

Introduction

In this chapter the state of social affairs and social policy in Israel is analyzed. Special attention is given to the activity concerning Israel's social security as implemented by the National Insurance Institute in 2007. Developments in poverty and inequality, developments in public welfare expenditure, as well as the government's plans to reduce poverty (Part 1) as reflected in the government's *socio-economic agenda*¹, are evaluated (Part 2). Developments in benefit payments – scope, level, number of recipients and their sources of finance – are reviewed (Parts 3, 4, 5 and 6). Recommendations in the sphere of social policy are presented (Part 7). The issue of migrant workers in Israel, viewed in an international perspective (Box 1) and the topic of poverty as opposed to inequality as reflected in the official *agenda* (Box 2) are also discussed in the present chapter.

1. Issues of social developments

The Israeli economy has been very successful in recent years according to accepted macro-economic standards. The Gross Domestic Product (GDP) grew at an annual rate of about 5% between the second half of 2003 and the beginning of 2008, reflecting a per capita growth rate of about 3%. Israel's international creditworthiness, as reflected in its rating by major international rating companies, improved both due to and its macro-economic discipline – as expressed in responsible fiscal and monetary policies as well as in developments in the balance of payments and the foreign debt – and to its achievements in hi-tech. The improved financial reputation enhanced Israeli firms' access to the international capital market since the end of 2007 and secured improved interest terms on their debts. It also improved the situation of individual debts of Israelis to institutions abroad as well as making foreign investment in Israel more attractive. All these developments strengthened the Israeli economy in recent years, and one would expect that they should also improve to some extent the general welfare of Israeli residents. However, unfortunately, 2007 still does not herald news of any real improvement in the social area. The following brief review of developments since the 1990's may serve as a platform for discussing Israel's main social problems in 2007 and the potential instruments with which these problems may be overcome.

The process of opening the Israeli economy to globalization was accelerated during the 1990's, after the gradual liberalization of capital and financial markets in the late 1980's. A new dimension to globalization was added with the outbreak of the intifada. Disruptions, mainly in construction and agriculture, persuaded the government at the time to open its gates to migrant workers, replacing Palestinian workers in Israel, many of whom could no longer regularly attend work due to frequent closures of border crossings from the territories, imposed for security reasons. During this period there was a worldwide general movement of many workers from very poor countries in Africa, Asia, and South America to Western countries with relatively high wages. Like European economies, the Israeli economy constitutes an attraction for migrant workers, particularly in light of falling

1 See "Socio-Economic Agenda" (2007), The National Economic Council, the Prime Minister's Office.

international travel costs. Thus the international movement of workers became an important aspect of globalization, in addition to capital flows between countries. Some countries, such as the United States, particularly encourage, through entry regulations, not only simple workers but also highly educated workers, in order to benefit from their high labor productivity and low wage cost relative to that of domestically hired workers. In Israel, a different approach was taken: since 1993, an increased flow of migrant workers has been allowed into the country, while making sure that only workers for simple jobs were allowed in – mostly for construction and agriculture – and in recent years, mostly nursing attendants for the elderly and the disabled.

Another important process that resulted from accelerated globalization was the loss of competitiveness in production of products based on cheap labor in developed economies, and a transition of these industries to economies in the early stages of industrialization. This development also affected the Israeli economy, creating a policy problem concerning the influx of migrant workers, which has not yet been solved. As a result of this process, described in Box 1, many Israeli workers with little education, many of them in the Arab sector, at first lost their jobs and at a second stage dropped out of the labor force altogether. This process has certainly contributed to increased poverty and inequality during the past 15 years. The massive immigration from the former Soviet Union during the 1990's, together with the exit of low-skilled workers from the labor market, pushed this population to the entrance of the income support system, to a large extent for the lack of any other option.

Box 1:

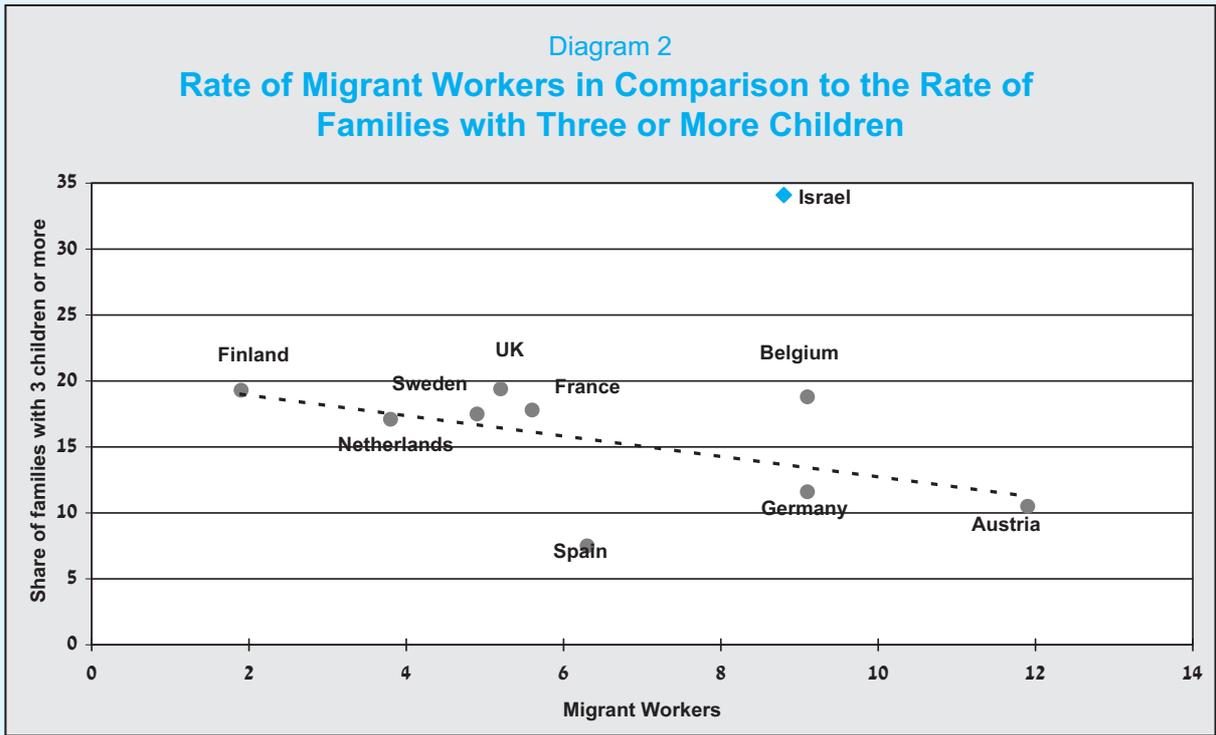
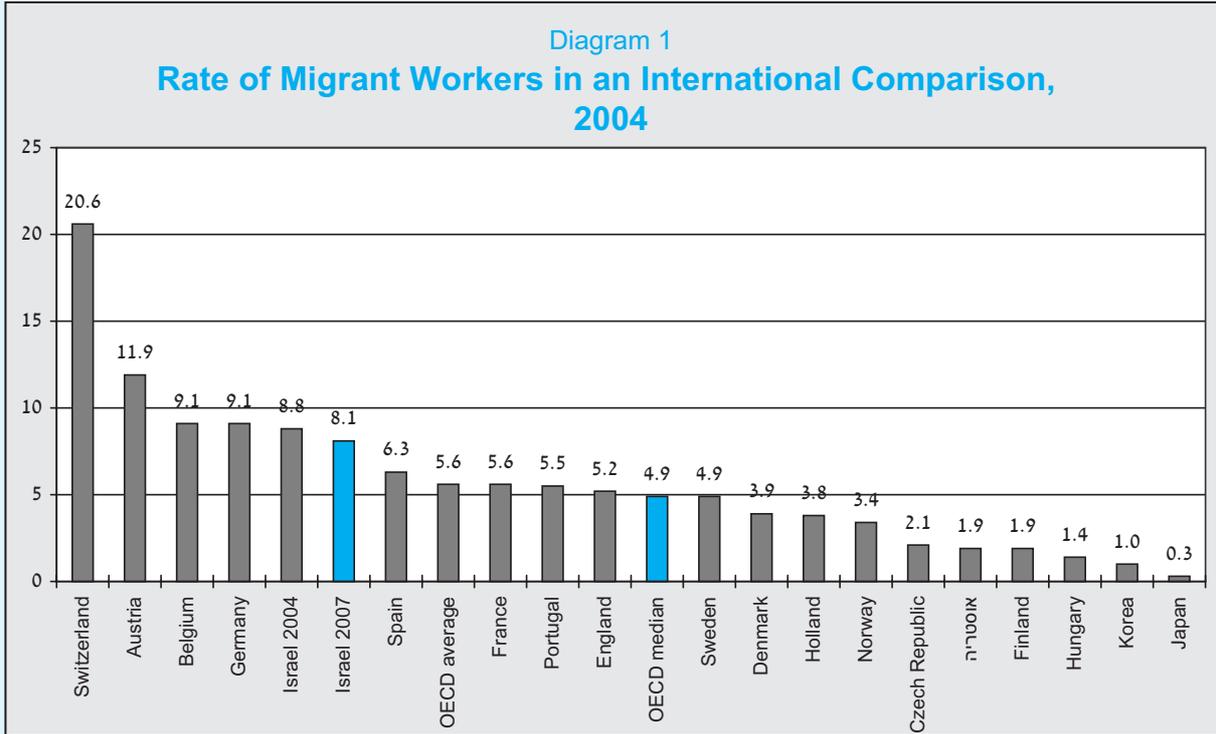
The Topic of Migrant Workers in an International Perspective

The rate of migrant workers in Israel is high in an international comparison: the median in OECD countries stands at 4.9%, while in Israel it reached 8.8% in 2004 (the year to which data pertaining to the other countries refers to) and in 2007 it decreased slightly – to 8.1% of the Israeli labor force (Diagram 1). A main reason for opening the country's gates to migrant workers is the aging of the population and the sparsity of young people at working age, a situation that characterizes many Western countries where the rate of migrant workers is higher than that in Israel. Despite the fact that in Israel the rate of young people is irregularly high in comparison to other Western countries, the rate of migrant workers is also irregularly high, though the trend indicates an inverse relation between the two (Diagram 2). The high rate of work migrants in Israel is problematic in light of the high weight of young people with little education within the Israeli population, and due to lacking enforcement of labor laws. These young people therefore confront unfair competition for their potential jobs.

Due to the above policy, the labor market of simple workplaces has been flooded with migrant workers who are, in many cases, employed in unfair conditions, while only half of them hold a permit. This process had a severe adverse effect on the prospect of Israelis with little education to secure employment with adequate wages in their potential labor market area – personal services – since success in this type of work does not require elaborate formal education. Moreover, a person who opts for this area can improve his competence through prior vocational training.

