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The Israeli work permit scheme and the West Bank economy

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Abstract

The integration of the Israeli and Palestinian labor markets has for a long time attracted attention due to the political-military conflict between the two regions and due to mobility restrictions. In the 1980s, access to Israeli labor markets accounted for a significant share of the total Palestinian employment. However, following the first and the second Palestinian uprisings, mobility restrictions and closures have been put in place and enforced. Depending on the intensity of the political tension, restrictions are either set at a high or at a low level. Taking advantage of this unique context, this study for the first time addresses the economy-wide effects of labor market relaxation between the two regions on the Palestinian economy. The study uses a SAM developed for the West Bank for the year 2011 with detailed representation of the labour market. Workers are categorized based on their demographic characteristics, their current workplace and eligibility to work permit in Israel. The behavioural relationships in a variant of STAGE suite of CGE models are extended to conform to the unique feature of the labour market between West Bank and Israel. The results demonstrate that while increases in the number of work permits increases welfare in the West Bank, it also distorts the operation of the West Bank labour market and economy. On the other hand, while decreases in the number of work permits reduces welfare, the limited opportunities in the West Bank restrict the ability of the West Bank economy to absorb the labour no longer employed in Israel.

Keywords: labor markets, conflicts, work permits, CGE, Palestine.

1. Introduction

The Israeli labor market is characterized by a shortage of low-skilled workers, while the Palestinian labor market faces a surplus of workers. In the 1980s, Palestinians working in Israel accounted for more than 30% of total Palestinian employment (Bulmer, 2003). This situation benefitted both sides. From an Israeli perspective, Palestinian labor is cheap and hardly competes with native labor for low-skilled work (Rosenhek, 2006). From a Palestinian perspective, job opportunities in Israel are an important source of income as wages in Israel are substantially higher than wages in Palestine (Miaari and Sauer, 2011). Despite the benefits of integrated labor markets for both sides, political tensions have led to extensive border restrictions (Mansour, 2010). Between 1999 and 2004, the share of Palestinians working in Israel fell from 23% to 8% (Flaig et al., 2013). As a result, unemployment rose sharply in the Palestinian territories.

The integration of the Palestinian and Israeli labor markets has been analyzed in various studies. Bulmer (2003) shows that 7% increase in Palestinian labor flowing to Israel raises wages in the West bank by about 3.8% and reduces unemployment by about 4%. Similarly, Mansour (2010) observes that mobility restrictions between 2000 and 2004 resulted in increased supply of workers in the domestic labor market in West Bank by about 50%. Furthermore, he estimates that 10% increase in labor supply in the West Bank depresses wages for low-skilled workers by about 1.2%, while it hardly affects wages of high-skill workers. Flaig et al. (2013) analyzed the effect of relaxing Israeli restrictions on Palestinian labor using a single-country general equilibrium model for Israel. They found that doubling the number of Palestinian working in Israel will reduce wage for past commuters by 17% but will almost double the aggregate income of the commuters with potential multiplier effects through aggregate demand for goods and services.

From this review, it appears that previous studies on the topic either lack the economy-wide effects of the labor market integration between Israel and Palestine (Bulmer, 2003; Mansour, 2010) or look only from the perspective of the Israeli economy (Flaig et al., 2013). Therefore, developing a general equilibrium model for Palestine with detailed representation of the linkages between the Israeli and the Palestinian labor markets in order to investigate the economy-wide implications for the West Bank economy consequent upon increases and decreases in access to the Israeli labor market fills a research gap. As migration of Gazan workers to Israel has been banned since the takeover in Gaza by Hamas in 2007, the study only focuses on the West Bank territory.

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The next section, section 2, describes the labor markets in the West Bank and the restrictions to the Israeli labor markets. Section 3, presents the model and the unique Social Accounting Matrix used. Section 4 describes the simulations conducted.

2. Labor markets in the West Bank and the Israeli work permit scheme

The labor force in the West Bank has a unique feature as it participates in two separate labor markets: the domestic and the Israeli market. While the domestic market offers jobs suitable for both skilled and unskilled workers, the Israeli market primarily offers jobs for unskilled workers. Hence, there is a skill premium on the domestic market as skilled wages are higher than unskilled wages. In contrast, there is no such a skill premium for Palestinian labor in the Israeli market. Nevertheless, wages received by Palestinian workers in Israel are comparable to skilled wages in the domestic market. Therefore, according to the size of the Palestinian employment in Israel in the total employment, the skill premium erodes (Etkes, 2012).

