# Chapter 4
# Employment and Wages

Average unemployment increased from 6.7 percent in 1996 to 7.7 percent in 1997. This increase was mainly the result of an easing in the rate of growth in labor demand due to a slowing down in economic activity (for both cyclical and structural reasons) while the civilian labor force continued to increase at a similar rate to that in 1996. Labor demand moderated mainly in the business sector and in most industries. However employment in the public services increased faster than the civilian labor force and faster than in 1996. The composition of the labor force showed a continuing growth in the share of foreign workers, but also, in contrast to recent years, an increase in the number of workers from the Palestinian Autonomy and the administered areas. In 1997, the share of non-Israeli workers in the labor force reached 8 percent. The real wage in the business sector and unit labor cost increased relatively rapidly, faster than in 1996, despite a rise in unemployment and the availability of foreign workers. This increase in labor cost aggravated the problem of unemployment. Despite the increase in business-sector wages, for the first time in several years there was a slight fall in the real wage in public services.

## 1. MAIN DEVELOPMENTS

Average unemployment increased from 6.7 percent in 1996 to 7.7 percent in 1997. This rise in unemployment resulted principally from a moderation of the rate of growth in labor demand due to a slowing down in economic activity while the civilian labor force increased at a rate similar to that in 1996 (2.5 percent). The slowdown of labor demand was concentrated in the business sector—where employment increased by 1.7 percent—and covered most industries. The number of Israeli workers in this sector grew more moderately, by 0.7 percent, while there was a significant increase of about 10 percent in the number of foreign workers (including workers from the Palestinian Autonomy and the administered areas) whose cost of employment is comparatively low. The rate of growth in employment in the public services accelerated in 1997, and unlike in the business sector, caused a slight fall in unemployment. Despite the slackness in the labor market this year, the business sector saw accelerated increases in the real wage per employee post and unit labor cost, which rose by 3.4 and 3.9 percent respectively. These increases led to a worsening in this year's unemployment. Despite this, wages in the public services dropped slightly, by 0.2 percent in real terms, after rising considerably since the second half of 1993.

The rate of unemployment rose from 6.7 percent in 1996 to 7.7 percent in 1997.

Real wages in the business sector rose rapidly, even faster than in 1996.

**Table 4.1**
**Principal Labor Market Indicators, 1994–97**

(percent change from previous year)

| | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|
| Population (annual average) | 2.6 | 2.7 | 2.6 | 2.5 |
| Working-age population | 2.9 | 3.0 | 3.0 | 2.7 |
| Participation rate[a,b] | 53.6 | 54.1 | 53.7 | 53.5 |
| Civilian labor force | 4.3 | 3.5 | 2.2 | 2.5 |
| Total number of employed | 6.9 | 6.4 | 2.6 | 2.0 |
| Israeli | 6.9 | 5.2 | 2.4 | 1.4 |
| Non-Israeli | 7.0 | 25.0 | 5.3 | 10.0 |
| Public-sector employees | 3.9 | 3.6 | 2.3 | 3.0 |
| Business-sector employees | 7.5 | 7.1 | 2.7 | 1.7 |
| Israeli | 7.4 | 5.4 | 2.5 | 0.7 |
| Non-Israeli | 8.1 | 25.9 | 4.7 | 10.3 |
| Business-sector labor input | 9.6 | 7.5 | 3.3 | 1.9 |
| Israeli | 9.1 | 5.1 | 2.7 | 0.6 |
| Non-Israeli | 14.7 | 33.3 | 8.4 | 12.4 |
| Non-Israeli share of total | 8.4 | 10.4 | 10.9 | 12.0 |
| Real wage per employee post | 2.8 | 2.2 | 1.6 | 2.3 |
| Business sector | –0.4 | 0.6 | 1.5 | 3.4 |
| Public services | 9.8 | 5.6 | 1.9 | –0.2 |
| Minimum wage | 1.6 | 2.3 | 2.5 | 6.1 |
| Business-sector unit labor cost | 2.3 | –0.1 | 2.4 | 3.9 |
| Net business-sector domestic product per man-hour | –1.5 | 0.4 | 1.4 | –1.2 |
| Unemployment rate[a,b] | 7.8 | 6.9 | 6.7 | 7.7 |

[a] Actual levels.
[b] According to the new definitions and sample of the Central Bureau of Statistics, which came into effect in 1995. Thus, for purposes of comparison, according to the previous system the participation rate in 1995 was 53.8 percent, and unemployment was 6.3 percent.
SOURCE: Central Bureau of Statistics and National Insurance Institute data.

The rise in unemployment came principally from a slowdown in growth of labor demand.

Developments in unemployment in recent years show that after a gradual decline in unemployment from more than 11 percent in 1992 to 6.5 percent in the second quarter of 1996, the trend reversed, and unemployment began to rise, reaching a peak of 8 percent in the third quarter of 1997, falling slightly in the fourth quarter; the average rate for the year reached 7.7. percent. The increase in unemployment was mainly the result of an easing of business-sector labor demand caused by a slowdown in economic activity, and aggravated by the increase in wages. Of the two factors affecting unemployment, the easing of labor demand and the rise in wages, the former was dominant; this can be seen from real-side analysis (Chapter 2) which shows that the slowdown in product demand was the dominant cause in the deceleration of economic activity whereas the effect of supply factors (including wages) was secondary. The large number of foreign workers in Israel, whose employment costs are relatively low, added to the moderation of the employment of Israelis.

