

# Overseas Foreign Workers in Israel: Policy Aims and Labor Market Outcomes

By

Shmuel Amir

## **Abstract**

The declared aim of the Israeli Government, since 1996, was to reduce radically the presence in Israel of foreign workers, both legal and illegal, within five years. This should have been achieved by drastically reducing the number of employment permits issued by the government and by deporting illegal residents. However, the government has not succeeded in carrying out its plans. Yielding from the beginning to strong political pressure from employers, the government introduced regulations that virtually indentured the legal foreign workers indefinitely to their employers. This transformed the employment of legal foreign workers into a source of easy gains and greatly increased the demand for them. At the same time, it created economic conditions that discriminated against legal foreign workers as compared to illegal ones and encouraged legals to turn illegal. As a result, the number of legal and illegal foreign workers has not yet declined significantly, even though the Israeli economy has been on a downtrend since 1997. This paper recommends that the mandatory relationship that binds foreign workers to the employers who recruit them be made to last for the first 2–4 months only, and not for an infinite period as in the current practice. For the rest of their stay in Israel, the workers should be allowed to change employers: They should receive an appropriate working permit (perhaps a kind of “green card”) that allows them to accept job offers from any lawful employer at any time and to earn the going market wage for their labor.

# Overseas Foreign Workers in Israel Policy Aims and Labor Market Outcomes<sup>a</sup>

## Introduction

Until 1993, the Israeli Government opposed massive employment of overseas (non-Palestinian) foreign workers in Israel. Palestinian workers performed most of the hard low-skill jobs and accounted for 7 percent of total labor employed in Israel. Following a series of Palestinian terrorist attacks in early 1993, the government limited the access of Palestinian workers and allowed overseas foreign workers to enter the country as substitutes. A rapid influx of foreign workers resulted. Due to inefficiency in controlling entry to Israel, many foreign workers entered and stayed in the country illegally. By 1996, about 100,000 legal foreign workers and a similar number of illegals accumulated in Israel, having replaced by then most Palestinian workers in the Israeli labor market. The rapid and uncontrolled growth of the foreign-workers population in Israel raised growing public concern about its social consequences and caused the government to change its policy again in 1996. The new declared aim was to reduce radically the presence in Israel of foreign workers, both legal and illegal, within five years. This should have been achieved by drastically reducing the number of employment permits issued by the government and by deporting illegal residents . The total number of foreign workers was planned to decrease rapidly each year and to fall to a targeted final figure of only 20,000 by 2001, and additional Palestinian and Israeli low-skill

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suggestions.

workers were expected to replace them. However, the government has not succeeded in carrying out its plans. Yielding from the beginning to strong political pressure from employers, the government introduced regulations that virtually indentured the legal foreign workers indefinitely to their employers. This transformed the employment of legal foreign workers into a source of easy gains and greatly increased the demand for them. At the same time, it created economic conditions that discriminated against legal foreign workers as compared to illegal ones and encouraged legals to turn illegal. Under these circumstances, the government's plan to reduce the quota of employment permits radically was severely curtailed by the employers' political pressure, and the number of permits actually has fallen much less than initially planned. In addition, the unpopular deportation actions taken by the government on a small scale have not compensated for the continuing inflow of foreign workers into illegal employment. As a result, the number of legal and illegal foreign workers has not yet declined significantly, even though the Israeli economy has been on a downtrend since 1997.

Recent legislation by the Israeli Government raised the tax on employing foreign workers in order to reduce the demand for them. The higher tax is due to be introduced gradually until the end of year 2000, so that its effects remain to be seen in the future.

The purpose of this paper is twofold: to analyze the economic determinants of the employment of foreign workers in Israel in the 1990s, focusing on the residential construction industry—in which most legal foreign workers are employed—and to investigate the reasons for the failure of the governmental policy to reduce significantly the presence of foreign workers since 1996.

Section 1 describes the background of the employment of foreign workers in Israel and basic developments in the construction labor force during the 1990s.

Section 2 presents selected survey findings on construction methods and methods of employment in residential construction and on the existing preference for employing foreign, as against Palestinian, workers.

Section 3 discusses issues in the recruitment of foreign workers and the methods used to

bring them to Israel for work. A model of the market for low-skill construction labor is presented and is used to analyze the various effects of government regulations on the employment of foreign workers.

Section 4 presents conclusions about the causes of the failure of the governmental policy to reduce significantly the presence of foreign workers and those related to them in Israel, and the lessons to learn from the failure.