A commonplace argument is that there is no chance to match Israelis who require 24-hour attendance with Israelis who are willing to provide this service. A similar argument was made several years ago with regard to the area of construction, and was proved wrong – appropriate wages have created a supply of Israeli manpower. Even if the argument is proved to be right further along, even with a significant pay rise, 24-hour work alternatives may develop, such as shifts, emergency services, etc. It is probable that when the obstacle is lifted, in time equilibrium will be created so that some of the services will continue to be rendered by migrant workers, though at a higher cost due to improved enforcement of labor laws.

In order to avoid the damages of mark-up in services for the needy (the elderly and the disabled), the government should subsidize these services. It is likely that in many cases the budgetary cost will still be smaller than the cost of increasing the number of beds in nursing homes, protected tenancy, etc. The government should include in its advisability calculations not only the need for increasing subsidization, but also the savings which result from a reduction in the share of the working-age population receiving income support, the advantages expected from reaching its social goals (see Chapter 1) and more.



In response to the economic crisis that emerged in Israel in the early 2000's, the government decided to reduce the government deficit in order to maintain the fiscal target. This was done mainly through a cut in social expenditure which had a severely unbalanced social impact. Even if the macro-economic program called for a cutback, this step was unnecessarily harsh. Part of the problem was that concurrently with the required cutback for the purpose of deficit reduction, the government decided on a steady and rapid reduction in income taxes, which led to an even stronger need for an expenditure cut in order to achieve the budget deficit target. This unbalance policy pushed poverty and inequality rates further up, leading to a situation whereby the weak population suffered twice – firstly, through its impaired access to the labor market and secondly through the policymakers' unwillingness to bear the consequences of their policy towards non-Israeli workers and of the weak compliance to labor laws by means of the social security system.

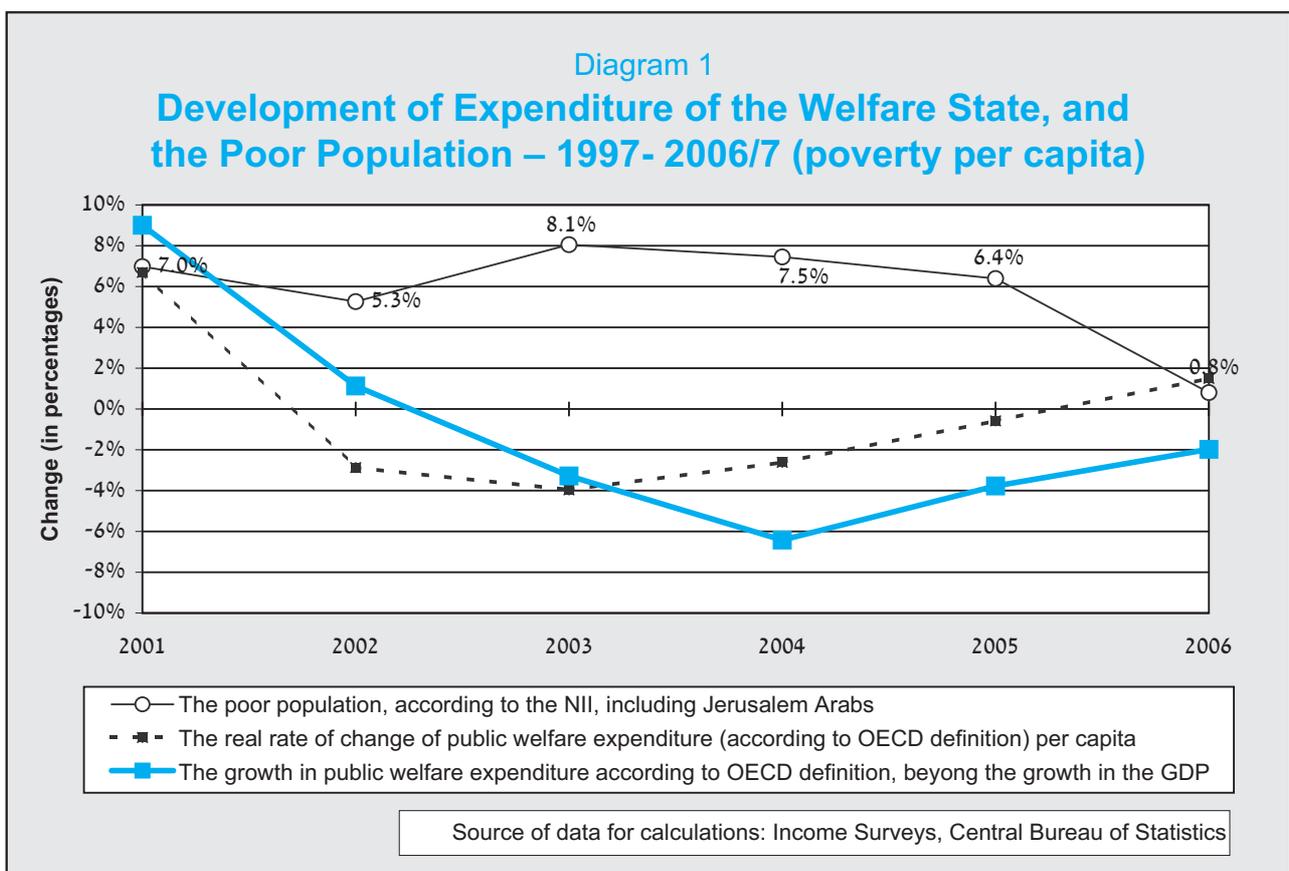


Diagram 1 illustrates the rate of growth of the poor population in Israel in comparison to the rate of change in public welfare expenditure (according to OECD classification) in 2001 and onwards. The diagram demonstrates the inverse relationship between the two variables: when welfare expenditure cuts were accelerated, the rate of growth in the poor population was moderated and vice versa. The overlapping of the two curves in 2006 points to the halt of the deterioration in the social situation.

The diagram illustrates that the growth of poverty and of cutbacks in welfare expenditure were moderated in 2005 and 2006, showing stabilization of poverty and inequality at high levels; although the continuous reduction in national welfare expenditure in terms of the GDP since 2002

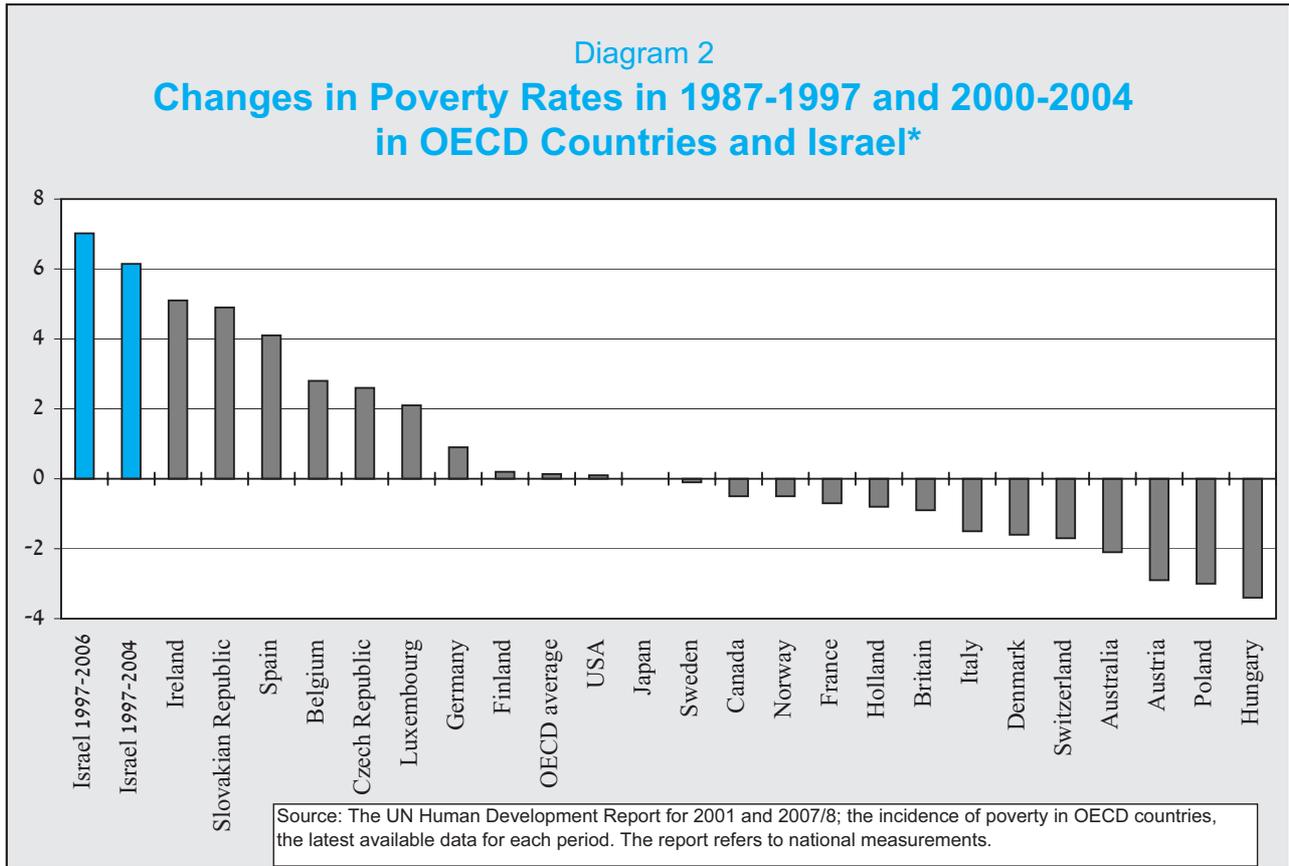
was indeed restrained, a positive correction was not made until 2006. It seems however, according to preliminary estimations, that a certain correction was effected in 2007. This positive trend is the upshot of recently increased social awareness of the government reflected in real measures such as the enactment of the Negative Income Tax Law and the increase of pensions for the elderly.

The reduction in national welfare per capita expenditure in recent years reflects the recent extensive cutbacks in benefits and the change in the method of adjusting benefits (their linkage to price changes rather than to changes in wages), but it does not explain all the factors that acted to stabilize poverty at its high level. The high level of poverty is also a result of government policy to increase the available income of the upper deciles through a gradual income tax reform in which tax rates were reduced. This tax reduction, in conjunction with maintaining the deficit target, has created – at least in the immediate term – the need for further cutbacks in expenditure. The decision to make substantial cutbacks in social services increased the regressive nature of the move. This conception reflects a priority which adversely affects low-income groups, thereby causing further poverty and economic inequality. Inequality also grew due to the nature of the economic growth: to the extent that this growth stems from the expansion of hi-tech branches, the resulting demand is mainly for highly skilled workers.

Inequality and poverty in Israel are high both historically and by international comparison. The data reflect increasing income polarization in Israeli society, which creates an increased risk of political and social instability. The strengthening of social security is an important tool for minimizing this risk while avoiding negative work incentives.

