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POVERTY AND INEQUALITY OVER TIME: IN ISRAEL AND THE OECD

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Poverty and Inequality Over Time

In Israel and the OECD

Dan Ben-David and Haim Bleikh*

Abstract

The focus here is on how rates of poverty and income inequality in Israel have evolved over recent decades and how they compare to other countries. Contrary to conventional wisdom, Israeli rates of poverty and inequality in disposable incomes are very high – compared with developed countries – even after excluding Haredim and Arab Israelis from the sample (though not particularly high in terms of market incomes). Israel’s elderly population is the smallest in the West, and poverty among the elderly before welfare and taxes is among the lowest while after the social welfare net is spread, poverty rates in Israel are the highest in the developed world. Poverty among children after welfare and taxes is also the highest in the developed world. The share of national income received by the top 1 percentile is not particularly high in Israel, but the gap between individuals at the 90th income percentile and individuals with median incomes is the highest in the West – with the gap between individuals with median incomes and those at the 10th percentile even higher in Israel. A systemic plan to deal with the underlying problems and their symptoms is outlined here.

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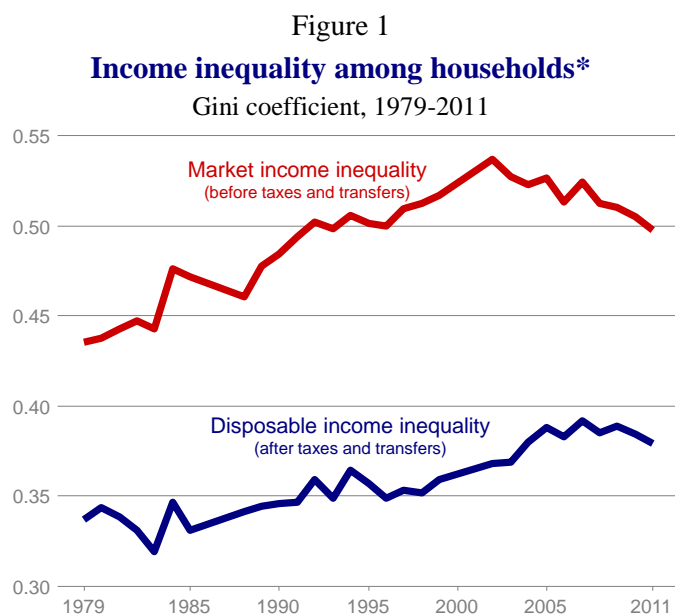
Which country today has the greatest equality? ... If we confine ourselves to the non-communist world, it has been suggested that the new state of Israel may lead the list.

Paul Samuelson, Nobel Laureate (1970)

During the first decades of its existence, Israel was unique in many respects. Though it suffered from severe economic challenges caused by waves of Jewish refugees and by wars that threatened its very existence, the country created some of the top universities in the world and exhibited high rates of economic growth that were unparalleled by other countries with similar levels of income (Ben-David, 2010a). It also earned the citation above by Paul Samuelson in what was once the number one economics textbook around the world. Today, Israel is 65-years-old, not an age that one would commonly associate with youth – and the list that it currently heads is not the egalitarian one.

It could be argued that a low rate of inequality in a country of refugees and native-borns with relatively meager resources was not much of an accomplishment when such a large segment of the population was poor. But this was also a country where the top leaders, political and military, also lived in tiny apartments or huts. That was then.

As Figure 1 indicates, income inequality in Israel rose steadily from 1979 – the earliest year that Israel’s National Insurance Institute, or NII (the formal name of the country’s social security institute), published data – through 2002. This figure highlights a number of issues that will be addressed here. The first is the need to look at problems from an altitude of 30,000 feet in order to see the forest for the trees. The analysis and understanding of long-run trends is vital for distinguishing between the more readily apparent symptoms and the fundamental core challenges.



* Including East Jerusalem from 1997 and chained for period before 1997

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: National Insurance Institute

A second issue is the need to broaden the spotlight of the public discussion on inequality and poverty. The common focus is invariably on disposable income – i.e., income after accounting for the effects of welfare and tax policies. Disposable incomes are the ultimate bottom line since they add welfare payments and other transfers to a person's market income while netting out the amount of taxes paid. This is what an individual has at his or her disposal to consume or to save. For this reason, public debate and social policies – not to mention academic research – tend to concentrate on rates of poverty and inequality in disposable income. After all, the arguments usually center on whether or

not welfare payments are sufficient, whether or not the tax burden is too heavy, and so on.

While this focus is important, it, nonetheless, masks an underlying picture that is crucial for understanding the actual magnitude of the problem. Rates of poverty and inequality in market incomes (incomes from labor, capital, and pensions) provide just such a perspective. They show what would have happened if the country's residents would have had to fend for themselves with their personal levels of human and physical capital. In other words, what is the extent of the problem that needs to be fixed through a social safety net comprising welfare and taxes because individuals are not receiving either the tools or the conditions to work in a modern economy – and is this underlying problem getting better or worse? One of the hallmarks of a modern society is its ability to transfer resources away from the relatively better off (using taxes) to the relatively worse off (using welfare payments). But knowing what is happening behind the scenes – i.e., in market incomes – gives an indication of the magnitude of the underlying problems that, if not dealt with decisively, needs to be addressed symptomatically through the social welfare system.

Figure 1 shows a very steady increase, of 23 percent, in market income inequality (as measured by the Gini coefficient¹) between 1979 and 2002, the height of the *intifada* wave of terror and Israel's worst recession in decades. The country's tax and welfare systems managed to substantially reduce the inequality in disposable incomes, though as will be shown, Israel still has some of the highest rates of disposable income inequality in the developed world. Not only is disposable income inequality considerably lower than market income inequality, the infusion of increased welfare payments also mitigated some of the underlying

¹ Gini coefficients ranges from 0 – the theoretical case of complete equality within a country – to 1, the similarly theoretical case of complete inequality within a country (i.e., one family receives all of the country's income). A rising Gini coefficient indicates rising rates of income inequality in a country.

inequality increases in market incomes – with disposable income inequality rising by “only” 9 percent during these same years.

