

DOES PALESTINIAN LABOR LAW HURT EMPLOYMENT POSSIBILITIES FOR PALESTINIAN YOUTH?

By Edward Sayre and Mary Kraetsch

INTRODUCTION

As with youth across the Middle East, youth in the Palestinian Territories are experiencing increasingly prolonged school-to-work transitions. In fact, the median waiting time for recent graduates in the West Bank and Gaza Strip is now two years, and nearly a quarter of graduates still do not have jobs five years after finishing school.¹ While some of the increasing delay has its roots in the macroeconomic and political uncertainties that have plagued the Palestinian Territories, Palestinian law has also played a role in effecting longer waiting periods.

The Palestinian Labor Law of 2000 has bolstered the legal protections provided to workers in several ways, including an increase in mandated severance payments to older workers. Subsequently, the costs of dismissing workers for Palestinian firms have increased substantially. This has made firms less likely to bring on new workers because the cost of eventually dismissing them is so high. This implies the need for adopting more flexible labor law provisions that would encourage the startup, growth, and expansion of firms in the private sector, and potentially lead to

increased employment opportunities for young people, while at the same time providing protection to workers from the vagaries of a competitive labor market.

This brief investigates the effects of the Palestinian Labor Law on unemployment duration for young Palestinians entering the labor market. The first section describes the Palestinian labor market in general and provides an overall analysis of unemployment duration among Palestinian youth. The second section provides a theoretical overview of the potential effects of rigid labor laws on unemployment among youth, as well as a description of specific clauses of the 2000 Palestinian Labor Law and the coverage rates of the law in different sectors of the economy. The third section identifies a correlation between the coverage rates of the law in different sectors of the economy and unemployment duration therein, using a “difference-in-difference” approach to determine the effects of the labor law on unemployment and unemployment duration among Palestinian youth. Our analysis concludes with some policy implications and areas for further research.

SUMMARY

This policy outlook investigates the effects of the Palestinian Labor Law of 2000 on unemployment duration for Palestinian youth. Our analysis finds that key components of the law, such as the increase in severance payments to dismissed workers, have introduced additional costs for employers seeking to hire and dismiss workers. This has, in turn, limited the willingness of firms to hire young workers. In this regard, easing school-to-work transitions for Palestinian youth may require reforms that both loosen labor market restrictions while simultaneously providing workers with alternative forms of social protection.

THE PALESTINIAN LABOR MARKET AND UNEMPLOYMENT DURATION FOR PALESTINIAN YOUTH

The Palestinian labor market has been marked by three distinct phases since the beginning of the Israeli occupation in 1967. During the first phase, the main outlet for young Palestinians unable to find employment in the Palestinian Territories was to travel to the Gulf region for jobs, which were plentiful for skilled workers at the time due to the rise in oil production in the Gulf states in the 1960s.

¹ Edward Sayre and Samia Al-Botmeh, “In Search of a Future: The Struggle of Young Palestinians,” in *Generation in Waiting: The Unfulfilled Promise of Young People in the Middle East*, ed. Navtej Dhillon and Tarik Yousef (Washington, DC: Brookings Institution Press, 2009); Edward Sayre and Samia Al-Botmeh, “Youth Exclusion in the West Bank and Gaza Strip: The Impact of Social, Economic, and Political Forces,” Middle East Youth Initiative Working Paper No. 10 (Washington, DC and Dubai: Wolfensohn Center for Development at Brookings and the Dubai School of Government, 2009). See www.shababinclusion.org/content/document/detail/1525/.