Diagram 2 illustrates the change in poverty incidence (in percentage points) in OECD countries and in Israel through 2001-2004 (according to available data), as compared with the average that prevailed through the 1987-1997 decade. The change from this decade to 2006 is also shown for Israel. Even though the years on which the data are based differ due to data availability for each OECD country, the overall picture is clear: while in more than half of the reporting countries poverty was reduced during this period, in the OECD countries reported on in the table, poverty remained more or less unchanged (an average increase of 0.1%), and in Israel, poverty incidence rose by 6-7 percent points.

The picture of poverty is influenced by recent government policy supporting a slower increase in public consumption than that compelled by the growth of the low-income population in Israel. A common contention in support of the expenditure policy is the need to maintain a responsible fiscal policy – that is, continuing to reduce the weight of the public debt and of government deficit in the GDP. There is no doubt that a responsible policy compels abidance by the rules aimed at reducing the government deficit and the weight of public debt in the GDP, but it is also clear that in order to implement these principles it was not necessary to make cuts specifically in the social security system and certainly not to the extent that this was carried out from 2002 to 2004. It should be remembered that the weak population groups have recently grown faster than has the population as a whole.



The condition of the poor in Israel also manifests itself in non-financial aspects: it is influenced by the long-term neglect of fundamental public infrastructure in the periphery – especially among the Arab population in the south of the country – in many basic areas, such as transportation, education and accessibility to industrial zones. Too many Arab communities are still unconnected to the systems of electricity, water and sewage. All this is detrimental to the welfare of the concerned population among these groups and its ability to integrate in employment. Box 3 in Chapter 2 reviews the particular poverty situations of various population groups in Israel and further elaborates on the topic of infrastructure.

2. Government social policy targets

In light of the above, the government declared in 2007, through its *socio-economic agenda* document, its intention to improve the socio-economic situation of Israel. The government recognized the complexity of the problem and the need to devise a perennial policy framework, and therefore defined its target to reduce poverty within three years – from 2008 to 2010. The government thus signals, and rightfully so, that improvement cannot be achieved overnight but rather requires a fairly long-term approach. We will therefore discuss not only steps decided upon in 2008, but also the government's aspirations as reflected in the three-year targets. This analysis must be made on the basis of a wide consensus that sometimes deviates from the immediate operative responsibility of the NII. At the same time, it is clear that changes in the social situation

affect not only the welfare of the population, but also bear indirect implications on social security policy. Thus, for example, the programs for enhanced integration of working-age income support recipients into the labor market is expected to reduce the number of recipients of subsistence benefits, as proved to a certain extent by the "Prospects of Employment"/Welfare-to-Work program ("from Income Support to Secured Employment" until 2007). It is important to assure that that the reduction in welfare dependence indeed stems from an increased participation in the labor market of program participants and not from other reasons.

Another important question is to what extent the relatively high economic growth has managed to improve the socio-economic situation. So far data suggest that there has been little such improvement. The reasons for this will be examined, and in order to do so we will expand the review to demographic developments expected in the coming years and we will examine the steps that may be taken in order to strengthen the link between economic growth and reduction of poverty and inequality. The responsibility for such steps lies with various government ministries, such as the Ministries of National Infrastructures, Transportation, Education and Health, and institutions responsible for the basic infrastructures such as electricity, water and sewage. The better the government manages to cope with a distribution of resources by region and population group, the lesser will be the burden on Israel's system of subsistence benefits, which is generally meant to provide. This will also help keep up the true fundamental tasks of a healthy social security system – namely to provide assistance to anyone requiring it, regardless of policy efforts for integration into the labor market.

The government decision – taken in the course of 2007 and in the beginning of 2008 – to adopt targets in the areas of poverty and employment, actually constitutes a change in social strategy. This step, important as it is for dealing with poverty in the medium and long run, does not address the immediate severity of poverty, since the government is not presently considering an increase in subsistence benefits for working-age persons.² There is thus a need to implement a combined policy which explicitly addresses short-term targets as well. This change of direction, if realized, requires time for planning and execution. The income support scheme in the social security net is designed to enable economically distressed families to bridge over the period during which active policy has not yet fulfilled its targets.

In addition to these targets, it was further decided to curtail poverty through enhancement of employment and remuneration for work, including negative income tax – so far only experimentally in the specific regions of the Lights to Occupation/Prospects of Employment Program. The government has also initiated a dialogue between the Industrialists' Association and the Histadrut, on operating a "compulsory pension" program. Beyond that, the *Agenda* document discusses reports by various committees concerning children at risk, education reforms, and more. It stresses the need for *improving efficiency* (as phrased) in the system of social security benefits – a choice of words that insinuates that the government believes it not to be adequately efficient at present. Behind the term *improving efficiency* hides a "residual" conception whereby benefit payments

2 It is noted that the government did recently increase old-age pensions, which significantly affected the incidence of poverty in the older population. Moreover, the *Agenda* document discusses the possibility of making the benefit system more effective, but not of increasing benefits.

should be channeled mainly to the poorest population, arguing that others do not need it. This attitude goes against the fundamental idea of social security, since the foundation of support for the social security system is the middle-class, on which rests most of the financing burden of this system. The policy of channeling benefits only to the poorest parts of the population may lead to a severance of the connection between payment of insurance contributions and payment of the benefits meant to be guaranteed to this public in time of need and thus to an erosion of support on the part of this important population group altogether.

The government resolved to set two targets concerning the juncture between economy and society: an employment target and a target to reduce poverty – thus indicating its awareness of the relationship between poverty alleviation and increasing employment.

Policy goals can be a useful tool to administer policy. It is designed to support policy implementation, particularly when implementation is a lengthy process. The problem and its solution can then be spread out gradually over a number of years, thus reducing the burden on annual budgets. The policy can be regarded as successful, even if the problem remains unsolved, as long as the public is convinced that reasonable effort is being exerted to mitigate it, and that it has produced at least partial results. It is therefore important for the chosen target to be convincing, i.e., recognized by the majority of the public as relevant, in light of the problem's extent. The public's patience can be stretched as long as it is convinced that the treatment of the problem is thorough and honest, and the very advancement favorably affects government credibility in the public eye. A dynamic relationship is thus created between the government and the public, which in turn creates a cycle reinforcing the policy and its outcomes, since the better the public understands the government's intent and accepts it as a desirable one, the more it adapts its behavior towards attaining the target. In other words, if government actions are indeed relevant to the desire of individuals to integrate into the labor force, their expectations will be affected accordingly, as will their behavior. A credible policy will generate hope of escaping the cycle of poverty and will influence the desire to work. This process is analogous to the force generated as a result of battling inflation by adapting inflation expectations to low levels. Expectations that coincide with government targets are government credibility made tangible.

A. The Israeli experience with policy targets

The Israeli economy has had experience with two main targets –the inflation target and the fiscal target. The latter had set a downward course for the deficit ever since its one-time increase to absorb the large immigration wave of the early 1990's.

The main success of the inflation target (a not particularly coherent course was selected at first, and later substituted by a long-term price stability target of 1%-3% along with the government's conviction of the policy's success) was in that it helped reduce inflation from about 16% to 20% through 1987-1991 and after several years of a very low level – less than 2% on average over the past six years. An important condition for the success of this inflation target policy was the unequivocal responsibility of a professional body, in this case the Bank of Israel, acting under a law

that explicitly specifies the Bank's responsibility for price stability.³ The declaration of the target per se also created an important dynamic process: when the target was introduced in 1992, at first in a somewhat hesitant and non-transparent manner, a focal point was created. The press, public and government agencies, even if they were not previously enthusiastic about the target, suddenly began to scrutinize the Bank of Israel's performance with respect to the target and to criticize it for deviating from it. Aside from the discomfort this caused for the Bank of Israel during those years, this fact set in motion an interesting dynamic: the Bank was forced to dedicate more efforts to understanding the process of reducing inflation and of the transmission mechanism at work between the policy tools (interest or monetary aggregates and the exchange rate) and the target. Thus systematic thinking was fostered, models were developed and policy papers were prepared and discussed as part of an ongoing and consistent policy. Over the years, the policy became more and more structured, with regular monthly and weekly discussions. In the course of the disinflation process, it became clear to the Bank heads that the Bank's authority must be broadened in order to better meet the target. Once the policy had been successfully implemented, a periodic follow-up report was added to enable the institution responsible for policy implementation to explain its measures. With all difficulties integral to the process, it is possible to conclude that the policy succeeded to a reasonable extent.

The fiscal target was in later stages supplemented with the debt to GDP ratio ("the 60% target"), and recently with a limitation on public expenditure (1% real annual growth, later increased to 1.7%). With hindsight, one may say that the two policy targets were achieved as far as policymakers are concerned, regardless of differences of opinion that arose in the course of the years.

The government's fiscal credibility was not steady. In the first years changes were made in the target that was first declared just prior to the 1992 budget: the (local) budget target was first set due to the fear of a breach in the budget after the immigration wave of the 1990's and the concern of uncontrolled deficits, as in the distant past. At first, the target of budgetary balance was set for 1995, but as it became clear that the target of a zero deficit would be too difficult to achieve it was replaced by the target of reducing the deficit. The succeeding government expanded the target indicator from the local deficit to one considering the entire deficit while changing the course of the target itself in a way that would make it more easily attainable. The succeeding government followed a similar course when it corrected another aspect of the government deficit, also by way of making the target easier to achieve. The government behaved in a similar way afterwards when it changed another technical aspect of the State deficit, making it easier to attain its target. Thus considerable skepticism was created regarding the target, but with the benefit of hindsight we can conclude that setting the fiscal target eventually improved fiscal discipline. The debt target (limitation of the public debt to 60% of the GDP, similar to the target of the European Union) struck roots in a less formal way and without a timetable, while it is compatible with the conception of reducing public expenditure, which Israeli governments have supported in recent years. The public debt has indeed decreased since a decision was taken regarding the law for reducing the budgetary deficit from a level of over 100% in the second half of the 1990's to about 80% in 2007.

3 This is regardless of the current discussion on the target's clarity under the existing law, as compared with the law being formulated in recent years.

These experiences suggest that the government can learn important lessons from its own experience in recent years with respect to the employment and poverty targets in the government's "agenda": Namely (1) that targets, when pursued consistently over a long enough period of time indeed produce positive results and (2) that if at first they suffer lack of aspiration, they will eventually have to be reset more ambitiously, and (3) once a government engages in the pursuit of policy goals, a serious policy effort will be benefited by improved policy credibility in the eyes of the public. This will cause the public to change its expectations and therefore its behavior in favor of the outlined policy target, thus making it achievable so that a way will be found out of Israel's social predicament.

B. The employment target

The government decided to direct its employment policy toward reaching an employment rate of 71% among persons aged 25-65 by 2010. This is a desirable target, though it would have been better to tighten the connection between it and the poverty target by setting consistent and detailed goals regarding populations characterized by high poverty rates and exceptionally low employment rates. This could then create a commitment on the part of the government to improve the infrastructure relevant for achieving the employment target in places where such infrastructure is lacking or defective. Furthermore, it is important to elaborate on the supplementary services for achieving the target in selected areas, such as day-care centers for young children and school lunches.