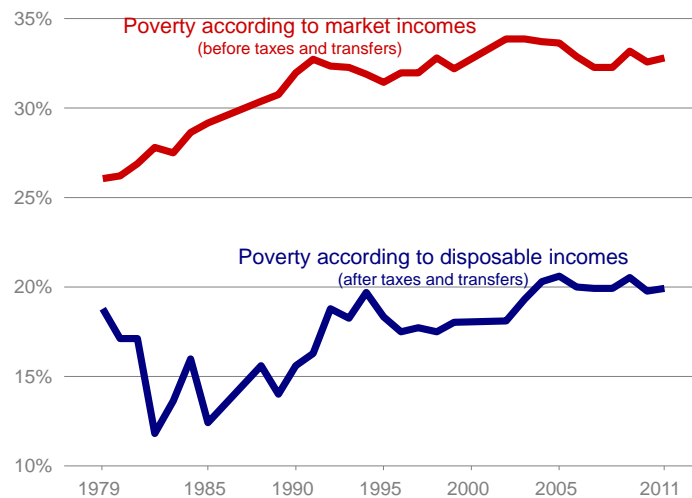
In the years since 2002, market income inequality fell by 7 percent, returning to mid-1990 rates by 2011. However, the terror wave at the beginning of the last decade required a major shift in resources away from social needs to defense. While market income inequality has been receding over the past decade, cuts in welfare led to an additional increase of 3 percent in disposable income inequality between 2002 and 2011.

The poverty picture in Figure 2 reflects a similar evolution over time. The share of Israeli families that would have lived under the poverty line in the absence of welfare and taxes was just over one-quarter in 1979. For the past decade plus, this share has been hovering at about one-third of the families. While rates of poverty in market incomes are substantially higher than they were over three decades ago, rates of poverty in disposable incomes are only slightly above where they were in 1979, at about one-fifth of Israel’s families (though they were substantially lower in the 1980s). Since 2002, at the height of the *intifada* and the lowest point of the accompanying Israeli recession, poverty rates according to market incomes have been relatively stable, falling slightly, by 3.2 percent. Poverty in disposable incomes has risen by 9.9 percent as the government sharply reduced welfare payments to cover higher defense expenditures during and immediately after the *intifada*.

That, in a nutshell, is the longest run view of poverty and income inequality in Israel. It is not without its problems. As Israel has grown and developed, so has its data. The surveys underlying the outcomes in Figures 1 and 2 have become increasingly more inclusive over the years – which is good – but they make long-run comparisons such as those in Figures 1 and 2 all the more challenging and imprecise. Creation of these figures required chaining of different datasets that involved ever-more sectors (e.g., the inclusion of self-employed from 1992 and the inclusion of East Jerusalem residents from 1997) and the accuracy of such chaining becomes all the more questionable. To avoid the need for such chaining,

the focus on Israel in the next section will be on the two decades spanning 1992 to 2011, with datasets that are comparable for the entire span. It will examine how different population groups in Israel affect the country's poverty and inequality picture and how these effects have changed over time.

Figure 2
Percent of households under the poverty line*
 1979-2011



* Including East Jerusalem from 1997 and chained for period before 1997

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: National Insurance Institute

Section 2 provides an international comparison of poverty and income inequality between Israel and other developed countries in the OECD, of entire populations as well as of subgroups. The long-run and

international perspectives provided here yield benchmarks necessary for assessing how similar – or dissimilar – today’s Israel is to different times and to different countries. The final section presents an outline of a comprehensive plan to deal systemically with both the core problems underlying poverty and income inequality in Israel and their symptoms.

1. Poverty and Inequality in Israel: A Look Inside

Not all countries define poverty the same way, though nearly all developed countries adopt the notion of relative poverty – that is, the position of the poor relative to the rest of the population – rather than defining a specific basket of goods that can or cannot be purchased. The formal Israeli definition of the poverty line is one half of the median disposable income per standardized person.² The analysis in this section is based on income surveys produced by Israel’s Central Bureau of Statistics (CBS) and includes self-employed individuals beginning in 1992. As noted above, the CBS began including the population from East Jerusalem in 1997.

Poverty Among Haredim and Arab Israelis

When focusing on poverty within Israel, it is hard to ignore two particularly large population groups (together comprising over one-quarter of the country’s population) that stand out in terms of the extremely low level of education received by their children and the relatively low (in some cases, one could describe these as extremely low)

² The number of persons per household used in this calculation does not include the actual number but rather a decreasing weight for each additional person (for additional details, see the next section’s comparison of the weights that Israel uses versus those used by the Luxembourg Income Study in its international comparisons). In other words, calculations of poverty and income inequality focus on income per standardized person in each household.

rates of employment. These two groups, Haredim (ultra-Orthodox Jews) and Arab Israelis, have been examined extensively in past *State of the Nation Reports* (e.g., Ben-David, 2010b and Kimhi 2011 and 2012) as well as in other sections of this report within the education and employment contexts (Blass, “Trends in the Development of the Education System: Pupils and Teachers”; Regev, “Education and Employment in the Haredi Sector”). One result of the low levels of education and the attendant low levels of employment are very high rates of poverty within each of these groups.

Figure 3 shows that over two-thirds of the Haredi households and three-quarters of the Haredi individuals (not included in the figure) would have lived under the poverty line had Israel’s welfare and tax safety net not existed, i.e., according to their market incomes.³ The incidence of disposable income poverty among Haredi families is lower, 44 percent in 1992, but rising substantially – reaching 57 percent in 2011.