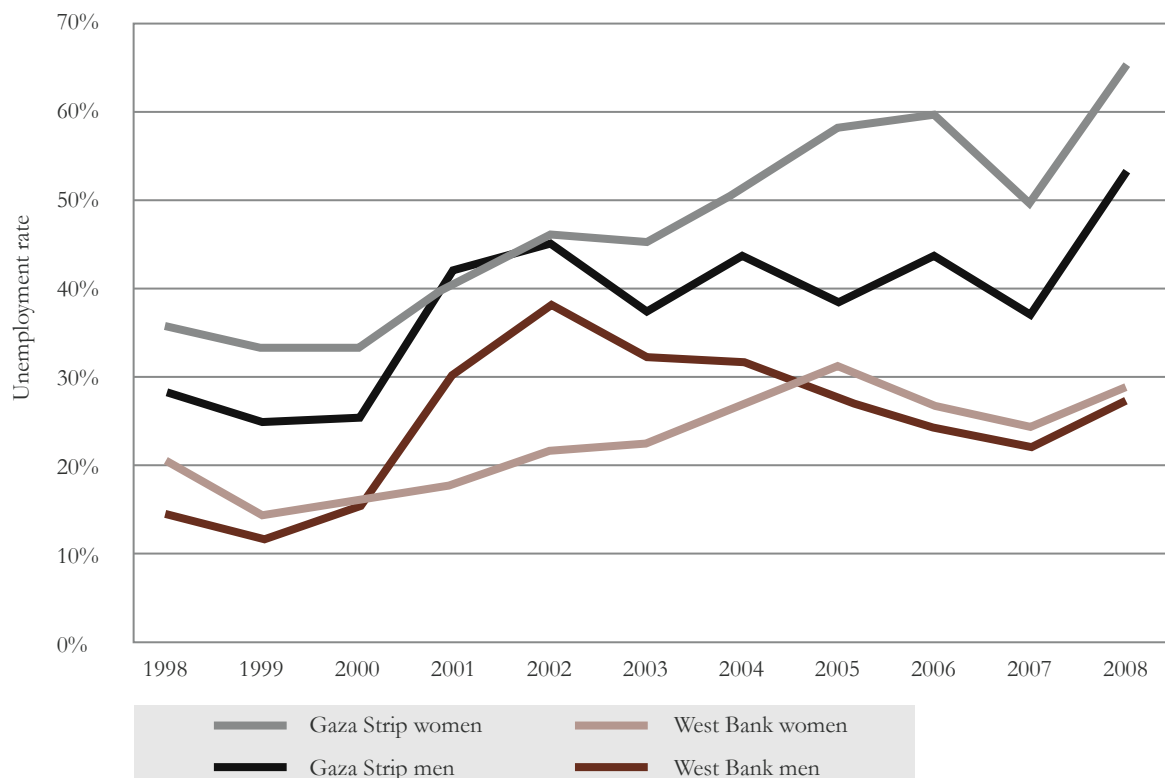
Beginning in the 1980s, employment opportunities for Palestinians in the Gulf countries began to decline, and many migrants returned home. At the same time, however, the Israeli economy began to recover from the economic downturn of the 1970s, and the economies of Israel and the Palestinian Territories became increasingly integrated as the Israeli economy began to depend on Palestinians to fill jobs, especially in manufacturing, construction and agriculture. In the mid-1980s, as many as one third of Palestinian wage workers were employed in Israel or on Israeli settlements in the Palestinian Territories.

The economic environment for Palestinians shifted again following the Al-Aqsa Intifada in 2000. Despite a doubling of the Palestinian labor force since 1990, fewer than 50,000 Palestinians now work in Israel. Industrial zones in Gaza have been closed, while land seizures for the expansion of Israeli settlements, bypass roads, and the new security barrier in the West Bank have limited economic activity. Political violence

