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Social Science Research

journal homepage: [www.elsevier.com/locate/ssresearch](http://www.elsevier.com/locate/ssresearch)

## Ethnic and gender earning gaps in a liberalized economy: The case of Israel

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### ARTICLE INFO

#### Article history:

Received 31 December 2015

Received in revised form 3 August 2016

Accepted 31 August 2016

Available online xxx

### ABSTRACT

During the 1990s and the 2000s Israel, a country ethnically divided into a dominant Jewish majority and a disadvantaged mostly Muslim Palestinian minority, underwent a transition from a heavily regulated to a neo-liberal economy. This paper makes use of the Israeli case to shed light on the effect of liberalization on earning gaps in the public and private sectors across dominant and disadvantaged population groups. The data, drawn from the 1995 and 2008 censuses—years that encompass the transition period, enable a dynamic investigation of the liberalization process by comparing labor market outcomes for Israeli Jews and Muslims of both genders working in the public or private sector. Liberalization reduced the protective role of the public sector, especially hurting women of both ethnic groups. In the private sector this process improved the position of the strongest group of Jewish men and of the weakest group of Muslim women. Discrimination against Jewish women and Muslim men in the private sector increased.

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### 1. Introduction

What happens to earning gaps between women and men and among various ethnic groups when the economy shifts from a highly regulated welfare state to a neo-liberal regime? Generally neo-liberal reforms weaken organized labor and reduce state interference in labor markets, thereby inducing an increase in overall wage inequality (Elliott and Bender, 1997). But what happens regarding gender and ethnic earning gaps? Will an economy with fewer collective arrangements be less biased in judging workers according to their ability and not according to their ethnic origin or gender? Or will it hamper anti-discrimination protection that a strong state may offer and harm weaker workers, among whom women and minorities are overrepresented?

There are two lines of thinking about the expected outcome of deregulation and privatization. Economists who concur with Becker (1957, 1993; Jolliffe and Campos, 2005) tend to argue that ethnic and gender discrimination cannot survive in competitive environments since “color blind” employers will attract workers who are paid less than equivalent non-minority males in discriminating firms, hence will be more efficient than the latter (Kelley and Evans, 2015). By contrast, sociologists, and some economists (most notably Kenneth Arrow, 1973a, 1973b, 1998), maintain that prejudice against ethnic minorities

A preliminary version of this article was presented at the RC-28 meeting of the International Sociological Association in Hong Kong, May 2012. We thank Yasmin Alkalai for her invaluable research assistantship. We also thank the Israel Science Foundation for financial support, grants numbers 637/06 and 405/11.

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<http://dx.doi.org/10.1016/j.ssresearch.2016.08.019>

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Please cite this article in press as: Bental, B., et al., Ethnic and gender earning gaps in a liberalized economy: The case of Israel, *Social Science Research* (2016), <http://dx.doi.org/10.1016/j.ssresearch.2016.08.019>

and women is pervasive in the free market, and the weakening of the state in neo-liberal regimes undermines protection against discrimination provided by state legislation and regulation. As for the public sector, much less is known about the impact of deregulation on gender and ethnic earning gaps. Overall, studies have shown that privatization increases outsourcing, the use of freelancers and other forms of non-standard employment. These are likely to weaken protection, specifically of minorities, thereby increasing ethnic and gender wage gaps (Corby, 1997; Lucifora and Meurs, 2006; Morgan and Allington, 2003).

The Israeli case provides a testing ground for these conflicting insights. In the last two decades Israel has undergone intensified liberalization which has fundamentally changed financial markets, labor relations, public services, and the Israeli industrial structure (Kop, 2005; Zilberfarb, 2005). The Israeli population is clearly split between a Jewish majority and a Palestinian (mostly Muslim) minority, a circumstance that allows a dynamic comparison of gender and ethnic income inequalities. To this end we used the 1995 and 2008 censuses, which enclose the period when most of the structural transformation took place. The analysis focuses on 25–50-year-old Jews and Muslims born in Israel, distinguishing individuals employed in the public and in the private sector. For both census years we estimated wage regressions for each of the eight combinations of ethnicity (Jews and Muslims), gender and employment sector, correcting for selection into the paid labor market and employment sector. The results of these regressions then served for a dynamic analysis of earning differentials of the various ethnic and gender groups over time.