Poverty rates among Arab Israeli households are lower than among Haredim, but increasing much more sharply. Arab Israeli poverty rates according to market incomes rose from 47 percent in 1992 to 57 percent in 2011. The climb in Arab Israeli poverty rates according to disposable incomes was even more pronounced, rising by over one-third from 1992 (37 percent) to 2011 (50 percent).

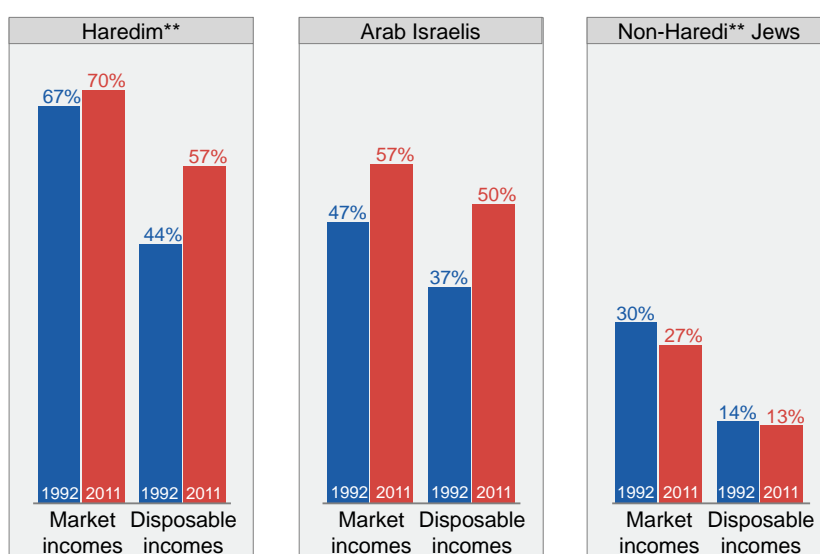
Given the large size of these two population groups, many Israeli’s tend to assume that the country’s high levels of poverty are due primarily to the inclusion of Haredim and Arab Israeli in the national data. Since 1997, Israel’s NII, which calculates the country’s formal poverty and income inequality measures, has also included the very large population of Arab Israelis living in East Jerusalem (124,000 in 1997, more than doubling to 288,000 in 2011). Consequently, the question is often raised regarding what Israel’s poverty rate would look like if these two groups, Haredim and Arab Israelis, were excluded from the sample.

³ Haredim are found in the data on the basis of the household head’s last place of study being a yeshiva. Data for both years excludes East Jerusalem.

Poverty in Non-Haredi and Non-Arab Israeli Populations

A simplistic – and deceptively misleading, as will be explained below – way of looking at poverty rates among the non-Haredi Jews is shown in Figure 3. Poverty rates in both market and disposable incomes are considerably lower and, in the case of disposable income, also relatively steady.

Figure 3
Percent of households under the poverty line*



* Using same national poverty line in all cases. Excluding East Jerusalem

** Haredi/m are ultra-Orthodox Jews

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Central Bureau of Statistics

There are two problems with the more simplistic approach to non-Haredi Jewish poverty rates as exhibited in Figure 3. The first is conceptual and the second is methodological. While this may be an interesting question from an analytical perspective aimed at understanding the extent of poverty as it pertains to different population groups within Israel, it is important to point out – particularly in light of much public debate that has taken place in recent years – the limitations of the analysis below from a conceptual policy perspective. *Haredim and Arab Israelis are an integral part of Israeli society and it is inconceivable to consider the national poverty problem as any less than it is just because poverty rates are not as low in the rest of society.* Furthermore, since the formal measure of poverty in Israel is a relative concept, it would be erroneous to simply look at the share of non-Haredi and non-Arab Israelis living below the national poverty line. This is because that poverty line would no longer be the relevant poverty line for the remaining subsample following the removal of any particular group. Following Dahan et al. (2006), a new poverty line needs to be calculated on the basis of half the median income of the new subsample in order to determine rates of poverty in that subsample.⁴

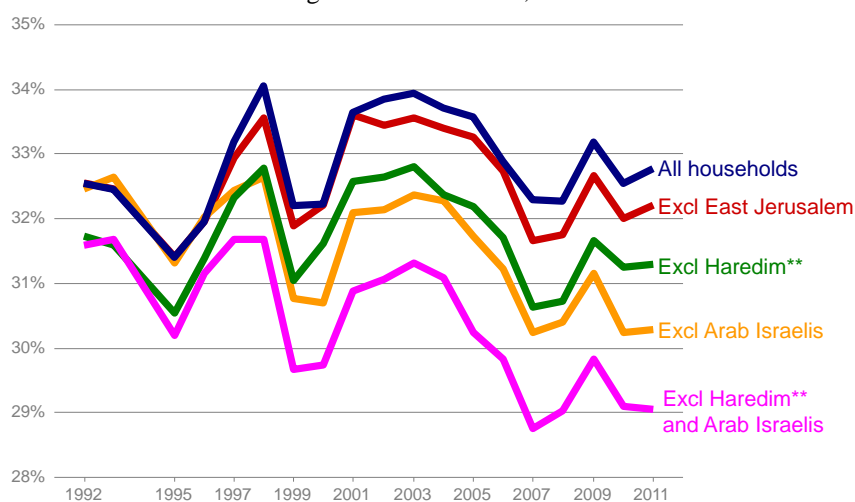
Figure 4 displays poverty rates according to market incomes in Israel between 1992 and 2011 with and without the various groups mentioned above. Poverty lines were recalculated in each of these cases to facilitate the determination of poverty rates in each of the subsamples.