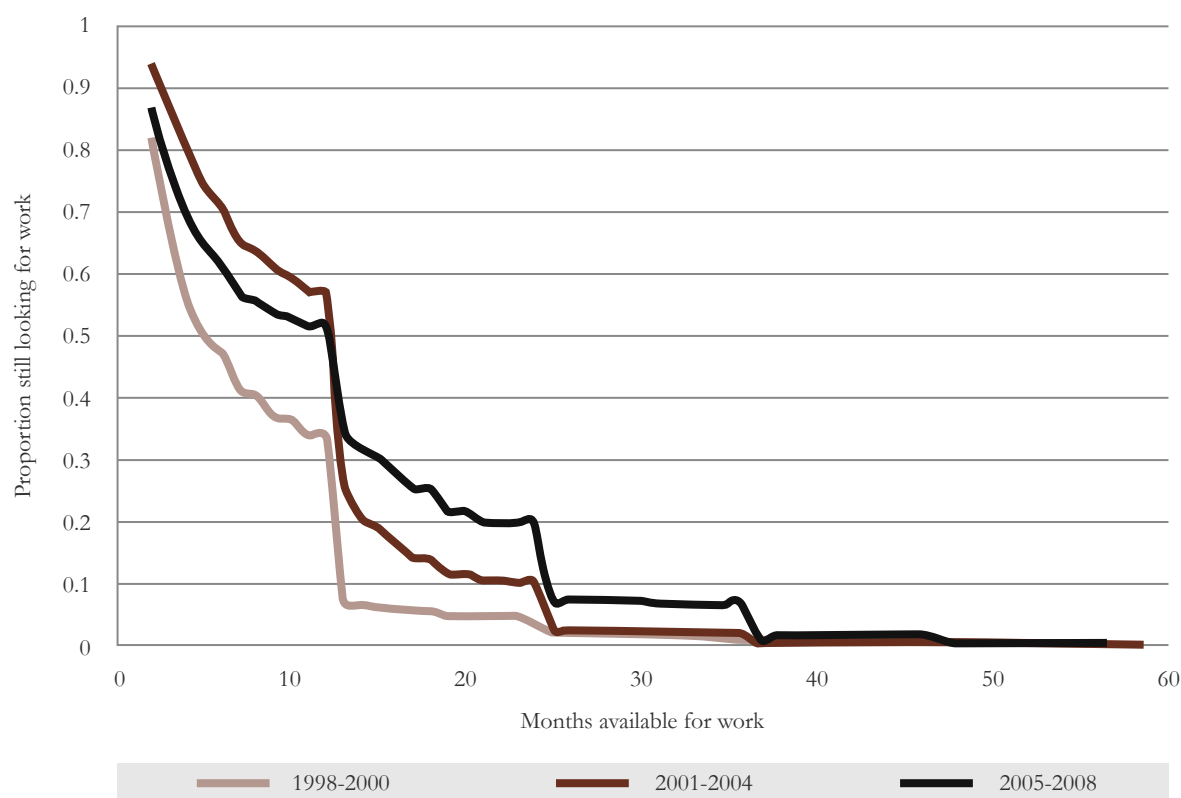
has stymied efforts to expand the tourism industry that could produce new jobs. In fact, the only sector in the Palestinian Territories that continues to grow is the public sector. The higher salaries earned in the public sector also put upward pressure on wage expectations for recent graduates, leading to longer periods spent waiting for a first job after graduation. As such, the Al-Aqsa Intifada and the continued political and economic upheaval witnessed since have resulted in higher unemployment, especially for youth (figure 1).

In addition to high unemployment rates, youth also experience a relatively long duration of unemployment. Based on “survival” functions for Palestinian youth unemployment, which measure the probability of persons remaining unemployed over time after losing their jobs, the median duration for youth unemployment during the period 1998-2008 was approximately one year. The survival functions in figure 2 illustrate how unemployment duration among youth has changed over time between 1998 and 2008.

Figure 1: Unemployment Rates for Palestinian Youth, 1998-2008



Source: Authors' calculations from 1998-2008 Palestinian Labor Force Surveys

Figure 2: Unemployment Survival Functions by year

Source: Authors' calculations from 1998-2008 Palestinian Labor Force Surveys

The three time periods in the figure are the pre-Al-Aqsa Intifada period (1998-2000), the height of the Intifada (2001-2004), and the late Intifada and post-Intifada period (2005-2008).