The analysis draws on the author's empirical survey of the residential construction industry (1997).<sup>1</sup>

## **1. Background and Basic Developments**

Foreign workers are a characteristic of many developed economies with relatively high wage levels. In these economies, low-skill workers from poor countries perform jobs that are considered inferior there.<sup>2</sup> These jobs are common mostly in non-tradable sectors in which specialization through international trade is absent, such as construction and personal services, and in industries where trade barriers are present, such as agriculture. As a rule, the wages paid to foreign workers are lower than the reservation wage of native workers for the jobs at issue. For a thirty-year period, Palestinian workers have performed these jobs in Israel. In the wake of the 1967 war and the occupation of the Palestinian territories, the Israeli labor market opened up to an ample supply of low-wage Palestinian workers, and by the 1980s their numbers grew to 7 percent of total labor employed domestically. As a result, while construction technologies in most Western countries became industrialized and labor-saving, in response to rising labor costs there, those in Israel have remained low-skill labor intensive.

The conditions of Palestinian employment in Israel have changed radically since April 1993. After a series of terrorist attacks against civilians, Israel imposed closures on the Palestinian territories, disrupting Palestinians' access to jobs in Israel and creating an acute shortage of low-skill labor in Israeli construction and agriculture. As a result, the employers' associations in these industries subjected the government to strong pressure to allow them to recruit thousands of foreign workers for their industries. Until then, the government's policy regarding foreign workers had been rather cautious, regarding their use in limited numbers as temporary solutions in cases of shortages in domestic supply of essential skills. According to the declared policy, the number of foreign workers should be restricted as much as possible in

order to prevent their permanent immigration and settlement and to ensure the employment and wages of local workers. Under the new circumstances, however, the government succumbed to the pressure of the interested parties and opened the labor market to a massive influx of foreign workers without any effective controls. The government endorsed ever-growing quotas of permits to employ foreign workers, but real control over the recruitment of these workers, their allocation among employers, and the terms of their employment were left in the hands of the aforementioned interested players. In the construction industry, it was vested with the Association of Contractors and Builders, which chose the recipients of employment permits, determined the number of permits to allocate to each recipient, and influenced the Ministry of Labor and Social Affairs' regulations concerning the methods of employing foreign workers. In 1996, Israeli employers held more than 100,000 legal permits for the employment of foreign workers. Concurrently, as aforesaid, the number of illegal foreign workers and attached family members grew steeply due to inefficiency in controlling the borders and the activities of foreign workers in the labor market. There is no survey-based statistical monitoring of foreign workers and family members; their exact numbers are unknown. The Central Bureau of Statistics estimated the number of undocumented foreign workers and family members in the country at the end of 1996 at roughly 75,000, but higher estimates exist. Since 1995, there have also been no Israeli survey data on the total population of legal and illegal Palestinians working in Israel.

In 1996, in view of the chaotic growth of the presence of foreign workers in Israel and the formation of population groups among them, and after a change in political leadership, the government changed its declared policy regarding foreign workers and other nonresidents. The new aim was to reduce radically, within five years, the presence in Israel of foreign workers and of the illegal foreign population.

Some idea of the developments in the construction industry in the 1990s can be gathered from Table 1<sup>3</sup>, which estimates the numbers of workers employed by origin and real industry output.

Table 1  
Real Construction Output and Persons employed  
in the Construction Industry, by Origin, 1992–1998<sup>a</sup>

Year	Employed (thousands) <sup>b</sup>				Real output Index (1996=100)
	Foreign	Palestinian	Israeli	Total	
1992		86	107	193	78
1993	4	61	118	183	74
1994	14	49	125	188	79
1995	48	43	144	235	93
1996	69	28	150	247	100
1997	69	32	146	247	98
1998	67	35	131	233	94

<sup>a</sup>Source: Bank of Israel, *Annual Report 1998*, Appendix, Tables B38, B37. These are estimates based on data and calculations from the Central Bureau of Statistics.

<sup>b</sup>The estimates in shaded cells are partly based on sources other than labor-force surveys.

Estimates not based on survey data should be treated with caution, but even so, these rough figures show that: 1) within three years (1993–1996) foreign workers replaced most Palestinians who had worked in the construction industry beforehand; 2) the number of foreign workers employed in construction has not declined significantly since 1996; and 3) the number of Israeli workers has declined since 1996 by 13 percent, although real output and total employed declined by only 6 percent each. This may indicate that foreign and/or Palestinian workers have been substituting for Israeli workers since 1996.

## **2. Construction Workers' Terms of Employment**

### ***2.a Job Characteristics of Construction Workers***

Elementary jobs in residential construction are performed by groups of low-skill laborers organized by subcontractors, rather than by salaried employees. These jobs include building the concrete skeleton and the casing of the walls of the building, plastering and covering interior and exterior walls, and tiling. The total cost of these jobs in Israel is, on average, 55 percent of total construction cost (excluding price of land). As long as low-skill workers specialize in elementary construction jobs, they do not compete with other construction workers, as a rule. Instead, they are complementary to them; an increase in the supply of construction workers stimulates the economic activity of the sector by lowering labor costs and, as a result, enhances demand for other occupations. However, construction workers of different origins (Israelis, Palestinians, and foreign workers) are substitutes who compete with each other.