Exclusion of Arab Israelis from the sample had no effect on national poverty rates from 1992 through 1996 (note that Arab Israelis from East Jerusalem were not included in the sample during these years and were

⁴ It should be pointed out that such a comparison still suffers from bias because Israel's existing welfare and tax systems currently take into account the Haredi and Arab Israeli populations and there is no way to know if the hypothetical subset of remaining Israelis would decide that taxes could be lowered if there was no need to support such large and disproportionately poor populations. On the other hand, this subset of the population could also hypothetically decide to simply divide the current pool of welfare benefits among the remaining poor by giving each more.

only added from 1997). But a growing gap developed thereafter. By 2011, overall market income poverty rates in Israel stood at 32.8 percent, but were a bit less, 30.3 percent, among the non-Arab Israeli population. Exclusion of the Haredim from the sample also led to a slight reduction in poverty rates among the remaining population. This ranged from just under 1 percentage point in the early 1990s to about 1.5 percentage points less in recent years. Exclusion of both Haredim and Arab Israelis from the sample yielded a drop in 2011 poverty rates from 32.8 percent to 29.0 percent, still a very high rate of poverty in comparison with developed countries (as will be seen).

Figure 4
Percent of households under the poverty line*
 according to market incomes, 1992-2011



* Poverty line recalculated after each exclusion. Data for 1992-1996 and 2000-2001 do not include East Jerusalem. No data available for 1994.

** Haredim are ultra-Orthodox Jews

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Central Bureau of Statistics

This finding of high poverty rates among the remainder of Israeli society is one that many Israelis need to comprehend and internalize. After all, these are poverty rates on the basis of market incomes, which reflect the tools and conditions available to each household – rather than on the basis of disposable income which also includes the effects of the social safety net. While it is crucial to bring down poverty in the Haredi and Arab Israeli sub-populations, it is just as important that Israelis understand that the poverty issue is pervasive even outside of these groups – and that a comprehensive, systemic, policy approach is needed to deal with the underlying causes of Israel’s extensive poverty problem.

Poverty Among Households Versus Poverty Among Individuals

Broadly speaking, there are two main approaches used in determining the extent of poverty within a country. One method is to focus on households – the approach adopted in Figure 4 – while the other method is to focus on individuals.⁵ There is no right or wrong involved, but the outcomes may vary considerably and it is important to recognize this possibility.

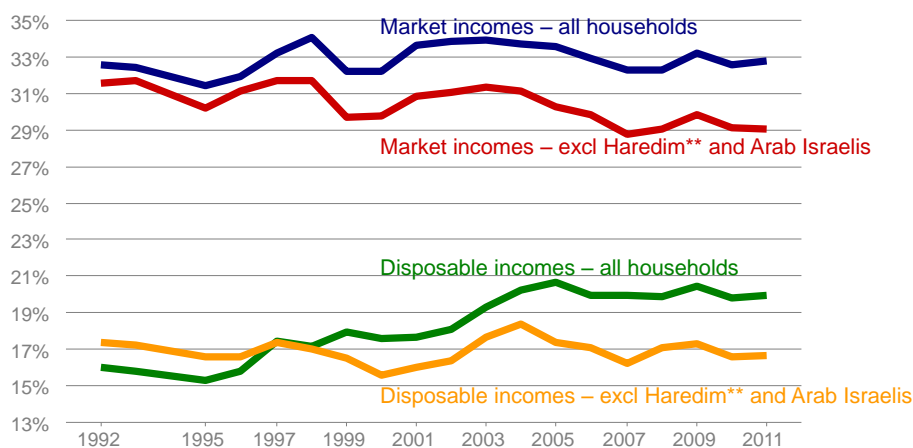
Panels A and B of Figure 5 highlight the different outcomes that are obtained when households are used versus when individuals serve as the basis for the analysis. Figure 5A redraws the market income poverty rates for households with and without Haredim and Arab Israelis. It also includes disposable income poverty rates for the national sample and for the subsample excluding these two groups. Figure 5B does the same, but is based on individuals rather than on households. The differences between both panels are clear.

⁵ Households are ranked in terms of income per person (actually, income per standardized individual) in each household. One approach is to determine the share of total households with incomes per person below the poverty line. The other approach is to determine the share of total individuals with incomes per person (on the basis of average household income per standardized individual) below the poverty line.

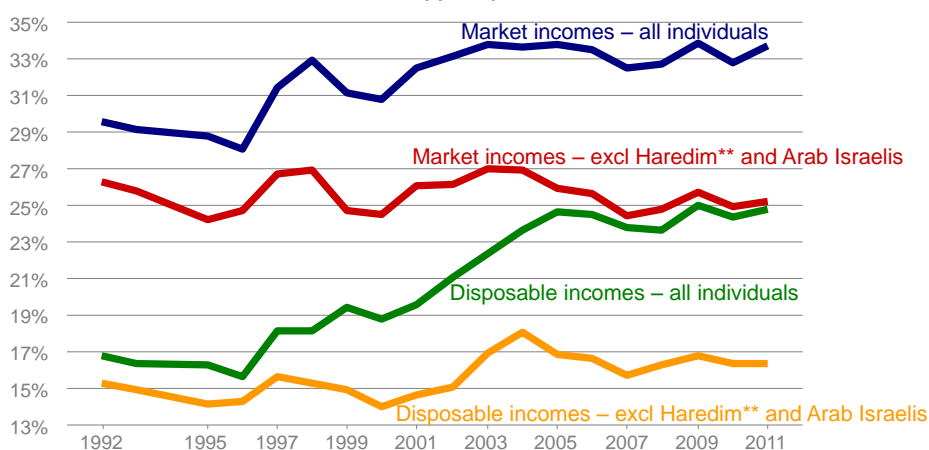
Figure 5

A. Percent of households under the poverty line*

1992-2011

**B. Percent of individuals under the poverty line***

1992-2011



* Poverty line recalculated after each exclusion. Data for 1992-1996 and 2000-2001 do not include East Jerusalem. No data available for 1994.

