



Palestine Economic Policy Research Institute

Determinants of Labor Absorptive Capacity in the West Bank and Gaza Strip

Basim Makhool

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4. The initial draft of the study is reviewed by the scientific committee for objective content-related amendments to be added to the second draft.
5. The second draft is then submitted for evaluation in accordance with the terms of reference to two or three external academic experts specializing in the subject. Provided that there is a positive evaluation by at least two experts, the researcher is asked to review the study taking into consideration the objective recommendations of these experts.
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7. Comments and feedback from the workshop are incorporated into the study and the final draft is reviewed by the scientific committee to ensure that the necessary amendments have been made. The study is then edited.
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Summary

The purpose of this study is to estimate the determinants of labor absorptive capacity of the Palestinian economy, at the macro and sectorial levels. Descriptive and quantitative analytical methods were used to estimate the influence of four variables on labor absorptive capacity: production and productivity, technological developments, factor substitution, and relative cost of labor. To estimate the influence of these variables, two econometric models were developed and estimated in the form of logarithmic functions. The analysis relied on the survey which was conducted by the Ministry of Industry in 1997, which included some 5900 firms and the national accounts provided by the Palestinian Central Bureau of Statistics. The available data allowed the estimation of the two models at the level of manufacturing sectors in the West Bank and Gaza Strip. For other economic sectors, the available data didn't allow the estimation of econometric models. To estimate the Palestinian economy's absorption capacity, the researcher estimated the employment elasticity with respect to output by using the averages of the period between 1995-1999.

Following is a summary of the most important relationships and results found:

At the macro level, employment elasticity with respect of output was estimated at 0.8 and 0.78 in the West Bank and Gaza Strip respectively. The highest elasticity was found in the West Bank agricultural sector (3.15) and industry (2.77). In Gaza Strip, the highest elasticity was in agriculture and construction sectors: 2.93 and 2 respectively. The estimated elasticity at the macro level is relatively high in comparison with international levels, which ranges between 0.45-0.5. Pertaining to the services sector, it was found that it had the highest absorptive capacity in both the West Bank and Gaza Strip: 2.26 and 1.79 respectively. This means that 43% of newcomers to the labor market in the West Bank would find work in the services sector as opposed to 24% in the Gaza Strip. This was followed by wholesale, retail restaurant and hotel sector (16.2%), the construction sector (15.4%), transport and storage sector (4.3%) and lastly the agriculture sector (1.8%) in the West Bank.

The total absorptive capacity in the West Bank was estimated at 85%. That is to say, the West Bank economy can absorb only 85% of all new entrants to its labor market. Pertaining to the Gaza Strip labor absorptive capacity,

the study found that it was 52%. This percentages was distributed among the following economic sectors: services sector (24.5%), construction sector (12.3%), transport and storage sector (5%), industry sector (4.8%), agriculture sector (3.8%) and wholesale, retail, restaurant and hotel sector (1.6%). As a whole, the Palestinian economy can absorb 62% of the increase in the workforce annually. And the most promising labor-absorbing sectors are the services sector, the wholesale retail, restaurant and hotel sector, and the construction sector. The lowest labor-absorbing sectors are agriculture, industry, and transport and storage.

Concerning the manufacturing sectors, it was found that there was a positive relationship between employment and wage productivity (the productivity of the dollar spent on labor). However, a negative relationship was found between employment and the worker's productivity, and capital-labor ratio. The employment elasticity with respect to output was 0.23 which is relatively low when compared with the value prevailing in developing countries (which amounted to 0.45). This shows the weakness of the absorptive capacity of manufacturing sectors. Concerning the elasticity of substitution, it was estimated at 0.33 for the various branches of manufacturing industry. This value is low when compared with results of previous studies which estimated elasticity of substitution between 0.5 and 1.2. The employment wage elasticity with respect to ... was estimated on average, at -0.22.

In addition, there were significant structural differences between small and large firms in terms of the employment elasticity. The estimated employment elasticity with respect to the value added was 0.22 for large firms as opposed to 0.12 for small ones. This means that large firms are more capable of creating job opportunities than small firms through increases in production. While the elasticity of substitution was 0.33 for small firms in comparison with 0.13 for large ones. These results indicate the job creation policies, through increases of the production will be more effective in large firms while policies aiming at creating job opportunities through encouragement of investment or lowering capital-labor ratio will be more effective in small firms.