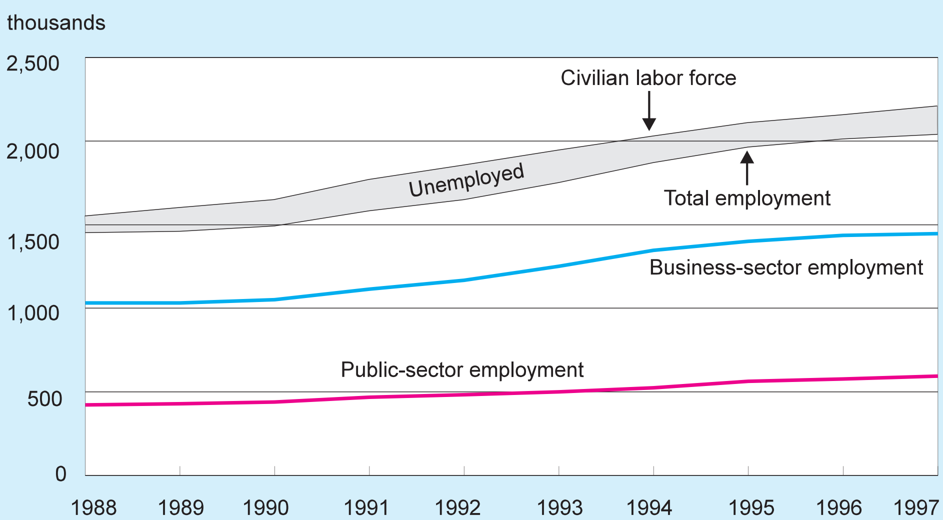
The slowdown in the rate of increase of business-sector labor demand occurred in most industries.

The easing of labor demand in the business sector covered most industries (see Table 4.A.10), a fact that bears out the high weight the cyclical component has on the unemployment rate. However, the effect was not uniform throughout the sector. Two central phenomena, reflecting the structural processes occurring in the economy, were prominent in the development of employment. One was the growing share of trade and services in employment, a long-established trend; in 1997, this was principally reflected in greater employment in the highly skilled services (banking, insurance and financial business services) coupled with high increases in wages, and reduced employment in manufacturing. The second phenomenon was the sharp fall in employment in the traditional industries, in particular clothing and textiles (which contributed 0.3 percentage points to the rise in unemployment, and which are expected to continue contributing to it in the future), despite a rise in the number of employed in the high-tech industries. In some of these industries, the growth in employment was moderated by the rising labor shortage in certain highly skilled occupations. Unlike in 1996, there was also a significant fall in employment in those mixed industries in which some two-digit industries are highly-skilled-labor-intensive and others are unskilled-labor-intensive.

The average real wage per employee post rose by 2.3 percent.

The average real wage per employee post in 1997 rose across the economy by 2.3 percent, covering a 3.4 percent rise in the business sector and a slight fall of 0.2 percent in the public sector; this followed a cumulative rise in the public sector of about 20 percent since the wage agreements signed in the second half of 1993. However the wage rise in the business sector was even higher than in 1996, despite the rise in unemployment and slight fall in labor productivity. The limited sensitivity of wages to

**Figure 4.1**
**Employment in Public and Business Sectors, and the Unemployed, 1988-97**




SOURCE: Central Bureau of Statistics.

labor-market conditions exacerbated this year's unemployment problem, and is connected to the institutional-organizational structure of the labor market and the character of the wage agreements in the business sector. Many such agreements cover a period of one or two years, and therefore many industries are still subject to agreements signed in the past when unemployment was low and growth high.

The greater slowdown in price rises than expected also contributed to the ex post rise in real wages, as some of the agreements were signed (in nominal terms) when inflationary expectations were much higher. Due to the Cost of Living Agreement (COLA), which compensates for 85 percent of price rises (although with a lag), the slowdown in price rises in 1997 made only a small contribution, estimated at between one half and one percent.

Moreover, despite the fact that the labor market has become more flexible in the last few years, rigidities still exist (for example the minimum wage law) which limit the sensitivity of wages to the level of unemployment.

Wages rose in all business-sector industries.

Wages rose in all industries of the business sector. The average wage was pushed upwards by the rise in wages in high-skill occupation in which there is a shortage of workers (for example in electronics) and by the rising cost of labor at the lower wage levels resulting from the significant rise in the minimum wages in the last two years—due to legislative changes as well as an increase in the average wage (to which the minimum wage is linked) which was boosted by exceptionally high wage increases in the public sector in the last few years. The rise in wages of the lowest paid, unconnected to the supply of and demand for these workers, was a factor in the falling employment in the traditional industries (for example, textiles and clothing).

66,000 immigrants arrived in Israel in 1997, about 7 percent fewer than in 1996.

In 1997, about 66,000 immigrants arrived in Israel, about 7 percent fewer than in 1996, similar to the decline from 1995 to 1996. This slowing down of the rate of immigration could be attributed to a reduction in the potential pool of immigrants and possibly the worsening of the economic situation in Israel. Average unemployment amongst immigrants rose from 9 percent in 1996 to 10 percent in 1997.

## 2. LABOR DEMAND AND EMPLOYMENT IN THE PRINCIPAL INDUSTRIES [1]

The number of employed in the economy grew by 2 percent in 1997. This growth in employment covered both the business and the public sector. While growth in business-

[1] Classifying industries when relating to the labor market is problematic, and caution must be exercised when analyzing changes. According to the classifications in the Labor Force Surveys and data of the National Insurance Institute, all workers in education and health are included in public services, even when supplied privately. An additional problem is how to classify workers employed via personnel companies or by contractors. In the last few years there has been a great increase in employment via such firms, which supply services (such as cleaning, security, computers) to other companies. In the Labor Force Surveys, workers in these firms are sometimes classified as employed in the business-services industry and sometimes as in the industries to which the service is provided (principle industry or public sector). National Insurance Institute data and industrial data, based on employers reports, classify these workers with the companies that employ them—in the business-services industry.