** Haredim are ultra-Orthodox Jews

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Central Bureau of Statistics

While market income poverty rates for the entire country fluctuate at around 33 percent during the entire sample period in Figure 5A (households), they are rising from roughly 29 percent in the first half of the 1990s to the same 33 percent during the past decade in Figure 5B (individuals). When the focus shifts to market income poverty rates for the subsample excluding Haredim and Arab Israelis, the differences are much starker with poverty rates reaching 29 percent in the households-based panel and 25 percent in the individuals-based panel. In fact, the difference between the national poverty rate and the subsample poverty rate grows from 3.7 percentage points in Figure 5A to 8.5 percentage points in Figure 5B. Since Haredi and Arab Israeli households tend to be large compared to other Israeli families and since poverty rates among these households tend to be higher than among other households in Israel, it is no coincidence that their exclusion from the sample reduces poverty among individuals by more than it reduces poverty among households.

The picture that emerges from the two panels differs even more when the focus shifts to rates of poverty according to disposable incomes. The biggest difference is in the rate of poverty in the nationwide sample. Disposable income poverty rates rose from 16.0 percent to 19.9 percent among households (Figure 5A), but rose from 16.8 percent to 24.8 percent among individuals (Figure 5B). On the other hand, changes over time in the subsample excluding Haredim and Arab Israelis were relatively negligible, with poverty rates reaching 16.6 percent (households) and 16.3 percent (individuals) in 2011.

The gap between the national poverty rate (24.8 percent) and the subsample poverty rate that does not include Arab Israelis and Haredim (16.3 percent) is substantial – 8.5 percentage points. This gap is identical to the difference in market income poverty rates depicted in the same figure. If one were to focus just on disposable incomes – as is common in poverty studies – then it might be possible to surmise that reductions in welfare assistance are the primary cause of the sharp increase in national disposable income poverty rates in Figure 5B. Alternatively, the fact that the dependent population (including large numbers of Haredim and Arab

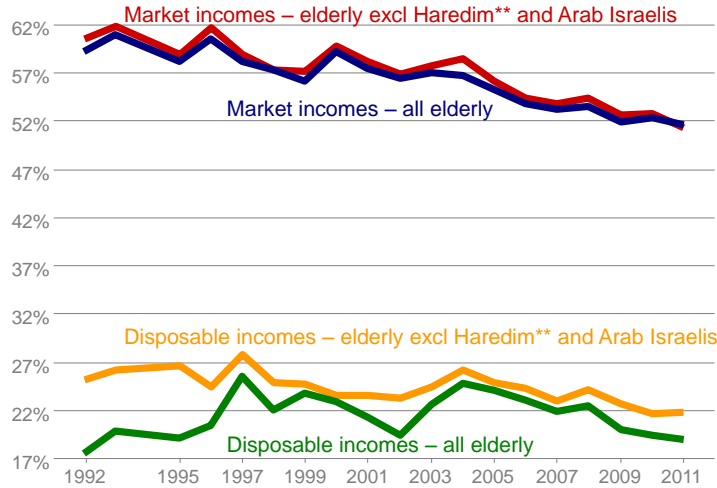
Israelis) has grown at a faster rate than the general population could have possibly resulted in a shifting of welfare benefits away from non-Haredi Jews. However, the fact that an identical gap also exists in market poverty rates between the two samples suggests that the poverty issue among Haredim and Arab Israelis is deeper than can be explained just by cuts or shifts in welfare spending. It also extends to the relatively deficient underlying education, skills, and conditions that these two groups have at their disposal to contend with Israel's increasingly competitive and open economy.

Poverty Among the Elderly and Children

Utilization of the poverty measure based on individuals also facilitates an examination of poverty among individuals of retirement age and children. These two groups are generally considered either above or below working age – although clearly some of both groups may be employed. Figure 6 focuses on the elderly. Rates of poverty based on market incomes for the entire country and for the subsample excluding Haredim and Arab Israelis are nearly identical.⁶ These rates are very high, though falling over time. Even with the decline in market income poverty rates, over half of Israel's elderly (51.2 percent) would have lived below the poverty line had the welfare and tax systems not intervened.

⁶ Since the share of Arab Israelis and Haredim among the elderly is smaller than their share in the general population, it is not particularly surprising that there are smaller differences between the subsample and the entire population.

Figure 6
Percent of retirement age individuals under the poverty line*
 1992-2011



* Age 60 and over for women; 65 and over for men. Poverty line recalculated after each exclusion. Data for 1992-1996 and 2000-2001 do not include East Jerusalem. No data available for 1994.

** Haredim are ultra-Orthodox Jews

Source: Dan Ben-David and Haim Bleikh, Taub Center

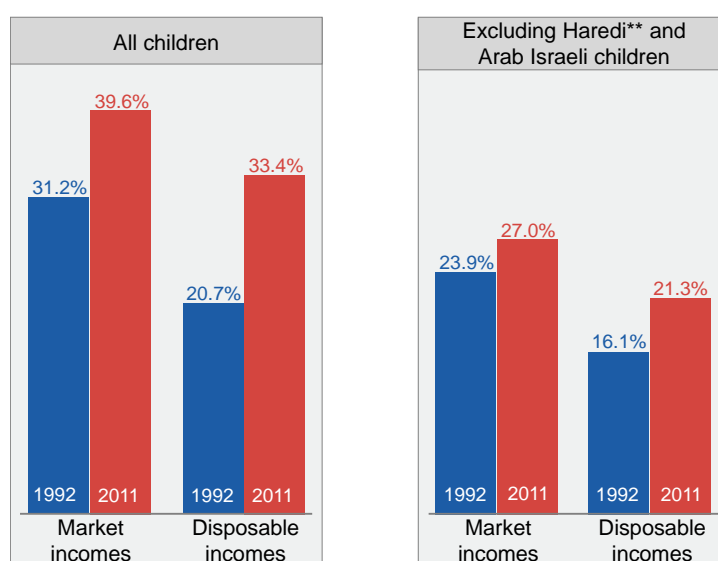
Data: Central Bureau of Statistics

Poverty rates according to disposable incomes in the entire elderly population rose from 17.4 percent to 18.4 percent between 1992 and 2011, while falling from 25.2 percent to 21.9 percent in the subsample excluding elderly Haredim and Arab Israelis. The fact that disposable income poverty rates are higher when Haredim and Arab Israelis are excluded (they are also higher – and similar to one another – when each group is excluded separately) could be due to higher income disparity among the non-Haredi elderly, resulting in a higher poverty line that leaves more elderly below it.