For some reason, the government decided not to include in its policy young persons under age 25, a critical group regarding the poverty target, since it is well known that poverty is particularly high among young persons (heads of households) up to age 24. In the Arab population and among new immigrants, for example, there are many young persons aged 21-25 who dropped out of the education system and who are not integrated in the labor force. The incidence of poverty in this age group is 34.5% among families and 51.9% among children (about 48,000 children). The average family size is 3.6 persons, and the average gap between their incomes and the poverty line is about 37%. Moreover, the limit of the target to the age of 65 is inconsistent with government policy of raising the age of retirement to 67 for men and to 62 for women.

In order to track the policy's success and difficulties it is important to immediately broaden the sample of income surveys, expenditure surveys and manpower surveys, so that we can analyze specific target groups according to combined factors of age, gender, nationality and size of family by region.⁴

4 The size of the current sample used for income surveys does not allow analysis of such small sub-groups. Such an effort was made at the time by the Central Bureau of Statistics when the Prime Minister at the time, Shimon Peres, together with his economic adviser, Michael Bruno, sought to calculate the price index every two weeks instead of once every month. This step then helped to enhance public trust in the success of the program, a fact that manifested itself clearly through swift reduction in inflation expectations. Policymakers wanted to track the success of the stabilization program in real time.

C. The poverty target

The poverty target was determined in two stages: at first, it was determined that the poverty incidence among families should drop to a level of 17.2% by 2010. This target was then abandoned in terms of poverty level, and a target was set in terms of change in net financial incomes for the bottom quintile. This target is defined as follows: During the three years 2008-2010, the average income for families in the bottom quintile should increase at least 10% faster than the per capita GDP growth rate. If, for example, the GDP per capita grows during this period by 10%, the target will be achieved if the real income for bottom quintile families will increase by 11%.

This approach of giving priority to income changes over a target defined in terms of poverty level may create results contradictory to the government's declared policy to reduce poverty. It is in fact possible that the formal target will be achieved while poverty actually increases during this period – for example, if per capita GDP growth is slower than the growth of the average income of the bottom quintile, while the latter grows less than the median income that constitutes a widely accepted indicator of the standard of living in the economy.

An additional important disadvantage of defining the target in terms of "change" is the association of the poor with the bottom quintile. Even if the current poverty rate among families is similar to that of the bottom quintile, this fact will become ever less accurate as the incidence of poverty grows beyond the bottom quintile. If poverty rises, it would mean that the new poor are being ignored, and if it drops, it would mean that the definition does not distinguish between those who are truly poor and those whose condition has improved.

The "change" index also suffers from asymmetry in that the GDP is measured in terms of individuals, while the bottom quintile income is measured in terms of income per family, rather than any weighted income according to family size. For example, if a family composition in the bottom decile changes, the change in income will be affected by the family composition as well, not only by the change in the family's situation.

Furthermore, in order to clearly express poverty among children, which is the most painful problem of poverty; it would have been desirable to add a specific target concerning this problem. It is important to remember that more than a third of the children in Israel are poor, and that 48% of all the poor in the country are children (2006). An examination of Israel's position in an international perspective shows that even the use of an internationally accepted equivalence scale places Israel high above the average incidence of child-poverty among many Western countries. A detailed discussion of child poverty is given in Chapter 2 and in its boxes.

In any event, it appears that setting the aforesaid triennial target is not ambitious enough – particularly when considering the large gap in the poverty incidence between Israel and OECD countries. It is important to set a target, even if it needs to be set as a very long-term goal (say 10 years), that will instill hope for a fundamental positive change in the situation. In this case one can learn from aspirations in the fiscal area, in which the European regarding the public debt as a weight of the GDP was adopted.

A similar approach concerning overall poverty could be to set, for example, a target of 10%, which would be reasonably close to the average incidence of poverty in OECD countries (9%). Since this target would present a formidable challenge, it is possible to set a longer timetable, for example 10 or even 15 years. A target that does not reflect reasonable aspirations is pointless since it is similar to marking a target too close to the current situation.

Beyond the change in income or in the incidence of poverty, it is very important to take into consideration the poverty gap. The National Economic Council intends to monitor the average income gap from the *poverty line*, but this is insufficient, since the average income gap fails to distinguish between the poorer and the less poor. Thus, for example, if policymakers opt to subsidize poor employees (usually situated close to the poverty line) by a negative income tax, to be financed by a cut in income support benefits or harshening conditions for entitlement to these benefits (for which mostly the very poor are entitled) this implies a transfer of incomes from very poor families to less poor families. The income gap cannot reveal this fact. Therefore measures are needed that give less weight to the income of the poor the less poor they are. There are a number of cumulative poverty indices accepted in the professional literature that are sensitive to poverty severity. One of them is the Sen Index (named after Amartya Sen, Nobel Prize winner for economics in 1998) that has long featured in NII reports, and recently also in reports of the Bank of Israel. They are also accepted today in research reports by institutions that specialize in poverty research such as The World Bank and the UN (e.g. the UN's Human Development Report). The internationally most widely accepted measure in addition to the poverty incidence measure is the index of poverty severity known as the *squared income gap*⁵. The data presented in Diagram 4 shows that the significant deterioration in the incidence of poverty and inequality was moderate in comparison to the deterioration in the severity of poverty, as reflected in the FGT Index, which doubled from the early 2000's until 2004 and onwards. The advantage that the poverty severity index brings to the incidence of poverty index is that the former also registers improvements in the poor person's condition, even though he remains poor. In many cases, policy measures improve the condition of the poor without completely extricating them from poverty, for which the government deserves recognition as well.

As aforesaid, by binding together the poverty and employment targets the government signals that the primary mechanism through which poverty needs to be attacked is the labor market. It is indeed important to reduce poverty through increasing employment, but in order not to neglect the monitoring of population groups that are not capable of finding a solution for their distress through the labor market alone (such as the elderly and weak population groups, particularly those of working age), intervention in supplementary areas is required.

5 This index was developed by Foster, Greer and Thorbecke and is therefore also referred to as the Quadratic FGT index. This well accepted index has important virtues described in the professional literature. It is regarded by the majority of researchers on poverty to reflect poverty severity adequately. Hypothetically, the index would be equal to the incidence of poverty, if **all** poor persons included in the index were to have no income at all ("the wretchedly poor"). Alternatively, if all that was needed for the poor to escape poverty was "one shekel", then the suggested severity index would be very close to zero, thus showing a very low severity of poverty. The higher the index of severity (the value of FTG^2), the more severe the poverty. The index thus varies between zero (negligible severity of poverty) and the value of the incidence of poverty (extremely severe poverty).

This chapter offers several means to improve the earning capacity of the poor population. Any fundamental solution in this context must include a real increase of the probability of needy persons to find suitable employment at reasonable wages. The government has indeed committed itself to this purpose through the *From Dependency to Self-Sufficiency/Prospect for Employment* program, the negative income tax program and other programs dedicated specifically to groups such as the ultra-Orthodox population and other special population groups. It appears that in order to effect a deeper change in earning capacity, a change in the range of interventions is required.

Box 2:

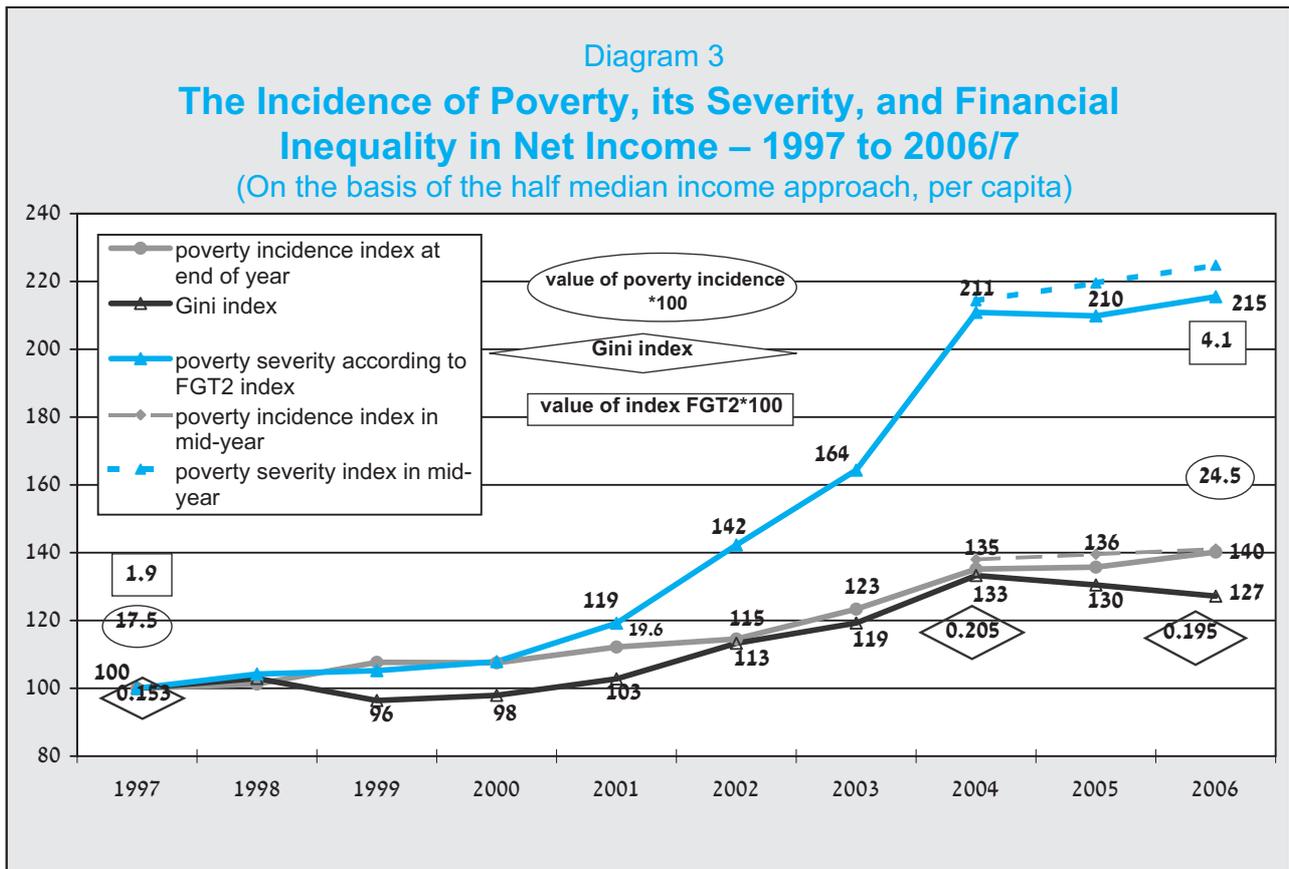
A Comment on the Relative Importance of the Struggle against Poverty As Compared to the Struggle against Inequality

If to judge based on the *Agenda Document* of the National Economic Council, the government "at this stage" does not intend to deal with inequality, but rather to focus solely on the topic of poverty in the hope that it will also have an effect in reducing inequality:

"Without undermining the importance of the broadening gaps, we believe that the main problem is the dimensions of poverty and not inequality per se. A high inequality index may be the result of various factors pertaining to various segments of the income distribution. Accordingly, there is no doubt that the rapid growth of the high-tech sector contributed to the expansion of inequality, since it yielded an increase in the income of those working in this sector at a much faster rate than that of the remaining population. However, it is not at all clear that stretching the top end of the income distribution for this reason presents a problem which merits government intervention. Moreover, it is probable that any attempt to moderate the growth of inequality for this reason will have a significant toll in terms of incentives to the future development of growing sectors. Conversely, deepening poverty also increases the level of inequality, but its results are far harsher on the individual and the public, by virtue of the above reasons. Hence, we believe that at this stage poverty, rather than inequality, has to be put at center stage, since it is clear that tending to the former is expected to also alleviate the latter..."¹

Focusing attention on poverty more than on inequality is understandable, since poverty constitutes a type of a particularly acute inequality, and for some of the poor it even has a considerable adverse affect on the minimum standard of living in dignity. Notwithstanding, inequality should not be ignored, particularly in certain cases: when the inequality originates from one's investment in human resources, or if one is endowed with a special talent or another ability of ingenuity or creativity, the inequality is an expression of recognition of one's qualities and amounts to an incentive to others to make an effort and share their abilities. However, when inequality originates from discrimination in the labor market or in infrastructures provided by the government, nepotism, corruption, unfair monopolistic power, or excessive wages – particularly if paid by public bodies or public enterprises – then inequality is an affliction that offends the basic sense of justice and squanders society's creative resources.² Inequality demands action also in the event of a taxation policy that excessively imparts benefits to the rich, especially when its extent reduces the funding of important public services, thereby endangering the orderly functioning of social security. Hence, the areas that create poverty are abundant and it is important, parallel to the policy aimed at reducing poverty, to try and separate bearable inequality (that which creates positive incentives) from excessive and unjustified inequality that must be reduced, and in part even uprooted.

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- 1 See the "Socio-Economic Agenda" by the National Economic Council in the Prime Minister's Office, 2007, pp. 16-17.
 - 2 See: Francisco Ferreira, 2007, "Inequality as Cholesterol", in "The Challenge of Inequality", International Poverty Centre, June, 20-21.



3. Scope of payments

NII benefit payments in cash and in kind – contributory and non-contributory – totaled NIS 47.1 billion in 2007, as compared with NIS 45.8 billion in 2006. These sums also include other payments made by the NII, mostly to government ministries, for expenses related to the development of community services. They are also included in the various administrative and operational expenses of the national insurance system (at the amount of NIS 1.2 billion). The real increase in total NII payments reached 2.4%. The increase is mostly the result of legislative changes, and to a lesser extent of an increase in the number of benefit recipients. On the other hand, the erosion of benefit payments has continued consistently since 2001 (Table 1): these payments dropped to 6.9% of the GDP in 2007, as compared with 8.9% in 2001-2002. A similar trend of gradual reduction in terms of GDP also characterizes collection by the Institute, mainly as a result of lowering the rates of collection from employers through a gradual process that began in 2005 (see below).

The data in Table 2 show the main trends relevant to benefit payments by branch. The 2.4% rise in the rate of benefit payments is explained by considerable increases in the Disability and Maternity branches. Payments of disability pensions increased by 7.1% following a 5.2% increase in the number of recipients, alongside an increase in payments due to implementation of the Polio Law – in 2007 about 1,800 polio disabled were paid a total of NIS 238 million. Payments of maternity benefits have increased by 15.6% due a rise in the number of recipients as well as due to

legislative changes made in the survey year: beginning in May 2007, maternity allowance is paid over a period of 7 or 14 weeks (as compared with 12 weeks previously), and beginning in January 2007, the hospitalization grant was increased by an additional 12.1% (beyond the costs of hospitalization) – a cost that totals NIS 151.6 million annually, and which is funded by the Treasury.

An additional and significant increase of 13.3% occurred in the "Long-Term Care branch and Other", as a result of several factors: a 4.3% increase in the number of long-term care benefit recipients (this increase is also the result of a change made to the definition of "solitary" that increases the number of eligible persons), creation of an additional level of eligibility, and an increase in the average fee per hour of care. A moderate increase (0.8%) was also registered in the Old Age and Survivors branch, the result of increasing pensions in mid-2006 – a change fully reflected in 2007 – and a slight increase (0.2%) in the number of eligible persons.

On the other hand, as in recent years, the scope of payments for benefits paid to the working-age population – unemployment (10.5%), income support (7.3%), and reserve service (12.1%) – continued to fall. The steep reduction in benefit payments at working age – unemployment and income support – is at least in part the result of the improvement in employment and the resumption of the downward trend in unemployment rates in 2007. An additional cause of this reduction is the amendment under which beginning in July 2007, a discharged soldier is required to have a qualifying period of six work months during the first year following his discharge in order to be entitled to unemployment benefit (previously, discharged soldiers were exempt from a qualifying period during the first year following their discharge). As a result of this amendment – which in essence terminates the entitlement of discharged soldiers to unemployment benefits – the number of discharged soldiers who received benefit fell drastically. It should be noted that this change is a further step in the policy of making eligibility conditions for unemployment benefit more stringent in recent years, after the introduction of the harsh legislative changes of 2002-2003. The reduction in payments for reserve service is a downward correction, after payments had soared by 18% due to the Second Lebanon War in 2006.

After child allowance payments went up by 8.5% in 2006 – for the first time since 2002 – following the expiration of the temporary order on cutbacks in child allowances, in 2007 they dropped again by half a percentage point. This reflects a continued process since 2002 of reducing payments for child allowances and determining a uniform allowance at a rate lower than the existing one for *new children* (born after June 2003) who are the third or subsequent children in their families. The process of replacing *veteran children* with *new children* is estimated to be completed by 2012, when most children will be considered as *new*. The exit of *veteran children* and the introduction of *new children* to the system gradually reduce the payments of child allowances. It should be further noted that similar to other NII benefits, the amounts of child allowances were not adjusted in 2007.

Table 1
Benefit Payments and Collection from the Public (not including administration expenditure), as a Percentage of the GDP, 1980-2006

Year	Benefit payments		Total collection	
	Total	Contributory benefits	Total*	National insurance contributions**
1980	6.09	4.98	6.77	5.15
1985	7.14	5.51	6.57	4.45
1990	8.36	7.04	7.21	5.28
1995	7.37	5.77	7.69	4.30
2000	7.89	6.28	6.19	4.21
2001	8.92	7.01	6.56	4.45
2002	8.94	6.94	6.56	4.46
2003	8.33	6.58	6.39	4.33
2004	7.54	6.04	6.20	4.15
2005	7.19	5.76	6.14	4.13
2006	7.07	5.69	5.97	3.99
2007	6.92	5.62	5.97	3.95

* Including collection for the sick funds.

** Including Treasury indemnification for reduced national insurance contributions from employers.

Total payments of contributory benefits under the National Insurance Law went up in 2007 by 3.3% in real terms. Payments of non-contributory benefits which are paid under State laws or under agreements with the Treasury, and which are fully financed by the State Treasury (e.g. income support, mobility, alimony, old-age and survivors' pensions to the non-insured – mostly new immigrants – and reserve service benefit) were reduced by 1.4%. In 2007 non-contributory benefits, including administration expenses, totaled NIS 8.9 billion, constituting 18.9% of total benefit payments.

Table 2 also features the distribution of benefit payments by branch. In the Old-age and Survivors branch, the largest branch, are concentrated 37.4% of total paid benefits – a rate slightly lower than that in the two years preceding 2007 (38%). On the other hand, the Disability branch, the second largest, increased its share by half a point, to 19.2%. The Children branch, which reduced its share by nearly a half since 1995, reduced its share even further from 2006 to 2007: from 11% to 10.7%. The shares of the Unemployment and Income Support branches in total benefits continued to be reduced in 2007, reaching 3.8% and 5.4%, respectively. It should be noted that between 2002 and 2007 the share of the Unemployment branch in total payments was halved, mainly due to profound legislative changes in 2002-2003 that made the conditions of entitlement to unemployment benefit more stringent, and to a lesser extent due to affirmative changes in the labor market in the following years. On the other hand, the Maternity branch increased its share by one percentage point through the two years as a result of the above-mentioned legislative changes. A similar increase was registered in the share of the Long-term Care branch. The share of the Reserve Service branch returned to its 2005 size after registering an increase in 2006 in the

wake of the Second Lebanon war. The condition of the other branches – Work Injury, Maternity and Reserve Service – remained mostly unchanged. Two-thirds of all benefit payments are concentrated in 2007 in the three largest branches – Old-age and Survivors, General Disability and Children.

Table 2
National Insurance Benefit Payments (including administrative expenditure), 1995-2007

Year	Total Payments'	Old-age and survivors**	General disability	Work injury and hostile and border actions	Maternity	Children	Unemployment	Reserve service	Income support***	Long-term care and other
1995	21,188	7,675	2,254	1,487	1,206	4,287	1,280	1,053	1,149	798
2000	39,706	13,670	5,128	2,569	2,423	7,000	3,023	1,039	2,957	1,897
2002	47,247	15,671	7,040	3,124	2,796	6,784	3,598	1,771	3,795	2,668
2004	42,759	16,032	7,355	3,145	2,727	4,887	2,166	708	3,003	2,735
2005	43,305	16,457	7,792	3,192	2,857	4,548	2,044	713	2,859	2,842
2006	45,760	17,376	8,392	3,306	3,103	5,038	2,013	860	2,730	2,941
2007	47,089	17,615	9,034	3,332	3,605	5,038	1,812	760	2,543	3,350
Real annual growth (percentages)										
1995	10.1	8.6	16.1	14.6	20.8	4.5	16.2	2.9	13.7	13.5
2000	8.1	8.4	14.8	11.4	10.8	1.5	-0.9	-7.4	18.1	18.2
2002	-1.6	-3.8	9.6	2.7	-0.7	-16.0	-4.9	24.1	0.3	11.6
2004	-4.2	2.2	0.8	-0.3	0.2	-20.3	-12.3	-38.1	-9.5	1.2
2005	-0.1	1.3	4.6	0.2	3.4	-8.1	-6.9	-0.6	-6.0	2.5
2006	3.5	3.4	5.5	1.4	6.4	8.5	-3.6	18.1	-6.5	1.4
2007	2.4	0.8	7.1	0.2	15.6	-0.5	-10.5	-12.1	-7.3	13.3
Distribution by branch (percentages)										
1995	100.0	36.2	10.6	7.0	5.7	20.2	6.0	5.0	5.4	3.8
2000	100.0	34.4	12.9	6.5	6.1	17.6	7.6	2.6	7.4	4.8
2002	100.0	33.2	14.9	6.6	5.9	14.4	7.6	3.7	8.0	5.6
2004	100.0	37.5	17.2	7.4	6.4	11.4	5.1	1.7	7.0	6.4
2005	100.0	38.0	18.0	7.4	6.6	10.5	4.7	1.6	6.6	6.6
2006	100.0	38.0	18.3	7.2	6.8	11.0	4.4	1.9	6.0	6.4
2007	100.0	37.4	19.2	7.1	7.7	10.7	3.8	1.6	5.4	7.1

* The figures for 1995 do not include the amounts transferred to the Ministry of Defense as reimbursement of debt for savings in reduced reserve service duty days.