**Table 4.2**
**Principal Labor Market Indicators, 1995–97**

(thousands, annual averages)

| | | Change over previous year | | |
|---|---|---|---|---|
| | 1997 | 1995 | 1996 | 1997 |
| Working-age population | 4,129.2 | 114.2 | 116.7 | 109.2 |
| Civilian labor force | 2,210.1 | 70.9 | 46.9 | 53.2 |
| Unemployed | 170.0 | –26.5 | –0.9 | 25.9 |
| Total number of unemployed | 2,216.3 | 127.1 | 55.7 | 43.5 |
| Israeli | 2,040.3 | 96.7 | 47.7 | 27.5 |
| Non-Israeli | 176.0 | 30.4 | 8.0 | 16.0 |
| The Autonomy[a] | 48.0 | –10.0 | –19.0 | 7.0 |
| Foreign workers | 128.0 | 40.4 | 27.0 | 9.0 |
| Public-sector employees | 599.5 | 20.0 | 13.0 | 17.5 |
| Business-sector employees | 1,618.8 | 103.4 | 42.9 | 25.3 |

[a] The Palestinian Autonomy and administered areas.
SOURCE: Central Bureau of Statistics.

sector employment slowed to 1.7 percent, continuing the significant slowdown of 1996, public-sector employment rose by 3 percent, exceeding the rise in 1996.

The number of employed persons rose by 2 percent, reflecting a deceleration in the business sector and an acceleration in public services.

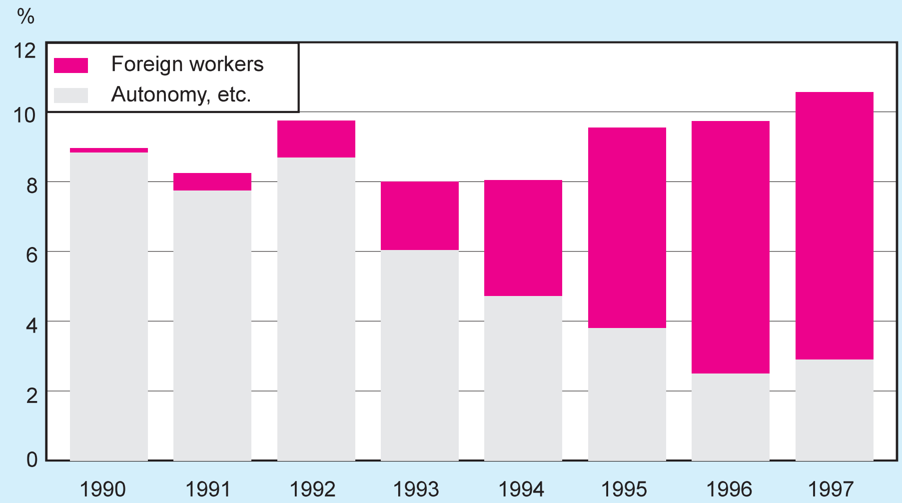
The trend of the rising share of foreign workers continued. In contrast to the previous four years, however, the number of workers from the Autonomy and the administered areas also rose, but that was from a low point in 1996 due to the large number of days when closures were imposed (see Figure 4.2). The number of Israeli workers grew by 1.4 percent, the number of foreign workers by 8 percent to 128,000[2] (about 6 percent of the total number of employed persons), and the number of workers from the Autonomy and the administered areas was about 48,000, a rise of 17 percent from 1996 (see Table 4.2).

The share of foreign workers continued to increase, and this year the number of workers from the Autonomy and the administered areas also rose.

The employment of foreign workers in Israel started in 1993. Security incidents and the resulting closures of the administered areas at the start of the 1990s led to irregular arrival of workers from there; this mainly affected construction and agriculture, in which the share of Palestinian workers was particularly high. This disruption, at a time of rapid expansion of domestic demand for housing services, prompted policy makers to allow the entry of foreign workers to replace those from the administered areas. The foreign workers also integrated into workplaces in which previously the share of workers from the administered areas was relatively low, for example the personal services sector. In 1997, despite a fall in activity in construction and agriculture (in which two thirds of foreign workers are employed), the number of foreign workers increased, though the rate of increase slowed considerably. In comparison to the end of 1996, the number of permits to foreign workers fell, due to the new policy of not issuing permits to bring in new workers to replace those who had left their jobs but were still in Israel. Despite the fall in the number of permits, the number of foreign workers continues to grow.

[2] These refer to estimates from the Central Bureau of Statistics. Note that the usual estimates by various government bodies of the number of foreign workers (legal and illegal) range widely, from 128,000 (CBS) to about 190,000 (the Ministry of Labor and Social Affairs).

**Figure 4.2**
**The Share of Workers from the Autonomy and the Administered Areas, and Foreign Workers,[a] in the Business Sector, 1990-97**




[a] Reported and unreported workers, as estimated by the Central Bureau of Statistics.
SOURCE: Central Bureau of Statistics.

The continued rising trend of the number of foreign workers, even at a time of growing unemployment, intensifies concern that the phenomenon is irreversible.

The continuing trend of increasing numbers of foreign workers while the economy suffers rising unemployment, intensifies concern that the phenomenon is irreversible. In the face of the economic and social effects stemming from the large-scale employment of foreign workers in Israel over time there is therefore a need to take steps that will safeguard the benefits to Israeli society while minimizing the negative effects of the phenomenon.

The slowdown in economic activity this year moderated the growth of demand for labor input in the business sector. Nevertheless, labor input in this sector grew by 1.9 percent more than the increase in GDP, so that net product per hour of labor fell 1.2 percent, which ended the rising trend of labor productivity evident in 1995–96.

The moderation in the rise of labor demand encompassed all areas of the business sector, but its degree varied from industry to industry.

In contrast to most industries, employment in highly skilled services surged.

The moderation in labor demand encompassed almost all industries in the business sector, but its degree varied from industry to industry—in some cases the growth in employment slowed, in others the actual level of employment fell (see Table 4.3). The decline in employment was most pronounced in manufacturing. In contrast, employment grew significantly in trade and services (and in particular in the highly skilled ones), thereby continuing the long-established trend of their growing share of employment. Employment in construction grew slightly this year, despite a fall in activity. This may be partly explained by the labor-intensive nature of the final stages of construction, the share of which in total activity surged in 1997. The growth in the number of employed persons in construction was reflected in the increased employment of foreign workers and those from the Autonomy and the administered areas, while the number of Israeli workers in the industry fell.

