EDUCATION AND WAGES IN THE WEST BANK AND GAZA 1995-2004:
TESTING THE AGGREGATE EFFECTS OF THE EDUCATION PREMIUM OVER TIME

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ABSTRACT

The annexation of the Palestinian territories by Israel in 1967 caused the Palestinian economy to be inexorably integrated with that of Israel. Palestinians increasingly have relied on the export of labor into Israel, a market with more jobs and higher wages. Studies indicate that as Palestinians became increasingly educated their wages did not rise accordingly. That is, the returns to education that normally apply, particularly in developing countries, did not hold true in the Palestinian case.

Since the Oslo accords of 1995, the Palestinian people have had partial self-rule, which, as limited as it may be, does allow for scenarios of economic development, particularly when paired with increases in international development aid. Accordingly, this paper tests whether Palestinian economic enrichment over the past ten years has been effective in achieving higher wages, or whether strict closure measures imposed by the Israeli government have further reduced the returns to education for the population. Analyzing aggregate labor and economic data for the Palestinian working population from 1995-2004, I conclude that over time higher education has served to benefit the Palestinian population living and working in the West Bank and Gaza, as well as those who work in Israel, and that the effect of the Intifada has been minimal.

As such, it is essential that international donors and the Palestinian government continue to invest in educational programs and institutions of higher learning. The future Palestinian state, now in its early stages of formation, depends on such enrichment to ensure its continued growth.
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INTRODUCTION

With the departure of Israeli troops from the Gaza Strip in September 2005 and the beginnings of unilateral withdrawal from the West Bank today, a possibility for state formation in the Palestinian territories (PT) reemerged after a five-year hiatus. Officially, the process to establish a Palestinian state began with the signing of the first Oslo Agreement in Washington on September 13, 1993, followed by the famous handshake between the late PLO leader Yasser Arafat, the late Israeli Prime Minister Yitzhak Rabin, and then Israeli Foreign Minister Shimon Peres. It stalled in late September 2000 with a popular uprising known as the Al-Aqsa Intifada in the Palestinian territories and inside Israel.

Now that Israel has embarked on a formal disengagement from the Gaza and the West Bank, the viability of the future Palestinian state relies on the capability of Palestinian leaders and international supporters to make the territory secure, politically stable, and economically prosperous. It is without question that the last of these measures, economic health, is of vital importance to the future of the Palestinian state. As such, the Palestinians and the international community must examine the existing economic structure in the territories, which depends largely on the export of labor into Israel, and consider future methods for its development.
The economies of the West Bank and Gaza (WBG) have been integrated with that of Israel since 1967, when Israel annexed the territories after the Six-Day War. Once it was clear that Israel intended to rule over the territories, politically, economically, and otherwise, scholars and economists took interest in the case. Notably, all economic decisions for the Palestinian territories were made by the Israeli government; however, public discussion in Israel regarding these decisions was limited. At least from an economic perspective, the resulting effects of Israeli annexation of the WBG have been both positive and negative. For one, the Palestinian economy has experienced a deep integration of its factor and goods markets with the richer economy of Israel. Economic and population statistics remain highly uncertain, but there is little doubt that the Palestinian population benefited from a catch up phenomenon, whereby a small and developing economy is taking advantage of its integration with a larger and more developed one, at least in its early phase.

Generally, the nature of this type of integration remains disputed, as it might indeed theoretically lead to very different patterns. Naqib (2000) distinguishes two opposite sets of theoretical effects of the integration between a large, advanced, and rich economy with a small, poor, and underdeveloped economy: “A favorable repercussion is an increased demand for the products of the small economy, a diffusion of technology and knowledge, as well as other spread effects, resulting from the geographical proximity to a large market leading to subcontracting, joint ventures and
coordination in tourism and other services. Unfavorable repercussion arises from the
disappearance of many industries in the small economy, its confinement to producing
low-skill goods and the emigration of a sizeable segment of the labor force to the
neighboring country, as well as to other countries.”

In the Israeli-Palestinian case, the fact that such integration was imposed by one
party to the other brings additional complexities. On the one hand, according to Arnon
and Weinblatt (2001) and others, Israel might have pursued economic policies that
were not in the best interest of the Palestinian economy. Fischer et al (2001) noted that
from 1967 through the early 1990s the Israeli government encouraged the development
of daily commuting by Palestinians into Israel, mainly to work in construction and
agriculture. At the same time, it took measures to restrict the development of
Palestinian economic activities in the WBG through a strict system of licensing that
affected the establishment of new businesses and the development of existing ones.

On the other hand, the imposition of economic policies by Israel might have
allowed Palestinian energies to concentrate on using market activities rather than the
political system (through rent-seeking) to generate income, as observed in comparable
cases (Schiff, 2002).

The literature on the net impact of Israeli occupation remains scarce. Valdivieso et al. (2001) noticed that Total Factor Productivity (TFP) and capital stock growth in WBG (over the period 1973-94) compares well with Israel, suggesting positive transfers of technologies and convergence in capital stocks. They found that a
detailed examination of the growth record shows that gross domestic product (GDP) growth averaged 6 percent and TFP growth 1.4 percent per year over the past 30 years, with substantial annual variations. In order to gain insights into the ultimate factors behind the growth in GDP and TFP, the authors of the paper undertook a cross-country growth regression and included the West Bank and Gaza in the sample. They concluded that the initial conditions for medium-term economic growth are generally favorable, with a relatively young, well-educated population and with the Palestinian population growth rate slowing and is expected to continue declining. If the political and security situation improve, which likely would be accompanied with the removal of significant obstacles and distortions in the Palestinian economy, then the economy should be able to enjoy an extended period of high growth. These of course all are big “ifs” and such improvements will be difficult to realize if the Palestinian government is not able to implement supportive policies along with improvements in infrastructure.