** Including payments for income supplement.

*** For the working-age population.

4. Benefit levels

The Economy Recovery Law of June 2003 determined that NII benefits, except old-age and survivors' pensions⁶, are to be frozen until the end of 2005, and that from January 2006, they will be adjusted at the rate of price rises, rather than according to changes in the *average wage* as previously. In the wake of the change in the method of adjusting benefits, the clauses in the National Insurance Law that defined the calculation of benefits and their adjustment according to the *average wage* were changed, and beginning in January 2006 benefits are calculated on the basis of the *basic amount*⁷. This amount is adjusted in January each year in accordance with the increase in the Consumer Price Index between the index of November that preceded the month of adjustment and the index of November of the preceding year.

The influence of the cancellation of the linkage to the *average wage* and its replacement with a linkage to price rises was felt as early as 2006, when benefits were adjusted by 2.7%. During 2002-2006, when benefits were frozen and when they began to be linked to prices rather than to the *average wage* (beginning in 2006) – the *average wage* went up by 6%; that is, benefit recipients in effect lost 3.2% of their benefits. In 2007, benefits were not adjusted at all, since there was a minor decrease in the price index for the relevant period. In this case, had benefits been still adjusted on the basis of the *average wage*, recipients would have enjoyed a 2% addition to their benefits. The cumulative loss to benefit recipients in the two years totaled over 5%, or about NIS 2 billion in budgetary terms. Past experience indicates that this trend of benefit erosion will gather momentum, since **real** wages rise at an average rate of about 2% annually. Moreover, the 4% reduction in most benefits that began in July 2002 continued, and was meant to continue only until December 2006, but was eventually extended up to 2007.

The data in Table 3 indicate that the basic old-age pension for a single person went up in real terms by 0.9%, and that the old-age pension plus income supplement for a single person went up by 1.6%. On the other hand, as a percentage of the *average wage*, all categories of the old-age and survivors' pension either remained at their 2006 level or were slightly eroded.

The data in Table 4 indicate that the minimum guaranteed income for the working-age population went up in 2007 by 1% to 3.5%, according to the different family compositions. Still, as a percentage of the average wage in the economy, the benefit more or less remained at its real level of 2005. This stabilization followed significant erosion in benefits for the working-age population through 2002-2005; a basic calculation shows that minimum income support for a single parent with two children, for example, was reduced by 23% in real terms through 2002-2007.

6 Including dependents' benefit in the Work Injury Branch.

7 The amount on which basis most benefits are calculated since January 2006. This amount is updated on January 1st each year, at the rate of the Consumer Price Index increase in the preceding year. The *basic amount* has three different rates for the purpose of updating the various benefits. For most benefits, the *basic amount* in 2007 was NIS 7,240; for child allowances it was NIS 152, and for old-age and survivor's pensions it was NIS 7,352.

Table 3

Old-age and Survivors' Pensions, and the Minimum Guaranteed Income for the Elderly and for Survivors (fixed prices and a percentage of the average wage in the economy*), monthly average, 1975-2007

Year	Basic old-age and survivors' pension				Minimum guaranteed income (including child allowances)			
	Single person		Widow/er with two children		Single person		Widow/er with two children	
	2007 prices (NIS)	Percent of the average wage	2007 prices (NIS)	Percent of the average wage	2007 prices (NIS)	Percent of the average wage	2007 prices (NIS)	Percent of the average wage
1975	640	14.9	1,064	24.8	1,096	25.5	2,130	49.6
1980	705	13.5	1,366	26.3	1,238	23.8	2,506	48.2
1985	795	15.2	1,541	29.5	1,586	30.5	3,042	58.3
1990	1,001	15.9	1,938	30.7	1,573	24.9	2,893	45.9
1995	1,014	15.5	1,965	30.1	1,696	26.0	3,749	57.3
2000	1,132	15.0	2,193	29.0	1,892	25.0	4,162	55.0
2001	1,228	15.7	2,378	30.5	2,053	26.3	4,499	57.7
2002	1,141	15.6	2,255	30.8	1,946	26.5	4,227	56.4
2003	1,107	15.6	2,235	31.5	1,929	27.2	4,174	58.7
2004	1,112	15.2	2,244	30.6	1,937	26.4	4,144	56.7
2005	1,127	15.2	2,235	30.2	2,049	27.6	4,284	57.8
2006	1,149	15.3	2,243	29.9	2,146	28.6	4,492	59.6
2007	1,159	15.1	2,247	29.5	2,181	28.6	4,533	59.4

* As measured by the Central Bureau of Statistics.

The average disability pension was eroded by 0.7% between 2006 and 2007, and as a percentage of the *average salary per employee post* it went down from 32.1% to 31.4%, thus returning to its 2002 level. Similar trends characterized benefits derived from the general disability pension: the benefit for a disabled child registered a real decrease of a similar rate, and the average attendance allowance, that went up slightly (0.2%) between 2006 and 2007, was eroded in terms of percentage of the *average wage* by half a percentage point. On the other hand, the average mobility allowance showed a real increase of 0.8% as compared with 2006.

The average long-term care benefit (translated into care hours) registered a real increase of about 4.4% in 2007 as compared with 2006. This increase expresses the effect of the legislative change of January 2007 whereby three dependency levels were determined in place of the previous two levels: a third level at a rate of 168% of the full disability pension for a single person was added. In addition, the fee for an hour of care increased at a real rate of about 3%.

Table 5 features the value of the allowance point for children and the rate of child allowance paid to various family compositions, in 2007 prices and as a percentage of the *average wage*. Since the *basic amount* did not change in 2007, the child allowance too (paid according to the *basic amount*), remained the same. As a result, the allowance point was eroded in relation to the *average wage*, going down from 2% to 1.9% of this wage. The nature of the continuing cutback in child allowances since 2001, as part of the program to equalize the allowance for all children, led to differential cumulative rates of change for various family compositions: while child allowance for families with two children was eroded by about 22% between 2001 and 2007, the allowance for families with four and five children was eroded by 47% and 54%, respectively, during this period.

Table 4
**Minimum Guaranteed Income to Working-Age Population (set prices and as a percentage of average wage *),
 Monthly Average, 1990-2007**

Year	Single person			Single parent with two children* (including child allowances)			Couple with two children (including child allowances)			
	Regular rate		Increased rate	2006 prices (NIS)		Percent of average wage	Regular rate		Increased rate	
	2006 prices (NIS)	Percent of average wage	2006 prices (NIS)	Percent of average wage	2006 prices (NIS)	Percent of average wage	2006 prices (NIS)	Percent of average wage		
1990	1,258	20.0	1,573	24.9	3,187	50.5	2,901	46.0	3,373	53.5
1995	1,268	19.4	1,585	24.3	3,513	53.9	3,040	46.6	3,516	53.8
2000	1,414	18.6	1,768	23.2	3,894	51.2	3,352	44.0	3,881	51.0
2001	1,535	19.7	1,918	24.6	4,218	54.1	3,600	46.2	4,174	53.6
2002	1,426	19.6	1,783	24.5	3,888	53.4	3,313	45.5	3,887	53.4
2003***	1,385	19.5	1,630	22.9	3,319	42.5	2,866	40.3	3,304	46.6
2003****	1,731	24.4	1,730	24.4	3,765	53.0	3,665	52.4	3,728	52.4
2004***	1,390	19.0	1,564	21.4	2,965	40.5	2,583	35.3	2,965	40.5
2004****	1,738	23.8	1,738	23.8	3,733	51.0	3,695	50.5	3,654	50.5
2005***	1,372	18.5	1,544	20.8	2,923	39.4	2,546	34.3	2,923	39.4
2005****	1,715	23.1	1,715	23.1	3,681	49.6	3,644	49.1	3,644	49.1
2006***	1,380	18.3	1,553	20.6	2,989	39.7	2,610	34.7	2,989	39.7
2006****	1,725	22.9	1,725	22.9	3,779	50.2	3,714	49.3	3,714	49.3
2007***	1,373	18.0	1,545	20.3	2,973	39.0	2,596	34.0	2,974	39.0
2007****	1,716	22.2	1,716	22.5	3,759	49.3	3,694	48.4	3,694	48.4

* As measured by the Central Bureau of Statistics.

** The 1985 and 1990 figures refer to a widow with two children who was entitled to an income support benefit.

*** The eldest member of the family is not yet 55.

**** At least one family member is over 55.

In branches that pay wage-replacing benefits, neutral trends were observed in 2007: the average daily injury allowance for employees and the self-employed increased by 3.6% and 3.4%, respectively, and the average maternity allowance per day increased by half a percent in real terms. On the other hand, the birth grant registered a real decrease at a similar rate and the average unemployment benefit continued to decrease relative to the average wage in the economy. This latter decrease is mainly due to the continued reduction in the share of the unemployed persons who received unemployment benefit at a rate of over half the average wage in the economy, together with a parallel increase in recent years in the share of those who received this benefit at a rate of under half the average wage in the economy.

Table 5
Child Allowances and Allowance Point* (fixed prices and as percentage of the average wage in the economy), Monthly Average, 1990-2007

Year	Allowance point value		Allowance for two children**		Allowance for four children		Allowance for five children	
	2007 prices (NIS)	Percent of average wage	2007 prices (NIS)	Percent of average wage	2007 prices (NIS)	Percent of average wage	2007 prices (NIS)	Percent of average wage
1990	192	2.9	92	1.5	1,493	23.4	2,116	33.2
1995	187	2.8	375	5.8	1,504	23.4	2,139	33.4
2000	190	2.5	382	5.0	1,534	20.2	2,185	28.7
2001	188	2.4	378	4.8	1,520	19.5	2,463	31.6
2002	179	2.4	319	4.3	1,267	17.3	2,063	28.1
2003	177	2.5	301	4.2	1,110	15.6	1,772	24.9
2004	178	2.4	253	3.5	867	11.8	1,365	18.7
2005	176	2.4	246	3.3	776	10.5	1,187	16.0
2006***	149	2.0	298	4.0	807	10.7	1,138	15.1
2007****	148	1.9	296	3.8	803	10.5	1,132	14.8

* Until 1995 includes the Special Allowance for Veterans.

** The allowance level in 1985 and 1990 refers to families (with up to three children) who were not eligible for child allowance for the first child, and since October 1990 – nor for child allowance for the second child. In March 1993, the payment of child allowances on a universal basis was resumed.