### ***2.b Numerical Estimates for 1996***

Of the 247,000 persons employed in construction in 1996 (Table 1), an estimated 155,000 were construction workers—69,000 foreign, 28,000 Palestinian, and 58,000 Israeli. The other persons employed in construction in 1996 were engineers and other professionals (9,000), managers (5,000), office workers (8,000), foremen (11,000), and other skilled workers such as plumbers, electricians, carpenters, and heavy-equipment operators (60,000).<sup>4</sup>

### ***2.c Findings of the Survey***

This section draws on the findings of an empirical survey performed in 1997 in a sample of thirty-six large and medium-sized homebuilding companies in Israel<sup>1</sup>. As a rule, the participating companies employed their foreign workers legally. Nearly all low-skill foreign and Palestinian workers in the industry were employed in elementary construction jobs (“wet jobs,” so called because they require the use of water). In the survey sample, 65 percent of workers in elementary construction jobs were foreign, 25 percent were Palestinian, and the remaining 10 percent were Israeli.

### *2.c.1 Subcontracting in Elementary Construction Jobs*

In all large companies and most medium sized ones, amounting together to more than 90 percent of cases, all elementary construction jobs were performed by subcontractors. In this arrangement, the building company, as a rule, supplies all materials and heavy equipment and the subcontractor does all the work. Payment to subcontractors for work performed is stipulated in the contract by measurable units of physical output such as floor surface, volume of cast concrete of the building skeleton, surface of walls built, and surfaces plastered and tiled. Hereinafter, we will refer to jobs performed under these arrangements as subcontracted jobs. Payments to subcontractors for these jobs amount, on average, to one-fourth of the total cost of inputs in residential construction.

The market for these subcontracted jobs is highly competitive. Contracts are signed with subcontractors that present the most attractive bids, and the market prices of the jobs are well known to all managers and subcontractors at any time. In this manner, building companies virtually escape responsibility for paying the wages of, and providing direct care for, the workers in the subcontracted teams. These responsibilities are transferred to the Israeli and Palestinian subcontractors,<sup>5</sup> or to manpower companies that perform all necessary functions in recruitment, placement and supervision, and living arrangements of the foreign workers who are formally allocated to the building companies.<sup>6</sup> Since subcontractors do not pay for materials or equipment in this system, their remuneration for their construction work is apportioned exclusively between payroll and profit. This underscores the direct dependence of wages on the physical output that characterizes these jobs. Indeed, even though wages are formally calculated and reported in terms of hourly rates multiplied by the number of hours worked, wage payments in contracted jobs are actually linked to physical output in various tricky ways: by setting a low wage base, combined with wage bonuses or deductions commensurate with physical output, or by flexibly manipulating the reported and rewarded number of working hours in accordance with physical output. As a result of such practices, there is a basic difference between wages paid to employees in salaried jobs as stipulated in wage agreements and the wages actually paid for contracted work in “wet jobs.”

### *2.c.2 Technological Progress in Residential Construction*

In the opinion of nearly all project managers, Israeli homebuilding has not made technological innovations in many years. Some claim that the reduction of labor costs in



recent years has actually reduced the use of sophisticated equipment and industrial methods. However, technological improvements are being made on a considerable scale in the construction of multistory office buildings in city centers, most of which are built for public institutions and businesses. Indeed, the estimates in Table 1 indicate that the average labor intensity of real output in construction did not decline during the 1990s.

### *2.c.3 Differences in Terms of Employment between Workers in Contracted Construction Jobs and Those Employed Directly by Building Companies*

Elementary building jobs are characterized by irregularity and frequent changes in size and location. Subcontractors who do these jobs compete in the market to obtain them in all parts of the country. They must occasionally interrupt their activity for certain periods, in order to revise the scale of their operations or to move from one region to another. Thus, they must frequently change the quantity and composition of their inputs; sometimes they must even halt operations altogether. This makes the permanent employment of workers and equipment inefficient.

These conditions make it advantageous to employ temporary workers who will toil without Israeli social benefits, require a minimal investment in human capital by the employer, can be fired without severance pay, and so on. Among temporary workers who are lawfully employed in contracted jobs, foreign workers are cheaper than Israelis or Palestinians because their social entitlements are much lower and because, due to their terms of employment (see below), they can be paid less than the market wage. In contrast, most workers directly employed by building companies are paid according to industrial wage agreements and are entitled to more social benefits, including COLA<sup>7</sup> and severance pay.