Rates of poverty among children are high, and they are rising rapidly (Figure 7). In the overall population, market income poverty rose by about one-third, from 31.2 percent in 1992 to 41.9 percent in 2011. While welfare and taxes reduced poverty in disposable incomes, their effectiveness fell over the two decades. Disposable income poverty among children increased from 20.7 percent to 35.6 percent, an increase of almost three-quarters.

Figure 7

Percent of children under the poverty line*



* Poverty line recalculated after each exclusion. Excluding East Jerusalem.

** Haredi are ultra-Orthodox Jews

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Central Bureau of Statistics

The incidence of market income poverty among children was considerably lower when Haredim and Arab Israelis were excluded from the sample – not surprising in light of the combination of high poverty rates within these groups and the large number of children in Haredi and Arab Israeli families compared to the rest of the Israeli families. Roughly one-quarter of the non-Haredi and non-Arab Israeli children were below the market income poverty line. The poverty rates in disposable incomes were considerably lower, 16.1 percent in 1992 and 21.3 percent in 2001, albeit a sizable increase of about one-third.

The issue of poverty among the elderly and among the children will be revisited later in this chapter – from a comparative perspective of Israel in relation to other developed countries.

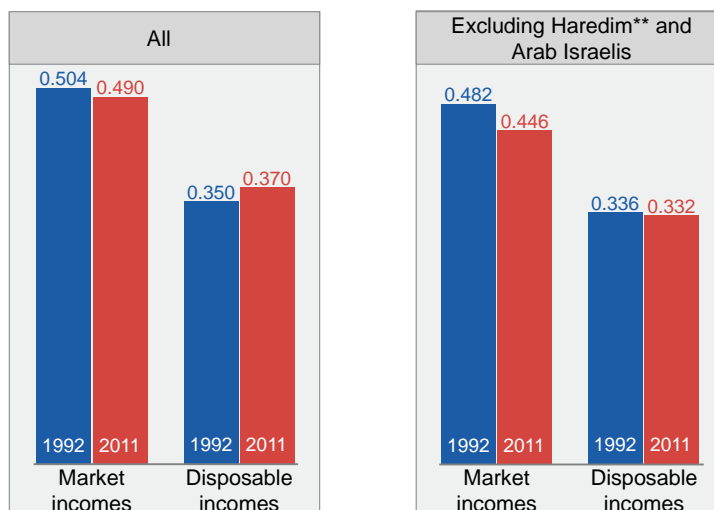
Income Disparity Within Israel

As shown in Figure 1, market income gaps in Israel rose steadily from 1979 through 2002 and have been declining since then. A comparison of 2011 to 1992 (Figure 8) indicates that the Gini coefficient on market income was slightly lower in 2011 than in 1992. Exclusion of Haredim and Arab Israelis from the sample does not have much of an effect on the degree of income inequality in Israel, although the decline in income gaps was a bit stronger in this case – about 7 percent.

While market income gaps in 2011 were lower than in 1992, the situation in disposable income gaps is the opposite, with small increases over the two decades for the entire population (Figure 8). Exclusion of Haredim and Arab Israelis has very little effect on the inequality and was at roughly the same levels in 2011 that were exhibited in 1992 – albeit, a little less.

The question is how similar – or different – are rates of poverty and inequality in Israel to those in other developed countries? Section 2 focuses on these comparisons.

Figure 8
Income inequality
 Gini coefficient*



* Based on individual weights. Excluding East Jerusalem.

** Haredim are ultra-Orthodox Jews

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Central Bureau of Statistics

2. *Income Inequality: International Comparisons*

The following analysis is based on data from the Luxembourg Income Study Institute (LIS). The LIS database is harmonized to enable data calculations according to uniform rules and methodologies for each country. It is important to note that there are differences in rates of poverty and inequality based on LIS and OECD databases.⁷

⁷ As explained by Wang and Caminada (2011), “LIS micro data are predicated on different surveys across countries ... From those surveys, LIS staff refined

Consequently, the LIS provides a more consistent and comparable database for cross-country analyses. The countries chosen here are 22 developed countries with at least two observation years in the sample. Further clarifications regarding differences in methodology and measurement may be found in the Appendix.