*** Since 2006, child allowances are calculated according to the *basic amount*, which in January 2006 was NIS 148.

**** The *basic amount* was not updated in January 2007, and child allowances at their current value remained unchanged.

5. Benefit recipients

In 2007, the number of persons who received old age and survivors' pensions – the largest of all NII branches from the point of view of the scope of benefit payments – went up by 0.2%: the NII paid pensions to 728,900 elderly and survivors, as a monthly average, in 2007 (Table 9). The slowdown in the growth rate of these pension recipients is attributable to the rise in the conditional age of entitlement to old-age pension for both men and women, and in the absolute age of entitlement for women, as well as to the steady decrease – at an annual rate of 4% – in the

number of non-insured recipients (new immigrants). This decrease is partly set off against a parallel increase in branches that pay benefits to the working-age population. In the second largest branch, General Disability, an increase of 5.2% was registered in the number of recipients of the general disability pension. The increase in the number of recipients also characterized the other benefits in this branch: the number of attendance allowance recipients went up by 6.9% and the number of recipients of mobility allowance – by 4.7%. The number of recipients of benefit for disabled child increased by 7.2%, after a 6% increase in 2006. It should be noted that in 2007, following the Polio Law, NIS 238 million were paid for the first time under this law to about 1,800 polio-disabled. In the third largest branch, Children, the number of families receiving child allowances increased by 1.3%, after an identical increase in 2006, as a result of the natural growth rate of the population. In 2007, child allowances were paid to about 2.3 million children who live in 980,600 families.

Significant increases were registered in the Maternity and Work Injury branches – branches mainly influenced by employment opportunities. In the Maternity branch, the number of maternity allowance recipients increased by 4.1%, and the number of birth grant recipients – by 2.5%. The Work Injury branch registered an increase of about 5% both in recipients of injury allowance and recipients of permanent disability pension. The Long-term Care branch, which pays in-kind benefits (care hours) for the elderly limited in their daily functions, registered a similar increase (4.3%).

The downward trend in the number of unemployment benefit recipients continued, and in 2007 this number went down by about an additional 11%, so that the cumulative reduction in this number since 2001 reached 52%. While the reduction of the past two years (a cumulative rate of about 16%) is attributed to the positive changes in employment and unemployment, the cumulative reduction since 2001 is mainly the result of restrictive changes made to the law in 2002-2003, first and foremost, the extension of the qualifying period of entitlement to unemployment benefit.

A sharp reduction (of 7.8%) was registered in the number of income support recipients, continuing the trend that began in 2004, and which can be attributed to the combination of several factors: the positive changes in employment and unemployment during the past two years, the restrictive changes in the law in 2003, and the implementation of the Law for Integrating Benefit Recipients in Employment.

6. Collection of contributions from the public and sources of financing benefits

NII benefit payments are financed from four sources: collection of national insurance contributions (direct collection from the public as well as *Treasury indemnification* against reduced national insurance contributions from employers and from the self-employed), government participation in financing non-contributory benefits, government financing of non-contributory benefits, and revenue derived from interest on investments of surpluses, mostly in government bonds. In addition to collecting national insurance contribution, the NII collects health insurance contributions and transfers them to the sick funds.

In August 2005 the first stage in the process of reducing national insurance contributions to employers began, a gradual process to extend until 2009. At its end, national insurance contributions for employers will be reduced by 1.5 percent points. At the same time, two rates of insurance were introduced – reduced and regular – in place of a uniform rate for all levels of income liable for insurance contributions. This step is part of a broader policy dating back to the 1980's, according to which the cost of labor to employers should be reduced. It should be noted that the NII expressed its objection to this measure: reduction in revenue from collection from the public enhances the dependency of the national insurance system on Treasury budgets, and may indirectly cause further cutbacks in expenditure on benefits.

Under an additional reform introduced in the area of collection by the NII in the beginning of 2006, the reduced rate of insurance contributions applying to the **worker** was lowered from 1.4% of income to 0.4%; the regular rate was increased from 5.58% to 7%, and the reduced rate was increased from 50% of the *average wage* to 60% thereof. These changes were made on a zero budget. Like the policy with regard to benefits, the *average wage* was not adjusted by law through 2002-2005, so that insurance contributions and the minimum income for the purpose of paying contributions for the various types of insured persons were not adjusted. The *average wage* continued to be frozen until the end of 2005, and beginning in 2006 the ceiling is adjusted only at the rate of the index increase. On the other hand, the reduced rate, as well as the minimum wage

for the purpose of paying insurance contributions, will continue to be adjusted on the basis of changes in the *average wage* even beyond 2006. The change in the method of adjusting the ceiling will lead in the long run to a lesser burden being imposed on very high wage-earners, who will be favorably discriminated relative to those who pay insurance contributions at the minimum level (such as students and the unemployed). On the other hand, continued linkage of the reduced rate to the *average wage* will prevent the imposition of a heavier burden of insurance contributions on low-wage earners.

A. Collection of insurance contributions from the public

The NII's revenue from collection of national and health insurance contributions totaled NIS 39.7 billion in 2007: NIS 24.45 billion for national insurance branches and NIS 13.46 billion for the health system. This collection from the public must be supplemented by about NIS 1.8 billion transferred by the State Treasury as indemnification for the reduction in national insurance contributions for the employers and the self-employed (under clause 32C of the National Insurance Law).

Table 7 indicates that direct collection from the public registered a real increase of 4.4% in 2007: collection of national insurance contributions went up by 3.3% and of health insurance contributions – by 6.6%. These increases stem mostly from positive developments in the areas of employment and wages. Estimates indicate that direct collection from the public in 2007 could have climbed at an even higher rate (of about 7% in real terms) were it not for the legislative changes of 2005 and 2006 that reduced the rates of national insurance contributions from employers and that will continue to influence the system until 2009. These changes did not affect collection of health insurance contributions.

The downward trend that characterized the scope of collection in terms of GDP was brought to a halt in 2007, after collection went down from 6.2% of the GDP in 2003 to 5.7% in 2006. The scope of national and health insurance contributions is identical to that of 2006 in terms of percentage of the GDP. Due to the income tax reform, the share of collection from the public went up to 46.2% of total direct taxes, a process that began in 2003, when collection from the public amounted to 40.2% of total direct taxes.

The changes in collection rates differ between employees and non-employees. While collection from the former registered a real increase of 2.7% in 2007 (after an increase of half a percent in 2005), the rate of collection from the latter went up by 9.7% (after an identical increase in 2006). These differences are attributable to the implementation of the program for reducing insurance contributions from employers between 2005 and 2009.

Table 7
Collection for the National Insurance and Health Systems, 2002-2007

	2002	2003	2004	2005	2006	2007
	Current prices (NIS million)					
Total revenue from insurance contributions	33,995	33,660	34,331	36,137	37,792	39,740
Total collection from the public	31,378	32,275	32,971	34,597	36,112	37,910
For national insurance branches	20,495	21,424	21,661	22,759	23,554	24,454
For health system	10,883	10,851	11,310	11,838	12,558	13,456
Total Treasury indemnification	2,617	1,385	1,360	1,540	1,680	1,830
	Indicators of development of collection from the public					
A. Rate of change in real terms						
Total collection from the public	-0.1	2.2	2.6	3.6	2.2	4.4
For national insurance branches	1.3	3.8	1.5	3.7	1.4	3.3
For health system	-2.7	-1.0	4.6	3.3	4.0	6.6
B. As percentage of GDP						
Total collection from the public	6.1	6.2	6.0	5.9	5.7	5.7
For national insurance branches	4.0	4.1	3.9	3.9	3.7	3.7
For health system	2.1	2.1	2.1	2.0	2.0	2.0
C. As percentage of direct taxes for a single person						
Total collection from the public	36.8	40.2	41.9	42.2	44.0	46.2
For national insurance branches	24.0	26.7	27.5	27.8	28.7	29.8
For health system	12.8	13.5	14.4	14.4	15.3	16.4
D. As percentage of direct taxes						
Total collection from the public	30.8	32.5	32.0	31.4	28.8	28.6
For national insurance branches	20.1	21.6	21.0	20.7	18.8	18.5
For health system	10.7	10.9	11.0	10.7	10.0	10.1

B. Sources of financing benefits

Table 8 indicates that total NII payments for financing the national insurance branches totaled NIS 55 billion in current prices in 2007. This constitutes an increase of 4.5% in comparison to 2006 and an accumulated increase of over 10% in comparison to 2004. This real increase, for the third consecutive year, stands in opposition to the real reduction in total financing sources during the two years preceding 2005 and is composed of an increase in all financing components, particularly government contribution to financing insurance branches, which registered a sharp increase (of 9.6%). This rate is the result of wage rises, with an approximate 7% influence on collection, and other additions to this expenditure, such as the addition of NIS 151 million for the 12.1% rise (over and beyond the rise in hospitalization costs) in the hospitalization grant as of January 2007 – a cost entirely financed by the Treasury.

Table 8
Sources of Financing of National Insurance Branches, 1995-2007

Year	Total revenue	Collection of national insurance contributions*	Government participation**	Government financing of benefits	Revenue on interest
NIS million, current prices					
1995	23,581	12,171	4,222	4,650	2,504
2000	41,207	20,751	8,336	8,148	3,907
2002	48,642	23,114	10,506	10,590	4,266
2004	47,513	23,021	10,996	8,548	4,617
2005	49,705	24,299	11,700	8,616	4,850
2006	52,344	25,234	12,600	8,982	5,290
2007	54,974	26,284	13,888	9,459	5,600
Real annual growth (percentages)					
2000	7.6	9.8	1.6	10.8	3.6
2002	-0.2	-1.7	-0.1	2.7	-1.0
2004	-0.6	1.3	2.2	-8.9	4.1
2005	3.2	4.2	5.0	-0.5	3.7
2006	3.1	1.7	5.5	2.1	6.8
2007	4.5	3.6	9.6	4.7	5.3
Distribution (percentages)					
1995	100.0	51.6	17.9	19.7	10.6
2000	100.0	50.4	20.2	19.8	9.5
2002	100.0	47.5	21.6	21.8	8.8
2004	100.0	48.5	23.1	18.0	9.7
2005	100.0	48.9	23.5	17.3	9.8
2006	100.0	48.2	24.1	17.2	10.1
2007	100.0	47.8	25.3	17.2	10.2

* Including Treasury indemnification.