Unemployment duration was generally shorter for youth during the pre-Intifada period than in the periods during and after the Intifada. Prior to the Intifada, two thirds of unemployed youth found jobs within a year. However, after 2000, no more than one half were able to find jobs within one year. While most of this increase in unemployment duration is undoubtedly due to the restrictions on Palestinians working in Israel during this time, it is worth noting that the Palestinian labor law was first unveiled during the 2001-2004 period. Below, we will describe this Palestinian labor law and show how it is possible to separate out the effects of the law from the effects of the Intifada on unemployment duration.

THE IMPACT OF JOB SECURITY REGULATIONS ON UNEMPLOYMENT DURATION

Labor market regulations, especially in the form of job security regulations, are designed to protect workers against changing economic conditions. However, these types of labor market regulations are widely considered to affect the duration of unemployment, especially for youth and new labor market entrants. A number of cross-country studies have found that stricter regulations generally increase levels of unemployment in both developed and developing countries. In particular, strict labor regulations and rigid employment laws—especially onerous hiring and firing rules—increase levels of unemployment, particularly among two demographic groups that usually have above-average unemployment rates: young people and women.²

² Horst Feldmann, "The Unemployment Effects of Labor Regulation Around the World," *Journal of Comparative Economics* 37(2009): 76-90; Juan Botero, Simeon Djankov, Simeon, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "The Regulation of Labor," *Quarterly Journal of Economics* 119 (2004): 1339-1382; Simeon Djankov and Rita Ramalho, "Employment Laws in Developing Countries," *Journal of Comparative Economics* 37 (2009): 3-13.

In the Middle East context, Wahba (2009) has studied the effects of 2003 Egyptian labor law, which has increased the flexibility of formal employment relations.³ She finds that the new labor law has been associated with an increase of formal private sector employment. However, research on this subject in other Middle Eastern labor markets is limited, and there is little evidence of how employment regulations or the reforms of these regulations impact young workers in the region.

Theoretically, there are three primary ways that employment regulations can lead to longer unemployment duration:

- First, employment regulations that require employers to provide mandated benefits (such as maternity leave, vacation or holiday pay, or sick leave) raise the costs of employing workers. In effect, benefits which impose additional costs act as a tax on labor.⁴ These mandated costs for employers can make firms less likely to hire additional workers, effectively reducing employment opportunities by reducing demand for labor.⁵
- Second, employment regulations that protect the jobs of current workers (by requiring severance pay or approval for dismissal by labor courts) lead to higher firing costs for employers. A number of studies of employment protection regulations in Latin America have found that job security provisions increase the costs of dismissals and have an adverse effect on total employment.⁶ By increasing the costs of firing, these regulations also increase the costs of hiring, because firms

have to consider all workers as lifetime employees. This biases firms in favor of incumbent and older, experienced workers to the disadvantage of new entrants and younger, relatively less experienced workers.⁷

- Third, employment regulations that provide mandated benefits and job security make working in the formal sector more attractive, and thus encourage more people to enter the labor market, adding to the number of people seeking jobs and increasing unemployment duration for job seekers. In effect, these types of regulations increase the demand for jobs while not creating an accompanying increase in the supply of jobs. When the coverage of employment regulations is not uniform and varies by sector of employment, demand for jobs increases in sectors with higher coverage rates. If workers become more attracted to a particular sector that has higher coverage rates, such as the public sector, then preference for employment in that sector will be higher and the queue for jobs in that sector will become longer.

THE LABOR LAW IN THE PALESTINIAN TERRITORIES

In the late 1990s, the Palestinian Authority initiated a series of reforms designed to unify the disparate legal systems that had existed in the Palestinian Territories, and in the process create a set of basic laws that would lay the foundation for a modern legal infrastructure for the Palestinian state. Prior to this time, the West Bank operated under Jordanian law and the Gaza

³ Jackline Wahba, "The Impact of Labor Market Reforms on Informality in Egypt," Population Council Working Paper (2009).