**Table 4.3**
**Employment and Labor Input in the Business Sector, by Industry, 1996–97**

(thousands, annual averages)

| | Employment | | | Labor input | | |
|---|---|---|---|---|---|---|
| | thousands | Rate of change | | thousands | Rate of change | |
| | 1997 | 1996 | 1997 | 1997 | 1996 | 1997 |
| Total business sector[a] | 1,617 | 2.7 | 1.7 | 66,320 | 3.3 | 1.9 |
| Construction | 242 | 3.0 | 0.4 | 10,765 | 3.7 | 1.9 |
| Manufacturing | 406 | 3.0 | –1.9 | 16,830 | 2.6 | –1.9 |
| Agriculture | 73 | –5.2 | 0.0 | 3,191 | –3.4 | 0.8 |
| Commerce and repairs | 263 | 2.4 | 3.1 | 10,813 | 3.2 | 2.1 |
| Catering services | 81 | –4.7 | 0.0 | 3,186 | –4.2 | –0.8 |
| Banking, insurance, finance | 78 | 0.0 | 8.3 | 2,979 | –0.9 | 8.5 |
| Business services | 209 | 9.4 | 6.1 | 8,242 | 10.3 | 6.8 |

[a] Figures may not add due to omission of 'miscellaneous'.
SOURCE: Central Bureau of Statistics.

In manufacturing, employment grew in the high-skill-intensive industries, and fell in the traditional ones.

The two-digit manufacturing industries did not follow a uniform trend. Although employment fell comprehensively in all these industries, in some occupations, particularly those requiring knowledge workers, there was an increasing shortage of labor.[3] This shortage restricted the growth in employment in the high-tech industries, which grew slowly, by half a percentage point. A fall in labor demand was prominent in most of the traditional industries (particularly textiles, clothing and leather), where employment fell by 3.5 percent.[4] This was due to a slowdown in domestic demand,[5] the composition of world trade, which is biased towards high-tech goods, the continuing trend of globalization and liberalization that increases the difficulty in competing in traditional products with those countries where labor is cheap, and the erosion of profits in these industries, reflected *inter alia* in the continuing appreciation and sharp increase in cost of labor, to which the increase in the minimum wage contributed. The possibilities of relocating manufacturing plants in neighboring countries, made possible by the peace process, has also contributed to the reduction of demand for workers in the traditional industries. However, in the absence of such possibilities, it is reasonable to assume that some of these factories would relocate even further afield or close altogether.

[3] According to a survey of firms in the Electronics Industry Association carried out by the Neeman Institute, the Manufacturers' Association, and the Ministry of Industry and Trade, there were 1,100 vacancies in electronic engineering and more than 2,000 vacancies for computer science graduates.

[4] Other data sources that show an expansion in industrial employment (industrial indices and employee posts) point to the same trend of increasing employment in the high-tech industries and reductions in the traditional ones. While the labor survey shows moderate employment growth in the former industries, other sources indicate a significant rise.

[5] As products of the traditional industries are directed mainly to the domestic market (see the section on industry in Chapter 2).

Employment rose in the public services at a higher rate than in 1996, and faster than the civilian labor force.

In public services, labor demand grew more than last year, and over and above the growth in the civilian labor force. This increase in employment covered all secondary industries, most prominently in public administration (5.3 percent). Employment in public administration and the national institutions rose by the same amount, despite the government decision in 1996 to cut back from the peak numbers employed in government offices by 2 percent in 1997 (and another 1 percent in 1998). This had little effect, apparently due to the many unfilled official posts. Nevertheless, civil service employment has stayed reasonably stable in the past two decades, while employment in the rest of the public services sector has increased sharply.

## 3. UNEMPLOYMENT

Average annual unemployment rose to 7.7 percent—169,800 unemployed.

Unemployment continued to increase this year, having started to rise in the third quarter of last year, and the average annual rate reached 7.7 percent—169,800 unemployed. During the year there was a rise (seasonally adjusted) in the first three quarters and a fall in the fourth. The increase in unemployment this year came after a sustained fall from more than 11 percent in 1992 to 6.5 percent in the second quarter of 1996.

Rising unemployment in 1997 showed in the Employment Service's data for the number of those seeking work, as well as national insurance figures for those claiming unemployment benefit. The number of job seekers rose this year by 24.8 percent in comparison to last year, and the number of unemployment benefit claimants rose by 27.5 percent.

Growth in unemployment reflects principally the slower rise in labor demand, aggravated by steep wage increases and the rise in the number of foreign workers whose cost is relatively low.

The rise in unemployment principally reflects the slowdown in growth of labor demand due to a moderation in economic activity that led to a slowdown in employment growth. The rise in employment of Israeli workers slowed even more due to the high wage rises this year and the opportunities of employing foreign workers at relatively low cost in some jobs.

The slowdown in labor demand was expressed in dismissals in some workplaces (the share of those laid off as a percentage of all the unemployed who had worked in the previous year rose from an average of 42 percent in 1996 to 47.4 percent in 1997); in other workplaces the slowdown was expressed as a reduction in the number of new workers taken on.

Employment in different industries had different effects on unemployment. The increase in unemployment came from the business sector, while the rise in employment in the public services acted to reduce unemployment slightly.