Other authors suggest that the opened access of the Israeli labor market to a large and cheap Palestinian labor force was the main driving force explaining the observed convergence in per capita incomes since 1968 [Kleiman (1999), Diwan and Shaban (1999)]. The two phenomena are not necessarily exclusive, but characterize very different models of development. In the former case, GDP growth is encouraged by innovation, competition and the development of productive capacities, notably for export markets; in the latter case, it is spurred instead by the demand for non-tradable goods, fuelled by workers’ remittances.
Most of the literature regarding Palestinian economic integration with Israel focuses on the latter, particularly since the first Intifada, when closures began to severely impact the Palestinian economy. Indeed, the export of labor from the WBG to Israel – as well as to Jordan and other neighboring countries – has become a centerpiece of the Palestinian economy since 1967. This, in a sense has made the economy one of the most reliant on workers’ remittances in the world. In 2003, total remittances were valued at $692 million, which was approximately 22 percent of total Palestinian GDP that year.¹

Some authors have found that Palestinian export of labor to Israel has resulted in an economy with a type of Dutch Disease², where exports of labor to Israel have paralyzed the development of the internal economy. Astrup and Dessus (2002) employed a general equilibrium model using data from 1998 to simulate the impact of a permanent closure of the Israeli labor market on the Palestinian export performance and on GDP growth. They did so in order to test whether (hypothetically) the Palestinian economy could in fact rid itself of its Dutch Disease by completely cutting itself off from Israel economically. Scenarios were built to identify under which conditions the Palestinian economy could benefit from a closure of the Israeli labor market, under a set of exogenous assumptions regarding population growth and

¹ Data Source: World Bank Development Indicators Database.
² Dutch disease is an economic phenomenon in which the discovery and exploitation of natural resources (although the definition has expanded to include other resources, including labor export) de-industrializes a nation’s economy. In the given scenario, the value of the country’s currency rises (making manufactured goods less competitive), imports increase, non-resource exports decrease. The Dutch Disease becomes an actual disease if there is something special to the activities resource extraction crowds out, such as learning by doing or economies of scale.
technological progress during the period 2000-2010. The results indicate that exporting large flows of Palestinian labor services to Israel tend to reduce the capacity of the Palestinian industry to export goods. Because of the development ineffectiveness of providing low-skilled labor to Israel, the authors concluded that instead external assistance, direct investments in the Palestinian economy, would be the best way to move forward with economic growth in the Palestinian territories.

Conversely, Bulmer (2001) concluded that an open Israeli economy could increase wages within the Palestinian territories. She hypothesized that an increase in labor flows to Israel raises the domestic Palestinian wage as some workers already employed domestically are drawn to higher-paying Israeli jobs which have become more readily available and at a lower commuting cost. To this end, she developed a model that characterizes the labor market in the West Bank and Gaza and its links to the unskilled labor market in Israel, which captures factors affecting labor supply and demand decisions in the West Bank and Gaza and Israel – namely, the importance of Israeli labor demand for Palestinian workers, the persistent wage gaps between domestic Palestinian employment and better-paying Israeli jobs that are available only in limited supply, and the structural unemployment observed in the West Bank and Gaza.

Additional studies take a different approach, focusing instead on the possibility of increases in education and human capital, in the context of Israeli closures, to increase GDP growth. These studies come out of a larger body of literature that
investigates the returns to education in developing countries more generally [see George Psacharopoulos (1994) and John Strauss and Duncan Thomas (1995) for surveys]. Estimated returns to education are, typically, larger in developing countries than in industrialized countries. However, the results found in other developing countries do not seem to apply to the WBG. Instead in the Palestinian territories, the returns to workers with college degrees, some college, and high school degrees all fell in the 1980s.

Angrist (1995) was the first to examine the effects of schooling on wage inequalities in the WBG. He used micro data from the Territories Labor Force Surveys conducted by the Israeli government in the WBG during 1981-1991 to show that wage differences between school groups fell dramatically. Since there were very few institutions of higher learning until the mid-1980s, Angrist had the opportunity to examine the effects given a large increase in post-high school educated laborers (enrollment in WBG universities doubled from 1981 – 1985). The problem arose when these newly educated men (almost all of them were men) could not find jobs, as the majority of jobs available for the Palestinian people consisted of low-paying unskilled labor. He found that while Israelis do pay a premium for some Palestinian schooling groups, it is much less than the premium given to Israeli workers with similar education and experience levels. Angrist used Israel labor force statistics as a control group to test whether similar effects were being experienced in the Israeli labor market. He found that while unemployment among educated Palestinians was growing worse,
unemployment for Jewish Israelis with higher education decreased\(^3\) relative to those with less education over the same time period.