Although access to the Israeli labor market is an important source of livelihood in the West Bank, it is highly volatile due to the political conflict. In fact, following the 1967 war, Israel has implemented an open border policy that enabled Palestinian workers to get access to its affluent market with no restrictions. Before the first Palestinian uprising in 1987, the share of Palestinian employment in Israel in the total employment was one third. However, in the 1990s, this policy was steadily modified to limit the Palestinian labor access to Israel and reached its heights following the second Palestinian uprising in 2000. Indeed, a barrier was built and a work permit policy was set up. Subsequently the share of Palestinian workers in Israel in the total significantly dropped up to 14% in 2011.

Permit for employment in Israel are issued to Palestinians who meet some age and personal status criteria presumed to reduce their likelihood to get involved in attacks against Israelis. These criteria at the height of the intifada (2001-04) required the Palestinian worker to be over the age of 35, and married with children. As of 2011, the main criteria is to be married and over the age of 24, while for some sectors the requirement is just to be over the age of 21. The permits are only valid to work in a specific sector and for a predetermined employer. In addition the permits are issued within a specific quota that is set by the government for each sector. The number of permits issued also changed substantially over time, from about 12,000 in 2005 to 33,000 in 2011 and 47,000 in 2014 mostly in agriculture and construction sectors (Etkes, 2012; KavLaOved, 2012, Btselem, 2014). However, the quota is much lower than the need for Palestinian workers. KavLaOved (2012) reported that in addition to the 27,000 formal Palestinian working in Israel with permits, some 20 to 30,000 were working in Israel without permits. This report argues further that in the construction sector alone, for the year 2011, there was a need of 20,000 more workers. Such need could have been met by the 125,000 unemployed Palestinians, if the permit policy and the quota system were relaxed.

3. Model and Data

The model developed for this study is a variant of the STAGE¹ suite of single country CGE models. STAGE uses a combination of linear and non-linear relationships governing the behavior of the model's agents (McDonald, 2009). Household consumption is based on utility maximization behavior modelled according to Stone-Geary utility functions. The model allows for imperfect substitution between imports and domestic goods specified as constant

¹ STAGE model is an open source model the code for which can be downloaded from www.cgemod.org.uk or is available by request from the developer.

elasticity of substitution (CES) following Armington (1969). The main model development for this study is the extension of the domestic production module from two to a seven-level production process in order to better reflect the labor markets in the West Bank. Aggregate value added is defined as a series of CES aggregates of inputs where relative prices determine the optimal combinations of these inputs. West Bankers either work in the domestic labor market, or in Israel or in other neighboring countries where they commute on quasi daily basis. Workers in the domestic market are further subdivided into two groups according to their education level. Next, they are categorized according to whether they are own-account workers or wage-workers, and are further disaggregated by gender and eligibility to a work permit in Israel. West Bankers working in Israel or in other neighboring countries are disaggregated by gender and eligibility to a work permit in Israel.

The modified STAGE model is calibrated to a West Bank SAM for 2011 (Agbahey *et al.*, forthcoming). This SAM is the first to disaggregate extensively labor account in the West Bank, in contrast to previous SAMs (Astrup and Dessus, 2001; Missaglia and Valensisi, 2010), which focused on trade. This SAM has several distinctive features. First, it differentiates between 51 factor types of which 49 are labor groups. Furthermore, it has 51 products of which 8 are agricultural commodities, 38 activities of which 5 are agricultural sectors, 20 manufacturing and the remaining 13 services. There are 120 representative households with explicit representation of expenditure quintiles in order to assess the implications of a relaxed access of Palestinian labor to the Israeli market for poverty and food security. Two foreign accounts, Israel and Rest of the World, have been introduced as Israel is the main trade partner of the West Bank. Accounts for custom duties, excise duties, VAT and income tax collected by the Israeli government have been created in order to reflect the Paris Protocol signed in 1994, which governs the economic relations between Israel and Palestine. The SAM has also specified an account for Non-Private Institutions Serving Households (NPISH) as NGOs and the United Nations Relief and Work Agency for Palestine refugees in the Near East (UNRWA) play an important role in the economy.

4. Simulation

After assuring that the model replicates the original data that represents the economy in 2011, which is called “base” scenario, two counterfactual scenarios are introduced. Scenario 1 simulates an increase in the number of permits by 50%, while scenario 2 simulates a decrease in the number of permits by 50%. In the two scenarios, total factor supply is assumed unchanged. Factor income earned by the Palestinians working in Israel is increased or decreased in the same proportions as their number.

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