### *2.c.4 Cost of Employing a Legal Foreign Worker*

The cost to a legal employer consists of a fixed and of a variable component. The fixed component, independent of labor input and productivity, includes outlays for creating the necessary preconditions for working in Israel—the cost of recruiting the worker, of bringing him to Israel, and of his residing there. The variable component is the pay for the marginal working hours. By covering most of these fixed outlays (travel expenses, visas, taxes, and guarantees<sup>8</sup>) the employers consolidate their position as the sole employers of “their” workers. The fixed cost to a manpower company of a foreign worker who stays in Israel for

one year ranges from \$200 to \$350 per month, depending on origin, region of employment, etc. In addition to this fixed cost, manpower companies calculate another \$200–\$350 for intermediation expenses and for their profit. Given the existence of fixed costs, the marginal cost—i.e., the payment for a marginal working hour, which, irrespective of individual differences in productivity, is the cost of the workers’ marginal product—always falls below the average cost, which declines as the number of working hours increases. This explains why foreign workers are put to extremely long hours: 11–12 hours per day and 250–280 hours per month are the norm, but the quotas are even higher in many cases. As mentioned, subcontractors are paid on the basis of physical output and wage payments are also output-dependent. Therefore, it is the common rule to work “as long as necessary” and sloppy recording of working hours is a common phenomenon. For the record, the net hourly wage of a typical foreign worker ranges from \$2.40 to \$3.50. However, according to the evidence collected, the actual wage in contracted jobs is often considerably lower. Foreign workers accept these terms because even at 280 working hours they make \$550–\$700 a month—a very high income for a low-skill worker in Romanian and Turkish terms. According to the evidence, subcontractors’ reports to the authorities then divide actual monthly earnings by a fictitious number of working hours in order to make reported hourly wages consistent with the mandatory minimum wage.

Calculations based on the correct number of hours show the following:

- 1) Building companies pay manpower companies \$5.0–\$5.5 per working hour for hiring foreign workers, covering gross wages, fixed expenses, and profit.
- 2) The average cost of a working hour to the manpower companies or subcontractors that recruit and import foreign workers, meet their basic needs, and employ them in contracted jobs, is estimated at \$3.20–\$4.50. This depends on the sort of worker, the type of work, and the level of personal services provided.
- 3) The profit per working hour of most manpower companies ranges therefore from \$0.80 to \$1.60.

### **3. Foreign Workers’ Terms of Employment**

Nearly all foreign workers in Israel come from poor countries and low-skill and low-income

population groups. The wages in these countries are very low. Even when Turkish, Romanian, or Ukrainian low-skill laborers are lucky enough to find employment in their countries, they usually earn less than \$150 a month. Chinese low-skill workers earn much less.<sup>9</sup> All these levels fall far short of Israel's minimum wage of over \$650 and the \$350 or so that is generally paid in the Palestinian territories. Thus, multitudes of workers from these countries are willing to work in Israel for wages that are far below the local wage level, and their cost to employers is very low even after one takes into account the added expense of their travel to and fro and their living expenses (see above).

There are difficulties to overcome in recruiting foreign workers abroad, flying them to Israel, and preparing their basic living needs. These workers can cover their own expenses after they start working and earning money, but they are too poor to pay for their transport and living preparations in advance. To solve the problem, employers provide interim financing for foreign workers who enlist with them and deduct these debts from the workers' wages in Israel. This is a familiar arrangement in economic history: Until the early nineteenth century, most immigrants to North America from Europe were brought in as "indentured servants."<sup>10</sup> Since the cost of the transatlantic voyage and primary resettlement was very high relative to earnings and family properties in those days, they had to mortgage their labor services for years and were often reduced to virtual serfdom in America. In the Israeli case, the initial outlays to recruit and transport foreign workers usually range from up to \$500 for workers from Eastern Europe or Turkey to \$750 for workers from eastern Asia. Foreign workers in construction generally put in at least 250 hours per month and earn at least \$550 net (after taxes), so that their debt of \$500–\$750 can be deducted from their first 2–3 (or 3–4) months of wages, depending on the worker's country of origin. Thus, the proper arrangement would require a compulsory relationship between the foreign worker and the employer who recruited him for the first 2–4 months, in order to ensure collection of the debt, and not an infinite indenture.

This brings us to a cardinal issue: The contractors who employ most legal foreign workers in Israel operate a strong political lobby. Their interest in employing foreign workers is to minimize labor costs in order to maximize profits, and they prefer their laborers to be as dependent as possible. They accomplish this by means of the excessive powers given them in regulations of the Ministry of Labor and Social Affairs. Yielding to the strong political pressure of these employers, the Ministry's regulations subjugate foreign workers to their

original Israeli employers during their entire stay in Israel. Their personal working permits are issued not to them but to their employers. If a foreign worker attempts to leave his employer for another, he loses his work permit, becomes illegal, and is liable to deportation. For all practical purposes, this system makes legal foreign labor indefinitely “indentured.”

### ***3.a Economic and Social Consequences***

Let us examine the economic and social consequences of this situation with the help of a simple model of the market for low-skill laborers. The model is based on three simplifying assumptions:

- (1) All types of low-skill laborers have equal productivity, but local and foreign laborers have different supply schedules.
- (2) Local low-skill laborers include Palestinians as well as Israelis, with no distinction made between their supply schedules.
- (3) All low-skill laborers are legally employed and all regulations are enforced (i.e., illegally employed low-skill laborers do not influence the market wage significantly).

