

Title: *Labor exports from the West Bank to Israel: between regretting the past and hoping for a better future*

Background

The export of labor to Israel has been a feature of the West Bank and Gaza's economy since 1967 (Mansour, 2010). Palestinian employment in Israel is driven by both a push and a pull factors. The push factor is related to the inability of the domestic economy to offer enough jobs for the growing labor force, while the pull factor is the wage premium enjoyed by Palestinian workers in Israel (UNCTAD, 2009). The wage for Palestinians working in Israel is on average 83% higher than that of workers employed in the domestic labor market over the period 2000-2011 (PCBS, 2012). Subsequently, the labor income from Israel plays a significant role in the Palestinian economy. In 2000, it was about 22% of GDP against a mere 18% of GDP for export of goods (Astrup and Dessus, 2005). However this income source is not stable as it is subject to fluctuations in the Israeli economy and more importantly to the intensity of the political conflict between Israel and Palestine. As illustration, in 1999 before the second Palestinian uprising, the share of Palestinians employed in the Israeli economy was 22% of total Palestinian employment. By 2004 that share fell to 8% (Flaig et al., 2013). As a result, unemployment and poverty rates in the Palestinian territories rose sharply (UNCTAD, 2012).

The vast majority of Palestinians working in Israel are employed in low-skilled jobs, mainly in construction, agriculture and services (Miaari and Sauer, 2011). The type of jobs occupied in Israel put into perspective with the higher wages earned led to distortions in the wage structure of the local Palestinian economy. It induced higher wages in the domestic economy, not arising from any increase in domestic productivity (UNCTAD, 2016). As a result, the production cost increases and competitiveness of the tradable activities has eroded leading the Palestinian exports to be less competitive on the world markets (Schiff, 2002). This "Dutch Disease" type of phenomenon led to the reallocation of productive factors out of tradable activities towards non-tradable activities, such as the Palestinian National Authority whose payroll has seen an exponential increase (Astrup and Dessus, 2005).

Although the Paris protocol of 1994, which formalized the *de facto* customs union with Israel in effect since 1967, provides in its provisions for a free movement of capital and goods, with both sides supposed to cooperate in determining the magnitude of Palestinian labor flows into Israel, its implementation has been imperfect (UNCTAD, 2009). The weak enforcement mechanisms and the unilateral decision of Israel to limit the number and the sectoral allocation of Palestinian workers made their flow to the Israeli economy volatile and dependent on Israeli political objectives and perceived security risks (Fischer et al., 2001). Palestinian access to the Israeli labor market is regulated by a permit policy, which was introduced in 1991. Permits for employment in Israel are issued to Palestinians who meet some age and personal status criteria presumed to reduce their likelihood to be involved in attacks against Israelis. The permits are only valid to work in a specific sector and for a predetermined employer. The number of granted permits is usually much lower than both the demand for Palestinian workers in the Israeli economy and the supply of Palestinians willing to work in Israel. As a result there is a substantial number of Palestinians working in Israel without permits (Etkes, 2012). The share of the unpermitted in the total Palestinian employment in Israel averaged 40% over the period from 2005 to 2015 (PCBS, 2016).

The Palestinian access to the Israeli labor market is likely to be a key point in the final status negotiations. Should the Palestinian export of labor to Israel be permanent and reasonably stable

in a final settlement, then the result might be a structural adjustment of the economy due to change in comparative advantage with a shift from less competitive tradable activities (Schiff, 2002). Under such conditions, this study provides a quantitative assessment of the impact of the increased access to the Israeli market for the Palestinian labor. It uses a computable general equilibrium model calibrated to a 2011 social accounting matrix of the West Bank. This study fills a research gap as only a few estimates of the impacts of different trade regimes for Palestine have been produced (e.g. Flaig et al., 2013; Mansour, 2010; UNCTAD, 2009; Astrup and Dessus, 2005; Schiff, 2002) and these are in general not sufficiently comprehensive.

Model and data

The database used is a West Bank SAM for 2011 (Agbahey *et al.*, 2016). The full SAM comprises 376 accounts, of which 83 are commodities produced by 49 activities. Two foreign accounts are included for Israel, and the rest of the world. This separation highlights transactions of goods and services with Israel, as well as transfers and factor income that allows simulating change in the number of Palestinians working in Israel. The SAM encompasses 59 production factor accounts and 110 household groups, allowing the assessment of the multiplier effects on factor markets and households' welfare to be comprehensively undertaken. Among the production factor accounts, labor is explicitly disaggregated according to the place of work, either inside the West Bank or in Israel. The workers employed in domestic market are further disaggregated according to their eligibility for a work permit in Israel. This disaggregation allows simulating various levels of increased access to the Israeli market. The Palestinians employed in Israel are disaggregated according to whether they hold a permit or not. This separation is also important for simulating the switch from unpermitted to permitted worker, when the Palestinian access to the Israeli labor market is increased.

The model used in this study belongs to the STAGE suite of CGE models. STAGE-2 uses a combination of linear and non-linear relationships governing the behavior of the model's agents (Mc-Donald and Thierfelder, 2013). For the needs of this study, the model is extended by including a migration function to capture the movement of labor across sectors in the domestic market and across regions from the domestic market to Israel in response to the shock.

Simulations

Apart from the base simulation in which the benchmark data are reproduced by the calibrated model, the simulations of this study include an increase of Palestinians working in Israel from the actual 14% of total workers in 2011 back to the level observed in the 1980s (Bulmer, 2003) before the introduction of restrictions following the first Palestinian uprising, which was 30%. The high unemployment rate of 17% in the West Bank and the gap between wages in the West Bank and Israel supports the assumption that an increased ratio of Palestinians working in Israel can be met.

Expected results

Increased Palestinian labor in Israel will result in a moderate decline of the average Palestinian wage in Israel but a tremendous increase in the total factor income received from Israel. There will be positive effects on the economy as GDP grows substantially, owing to increased public and private consumption in the West Bank. The increased consumption will drive up domestic production moderately, and import substantially. Regarding distributional effects, welfare gains

will accrue essentially to households in the lowest quintiles with the highest shares of low-skilled members. This is supported by the fact that most jobs for Palestinians in the Israeli market are of low-skilled type. Even skilled Palestinians employed in Israel are mostly involved in low-skilled jobs. Palestinian households with previously no member working in Israel, but having now some members employed in Israel will experience higher welfare gains. Households with members already working in Israel and without extra member in workforce will experience a welfare loss, as individual wages in the Israeli market decrease. For the economy as a whole, welfare gains will largely offset losses.

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