⁴ Tito Boeri, Brooke Helppie, and Mario Macis, "Labor Regulations in Developing Countries: A Review of the Evidence and Directions for Future Research," SP Discussion Paper No. 0833 (Washington, D.C.: World Bank, 2008).

⁵ Richard Freeman, "Labor Regulations, Unions, and Social Protection in Developing Countries: Market Distortions or Efficient Institutions?" *Handbook of Development Economics*, Volume 5 (2010).

⁶ James Heckman and Carmen Pages, "The Cost of Job Security Regulation: Evidence from Latin American Labor Markets," NBER Working Paper No. W7773 (2002); Adriana Kugler, "The Effect of Job Security Regulations on Labor Market Flexibility: Evidence from the Colombian Labor Market Reform," in *Law and Employment: Lessons from Latin America and the Caribbean*, ed. James Heckman and Carmen Pages. (Chicago: University of Chicago Press, 2004); Claudio Montenegro and Carmen Pages, "Who Benefits from Labor Market Regulations? Chile, 1968-1988," in *Law and Employment: Lessons from Latin America and the Caribbean*, ed. James Heckman and Carmen Pages. (Chicago: University of Chicago Press, 2004).

⁷ Freeman (2010).

Box 1: Employment Protection Provisions of the Palestinian Labor Law of 2000**Article (42)**

1. The employee has the right to resign from his position while maintaining his full legal rights, including the end of service award, after informing the employer in the presence of the following conditions:
 - a. Placing the employee in a job that is clearly different in its kind and degree from the job that was agreed upon in the work contract unless such placement is necessary to prevent catastrophe and for a short period of time.
 - b. Employing the worker in a way that requires him to change his living place.
 - c. Medical proof issued by the medical committee which states that the continuation of the employee's work places danger on his life.
 - d. Physical or verbal assault toward the employee during working hours by the employer or anyone who represents him.
 - e. The failure of the employer to fulfill his obligations toward the employee after written request by the employee.
2. Except what is indicated in item (1) above, if resigned from his work during the first five years, the employee has the right to one-third of the end of service award, two-thirds of the end of service award if he resigns during the second five years of service, and the full end of service award if he spends ten years or more at work.

Article (45)

The employee who spent a year at work has the right to the end of service award, which equals one full month of average last monthly pay for each year he has served without factoring the overtime hours spent.

Article (47)

While preserving all his other legal rights, and if dismissed from work without a legitimate reason, the employee deserves compensation worth two months of regular pay for each year he served at work but the total compensation shall not exceed two years of his regular pay.

Strip operated under Egyptian law. The reforms of the late 1990s included the implementation of the Palestinian Basic Labor Law of 2000, which replaced the Jordanian Labor Law of 1960 and the Egyptian Labor Law of 1964.