Angrist attributed drops in wage premiums for educated Palestinians – which fell by 50 percent – to increases in the supply of labor. That is, he found that decreases in returns to schooling could be attributed directly to the large number of college degrees being obtained. Sayre (2001) conducted a similar study for the same time period in which he found that, while increased labor supply certainly did contribute to a lowering of returns, a set of three demand shocks equally contributed: the decrease in demand by oil-exporting countries for skilled Palestinian workers, the increase in demand for unskilled Palestinian workers by Israeli firms, and the change in labor demand derived from fluctuations in the volume of international trade.

Al Kafri (2003) used yet another approach to examine the impact of Israeli closures on the labor market in the WBG during the first Intifada. Based on Labour Force Survey Statistics from the Palestinian Central Bureau of Statistics, Al Kafri employed probit analysis, studying the probability of employment through the Intifada, varying by status of employment prior to the uprising. He found that personal characteristics had the most significant effect on labor status change, though education and age had no effect through the Intifada. Interestingly, he found that education had the same effects both before and during the Intifada in the West Bank and Gaza; the

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\(^3\) For example, Israeli Jews with tertiary education experienced a 1.6 percentage point lower unemployment rate in 1981 than did Israeli Jews without tertiary education. This gap expanded to 3.9 percent by 1985.
completion of a Bachelor’s degree in the WB and any college education in Gaza increases one’s chances of getting and/or holding a job in the territories.

Sayre and Miller (2003) proceeded to analyze returns to schooling in the WBG, during the Oslo period: 1995-2000. They found that during the peace process itself and the period immediately following, there was an increase in overall economic growth and that educated workers were able to find employment more often. The authors concluded that the spike in employment was in large part due to additional job opportunities created by the formation of the Palestinian caretaker government. Additionally, they found that college graduates earned a 30 percent premium (as compared with persons with high school degrees or less) during 1995-1996, after the implementation of Oslo, but only a 15 percent premium by 2001. [See Appendix A for a graph depicting returns to schooling from 1981 to 2001.]

Employing statistics from the Palestinian Central Bureau of Statistics (PCBS), they estimate returns to schooling as well as two empirical models of the determinants of earnings on schooling returns to examine what caused movements in the returns. They analyze the changes in relative wages to determine if supply shifts are the only source or if there are also demand shifts present. They then parse their data into five education level groups and examine relative wage changes and employment shares. In doing so, they aim to determine the degree to which wage changes and employment shares move together or diverge, giving evidence as to whether demand side factors can be important. They find that demand side influences do play a role, as do supply
side factors. Secondly, they employ a traditional human capital model of schooling returns. To do so, they pool all observations over the 1995-2000 time period and test to what degree trade volume, GDP, closures, working in Israel, and public sector employment are correlated with changes in the returns to schooling and experience from 1995 to 2000. They find that closures have an ambiguous effect and that those most affected by Israeli closures are those with lower levels of education. Sayre and Miller also find that the return to a year of schooling is 2.4 percent and that working in Israel has a positive and dramatic 80 percent premium, when compared to those who work in the West Bank or Gaza Strip.

**HYPOTHESIS TO BE TESTED**

In this paper, I ask the question if Palestinian partial self-rule has been effective in recent years by diversifying employment opportunities for educated Palestinians in the West Bank and Gaza, or whether strict closure measures imposed by the Israeli government during the Al-Aqsa Intifada have further reduced the returns to education for the population. I hypothesize that while during the Intifada returns to schooling may be depressed slightly, over time Intifada effects are minimal, and that educated Palestinians who live and work in the West Bank and Gaza, as well as those who work in Israel, have been more successful than their less educated counterparts in achieving higher wages. I test this hypothesis by analyzing aggregate indicators for the Palestinian population from 1995 – 2004.
The following model, which I will use to analyze the education effects on wages in the West Bank and Gaza over a ten year period (1995-2004), originates from a model used in the study on the Oslo period by Sayre and Miller (2003). [See the Literature Review for more information on this study and its findings.] The foundation of this model is that education should positively affect wages, as part of an investment in human capital.

For my study, I apply a commonly used model first developed by Jacob Mincer (1974), in his landmark book “Schooling, Experience, and Earnings.” Mincer’s study has had a profound and lasting influence on empirical work in the field of labor economics. In the most widely used version of Mincer’s "human capital earnings function," log earnings are modeled as the sum of a linear function of years of education and a quadratic function of years of experience.

Mincer’s model has been estimated on thousands of datasets for a large number of countries and time periods, making it one of the most widely used models in empirical economics. It is quite remarkable that, thirty plus years after “Schooling, Experience and Earnings,” most studies still tend to estimate earnings regressions that are very closely related to Mincer’s basic equation (though a list of other regressors is typically added).
In the major contributing article to “Schooling, Experience, and Earnings,” a version of his doctoral thesis, Mincer (1958) argues: “the greater the amount of human capital the higher the wage level and the larger the investments the steeper the ‘wage profile,’” that is the increase in wages over one’s working life. He secondly asserts that increasing in the duration of a person’s training translate into proportional increases in wages.

Therefore, in order to analyze education effects on wages, I apply and modify Mincer’s traditional human capital model of schooling returns. In this way, I can directly assess which factors are most closely associated with changes in the returns to schooling. By using the standard log wage regression, the results from this approach are easily interpretable and generally compare well with other approaches that are more structured in their methods of explanations.

