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The Economic Impacts of Labor Shortage on Certain Key Sectors in the Local Economy

The Palestine Economic Policy Research Institute (MAS) regularly publishes applied and scientific studies, in addition to brief research papers, as part of an annual series of roundtable sessions on important economic topics of interest to the public and decision-makers. The policy briefs outline the key recommendations of selected scholastic activities, in order to disseminate this information and maximize the benefits derived from this series of sessions. This Policy Brief was prepared with the support of Heinrich Boll Stiftung (HBS Jordan and Palestine)

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The Future of Palestinian Employment in the Israeli Labour Market in light of Political and Economic Realities

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1. Background – prolonged colonial economic dependency

During the past few years, the increase in the number of Palestinian workers in Israel was accompanied by an alarming phenomenon in the Palestinian labor market; namely, the shortage and scarcity of labor in certain sectors within the local economy, despite the significant increase in unemployment rates, reaching 24.4% in 2022 (and about 13% in the West Bank) (PCBS, 2023a). Meanwhile, the number of Palestinians working in Israel grew to over 200,000 in 2021, though has moderated somewhat since. This ignited wide debate among stakeholders in affected economic sectors, as well as economists and government, in diagnosing the extent of this phenomenon, and its effects on the Palestinian labor market specifically and the economy overall. The Palestinian Prime Minister has affirmed that there is a shortage of labor in the local market, confirmed by both the Private Sector Coordination Council and the Palestine Economic Policy Research Institute (MAS, 2022a). As such, it is useful to shed light on the professions that indicate labor shortages and examine impacts on the Palestinian labor market and the local economy, to propose possible interventions and solutions to this phenomenon, in order to reduce its negative impacts on the local economy.

2. Challenges: Causes of Labor Shortage

Based on in-depth interviews with relevant parties, it can be concluded that the shortage of labor supply in Palestine is not a general problem, but rather limited to a specific cohort - namely, skilled labor, especially skills that are associated with higher levels of education. In other words, it is not a quantitative problem caused by the scarcity of labor, but rather labor non-availability in terms of required quality, skills, and experiences required to fill available vacancies in the local market.

Also, field interviews revealed that certain sectors are more affected than others by this shortage of skilled labor, especially the agricultural, industrial, construction, and tourism sectors. The Palestinian labor shortage in the local market can be attributed to two primary reasons:

- **The growing tendency of Palestinian workers to work in Israel:**

Given the shrinking job opportunities and low wages in the local market compared to better-paying jobs in the Israeli labor market, a significant proportion of the Palestinian labor moved to the Israeli labor market, such that it became a major source of jobs for Palestinians, especially for West Bank workers.

- **The skills mismatch between technical vocational education and training (TVET) in Palestine and the labor market needs:**

TVET play a significant role in bridging the gap between supply and demand in the labor market and in providing a pathway for skilled labor. On the other hand, the TVET sector suffers from a number of challenges and drawbacks, most importantly; the weak relationship between vocational training and the labor market, and the lack of sufficient funding and support. Undoubtedly, these challenges constitute an obstacle to TVET's efficiency in bridging the demand gap in the labor market

3. Potential Economic Effects

The increasing tendency and preference of Palestinian labor to work in the Israeli labor market, is associated with a series of economic impacts, especially in sectors that suffer from labor shortage, as well as at the level of the economy as a whole. Labor shortage in these sectors could cause disruptions in production (supply) chains, higher price levels, and a downturn in economic activity.

- **Declining production in certain vital sectors**

The absorption of a significant portion of the skilled Palestinian labor in the Israeli labor market withdraws labor from the local market, especially in some vital economic sectors such as agriculture, industry, construction, and tourism. This, in turn, leads to a reduction in the volume of production. Additionally, it undermines the sustainability and ability to compete of numerous Palestinian industrial establishments, especially that the majority of which are small- to medium-sized enterprises.

The shrinking labor force without providing a qualified and efficient substitute will negatively affect the production capabilities of these enterprises, which in turn negatively affects their sustainability. On the other hand, the inability to attract more labor, given low local wages and the large wage gap in favor of the Israeli labor market, hinders the growth prospects and development of these enterprises and their ability to increase production. They simply cannot pay qualified local laborers the same wage that they would otherwise receive in the Israeli market.

- **Raising Wages and its Impact on Downsizing of the Productive Sectors and the Decline in the Competitiveness of Palestinian Products**

Given the growing tendency of Palestinian workers to work in the Israeli market over the last years, it is expected that the same economic impacts of the economic relationship of the past prevailing for decades now, will continue. With the steady increase in the number of Palestinian workers in Israel and its settlements, income levels in the local economy will rise, and in turn, the volume of economic activity at the macro level. However, in the long term, the increase in Palestinian workers' remittances can harm the local economy by raising inflation levels, which will weaken the competitiveness of Palestinian productive sectors (MAS, 2022).

3. Policy Recommendations

Usually, economies facing a labor shortage resort to raising wages to attract and encourage qualified workers to take up vacant jobs or attract workers from abroad. In the Palestinian case, the second resort is not feasible, given the economic and political challenges that the Palestinian economy faces, and its negative effects on the local economy, especially rising inflation levels and the downsizing of the productive sectors.

Under the current configuration of economic and security powers between Palestine and Israel, and in light of the inability of local employers to give workers in the local market of various professions

and specializations the same wage that they would receive in the Israeli labor market, the options available to confront the labor shortage are limited to:

1. Provide workers with flexible working conditions in sectors that face labor shortages.
2. Employers and industrial enterprises should also play a greater role in identifying the skills gaps in the local market, needed to plan future trends in educational institutions, especially vocational and technical education and training.
3. Improve the governance of the vocational education sector and address gaps in management and coordination between the main players in this sector.
4. Enhance special policies and interventions for capacity building of the unemployed and university graduates to align their skills with the local labor market.
5. Increase the private sector's investment in promoting TVET and the development of new vocational education programs, to maximize the benefits to the private sector from investing in their human resources.
6. Improve the social protection systems and strengthen the role of regulatory bodies, especially with regard to monitoring the application of the minimum wage.
7. Providing financial support for TVET centers.
8. The Palestinian government is urged to adopt development policies that target the productive sectors and provide the necessary facilities that serve the private sector's investments in these sectors.