Different industries had different effects on unemployment (Table 4.4). Public services, where labor demand rose over and above the growth in the civilian work force, acted to reduce unemployment slightly. In contrast, the business sector contributed 1.1 percentage points to the rise in the unemployment rate, a contribution deriving from many industries in the sector—a fact that points to the great importance of cyclical components on this year's unemployment. The non-uniform effect of different industries reflects the structural changes which the economy is undergoing. Particularly prominent is the contribution of the non-categorized industries (those employing workers of varied degrees of skill and training) that contributed 0.7 percentage points, and that of the unskilled-labor-intensive industries, particularly textiles and clothing (0.3 percentage

**Table 4.4**
**Contribution to Change in Unemployment Rate,[a] 1996–97**

(year-on-year change, percentage points)

| | 1996 | 1997 |
|---|---|---|
| **Total** | **–0.2** | **1.0** |
| Business sector | –0.2 | 1.1 |
| High-skill industries[b] | –0.5 | –0.3 |
| *of which* Nontradables | –0.2 | 0.3 |
| In manufacturing | –0.1 | 0.1 |
| Computer services | –0.2 | –0.1 |
| Unskilled-labor-intensive industries[c] | 0.5 | 0.7 |
| *of which* In manufacturing | 0.5 | 0.4 |
| Textile and clothing | 0.2 | 0.3 |
| Construction | –0.3 | 0.3 |
| Catering and hotel services | 0.3 | 0.1 |
| Other industries (not classified)[d] | –0.2 | 0.7 |
| *of which* In manufacturing | –0.1 | 0.3 |
| Public sector | –0.0 | –0.1 |

[a] The contribution to the rise in unemployment was calculated as the difference between the number of Israelis who would be employed if employment had expanded in line with the growth of the civilian labor force and its actual expansion (for by-industry breakdown, see Table 4.A.10).

[b] High-skill industries include some manufacturing, computer services, banking, insurance, financial institutions, and other business activities.

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

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

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

points), and construction (that directly contributed 0.3 percentage points). In contrast to the above, rising employment in the high-skill-intensive industries—in particular the nontradables, i.e., business services and banking, and computing, which suffers a shortage of suitable personnel—acted to reduce unemployment.

Unemployment rose among workers of all levels of education, but was most marked among the less educated.

A study of the principle industries from which Israeli workers have been dismissed, shows that the share of the latter dismissed from the unskilled-labor-intensive industries is relatively high. This fact, together with the tendency to lay off workers of relatively low human capital first in slack times, makes it harder for those dismissed to find alternative work, especially as unemployment amongst the lower educated was relatively high to begin with (Table 4.5), as in most of the OECD countries. Higher unemployment amongst the lower educated is connected to the relative reduction in labor demand for the unskilled, due to technological changes that require more highly qualified workers in most fields, and to a decline in the share of traditional products in manufacturing (see discussion in previous chapter). The opening of the economy to foreign workers, whose employment costs are significantly lower than their Israeli counterparts, exacerbated the situation. The increase in unemployment therefore, that encompassed all levels of education this year, was particularly high for the lower educated.

**Table 4.5**
**Unemployment Rate, by Years of Education, 1995–97**

(percent)

| | 1995 | 1996 | 1997 |
|---|---|---|---|
| **Total** | **6.9** | **6.7** | **7.7** |
| Years of education | | | |
| 0–8 | 7.5 | 7.3 | 10.0 |
| 9–12 | 8.7 | 8.3 | 9.5 |
| 13–15 | 5.6 | 5.7 | 6.5 |
| 16+ | 3.5 | 3.7 | 4.1 |

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

Alongside the rise in the rate of unemployment, the depth of unemployment also increased slightly: those who had been looking for work for more than six months rose from 19.8 percent in 1996 to 20.5 percent in 1997. This growth reflects the increasing share of those seeking employment between six months and a year, while the numbers of those looking for more than a year remained stable.

Unemployment rose among men and women. The number of unemployed women rose by about 16 percent, and unemployed men by 19 percent. However, as there was a greater increase of women in the labor force, there was no significant change in their share of the unemployed.

Unemployment rose in all areas of Israel, with particularly high rates away from the major conurbations and particularly in the south.

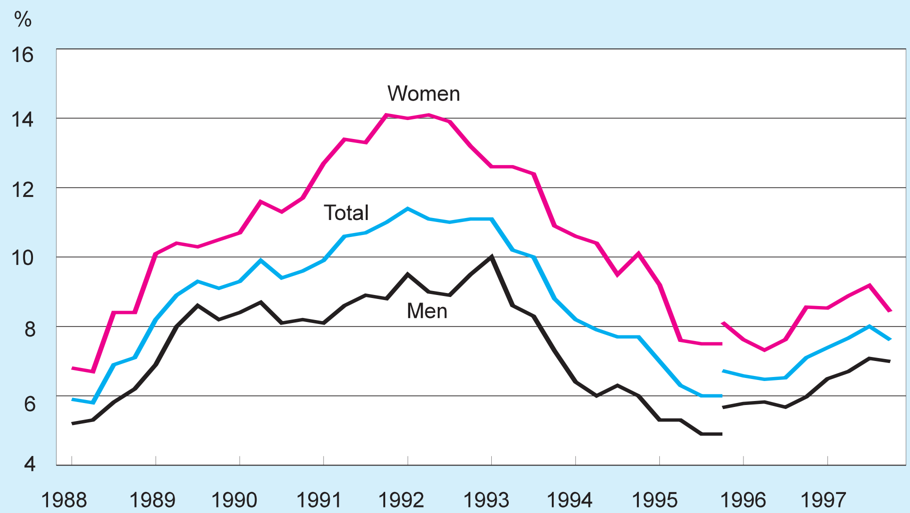
Rising unemployment affected all parts of Israel, though not uniformly. Particularly high rates were registered outside the major conurbations and especially in the south. Many of the towns defined as unemployment black-spots by the Ministry of Labor and Social Affairs—areas where the percentage of job seekers rose to more than 10 percent of the labor force—were situated in the south of the country.[6] Unemployment in these areas was aggravated by their dependence on individual factories, their distance from the center, and the high concentration of factories employing unskilled labor in these locations. Employment problems in outlying areas emphasize the need to invest in transport infrastructure which would contribute to the expansion of the appropriate labor market to these locations.

High unemployment causes economic and social damage, some of it irreversible.