The standard Mincerian Wage equation has the form:

$$\ln WAGE_i = \beta_0 + \beta_1 SCHO_i + \beta_2 EXP_i + \beta_3 EXP_i^2 + \epsilon$$

Where, $\ln WAGE_i$ = the natural log of individual $i$’s daily wage;

$SCHO_i$ = the number of years of schooling for individual $i$; and

$EXP_i$ and $EXP_i^2$ = years of experience and experience squared.
This model is derived from a model of optimal human capital investment, where an individual invests in schooling and on the job training up until the point where the marginal benefit of such investment is equal to the marginal cost.

In the case of this study, since I am analyzing aggregate changes in the population over time, rather than years of experience, I employ a variable that in essence acts as the converse for experience. I test the effects of changes in the proportion of the youngest of potential workers, those in the 15-24 year old age category, who presumably have the least experience. It would follow that the higher this proportion, the less experienced the Palestinian workforce. Since this age measure behaves differently than the traditional experience variable that would be implemented in a traditional Mincer human capital model (that is, it does not reach a peak and then decline), I do not include it in its quadratic form.

For the ordinary least square (OLS) regressions, I will test to what degree working in Israel, working in low-wage industries, GDP, and the Al-Aqsa Intifada are correlated with changes in the returns to schooling and inexperience from 1994 to 2005.
Thus the modified Mincer model is:

\[
2) \quad \lnWAGE = \beta_0 + \beta_1 BACH + \beta_2 ISRAEL + \beta_3 GDP + \beta_4 AGE + \\
\beta_5 HOTREST + \beta_6 INTIF + \varepsilon
\]

Where, \( \lnWAGE \) = the natural log of average daily wages (in New Israeli Shekels (NIS)) for all Palestinians who work in the West Bank, Gaza, or Israel;

\( BACH \) = the proportion of Palestinians who have Bachelor’s degrees;

\( ISRAEL \) = the proportion of Palestinians who work in Israel;

\( GDP \) = the annual growth rate of the Israeli Gross Domestic Product (GDP);

\( AGE \) = the proportion of 15-24 year old Palestinians who are employed, measuring inexperience of the workforce;

\( HOTREST \) = the proportion of Palestinians who work in the hotel and restaurant industry, as a proxy for low-wage work; and

\( INTIF \) = a dummy variable that equals 1 during the years when the Al-Aqsa Intifada was active (2000-2003).
By expanding the equation in this way, I am able to show the importance of the macroeconomic environment on overall wage levels and also show to what degree these macro changes are associated with changes in the returns to human capital.

**Statistical Data**

I will employ aggregate annual data from the Labor Force Survey (LFS) of the Palestinian Central Bureau of Statistics (PCBS) in my analysis. The PCBS began to conduct the LFS in 1995, before which a similar program was conducted by the Israeli government\(^4\).

According to the literature on returns to education (Pritchett 2001), aggregate data can be used to estimate the impact of schooling in order to conclude whether the impact is greater or less than that from micro-data, and hence to provide some indication of the presence or absence of externalities. Accordingly, regressions using aggregate data must demonstrate that the educational premium is higher than the value expected, given the microeconomic evidence applied to the same model in order to exhibit the effects of positive externalities. Positive externalities should mean that the impact of education on aggregate wage is greater than the aggregation of individual impacts. I will analyze the results from my data analysis with this in mind.

\(^4\) While the aggregate data is helpful in allowing the reader to understand the education implications of shifts in the workforce over time, this analysis would have been improved with the use of individual level survey data. I attempted repeatedly to obtain such data, following the instructions provided on the PCBS website, and further direction given by a PCBS employee; however, even after submitting the appropriate forms as well as payment for the requested data, I did not receive the PCBS LFS data.
**Data Description**

The data show that in the aggregate, the labor participation rate in the Palestinian territories in 2004 of 66.8 percent has increased only slightly from its 1995 levels of 60.7 percent, when the Oslo agreements began to take effect. In Gaza, increases in employment rates over the same period, have been more significant, increasing from 48.6 percent to 62.5 percent, while those in the WB have increased from 65.3 percent to 68.8 percent. A clear increase in labor force participation occurs after Oslo and drops back down after the outbreak of the Al-Aqsa Intifada. In recent years, employment has increased slightly, but it is nowhere near the levels that it reached at the height of the Oslo period. It should not be surprising then that the percentage of Palestinians working in Israel also has declined during the same period; in 2004 only 8.7 percent of employed Palestinians were working in Israel. [See Appendix B for a complete listing of employment rates in the Palestinian territories 1995-2004, and Appendix C for a graph depicting employment rates.]

Pie charts of the schooling levels of employed persons in the West Bank and Gaza in 2004 look almost identical, indicating similar schooling levels for the Palestinian populations. A slightly higher percentage of Gazans have completed one or more years of college than West Bank residents. While the statistics available do not

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5 A March 2006 World Bank report, the full results of which have not yet been released to the public, indicates that if aid is significantly reduced to the Palestinians, unemployment rates would rise to nearly 40 percent, which is nearly twice its current level. Donor countries, including the United States, are entertaining the notion of significant aid cuts to the Palestinians after the parliamentary victory of Hamas. Erlanger, Steven. March 16, 2006. “World Bank Warns Palestinians of Bleak Year for Economy,” *The New York Times.*
provide information on wages by place of residence, only by location of work, it still is
interesting to note that West Bank jobs pay consistently better than those of the Gaza
Strip, and those in Israel pay a significantly greater amount than those in the West
Bank. [See Appendixes D and E for depictions of schooling levels in 2004.]