The model is represented in Figure 1:

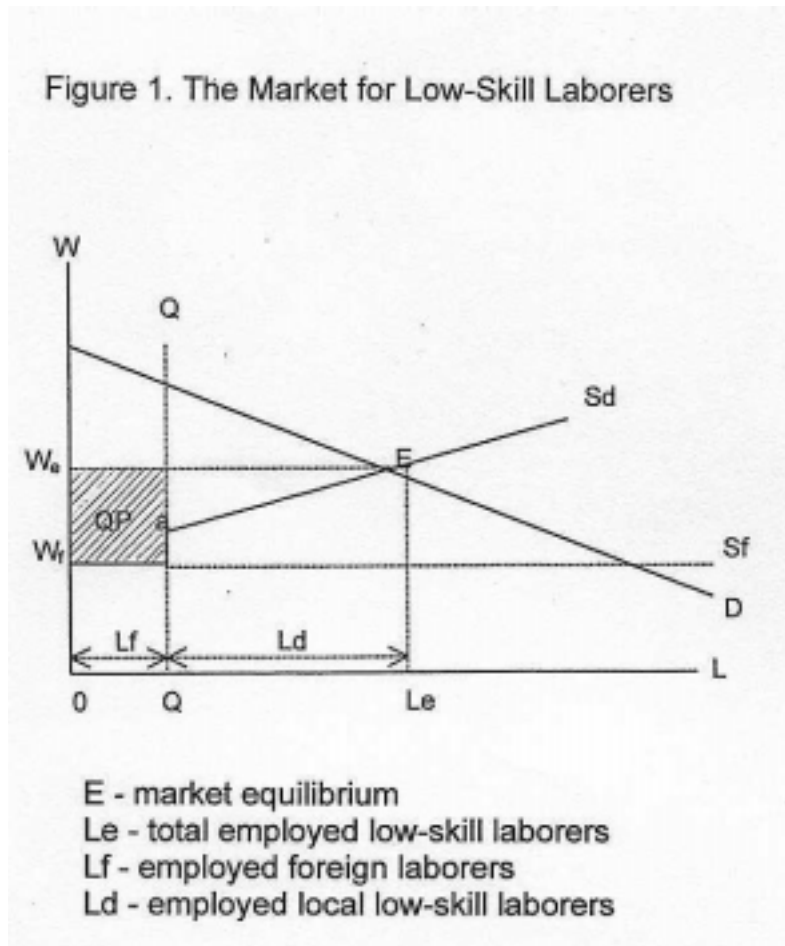


Figure 1 shows:

- (a) an infinitely elastic supply of foreign workers,  $S_f$ , at a very low wage level,  $W_f$ , limited by an effective quota,  $Q$ ;
- (b) a local supply of Palestinian and Israeli laborers that ascends from left to right,  $a-S_d$ , starting from  $Q$ <sup>11</sup>.
- (c) the demand schedule of Israeli employers (mainly contractors) for low-skill laborers, denoted by  $D$ .

In a normally functioning labor market, a competitive market mechanism creates market equilibrium wages for every type of occupation and worker that represent their real economic value (in economic terms, the value of their “marginal product”) in that economy. This market wage is paid, as a rule, to all workers of that type.<sup>12</sup> We denote the market wage

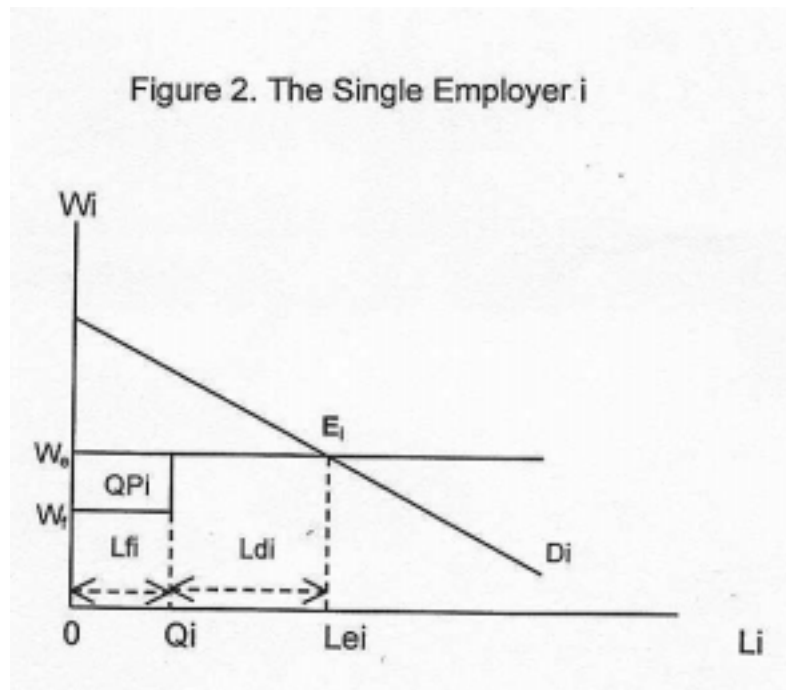
for low-skill laborers by  $W_e$ .