A high unemployment level causes both economic and social damage, some of it irreversible. If the situation continues, some of the increased unemployment may become permanent (‘hysteresis’), as has happened in many European countries. Long periods spent outside the work environment reduces the ability of the unemployed to use their experience as an indication of their abilities, reducing their human capital and consequently damaging their chances of finding employment. Sustained high unemployment therefore increases the ‘natural’ level of unemployment, and consequently the future unemployment level. A high unemployment level also leads to

[6] By the end of the year, the numbers of job seekers in the main centers of unemployment reached about 20,000, or 13 percent of the national total.

**Figure 4.3**
**The Unemployment Rate,[a] 1988-97**




[a] Quarterly data, seasonally adjusted; the Central Bureau of Statistics definition was changed in 1995.
SOURCE: Central Bureau of Statistics.

the 'discouraged worker effect,' i.e., the tendency for those who have unsuccessfully looked for jobs for a long time to lose hope of finding employment and to drop out of the labor force, a phenomenon which is not reflected in the recorded unemployment figures. Experience has shown that a significant rise in unemployment also leads to increasing emigration from Israel and a reduction in future immigration.

These phenomena stress the need to implement a macroeconomic policy which will act to reduce unemployment. The rise in unemployment that began in the second half of 1996 was the result of the slowdown in the economy. Therefore, creating conditions for the economy to return to a path of sustainable growth led by the business sector, while maintaining stability, is a necessary condition for solving the problem; increasing the share of infrastructure investment in the budget would contribute to this goal (see recommendations in Chapter 1). Relief work projects should be avoided as they are short-term, nor do they help workers acquire skills that lead to employment in the business sector.

Creating conditions for the economy to return to a path of sustainable growth, led by the business sector, while maintaining stability, is a necessary condition for reducing unemployment.

Macroeconomic policies such as these should be accompanied by structural and institutional steps in the labor market that will help to speed up the absorption of the unemployed into growing industries, reducing the frictional element of unemployment and unemployment in general, even in the short term. Streamlining professional training would help to reduce the structural component of unemployment. In order to ensure that training matches firms' needs, employers should participate in planning and running courses, and the share of in-house training should be increased. As an incentive to those running the training courses, their success in placing trainees should be taken into account. The recommendations of the Directors' Committee, chaired by the General Secretary of the Ministry of Labor and Social Affairs, that discussed the problems of unemployment, focused on the issue of training and adjusting it to labor demand in different locations.

The restriction on the number of foreign workers should be enforced more rigorously, the minimum wage law and other employment laws should be upheld, and work permits for foreign workers should be independent of any specific employer.

In the light of the increased proportion of foreign workers in the economy, even at a time of rising unemployment, and the concern that their availability will lead to a rise in the natural level of unemployment because of the difficulties in regulating their numbers according to economic conditions, their employment should be made relatively less worthwhile, in a way that ensures fair competition with Israeli workers, while maintaining their rights. The restriction on the numbers of foreign workers should be enforced more determinedly, as should the minimum wage law and other laws covering employment of foreign workers, and the work permits for foreigners should be independent of any specific employer.

## 4. WAGES[7]

The real wage per employee post in the business sector rose by 3.4 percent, and in the public services it fell by 0.2 percent.

The average nominal wage per employee post rose in 1997 by 11.5 percent in the economy as a whole, by 12.7 percent in the business sector, and by 8.7 percent in the public services. In real terms (from the worker's point of view), these rises were 2.3 percent in the economy as a whole, 3.4 percent in the business sector, and a slight real fall of 0.2 percent in the public services (Figure 4.4).

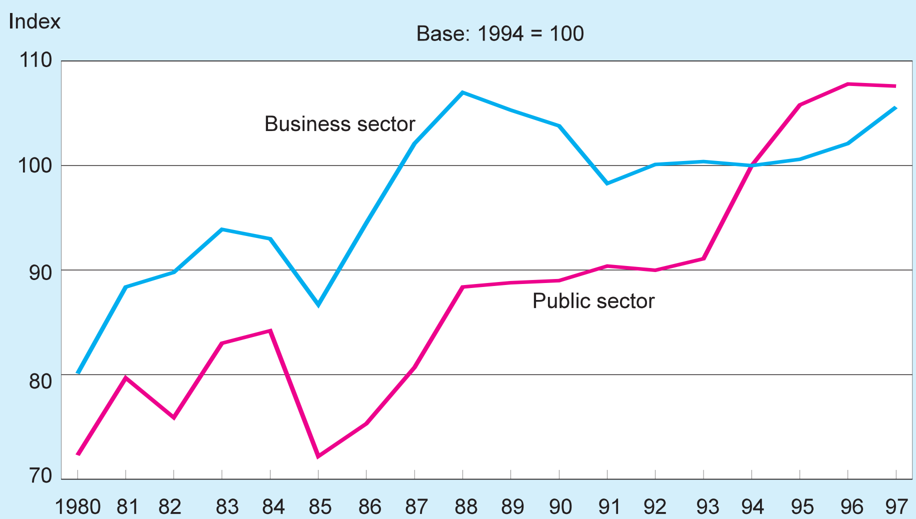
Unit labor cost (measuring labor's share of the product, and reflecting wages from the employer's view) rose this year in the business sector by 3.9 percent, following its 2.4 percent rise in 1996. The increase in unit labor cost in 1997 reflects a growth of 2.7 percent in labor cost and a fall in product per hour of work.

The rise in real wages in the business sector accelerated this year, despite higher unemployment.

In 1997, the rate of increase in real wages in the business sector accelerated, despite the rise in unemployment—following a continuous fall since 1992—and a slight fall in labor productivity. This was notable in light of the structural changes in the labor market in the last few years. High unemployment in the late 1980s forced the labor market to react by making the institutional basis of wage arrangements and agreements more flexible. Since 1988, no national or industry-wide wage increments have been granted. The COLA was amended such that a large part of the rise in prices since 1989 has not been covered by the cost-of-living allowance. The growing share of non-unionized labor (the increase in the number of those employed via personnel agencies

[7] Wage per employee post is calculated as total wage payments *divided by* the total number of employed persons (regardless of whether they are employed full or part time). Consequently, part of the change in wages is technical, arising from changes in the extent of the job, the number of days worked per employee, the rate of labor mobility between workplaces, their composition of human capital, etc. In addition, due to the problems in recording wages paid to foreign workers and their high share in the work force, the wage data are biased.