Wages over the time period studied have experienced significant growth, with
2004 average daily wages reaching approximately 70 Israeli Shekels (NIS), which is
roughly US$15. This is a 21 percent increase from 2003, which not surprisingly
coincides with the end of the majority of Intifada activity. Inflation from 2003 to 2004
was slightly negative, with consumer prices deflating at a rate of approximately 0.41
percent. Over the entire 10-year period, wages increased by approximately 51 percent,
while prices fell by slightly more than 4 percent.  

RESULTS

Log Wage OLS Regressions

I begin by running a simple bivariate regression to test the affects of education
on log wages, where education is measured as a proportion of the Palestinians that
have attained Bachelor’s degrees. When Bachelor’s degree is regressed against log
average daily wages, the results indicate a significant education premium, with wages
increasing by 9.53 percent as a greater proportion of Palestinians attain higher
education. Initially, I considered including multiple strata of tertiary education in my
analysis, but other indicators of higher education were less significant and highly

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6 Inflation data source is the World Bank Development Database online.
correlated with the Bachelor’s degree variable. I hypothesized that Associate’s degree attainment likely would be a substitute for Bachelor’s degree attainment, that a greater proportion of people with Associate’s degrees will be correlated with a lower proportion of Palestinians with Bachelor’s degrees. A correlation analysis reveals that this is indeed the case: there is a nearly perfectly negative correlation, at negative 0.93, between the two indicators. Furthermore, when regressions are run that include both Bachelor’s and Associate’s degrees, the coefficients for both regressors become highly insignificant. For example, when the proportion of the Palestinian population with two-year University degrees is regressed against log wages, the results indicate a negative relationship between wages and Associate degree attainment of negative 20.68 percent. These results however are insignificant, with a p-value of 0.105. The Bachelor’s degree measure alone accounts for 38.45 percent of the variation in wages. [See Table 1 for all final OLS regression results.]

As was mentioned earlier, my “inexperience” measure, the proportion of 15-24 year-olds in the labor force, behaves differently than the traditional experience variable that would be implemented in a Mincer human capital model; therefore, I do not include the quadratic form of the proxy regressor. I did attempt to run regressions using a squared form of this variable, but found the results to be insignificant.

The Israeli GDP growth rate is employed, rather than the Palestinian GDP growth rate, because the latter proved insignificant in a number of OLS regressions. The Intifada measure was significant only when I considered the Intifada active in the
years 2000 through 2003; including 2004 as an Intifada year caused the coefficient to become insignificant. This can be explained by the fact that the effects of the Intifada on the labor market largely subsided by 2004. Additionally, I attempted to account for any changes that occurred specific to each year by employing year dummy variables. These variables proved insignificant, other than in 2000, when the Intifada broke out. Each successive year after 2000 was increasingly insignificant to the model.

I attempted regressions that included a series of interaction variables to measure the impact of macroeconomic conditions on the returns to higher education. However, all of the interaction terms (including interactions between GDP growth and education and Israel and education) tested obtained highly insignificant results.

In the final OLS analysis, wages are regressed against education, incrementally including each of the control variables, with each successive regression explaining an increasing proportion of the changes in wages over time. Wages are measured using average daily rates in NIS for the population for those Palestinians who work in the West Bank, Gaza, or Israel, but are not segregated based on place of work. Although I did consider parsing out the regression, testing the effects of the macroeconomic indicators on average wages for each of the three possible places of work, I was not able to determine levels of the independent variables for each of the locales, and therefore discarded the results as inconclusive.

As one might expect, the results from the final regression indicate that as more young people enter the labor market (in the 15-24 age group), wages fall, acting in
essence as the converse of an experience variable. In the full regression, as the proportion of 15-24 year olds in the labor market increases by one percentage point, the model predicts that wages will decrease by 4.05 percent on average. I also attempted a regression that excluded the inexperience variable, particularly since it was highly correlated with Bachelor’s degree, to test how such a change might skew the results. I found that this exclusion (not shown in Table 1) increased the effect of the Bachelor’s degree variable to 17.73 percent (with a p-value of 0.004), while pushing the other variables in the model closer to zero. The Intifada dummy becomes highly insignificant in this case, with a p-value of 0.815.

Changes in the proportion of Palestinians working in Israel between years have a lesser impact on wages, only 1.89 percent. This small effect is noteworthy, given the declining rate of Palestinians employed in Israel [see Appendix F for a depiction of Palestinian’s employment rates in Israel], and the relatively higher wages of this group. When I ran a regression omitting this variable, all of the variables in the model became less significant, with only the low-wage worker proxy remaining significant at the 1 percent level. Education’s effect on wages increased to explain nearly 13 percent of the changes in mean wages, though it was significant only at the 4 percent level.

The Intifada too seems only to have had a mild impact on wages in the model, with wage elasticity decreasing by 3.8 percent (and a p-value of 0.031) during the Intifada years. This negative relationship intuitively makes sense, and is consistent with previous studies that have shown increases in Intifada-related Palestinian activities.
have reduced wages, particularly for those who are less-educated (Angrist 1995, Sayre and Miller 2003).