Under Israel's current employment arrangements, however, legal foreign workers are not affected by this competitive market mechanism. Bound to their employers, they cannot accept higher wage offers from other employers as long as they wish to work legally. There, they are paid much lower wages,  $W_f$ —a level that barely suffices to prompt them to work in Israel but falls significantly short of  $W_e$ , the economic value of their work in the Israeli labor market. This reduces the labor costs of their Israeli employers and augments employers' profits—by the “quota profit” (Area  $QP = (W_e - W_f)Q$  in Fig. 1) that results when workers are bound to specific employers and their numbers are limited by an effective quota. (For an empirical estimate of the quota profit, see 3.a.3 below.)

This distortion has a number of adverse effects:

### 3.a.1 *Augmenting Employer Demand for Permits for Legal Foreign Workers to Replace Local Low-Skill Laborers*

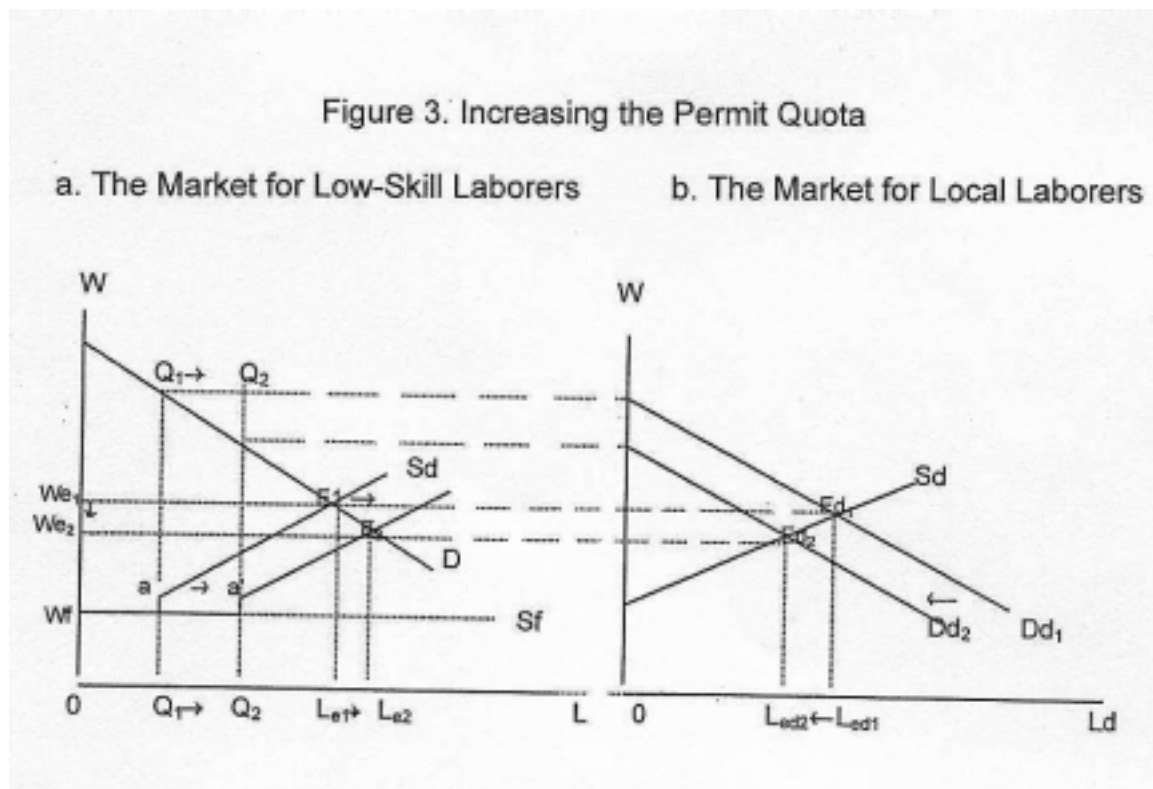
Figure 2 delineates the considerations of the single employer  $i$ , who has a limited quota of permits for legal foreign workers,  $Q_i$ , whom he employs ( $L_{fi}$ ) along with local laborers ( $L_{di}$ ).