**Figure 4.4**
**Indices of Real Wage per Employee Post in Business and Public Sectors, 1980-97**




SOURCE: Central Bureau of Statistics.

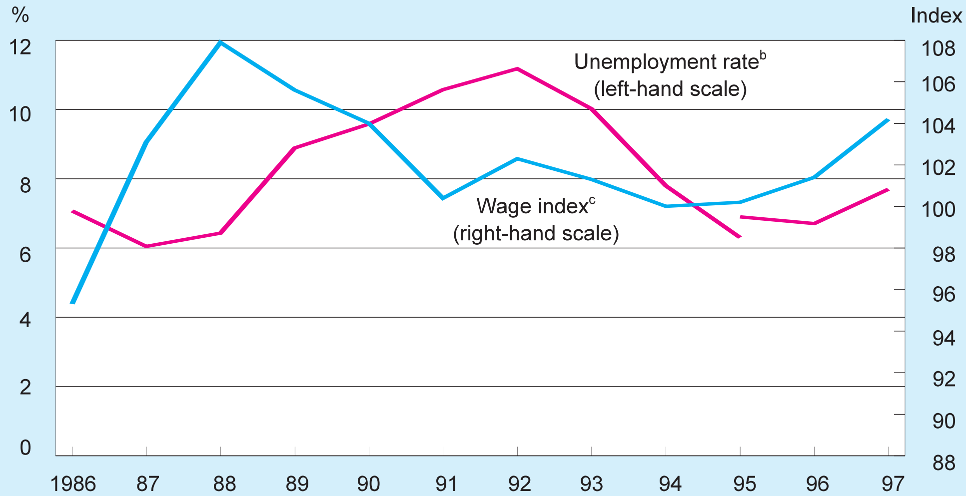
or with individual work contracts, and foreign workers) has also weakened the linkage between sectors and different professions and increased the flexibility of the labor market. These structural changes increased the share of company wage agreements, and allowed firms to link wage increases more closely to the state of the labor market and their profitability.

Despite all this, the sensitivity of business-sector wages to the level of unemployment is still limited (this phenomenon itself has a negative effect on the unemployment level). This may be partly explained by the lagged effect of unemployment on wages. Many wage agreements in the business sector cover a period of one or two years and therefore in many sectors agreements signed before the above changes in the labor market occurred are still in effect.

The sensitivity of business-sector wages to unemployment is limited, a fact which itself has a negative effect on unemployment.

Furthermore, despite its flexibility, the labor market is still characterized by rigidities, some deriving from the nature of the employer/employee relationship, and others arising from intrinsic institutional factors. In many places, wages are determined through negotiations between employers and unions representing the interests of the employed and not the unemployed, which necessarily restricts the ability of the unemployed to cause a fall in wages—the unions can prevent the dismissal of workers who would otherwise be replaced by the unemployed at lower wages (the insider-outsider theory). The sensitivity of wages to unemployment is also restricted by the costs of replacing workers—the investment in specific human capital and the associated costs of looking for new workers—that also prevent employers from replacing old (expensive) workers with new ones.

**Figure 4.5**
**Index of Real Wage per Employee Post in Business Sector,[a] and Unemployment Rate, 1986-97**



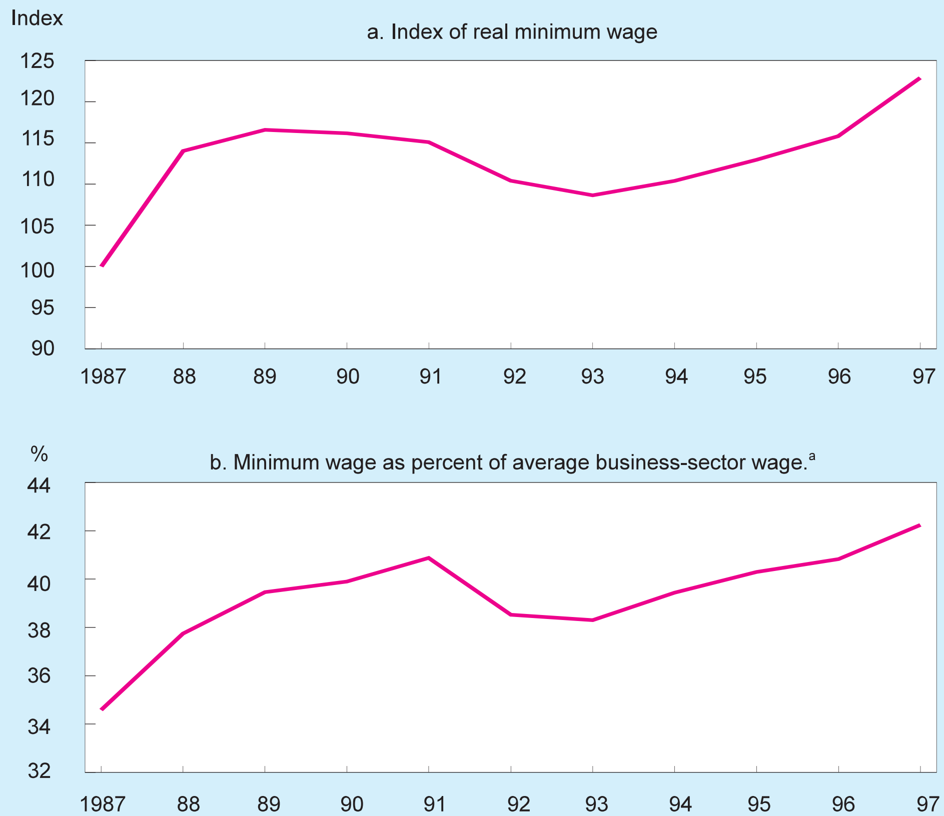

[a] Excluding workers from the Autonomy and the administered areas.
[b] The Central Bureau of Statistics definition was changed in 1995.
[c] Base:1994=100.
SOURCE: Central Bureau of Statistics.