Still, I can not conclude with certainty that the Intifada has had a significant impact on wages other than through its effect on GDP growth. When any of the other variables (either singularly or in conjunction with one another) are removed from the model, the Intifada variable varies from having slightly negative to slightly positive effects, and becomes highly insignificant in all cases. Furthermore, I hypothesized that while the Intifada might not have an important effect on wages, it might possibly affect employment. However, the results from regressions with the Intifada variable on employment levels in the Palestinian territories over the decade proved highly insignificant, with a p-value of 0.938 (not included in Table 1).

GDP growth has a 2.40 percent positive effect on wages, a relationship that I hypothesized at the outset of my analysis. I also considered inflation’s impact on wages, but found that it was insignificant when added to the model. When I replaced GDP growth with inflation (rather than adding it to the existing model), it pushed the effect of the other variables in the model closer to zero, including the Bachelor’s degree variable, which had a p-value of 0.972. Inflation itself only was significant at the 8 percent level.

There was a strong and significant downward relationship between those workers employed in hotels or restaurants and wages. As the proportion of the population working in this sector increased, the model predicted a 6.4 percent decrease
in average daily wages. One might expect such a result, since the majority of jobs available for Palestinians in the hotel and restaurant sector are lower level service positions, such as janitors, maids, and waiters. Interestingly, average wages for this group remained practically stagnant, with a slight decline over the ten year period. In completing my analysis of the data, I considered including measures of Palestinian employment in multiple economic sectors. The PCBS LFS measures employment by sector in six categories: manufacturing, agriculture, construction, hotel and restaurant, transportation and communication, and services and other. The results from each of these sectors, individually, collectively, and in different combinations are insignificant. Only the measure of the proportion of Palestinians working in the hotel and restaurant sector had any effect on wages, which is one reason it was included in this final analysis.

The final regression results indicate an education elasticity effect on wages of 11.23 percent (as the proportion of Palestinians with Bachelor’s degrees increases by one unit, there is an average increase of the mean daily wages of Palestinian workers of 11.23 percent), and an $R^2$ of 0.995. An $R^2$ of this magnitude can mean that almost all of the changes in Palestinian wages can be attributed to the factors measured in the model employed in this paper.

In order to analyze the data more extensively, I ran two tests of sensitivity for the model: a Durbin-Watson test and a test for heteroskedasticity. Since wages are trending over time, it is possible that this $R^2$ is artificially high, that the model is
overestimating the variance in wages because it does not account for these time effects. In order to test whether this $R^2$ is indicative of a high degree of explanatory power from the model, or whether time trends should be incorporated, I ran a Durbin-Watson test for autocorrelation, which tests the correlation of the variables with themselves over successive time periods. The Durbin-Watson statistic for the final regression model is 2.53, indicating very little serial correlation\textsuperscript{7}. One can therefore conclude that the $R^2$ likely is not over-inflated as a result of time trend effects.

The final regression results indicate that all of the variables in the model are statistically significant at the 1 percent level, with the exception of the Intifada dummy, which is significant at the 4 percent level. However, I was concerned with incorrect standard errors, due to potential heteroskedasticity in the model. Table 2 indicates that some of the independent variables in the model are fairly highly correlated with one another. For example, the variable measuring Bachelor’s degree attainment is highly negatively correlated (negative 0.88) with the variable measuring employment for Palestinians aged 15-24. While heteroskedasticity will not affect the coefficient measures, it can create biased standard errors. To account for this possibility, I ran another regression, using robust standard errors. Using this method, the p-values for the independent variables actually decreased, further enhancing their statistical significance. The robust p-values in Table 1 reveal these improvements.

\textsuperscript{7}Durbin-Watson statistics have a range of 0-4. A result of 0 indicates a strong positive correlation; a result of 4 indicates a strong negative correlation; and a result of 2 indicates no correlation.
**Potential Measurement Error**

As in any study, this one leaves room for potential measurement error. For example, the small sample size used in this analysis (N=10), may be cause for concern in the accuracy of the outcome. A study of aggregate effects over a larger swath of time, or an analysis incorporating several countries could have eliminated this error.

Additionally, this model has the potential for omitted variable bias. Some of the literature suggests that years of education do not actually indicate level of learning and therefore may not be an appropriate measure to predict earnings, and that educational quality instead is a better measure. However, while difference in educational quality can account for differences in the impact of schooling, it likely will not explain a low average impact. In fact, due to the “general underlying positive covariance between quantity and quality of schooling” (Schultz 1988), one would expect that excluding quality would bias the estimated return upward, as more schooling is accumulated where quality is high. For instance, Behrman and Birdsall (1983) have shown, for Brazil, that not controlling for school quality leads to a doubling of the impact of years of schooling. Higher education institutional quality in the Palestinian territories is likely, as international aid organizations have been investing in them over the past decade. This could lead one to conclude that the results of this study actually underestimate the effects of a higher proportion of educated Palestinians over time.
**Findings**

The results of this study indicate that the majority of the increases in Palestinian average wages over time are in fact linked with the increase in the proportion of the population with higher education degrees over time, with an overall effect of 11.2 percent. Yet, these findings are in marked contrast with similar models applied to micro-data which find Palestinian returns to education to be 3.9 percent in 2001 (Sayre and Miller 2003, most recently). This contrast indicates that somehow macro externalities had an aggregate positive effect on the wage structure that did not affect wages for educated Palestinians on an individual level. How can this be the case?