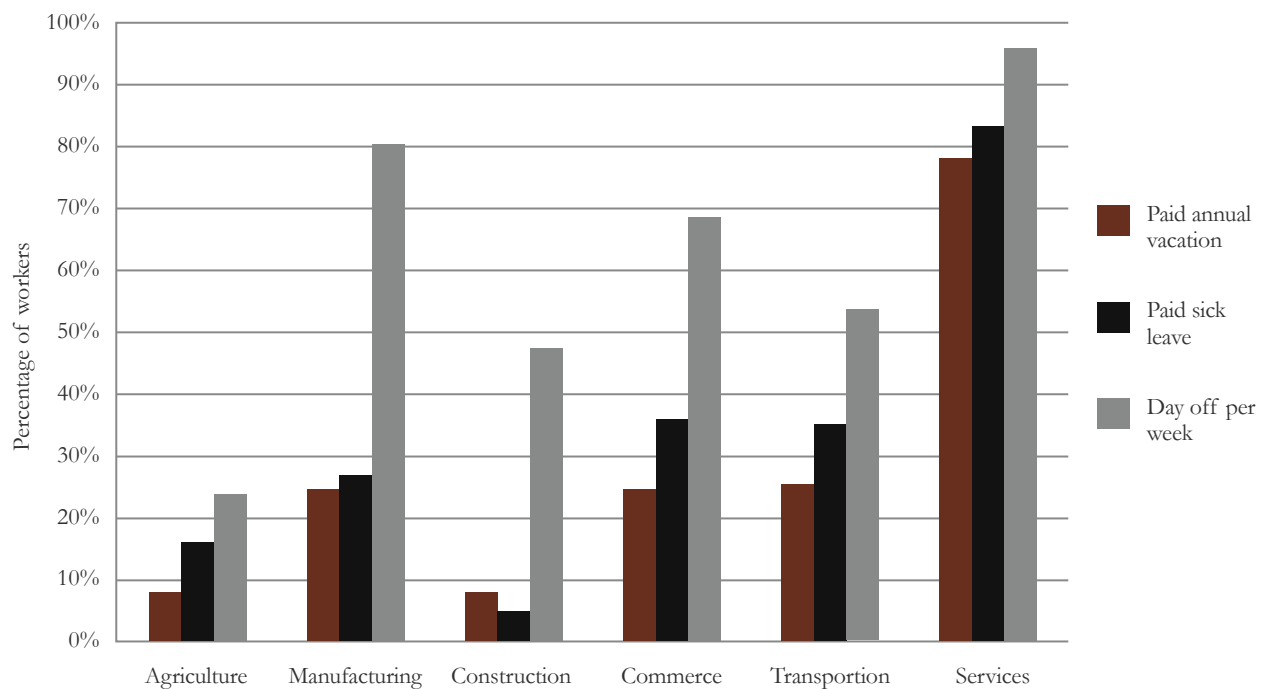
Some of the regulations contained within the law are the following: mandated end-of-service award, available to all employees (details in Box 1); a work week of 45 hours that would be reduced by one hour per day for jobs classified as hazardous; twelve hours maximum of overtime, with an overtime premium of time-and-a-half; two weeks of mandatory paid leave; and, 14 days of sick leave at full pay, with another 14 days at half pay.⁸

When compared with the prior laws, the employment protection and security provisions of the 2000 law are more restrictive on employers, and increase the costs associated with firing employees. The 1960 Jordanian law in the West Bank stipulated a severance payment of half a month of pay for each year

of service. In Gaza, the 1964 Egyptian law stipulated a half month of wages for each year of the first five years of service. In contrast, the 2000 law calls for one month of pay for each year of service, effectively doubling the severance payment for longtime workers. Thus, because the new law creates a stronger system of employment protection and consequently represents an increase in the cost of firing workers, it should lead to longer wait times for the reasons described above.

At the same time, it is also worth noting that, especially for workers in the West Bank, the change in law decreased the cost of having temporary employees that work for only a short time. First, the new law allows for a three-month trial period during which the employer does not need to offer a formal contract.⁹ Furthermore, while the 1960 Jordanian law included a formula to determine a fraction of the severance payment for workers who were employed less than 12

⁸ Articles 42-47, 69-70, 71, 74, and 79 of the 2000 Palestinian Labor Law.

Figure 3: Percentage of Workers Receiving Mandated Benefits by Industry

Source: Authors' calculations from Palestinian Work Conditions Survey of 2004

months, the new Palestinian law provides for no severance payment for employees who have worked less than a full calendar year. The removal of severance payments for short-term work is expected to result in an increased availability of short-term jobs.

Coverage of the benefits and regulations codified in the basic labor law is not universal. In this regard, data from the Work Conditions Survey of 2004 provide an indication of overall coverage rates of the law.¹⁰ This survey asked an extensive set of questions about working conditions and about different types of employment benefits available to workers at their jobs, some of which are mandated by the Palestinian Labor Law of 2000. Figure 3 shows the percentage of workers who receive three benefits (paid annual vacation, paid sick leave, and one day off per week) across different employment sectors (agriculture, manufacturing, construction, commerce, transportation, and services).