The minimum wage causes wage rigidity, and links wage rises in different sectors.

In institutional agreements, the minimum wage is a central factor of the wage system that causes rigidities and links wage increases in different sectors: by law, the minimum wage is linked to the average wage in the economy. Due to this linkage, any rise in wages—whether in the public sector, or in occupations where there is a shortage, or in sectors where productivity has risen—rolls over (wherever the law is observed) into cheap-labor-intensive industries, without reference to their profitability. Thus, for example, the traditional industries had to raise the wages of their workers relatively steeply, due to the significant rise in the minimum wage in 1996–97 (partly as a result of the exceptional increases given in the past in the public sector) and despite a cumulative erosion of their profits. In April 1997, several legislative changes were passed which only strengthened this link between wage rises in different sectors. Amongst the main changes, the minimum wage was increased from 45 percent of the average wage in the economy to 47.5 percent, and it is to be updated annually, according to the average wage, whereas previously it was updated on a two-yearly basis, by the average wage in one year, and by the consumer price index in the other.

The considerable rise in the minimum wage in April 1997 (of about 12 percent), following a steep rise in April 1996 (of about 11 percent), contributed to a rise in wages, in places where the law was observed, both by raising the price of simple labor and by raising the salaries of employees earning more than the minimum wage, because of the formal and informal linkage of wage scales (Figure 4.6). The increase in the

**Figure 4.6**
**The Minimum Wage, 1987-97**




[a] Excluding workers from the Autonomy and the administred areas.
SOURCE: Central Bureau of Statistics.

minimum wage explains a rise of about half a percentage point in the real increase in the average business-sector wage in 1997.

The average business-sector wage was also pushed upwards by the rising wage for those on the upper rungs of the wage scale due to a continuing shortage of highly-skilled workers.

An additional factor in the accelerating average wage in the business sector this year was the slowdown in the rise in employment which reduced the share of the newly employed, who normally enter the labor force at beginners rates of pay. In contrast, the falling share in employment of Israeli workers with relatively high wages acted to reduce the average wage.[8]

[8] Changes in the composition of employment by industry in 1997 had no effect on the level of wages in the business sector.

The slowdown in inflation beyond what was expected contributed to a rise in the real wage of between a half and one percent.

The slowdown in the rate of inflation beyond what was expected also contributed to the rise in real wages in 1997, as some wage agreements were written in nominal terms and signed when expectations were higher. As the structure of the cost-of-living agreement compensates for only 85 percent of price rises (with a lag), the contribution of a lower inflation rate was not great, between a half and one percentage point.

The real wage rose in all business-sector industries, both the high-skilled-labor-intensive and the unskilled-labor-intensive. Most prominent were the rises in the banking and business services—where labor demand increased markedly (employment grew in these areas by about 7 percent)—and in manufacturing (Table 4.6). The rise in real wages in manufacturing was accompanied by an increase in labor productivity, continuing the trend evident since 1995. There was a fall in employment in manufacturing this year, and the rise in average wage may be partly explained by the changes in worker composition: in a period of deceleration the first workers to be dismissed are those with low productivity and relatively low wages, so that the average wage rises. The change in the composition of employment—with the share of industries paying above average wages increasing—contributed a further 1.5 percentage points to the rise in wages. Within manufacturing, the wage rises in textiles and clothing—where the rate of dismissals and the share of those earning the minimum wage are relatively high—were the most notable (about 8 percent in real terms), and those in the high-tech industries, where wages rose due to a shortage of trained workers (amongst industries registering particularly high wage rises was the electronic components industry with about 13 percent).

In contrast to the rises in the business sector, real wages in public services fell slightly, by 0.2 percent, after a significant cumulative rise of about 20 percent since the second

**Table 4.6**
**Change in Real Wage per Employee Post,[a] by Industry, 1995–97**

(percent)

| | 1995 | 1996 | 1997 |
|---|---|---|---|
| **Public sector** | **5.6** | **1.9** | **–0.2** |
| **Business sector** | **0.6** | **1.5** | **3.4** |
| *of which* Agriculture | 5.5 | 4.2 | 3.4 |
| Manufacturing | 3.9 | 2.2 | 5.7 |
| Water and electricity | 5.8 | 3.5 | 2.5 |
| Construction | 0.0 | –3.3 | 3.8 |
| Commerce | 1.1 | 1.9 | 1.4 |
| Catering services | –1.1 | 1.1 | 2.1 |
| Transport and communications | 0.1 | –1.5 | 3.9 |
| Financial services | –4.3 | 5.7 | 5.0 |
| Business services | 0.2 | 4.7 | 4.8 |
| **Total** | **2.2** | **1.6** | **2.3** |

[a] Including workers from the Palestinian Autonomy and administered areas, and reported foreign workers.

SOURCE: Central Bureau of Statistics.

half of 1993—the outcome of expansionary wage agreements signed by the professional associations in that sector. This reduction in wage in public services is connected to the structure of the agreements, which ran out during 1997, and which granted wage increments mainly in the first years of the agreement.

The real wage per employee post in public services fell this year, after a 20 percent rise since the second half of 1993.

By the end of the year, many of the wage agreements in the public sector had expired (some—those with para-medics, academics and research workers—expired at the end of 1996). In negotiations between the Treasury and the Federation of Labor (the Histadrut) on wage agreements for 1998 and 1999, the Treasury's position is to ensure no growth in real wages, while the Labor Federation is demanding real wage increases. The dynamics of reaching wage agreements in the public sector in the past and the high wage rises fixed by agreements in recent years, against the background of industrial unrest (the strikes at the end of 1997 and their results), should serve as a warning light for the next round of wage settlements. This is particularly relevant as the wage agreements in the public sector greatly affect the government deficit and inflation target, as well as the possible effects on wages in the public sector and on the level of unemployment.