Such results could suggest that although higher-educated Palestinians are not getting paid at a much higher rate than their less educated statesmen, the former group is able to remain active in the very fragile and constrained Palestinian labor market in a way that the latter group is not. As labor forces become more educated, workers generally are able to more effectively self-allocate into the labor market. An educated Palestinian labor force therefore might be better able to adapt to the volatile conditions imposed by the constraints of the Israeli government.

This set of outcomes would be particularly true for workers who are employed in Israel, as higher educated Palestinians likely would have the profile – for instance language skills – that would be more employable to an Israeli employer and government. It is the Israeli government after all that decides which Palestinians are permitted to work in Israel. The Israeli-Palestinian Interim Agreement of 1995
indicates that “every Palestinian worker conforming to the security requirements with a job in Israel can obtain a work permit,” with said security determination (I would argue appropriately) left to the Israeli authorities. The results of the regression analysis indicate that this is indeed the case, with the effect of working in Israel having a positive impact on wages.

The likely Israel employability effect aside, the results of the model indicate that workers in lower skill positions, have a strongly negative impact on wages, and a look at the data in its raw form indicates that wages for this group actually decreased over the time period. That is, one might conclude that while educated Palestinians might not be receiving the wages that they “deserve” given their education levels, they are able to maintain and slightly increases their wages over time, while the wages of their less educated counterparts have declined. Therefore, education consistently is an important variable in explaining increases in the average aggregate wages of Palestinians from 1995-2004.

**Policy Implications**

The most direct and efficient policy change, and one that is highly likely to improve the effects of education on wages over time in the Palestinian Territories, would be a complete cessation of Israeli closures on Palestinian borders and an integration of the two economies. In this way, Palestinians, both higher educated and otherwise, would be able to benefit from appropriate wages given their skill sets.
Additionally, the Palestinian economy would be able to more effectively capitalize on the catch-up phenomenon, described in an earlier section of this paper, in which a smaller economy reaps the benefits of integration into a larger one. However, at least in the foreseeable future, particularly since Hamas’ recent victory in the Palestinian parliamentary elections, this kind of opening up is extremely unlikely.

Working within the boundaries of existing political constraints, there may be some more realistic policy prescriptions that can come out of the results of this study, beyond the ideal but unfeasible outcome of peace and open markets. First, the findings indicate that an educated Palestinian labor force is required in order to maintain significant increases in Palestinian wages over time. Therefore, the international donor community and the Palestinian government should continue to invest in the quality of higher education institutions in the territories.

The problem, of course, is how to maintain increases in higher education without short-term returns on the investment of tertiary education for individuals. Given the unrealistic nature of any significant increases in Palestinian employment in the Israeli labor market, at least in the near term, it is essential then that educated workers are given opportunities within the West Bank and Gaza.

I would be remiss to not consider a potential policy solution that would encourage Palestinians to work outside of Israel or Palestine altogether. After all, the Palestinian economy already is set up to be reliant to a large extent on outside remittances, and – at least prior to the Gulf War – Palestinian workers were employed
significantly throughout the Gulf region. In many non-oil Arab states, workers remittances contribute to a significant portion of GDP. Jordan, where more than half of the population is of Palestinian descent, benefits spectacularly from remittances from abroad. In fact, historically private remittances from oil workers were of much greater economic consequence than earnings derived from agriculture (Diwan 1995).

While a policy that would increase remittances from Palestinians working in oil states might prove to be a feasible short-term solution, it might not be more than a “band aid” for the Palestinian economy. Such a solution likely would serve to further entrench Palestinians in the Dutch Disease that has been the centerpiece of their economy to-date. Instead, international donors, including the United States, the United Nations, and the World Bank, should focus their investments in the West Bank and Gaza on economic development opportunities that will help to nurture and grow the Palestinian economy.

**CONCLUSION**

At the outset of this paper, I questioned whether Palestinians have been able to diversify their employment options beyond the Israeli labor market to such an extent that Israeli closure measures no longer have an impact on wages. Based on the research and the data analysis that I have conducted, I can only conclude that the Palestinian economy still is very much integrated with that of Israel.
Furthermore, I hypothesized that over-time, shorter term effects of insignificant wage premiums for educated workers would prove to be less important. The results of my regressions indicate strongly and significantly that as a greater percentage of the Palestinian population obtains degrees of tertiary education, wages do in fact increase. Over time, it seems that education is an important factor in determining increases in wages on average for the Palestinian population. However, such aggregate increases likely are not reflected in wage increases that are education-appropriate on an individual level.

Therefore, it is essential that international donors and the Palestinian government continue to invest in educational programs and institutions of higher learning. The future Palestinian state, now in its early stages of formation, depends on such enrichment to ensure it will continue to grow and thrive.
### Table 1: OLS Regressions