As figure 3 shows, while most workers (outside of the agricultural sector) receive at least one day off per week, other benefits (paid annual

vacation and paid sick leave) show much more variation, even though both types of leave are mandatory under the Palestinian labor law.¹¹ Specifically, less than 10 percent of agricultural and construction workers receive annual vacation leave. Less than 30 percent of manufacturing workers and less than 10 percent of construction workers receive paid sick leave.

These data provide an indication of overall coverage rates of the law, which allows us to analyze the distribution of various benefits to Palestinian workers by sector. In previous studies, whether or not an employer abides by certain aspects of labor legislation (e.g., paying into social security) has been shown to serve as a good proxy for whether or not the employer abides by other regulations in the labor law, such as employment security regulations.¹² Thus, although the survey does not provide specific information about employment protection legislation found in the Palestinian labor law, these data give an indication of the overall coverage rates by looking at other mandated benefits. Since sick leave and annual leave are most closely related to a general

⁹ Unlike the case of the recent reforms in Egypt, these temporary contracts are not renewable.

¹⁰ The Work Conditions Survey of 2004 was conducted as an appendix to the fourth quarter 2004 Labor Force Survey.

¹¹ Articles 74 and 79 of the Palestinian Labor Law.

package of social benefits, we use coverage of those benefits as proxies for overall coverage of the law, including employment protection regulations. According to this approach, the construction and agricultural sectors have the lowest coverage rates, while the service sector has the highest coverage rate.

REGULATIONS AND EMPLOYMENT TRANSITIONS FOR PALESTINIAN YOUTH

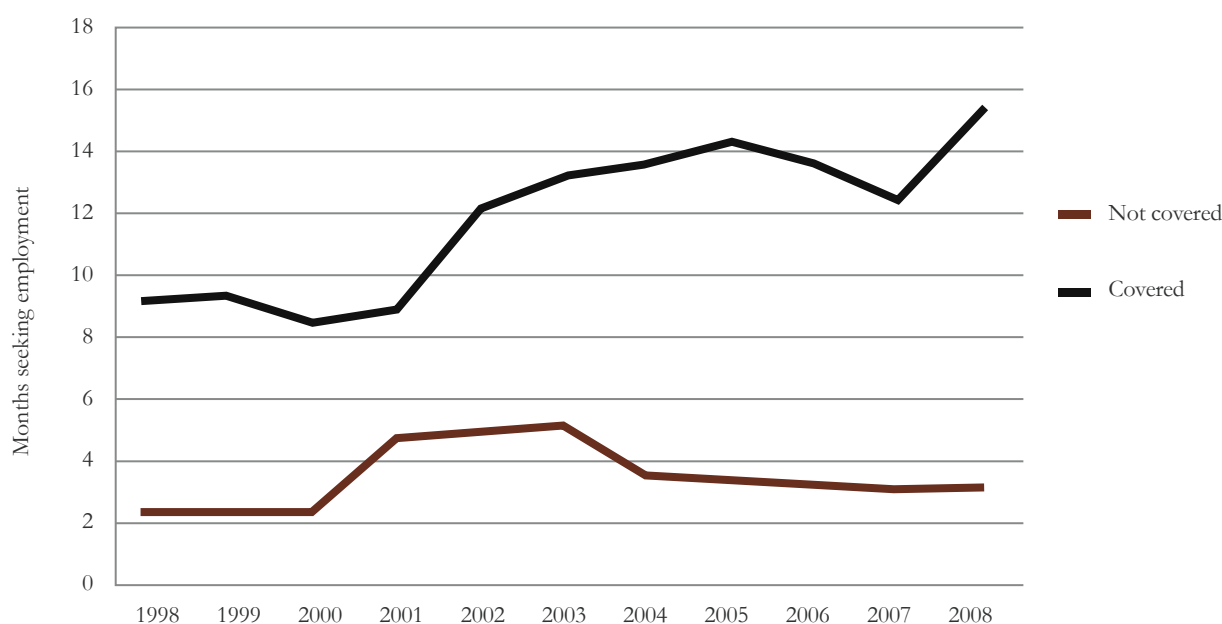
Given the potential for employment regulations to lead to longer unemployment, what is the relationship between coverage of the labor law and the wait time for employment in the Palestinian Territories, especially among young workers? Because there are many reasons why queueing for public sector jobs may be longer than for private sector jobs, we focus our analysis on employment duration within the private sector.

