Trade, Foreign Trade Department, International Division.

Appendix V: The “Package Deal”

A. Structural Reforms in Israel Real Land Administration, Israel's Ports and Israel Electric Company (IEC)
B. Budgetary supplements, as well as Government financial backing to encourage economic growth. These include:

i. Programs of the chief scientist in the ministry of industry, trade and labour – investments in R&D

ii. Budget increase for the ministry in order to increase capital investment, support small businesses, support foreign trade and the periphery

iii. Support tourism

iv. Renovate education buildings

v. Credit fund for small businesses

vi. Assistance for export
C. Additional steps for enhancement of local businesses and the periphery, increase in water taxation, and other changes
D. Workers’ contribution: Deduction of benefits from workers in the public service, as their contribution to the overall situation due to the impact of the economic crisis on the Government's budget
E. Labour Law Legislation:

i. Mandatory negotiation with organized workers

ii. Fines for employers preventing workers to unite

iii. Broadening the authority of Labour Courts to jurisdiction in regards with work related reputation disputes

iv. Putting into effect labour laws on manpower agencies

v. Sanctions on employers in regards with enforcement of trade agreements, in regards with holding back wages

vi. Extension of period in which workers can press charges on former employers regarding equal opportunities and regarding union collective agreements and duration of time limitation for pressing charges

vii. Sick days – employers may not fire workers while they are sick and absent, and still have unused sick days. Increase from 30 to 90 sick days due to a fatal illness of a child. Setting 60 sick days due to a terminal illness of a spouse

viii. Improvement of the process to appoint directors in Governmental companies from among the employees

ix. Setting up professional committees to examine: employers in bankruptcy incomplete contributions to the workers' provident fund, fee required from workers requesting a company's liquidation, the correct jurisdiction for damages caused by strikes, pensioners duties and rights

F. Employers' contribution: In the effort to add to the budgetary sources, the social security payments by the employers will increase temporarily from July 2009 to March 2011, by 0.4 percent up to 60% of the average wage tax bracket.

G. A committee will be set up to ensure implementation of the "Package Deal" in order to save the economy. The committee will include the Prime minister, Finance Minister, Chairman of the Histadrut (Labour Unions) and Chairman of the panel coordinating the Economic Organizations
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