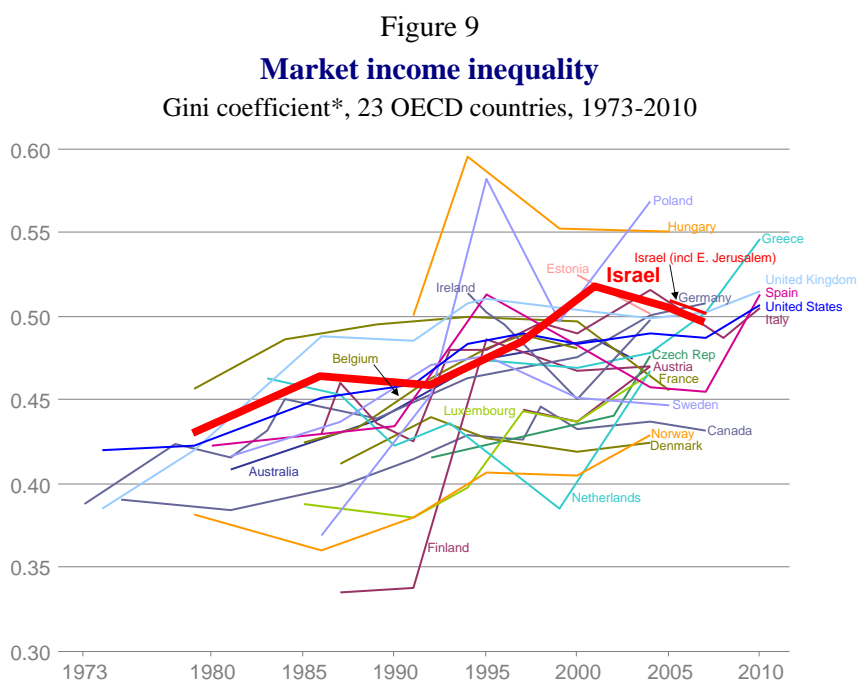
Long-Run Trends in Inequality

A comparison of long-run trends in market income inequality appears in Figure 9 (in this section's cross-country comparisons, the calculations for Israel do not include East Jerusalem).⁸ As is clear, nearly all developed countries have experienced increases in their market income inequality over several decades (for some countries, the data extends all the way back to the 1970s).

Market income inequality in Israel places the country near the top of the developed world's income inequality ladder (Figure 9). In recent years, with the onset of the major recession, market income inequality has exhibited sharp increases in the few countries for which data exist in the LIS statistics while it has continued to decline in Israel (as also shown in Appendix Figure 1).

and formalized rules used to classify variables, offering comparable micro dataset. Computations in OECD dataset are based on the OECD income distribution questionnaires. Therefore, the sample of surveys is not the same, leading to the different values of income inequality and the redistributive effect of taxes and transfers.”

⁸ One drawback to the LIS data is that it is not annual, and the length of the different time series varies from country to country. Israel's NII's weighting formula was used for all countries in this figure to ensure comparability.



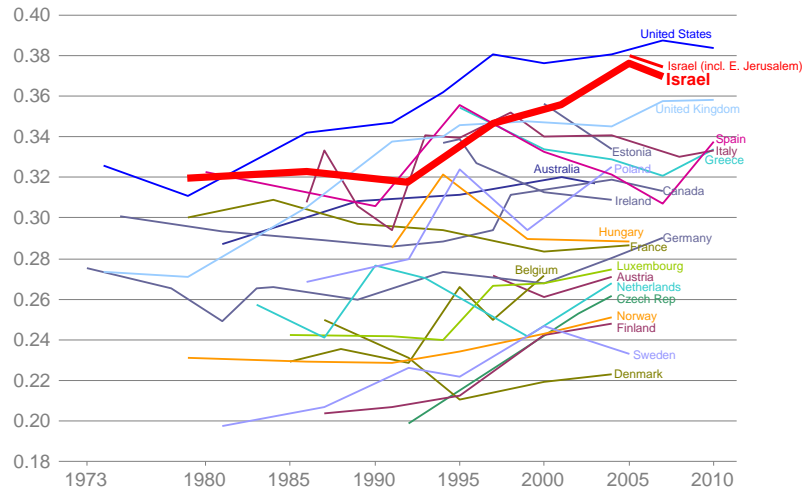
* Based on individual weights

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

When the focus shifts to disposable income inequality (Figure 10), Israel is second only to the US and has been steadily near the top relative to other developed countries as inequality has risen across the 22 OECD countries. The gaps between countries in the rate of income inequality are much greater in disposable incomes than they are in market incomes. This is due to the considerable variance in the social safety nets offered by the countries' different welfare and tax systems.

Figure 10
Disposable income inequality
 Gini coefficient*, 23 OECD countries, 1973-2010



* Based on individual weights

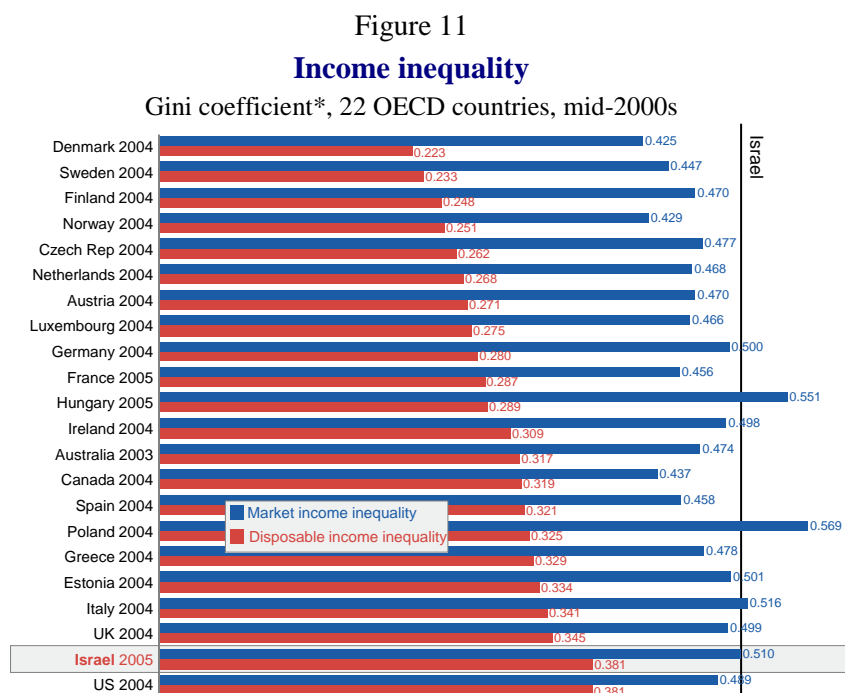
Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

Income Inequality in the Past Decade

To facilitate a clearer comparison between Israel and the developed world, the following analysis will use computations from around the middle of the past decade (specific years depend on data availability), which includes the greatest number of countries in the LIS dataset. As before, the Israeli weighting method and definitions were used for each of the other 21 developed countries in the comparisons below to make the international comparisons comparable to Israel.