We assess the degree to which the implementation of the Palestinian Labor Law of 2000 led to longer waits in the private sectors with the highest coverage rates. This is necessary in order to isolate the effect of the introduction of the labor law from the effects of the Al-Aqsa Intifada. The best way to tackle this question

is to conduct a “difference-in-difference” analysis and treat the policy intervention (implementation of the labor law) as a “natural experiment,” following the approach used by Kugler (2004). Since the policy will only affect groups in the sectors that are abiding by the law (the “covered” sectors), we can examine the effect of a labor force shock in both the “covered” and “uncovered” sectors. For the sake of this policy brief, we will consider services, manufacturing, commerce and transportation to be “covered” while agriculture and construction are “uncovered.”

We estimate that the impact of the 2000 labor law was to decrease the probability that Palestinian youth found jobs. The overall probability of ending an unemployment spell decreased due to the Intifada. However, the probability of ending an unemployment spell for young Palestinians in the covered sectors (manufacturing and services) decreased more than in the uncovered sectors (agriculture and construction). This finding is confirmed in Figure 4, which shows the mean unemployment duration for Palestinian youth from 1998 to 2008. Unemployment duration increased for all workers beginning in 2001, but in the uncovered sectors (agriculture and construction), the rate decreased after 2003.

Figure 4: Unemployment Duration over time by Employment Law Coverage



Source: Authors' calculations from 1998-2008 Palestinian Labor Force Surveys

¹² Kugler (2004).

For the covered sector workers, unemployment duration increased more during the Intifada and continued to increase even after the worst effects of the Intifada had ended.

POLICY IMPLICATIONS AND CONCLUSIONS

This brief has examined the enactment of the Palestinian Labor Law of 2000 and its implications for the employment of Palestinian youth. The implementation of the labor law could have either raised or lowered costs of employing young workers for Palestinian firms. By unifying the laws between the West Bank and Gaza Strip, it clarified and simplified the regulatory framework surrounding employment and therefore, would have encouraged Palestinian firms to expand employment. Furthermore, it could have encouraged more firms to fully adopt the regulations due to their recognition and sanctioning by the Palestinian Authority. On the other hand, this law expanded the mandated benefits given to Palestinian workers in terms of severance packages, vacations and rest periods.

This paper finds that for those sectors of employment with greater coverage by the labor law, workers experienced longer unemployment durations than workers in sectors with lower coverage rates. After the law was implemented, overall duration times increased for those in covered sectors relative to those in sectors with less coverage. As such, the implementation of the law itself brought about more

negative outcomes for Palestinian youth trying to penetrate the labor market, leading to longer waiting times to secure gainful employment, particularly for educated youth seeking formalized employment.

Ultimately, policy makers in the Palestinian Territories, and indeed in each country in the Middle East, need to carefully assess the impact that their regulatory framework, including the labor law, has on youth. While some regulations may seek to protect workers, governments need to be aware of potential unintended consequences. In some cases, the groups that laws are meant to protect end up being negatively impacted. Job security regulations are one such area in which laws that are meant to protect workers can actually hurt workers—especially young workers—by decreasing the willingness of firms to make positions available to new workers.

In drafting labor market regulations, policy makers must provide needed worker protections while simultaneously offering firms a degree of flexibility in their hiring and firing decisions. Crafting such regulations must strike a balance between social protection and labor market efficiency. Across the Middle East, this is an area that requires further research and policy experimentation. However, instruments such as unemployment insurance schemes, which provide security without the skewing of hiring and firing decisions of firms, are worth consideration in this regard, as are more universal social protection schemes that are not linked directly with labor market participation.

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