Effects of Education on Wages in the West Bank and Gaza: 1995-2004

<table>
<thead>
<tr>
<th>Independent variables:</th>
<th>(1) Coefficient (p-value)</th>
<th>(2) Coefficient (p-value)</th>
<th>(3) Coefficient (p-value)</th>
<th>(4) Coefficient (p-value)</th>
<th>(5) Coefficient (p-value)</th>
<th>(6) Coefficient (p-value) [robust p-value]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportion of labor force with Bachelor’s degrees</td>
<td>9.529 (0.056)</td>
<td>15.281 (0.005)</td>
<td>19.175 (0.002)</td>
<td>12.114 (0.034)</td>
<td>11.852 (0.002)</td>
<td>11.231 (0.001) [0.000]</td>
</tr>
<tr>
<td>Proportion of labor force that works in Israel</td>
<td>2.141 (0.028)</td>
<td>2.100 (0.016)</td>
<td>2.834 (0.005)</td>
<td>1.816 (0.004)</td>
<td>1.889 (0.001) [0.000]</td>
<td></td>
</tr>
<tr>
<td>Israeli GDP growth rate</td>
<td>2.507 (0.073)</td>
<td>3.221 (0.019)</td>
<td>2.432 (0.004)</td>
<td>2.404 (0.001) [0.001]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proportion 15-24 year olds employed</td>
<td></td>
<td>-3.866 (0.075)</td>
<td>-3.389 (0.008)</td>
<td>-4.049 (0.002) [0.001]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proportion of labor force employed in a hotel or restaurant</td>
<td></td>
<td></td>
<td>-6.368 (0.006)</td>
<td>-6.423 (0.002) [0.000]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intifada dummy (1 for years in which the Intifada was active)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-0.038 (0.031) [0.027]</td>
<td></td>
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<tr>
<td>Constant</td>
<td>3.497 (0.000)</td>
<td>2.833 (0.000)</td>
<td>2.530 (0.000)</td>
<td>3.931 (0.002)</td>
<td>5.196 (0.000)</td>
<td>5.441 (0.000)</td>
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<tr>
<td>R²</td>
<td>0.3845</td>
<td>0.7044</td>
<td>0.8341</td>
<td>0.9174</td>
<td>0.9895</td>
<td>0.9982</td>
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<tr>
<td>Adjusted R²</td>
<td>0.3076</td>
<td>0.6200</td>
<td>0.7512</td>
<td>0.8513</td>
<td>0.9764</td>
<td>0.9947</td>
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TABLE 2: CORRELATIONS BETWEEN INDEPENDENT VARIABLES

<table>
<thead>
<tr>
<th></th>
<th>Bachelor’s degree</th>
<th>Israel</th>
<th>Israeli GDP growth rate</th>
<th>15-24 yr olds working</th>
<th>Hotel and Restaurant workers</th>
<th>Intifada</th>
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<td>workers</td>
<td></td>
<td></td>
<td></td>
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<td>Intifada</td>
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<td>-0.6323</td>
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</table>

APPENDIX A – RETURNS TO SCHOOLING: 1981-2001

* The education premium is the multiplier for wages for those Palestinians who have achieved the stated level of education, as compared with a person with a high school degree or less.

Source: Sayre and Miller (2003)
## APPENDIX B – LABOR STATUS OF PALESTINIANS (AGED 15+): 1995-2004

### #s in thousands

<table>
<thead>
<tr>
<th>Year</th>
<th>In Labor Force</th>
<th>Outside Labor Force</th>
<th>Total</th>
<th>Employment</th>
<th>Underemployment</th>
<th>Unemployment</th>
<th>Total</th>
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<tr>
<td></td>
<td>%</td>
<td>#</td>
<td>%</td>
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#### TOTAL PALESTINIAN TERRITORIES

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#### WEST BANK

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<tr>
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<th>Outside Labor Force</th>
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<th>Underemployment</th>
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#### GAZA STRIP

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<th>Underemployment</th>
<th>Unemployment</th>
<th>Total</th>
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<td>516</td>
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<td>490</td>
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<td>154</td>
<td>2.1</td>
</tr>
</tbody>
</table>
APPENDIX C – DEPICTION OF PALESTINIAN EMPLOYMENT RATES: 1995-2004

* Employment is defined as “all persons aged 15 years and older who were at work at least one hour during the reference week, or who were not at work during the reference week, but held a job or owned a business from which they were temporarily absent (because of illness, vacation, temporarily stoppage, or any other reason).”

* Underemployed is “when a person’s employment is inadequate in relation to alternative employment, account being taken of his/her occupational skills.”

* Unemployment includes “those individuals 15 years and over who did not work at all during the reference week, who were not absent from a job and were available for work and actively seeking a job during the reference week. Persons who work in Israel and were absent from work due to closure are considered unemployed, and also those persons never work and not looking for work but waiting to return back to their works [sic] in Israel and Settlements.”

Source: Palestinian Central Bureau of Statistics
APPENDIX D – SCHOOLING LEVELS OF EMPLOYED PERSONS IN WEST BANK: 2004

Schooling Levels of Employed Persons in the West Bank: 2004

- Completed High School: 31%
- Completed ninth grade: 25%
- Completed sixth grade: 14%
- Completed one or more years of college: 27%
- No education: 3%

Source: Palestinian Central Bureau of Statistics
APPENDIX E – SCHOOLING LEVELS OF EMPLOYED PERSONS IN GAZA: 2004

Schooling Levels of Employed Persons in the Gaza Strip: 2004

- Completed one or more years of college: 32%
- Completed High School: 28%
- Completed ninth grade: 22%
- Completed sixth grade: 16%
- No education: 2%

Source: Palestinian Central Bureau of Statistics
APPENDIX F – DEPICTION OF PALESTINIAN ACTIVE LABOR FORCE EMPLOYED IN ISRAEL: 1995-2004

Percentage of Palestinian Active Labor Force Employed in Israel: 1995-2004

Source: Palestinian Central Bureau of Statistics
SOURCES CITED AND REFERENCED