Since the foreign workers have no alternative but to work for him, he pays them less than the market wage and benefits from the quota profit,  $Q_{Pi}$ . If he obtains additional foreign

workers, he will use them as substitutes for local workers and boost his profit even more. Therefore, he is always predisposed to claim that he is short of low-skill labor and needs more foreign workers to complete his jobs. This is exactly what the Contractors' Association demands from the government<sup>13</sup>—more and more permits, even at times of declining industry output. The obvious reason for this is their desire to increase profits by replacing local workers and higher-wage illegal foreign workers with legal foreign workers. The Contractors' Association has always maintained that its members are short of labor since Israelis refuse to work in construction, Palestinians are unreliable, and “runaway” foreign workers need to be replaced.

Figure 3 demonstrates the effect of increasing the quota of foreign workers in the low-skill labor market:



The increased quota ( $Q_2$  in Fig. 3a) expands total supply ( $a-S_d$  moves to the right) and, in turn, causes the market wage to decrease ( $We_2$ ). This is the result of a decline in the demand for local laborers ( $Dd_2$  in Fig. 3b.), some of whom have been replaced by additional foreign workers ( $L_{ed2}-L_{ed1}$ ).

### *3.a.2 Creation of Advantageous Conditions for Illegal Employment and Illegal Residence of Foreign Workers, as against Legal Ones*

The existing situation encourages legal foreign workers to turn illegal and, indirectly, encourages illegal immigration.

Placing legal foreign workers at the mercy of their employers gives employers an incentive to exploit them in extreme ways. The foreign worker's dependence also encourages employers to raise their profits by minimizing outlays on such workers in ways other than paying lower wages, i.e., by lowering the quality of basic services provided for them. Indeed, the living conditions of legal foreign workers are seriously inadequate for the most part. When legal foreign workers become illegal, they stand to gain the much higher market wage and they escape the dependence on an obligatory "master." They do run the risk of getting caught and deported, but the odds of this happening are rather slim. This situation encourages legal foreign workers to leave their legal employers and opt for illegal employment and illegal residence. By turning illegal, they also forgo the low-level residential services provided by the legal employer and have to find alternative arrangements. Over time, they realize that illegal work and residence in Israel has its advantages. This encourages them to convince additional family members—wives, mothers—to join them in illegal residence and employment in Israel.

Since the "runaway worker" phenomenon has caused the employers considerable damage, the Contractors' Association has introduced a special insurance scheme that compensates them for the loss. Romanian insurance companies, in conjunction with the Association, mortgage the meager assets of foreign workers who apply for work in Israel as collateral against their "escape" from their employers.

### *3.a.3 Inefficient Allocation of Legal Foreign Workers in the Labor Market*

In the current system, permits for foreign workers are allocated by officials, not the market mechanism. Although formally this prerogative rests with the Ministry of Labor and Social Affairs, in the construction industry the contractors' quotas are in effect allocated by the Contractors' Association. Since the Association represents mainly a group of large contracting firms, most permits for foreign workers are allocated to them, to the detriment of thousands of medium and small contractors. In due course, a black market in legal foreign-worker permits has developed, in which legal workers hired by one contractor are



“sublet” to another. The rents paid for the sublet permits are a good indicator of the quota profits gained by employers of legal foreign workers. According to the findings of the 1997 survey, contractors collected monthly payments of about \$250 per legal worker sublet to other contractors (roughly \$1 per hour, 20 percent of gross wage and 30–45 percent of net wage). Paradoxically, this illegal practice has made the allocation of foreign workers more efficient.

#### 4. Conclusions

The advent of foreign workers in the Israeli labor market should have a dual impact. As in the case of any input, an increase in the supply of foreign workers has both a substitution and an expansion effect. The relationship between foreign workers and local low-skill workers is one of substitution; the foreigners depress the local workers’ wages and compete for their jobs. The relationship with higher-skilled workers is complementary: by lowering the cost of low-skill labor, an increase in the supply of foreign workers enhances economic activity and boosts demand for other sorts of labor. While the net effect on overall Israeli employment is unclear, the consequences for income distribution are evident—the advent of foreign workers increases income inequality among Israelis. The effect spreads from construction to other industries, particularly when foreign workers quit construction, become illegal, and enter other industries.

It should be kept in mind that hundreds of millions of low-skill workers in lesser developed countries earn much less than the wages Israeli employers are willing to pay foreign workers. If Israel does not limit their numbers, like most developed countries, they will flood the domestic labor market, induce mass-immigration of destitute foreign populations, and crowd most local low-skill workers out of the job market. Therefore, the effective regulation of the entrance of foreign workers is of the utmost social and economic importance to Israel, as it is in most developed countries. For this reason, and for other social reasons, it has been the declared policy of the government of Israel since 1996 to reduce the presence of foreign workers, both legal and illegal, radically. Thus far, however, their numbers have not declined significantly, and one of the main reasons is an inadequate set of government regulations regarding their employment. The current regulations indenture these workers to their employers indefinitely and isolate them from the competitive mechanism of the labor market. These arrangements affect their employment in a number of ways. They set

foreign workers' wages below the market equilibrium level and distort the workers' allocation in the labor market. They benefit employers who are lucky enough to obtain employment permits for foreign workers and encourage them to substitute foreign for local workers—thus whetting their demand for more. The system also discriminates against legal foreign workers relative to illegal ones, encourages them to turn illegal, and, thereby, indirectly encourages illegal immigration to Israel.