** Under clause 32(a) of the National Insurance Law.

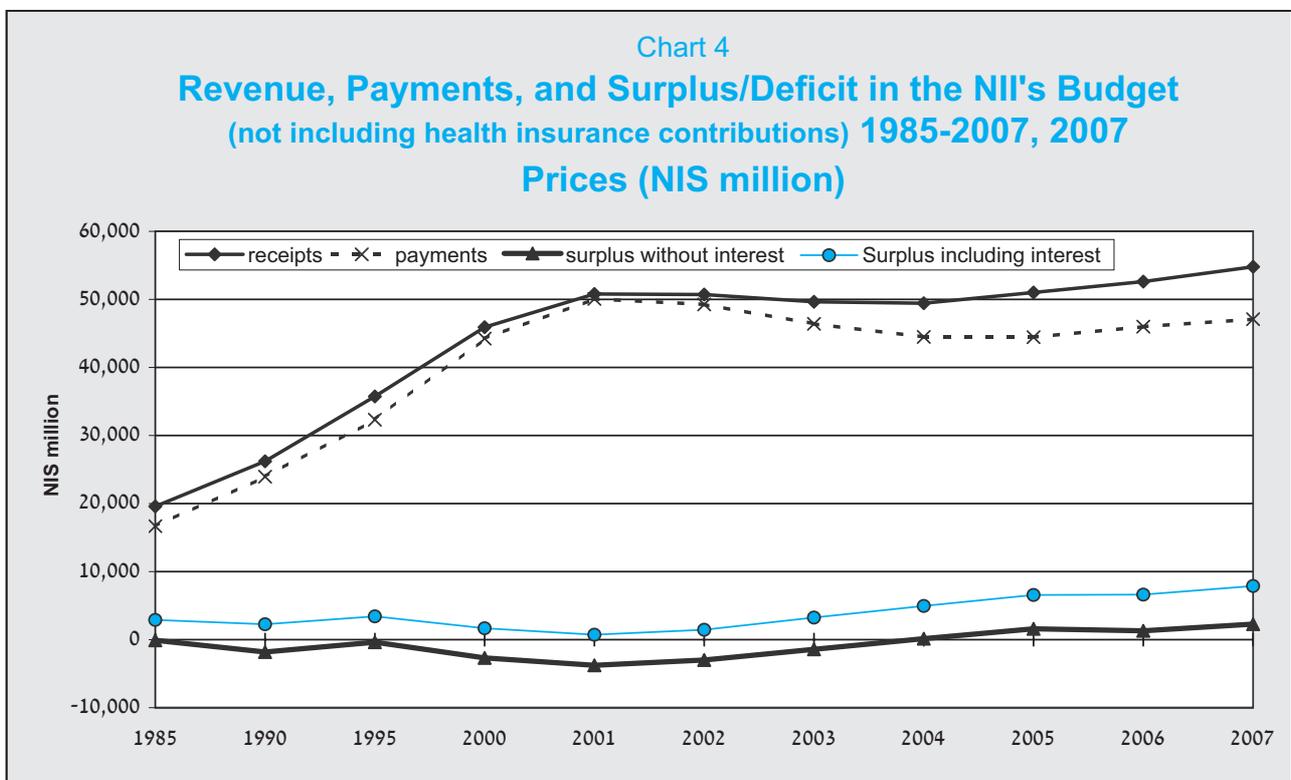
The other components of financing increased by 4%-5%. The increase in government participation, anchored in clause 32 to the National Insurance Law, aims at compensating the NII for the loss of income following the reduction in national insurance contributions from employers⁸. The contribution on part of the Treasury under this clause varies according to the increase in collection rates, which is in itself influenced by legislative changes and changes in the labor market, which were positive for the year under review. An examination of the distribution of benefit financing by source indicates that the share of government financing went up at an average rate of 7.6% in 2007, after an increase of about 4% in 2006. The data indicate an ever-growing intervention on the

8 The NII reached an agreement with the Treasury whereby Treasury appropriations under clause 32 of the National Insurance Law will not be adversely affected by the reduction in insurance contributions, and necessary adaptations were accordingly made in the law.

part of the government through government financing of NII benefits, which means erosion in the NII's independence. The increase in the remaining components of financing – collection of national insurance contributions and revenue on interest – was more moderate (an average of 3.7%).

C. Surpluses/deficits and financial reserves

Excluding revenue from interest on NII investments, the budgetary surplus reached about NIS 2.3 billion in 2007, after it stood at NIS 1.3 billion in 2006. The NII's budget went from current deficit to current surplus in 2004, and the surplus continued to grow from one year to the next (see Diagram 4). The increase in collection from the public in addition to the increase in participation on part of the Treasury – that went up at high rates in 2007 as a result of the positive developments in employment and wages, as against the non-adjustment of benefits in 2007 – led to an increase in the NII's budgetary surplus. The additional increase of about NIS 5 billion in the Children branch (Table 9), characterized throughout the years by an extensive current surplus, is in fact the main cause of the increase in current surplus. An examination of the other components of growth in the current surplus shows that between 2006 and 2007 the deficit was reduced in the Old-age and Survivors branch as well as in the Unemployment branch, in which the deficit is entirely covered with monies from the Children branch since 1999. On the other hand, the growing deficit in Maternity, Work Injury and General Disability branches contributed to a certain moderation of the rise in budgetary surplus. Beginning in 1999, the deficit in the Unemployment branch is wholly financed with monies from the Children branch.



Inclusion of revenue derived from interest on past surpluses presents an improvement in the financial state of the NII branches: the overall surplus including interest grew from about NIS 6.6 billion in 2006 to NIS 7.9 billion in 2007. However, the Disability, Work Injury, Unemployment, and Long-term Care branches remain in deficit. The absence of a current deficit in the Institute's budget and the transition to current surplus naturally manifest themselves in a reduced deficit in the State budget.

Table 9
Surpluses/Deficits in NII Branches (NIS million, current prices), 2001-2007

Insurance branch	Surplus/deficit without interest on investments			Surplus/deficit including interest on investments		
	2001	2006	2007	2001	2006	2007
Total	-3,420	1,293	2,285	657	6,583	7,885
Old age and survivors	-633	-762	-366	1,019	1,389	1,844
General disability	-1,762	-2,890	-2,927	-912	-2,455	-2,507
Work injury	-1,193	-1,213	-1,104	-821	-1,013	-914
Maternity	-852	-1,019	-1,239	-674	-1,044	-1,229
Children	5,338	10,333	11,161	5,890	12,748	13,791
Unemployment	-3,090	-1,543	-1,312	-3,090	-1,573	-1,342
Long-term care	-1,410	-1,730	-2,000	-1,049	-1,695	-1,970
Other	182	117	73	294	227	213

In 2007, the Finance Committee of the NII approved the transfer of monies from the surplus of the Children branch to the Maternity and Long-term Care branches, which are in deficit, as well as to two additional branches in deficit (General Disability and Work Injury) so as to ensure their continued operation.

7. Social policy recommendations

The recommendations of the NII, as stemming from this chapter and from the Annual Survey as a whole, are as follows:

1. **Reduction in the number of migrant workers** employed in the potential labor market for persons with low education, and encouragement of Israelis to work in all areas that currently employ migrant workers, especially those in which a significant and continued excess demand for services is expected and which is suitable for less educated workers; for example, nursing care for the elderly and the disabled, and tourism. These areas hold substantial employment potential for less-educated workers. Specifically we suggest subsidizing those elderly and disabled who are willing to accept nursing services performed by Israelis. This step will minimize the possible impact on the costs of such services. If the government wishes to secure adequate and low-priced nursing services, it must do so by means of direct subsidization and not through violation of labor laws in the area of home nursing care. As long as the total

number of non-Israeli workers in the country is not restricted, the surplus demand will continue to influence the earning capacity of less-educated Israeli workers. Regaining control over the number of migrant workers and stabilizing it at a level significantly lower than the current level will improve the earning capacity of less-educated Israeli workers⁹.

- 2 Action must be taken to **enforce labor laws** on employers of Israelis and non-Israelis alike, especially those employed in private households as nursing attendants. Foreign nursing attendants constitute a growing branch, and in recent years have even become the largest branch with regard to permits issued by the government¹⁰. In order to alleviate pressure off the labor market for low-educated persons, a wider range of migrant workers must be permitted: the more educated these workers are, the greater their contribution to the GDP, and thus the least damage inflicted to the labor market of low-educated persons. In this matter, it is recommended to adhere to principles practiced by immigration authorities of many developed countries¹¹. The conclusions of the Committee for Formulating Policy on Non-Israeli workers are inconsistent with these recommendations.
3. In order to strengthen the connection between the two above targets, it is recommended to award **temporary payment of benefits to families in distress in the process of integration into employment**, gradually reducing their benefit at the rate in which integration is accomplished. Both the poverty and employment targets will thus be promoted at the same time. Benefits will be paid directly to persons who have been out of the labor force for a long period (or all the time). The negative income-tax credit will be paid to these people only at the lapse of one year, and the credit will be therefore less relevant to their decision on whether or not to join the labor force.
4. **Link NII benefits to changes in the standard of living** and not to price changes only. This can be achieved by re-linking the benefits to the average or median wages in the economy, while taking into consideration possible implications on collection and long-term financial sustainability.
5. International comparisons have shown that the level of generosity of Unemployment Insurance, after benefit restrictions introduced in recent years, is very low, a fact that makes Unemployment Insurance a deficient instrument for achieving its main objectives: (a) to extend time in which the worker may look for work suitable to his skills and wage level, (b) to provide a financial safety net until new work is found¹². It is recommended that **the restrictions introduced to Unemployment Insurance be moderated** in various ways, for example, by setting a shorter work period for entitlement to unemployment benefit (qualifying period) than

9 In addition to an effective limitation of the number of migrant workers, the quota of migrant workers should be distributed among all occupations in which there is a surplus of demand for workers, and not be focused only on occupations in which there is competition with Israeli non-educated workers.

10 See Illustration 1 in Chapter E (The Labor Market) to the Report, 2007, the Bank of Israel.

11 Ruhs Martin, 2005, "The potential of temporary migration programs in future international migration policy", Centre on Migration, Policy and Society, University of Oxford, September, 1-29.

12 M. Endweld and E. Toledano, **Reducing the Insurance Coverage for Unemployment in a Flexible Labor Market**, 2007, presented at the ISSA convention in Warsaw.

the one that currently applies to all types of workers, and by equalizing the qualifying period for monthly workers and daily workers: calculation shows that daily workers currently require 14.4 active work months in order to be entitled to unemployment benefit, while monthly workers require only 12 work months.

6. The data indicate an ever-growing intervention through government financing of benefits, which means erosion in the independence of the NII. The recommendation is **to stop reducing the share of employers in national insurance contributions** and to initiate a reverse move, in which the employers will still pay low rates that will not significantly increase the cost of labor but will help preserving the NII's independence.
7. **Enhancement of accessibility to employment and transportation infrastructures** in Arab population of the periphery, particularly in the southern areas of Israel (see more details on the topic in Box 3 in Chapter 2).
8. **Intensification of education and vocational training in order to improve future earnings** of low-educated populations, inter alia, through real investment in education infrastructure. This intensification should be mainly directed at two population groups: (a) the Arab population in the periphery, especially Bedouin women, (b) the religious Orthodox population, especially the men (for more details on this topic see Box 3 in Chapter 2).
9. In order to increase the influence of affirmative action in the area of **poverty among children**, it is important that the government **adopt interim targets** such as in the area of dropout from different levels of schools, which will also permit the introduction of changes in this area in real time.
10. Regarding the intermediate goals at least, it is recommended to define the employment target not only in quantitative terms, but in **qualitative** terms as well, relating to topics such as adequate wages and pension rights.