The next section of the paper summarizes literature on the impact of neoliberalism, deregulation and privatization on gender and ethnic wage differences. Section 3 discusses the Israeli context and the changes in economic regime, policy and industrial relations over time. Section 4 presents the data, the variables, and the method of analysis. In section 5 we present our results, starting with descriptive statistics, followed by a multivariate analysis, and concluding with a dynamic decomposition to trace the development of ethnic and gender gaps over time. We summarize the paper in section 6.

## 2. Theoretical perspectives and previous studies

Economists see economic competition as a means for equitable treatment of workers. Already in 1922 Francis Edgeworth suggested that “leaving employers free to compete for male or female labourer” would secure “equal pay for equal work” (quoted in Weichselbaumer and Winter-Ebmer, 2007, 240). Gary Becker in his seminal *Economics of Discrimination* (1957) developed this argument by claiming that competitive markets force employers to offer fair wages; otherwise they might be driven out by other employers, who pay women and minority workers according to their productivity.

Several studies support this line in respect of different industries and across countries. Rose (1987) as well as Peoples and Saunders (1993) found that deregulation narrowed earning differentials between black and white workers. Heywood and Peoples (1994) found that deregulation in the trucking industry improved employment opportunities of black drivers. Peoples and Talley (2001) observed that privatization of public transit companies and deregulation in the trucking industry were associated with smaller racial earning differentials (eroding also the advantage of black over white bus drivers). Deregulation of the banking industry lowered the earnings of all workers, but men's shrank much more dramatically than women's (Black and Strahan, 2001) and lowered racial segregation in the workplace, especially in states with a high degree of racial prejudice (Levine et al., 2014).

Additional support for Becker's hypotheses, this time with respect to women, is found in Schwarz-Miller and Talley's (2000) study of the motor bus industry: “creating an increasingly competitive environment, making discrimination more costly and providing greater incentives for firms to employ female drivers ultimately leads to an improvement in their wage position relative to men” (2000,153). Black and Brainerd (2004) found that increasing trade reduced the earnings of low-income workers, but also lowered gender differentials. Based on meta-analysis of estimates of the gender wage gaps in various countries, Weichselbaumer and Winter-Ebmer claim that “countries with a higher economic freedom have a lower gender wage residual than others” (2007, 272). On the country level, Jolliffe and Campos (2005) studied male-female differences in the labor market before and during the transition from central planning to market economy in Hungary. They found that the gender wage gaps declined dramatically after market liberalization.

Contradicting Becker, Arrow (1998) states that competitive markets cannot eliminate or even reduce discrimination. In his critical paper Arrow challenged the ability of economics to study discrimination and claimed that despite the competitive pressures of the market, employers made decisions about hiring that were *not* free of beliefs and expectations concerning workers' skills and abilities according to race and ethnicity (Arrow, 1998, 96). For sociologists, the phenomena of cultural prejudice, cognitive biases, and social closure are inherent to many societies. Formal restrictions on women's and minorities' entering certain occupations and positions of authority have been removed due to ideological commitment to equality and the consequent legal measures which proscribe official limitations (Pager, 2007, 106–7). Still, many employers believe that women and men have different talents, and prefer men over women for many desirable occupations and positions of authority (Jacobs, 1989; Kraus and Yonay, 2000a; Padavic and Reskin, 2002). Similarly, in many countries employers believe members of ethnic and racial minorities have lower skills or disruptive traits that interfere with the work processes (Cain, 1986; Kelley and Evans, 2015; Tomaskovic-Devey and Stainback, 2007). Refuting a common belief that ethnic and racial discrimination has become much less pervasive and harmful, Pager et al. (2009) used field experiments to show that blacks and Latinos were still severely discriminated against in job hiring.

The level of discrimination has proven dependent on the nature and degree of political and legal measures to combat it. For example, Tomaskovic-Devey and Stainback (2007) found that the response to the Civil Rights Act in the U.S. was more positive

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