Thus, the current system of employing foreign workers strongly counteracts the declared policy aims of the government. Its shortcomings, however, are the result of the political pressure of interested employers, not of objective requirements. This paper recommends that the mandatory relationship that binds foreign workers to the employers who recruit them be made to last for the first 2–4 months only, and not for an infinite period as in the current practice. For the rest of their stay in Israel,<sup>14</sup> the workers should be allowed to change employers: They should receive an appropriate working permit (perhaps a kind of “green card”) that allows them to accept job offers from any lawful employer at any time<sup>15</sup> and to earn the going market wage for their labor.

If this policy is adopted, one may expect the quantity of foreign workers demanded to plummet and the workers' incentive to turn from legal to illegal employment to decrease sharply. At the same time, however, the economic conditions of foreign workers in Israel would improve, thereby raising the incentive for foreigners to work in Israel. This might result in efforts to enter Israel illegally, requiring increased efforts and improved measures to control entrance to the country.

Developed countries that have grown accustomed to large-scale employment of foreign workers have always found it difficult to reduce their numbers and limit the presence of nonresidents in any effective way,<sup>16</sup> even when they apply appropriate policy measures. To succeed, policies should adopt administrative measures that create economic conditions that help to achieve the policy aims. In the Israeli case, the administrative measures adopted have created economic conditions that counteract the policy aims and render the policy futile. This is the result of having turned the employment of legal foreign workers into a source of easy gains, and of having created economic conditions that discriminate against legal foreign workers in favor of illegal ones. Therefore, it will come as no surprise if the Ministry of Labor's plan to downscale foreign employment radically by 2001 will end in failure.

## NOTES

<sup>1</sup>Amir, S. (1999), “The Impact of the Entrance of Foreign Workers into the Residential Building Industry in Israel” (Hebrew), in Nathanson, R. and Achdut, L. (eds.), *The New Workers: Wage Earners from Foreign Countries in Israel*, Hakibbutz Hameuchad Publishing House Ltd..

<sup>2</sup>Stalker, P. (1994), *The Work of Strangers: A Survey of International Labor Migration*, ILO, Geneva.

<sup>3</sup>Since 1995, the Palestinian Central Bureau of Statistics (PCBS) regularly has been conducting a labor-force survey in the Palestinian population. The reported survey data include the following estimates of Palestinians employed in construction jobs in Israel (thousands): 1996—31, 1997—42, 1998—60. These estimates show that Palestinian employment in the construction industry may have increased much more between 1996–1998 than the CBS estimates in Table 1 indicate. This possible rapid increase in the number of Palestinian workers may also cast doubt on the rough estimates of the number of foreign workers in 1997 and 1998, since Palestinian and foreign workers in construction are close substitutes, and a significant increase in low-skill labor would not be compatible with the continuous decline in the real output of the industry.

<sup>4</sup>Central Bureau of Statistics, *Labor Force Surveys 1996*, Special Series No. 1080, CBS (June 1998).

<sup>5</sup>Palestinian subcontractors are commonly known as *ra'is*, i.e., chief.

<sup>6</sup>Many manpower companies also function as subcontractors that perform elementary construction jobs for building companies.

<sup>7</sup>Cost-of-Living Allowance.

<sup>8</sup>Employers must deposit a certain sum for each documented foreign worker to guarantee his departure from the country after his contract expires.

<sup>9</sup>Based on evidence of nonresidents from those countries who work in Israel, collected in interviews that were part of the 1997 survey.

<sup>10</sup>Galenson, David, W. (1984) “The Rise and Fall of Indentured Servitude in the Americas: An Economic Analysis,” *The Journal of Economic History* (March).

<sup>11</sup>It is assumed that  $W_f$  is below the local reservation wage, i.e.,  $a > W_f$ .

<sup>12</sup>This market equilibrium wage is the result of competition among both employers and

workers: As long as workers are employed anywhere for less than the competitive wage level, it pays other employers to offer them higher wages. Since workers search for higher wages at the same time, this competitive market mechanism moves wages continuously toward their equilibrium wage level.

<sup>13</sup>In a series of “open letters” to the Prime Minister, published in all newspapers since 1994, and in TV commercials broadcast in 1998 and 1999.

<sup>14</sup>Workers from Europe and Turkey generally come for one year and those from eastern Asia for two years.

<sup>15</sup>Permits to employ foreign workers should be given to employers in industries that the government has endorsed for foreign labor.

<sup>16</sup>Chiswick, Barry R., “The Economics of Illegal Migration for the Host Economy,” paper presented in Jerusalem in September 1999 at an international expert meeting on irregular migration.