Figure 11 compares all of the 22 OECD countries in the analysis. Israel – which includes East Jerusalem here and in subsequent international comparisons – is tied with the United States for the highest disposable income inequality, coming in fifth place with regard to market income inequality.



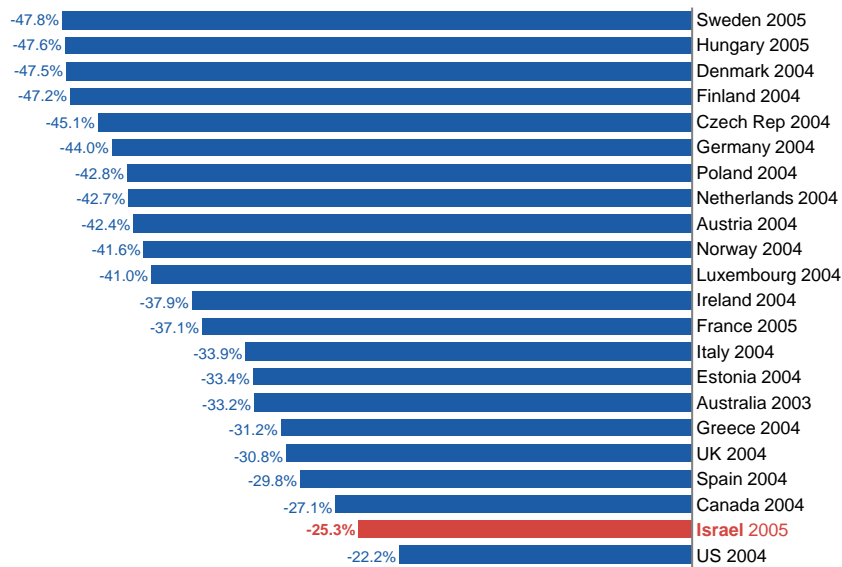
* Ginis calculated according to National Insurance Institute method.
Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

The impact of the welfare and tax systems in reducing income inequality in Israel (Figure 12) is the second smallest among all of the countries – second only to the United States. While the median drop in inequality among the other countries (from market incomes to disposable incomes) exceeds 40 percent, the Israeli decline in inequality reaches just 25 percent.

Figure 12
Percent reduction in income inequality*
 from market income Gini to disposable income Gini, mid-2000s



* Ginis calculated according to National Insurance Institute method.
 Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

Income Share of the Wealthy

Much of the public debate on income distribution in Israel focuses on the country's most wealthy and the high concentration of wealth at the very top of the income ladder. This issue is the subject of public debate in other countries as well. Alvaredo, Atkinson, Piketty, and Saez (2013) find that while many high income countries have experienced an increase in the top 1 percent income share, recent increases in English-speaking countries have been particularly sharp, with the income share accruing to the top 1 percent in the United States more than doubling over the past three decades.

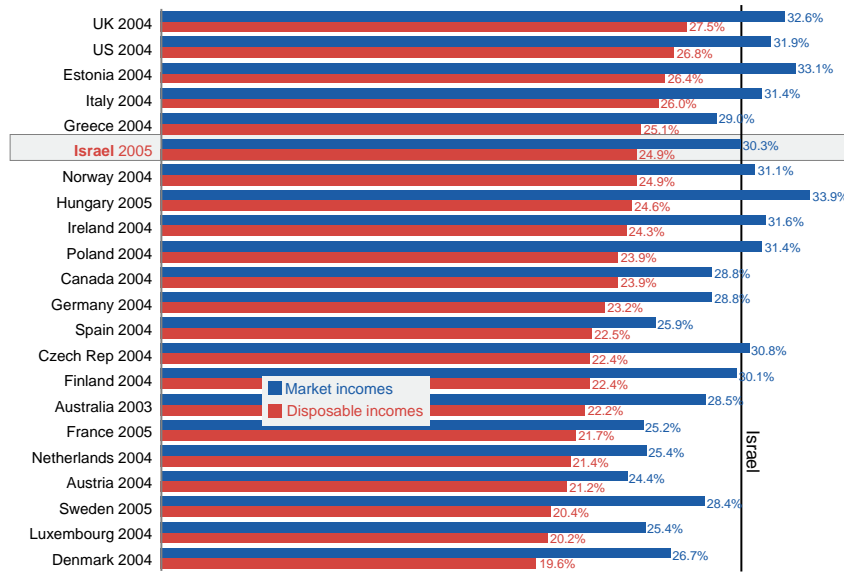
How does Israel compare with the developed world in this regard? Figure 13 compares the relative share of total income of the top income decile in all 22 countries.⁹ The countries are ranked according to the share of total disposable income going to the top income decile. The lowest disposable income share going to the wealthy is in Denmark, with the individuals in the top income decile receiving 19.6 percent of the total. The highest share is in the United Kingdom, with 27.5 percent of the country's disposable income going to the top income decile. The United Kingdom is followed by the United States, with a 26.8 percent share of income received by the top decile. Israel is situated in sixth place out of the 22 countries, with nearly a quarter (24.9 percent) of its total disposable income going to the top income decile.

In market incomes, before income taxes and welfare, the share going to each country's wealthiest is even greater – as would stand to reason. Hungary and Estonia top this list, with the top decile in each country receiving 33.9 percent and 33.1 percent, respectively, of total market income. These two countries are followed by the United Kingdom (32.6 percent) and the United States (31.9 percent). Israel is ranked in the tenth place overall – close to the middle position – among the 22 countries,

⁹ The income deciles are determined according to disposable income per standardized person. By definition, each decile accounts for 10 percent of all individuals.

with 30.3 percent of total income going to the top decile. Austria's wealthiest receive the lowest share of total market income, 24.4 percent, roughly what Israel manages to accomplish after taxes and welfare payments partially redistribute its disposable income.

Figure 13
Top income decile as a fraction of total income*
 22 OECD countries, mid-2000s



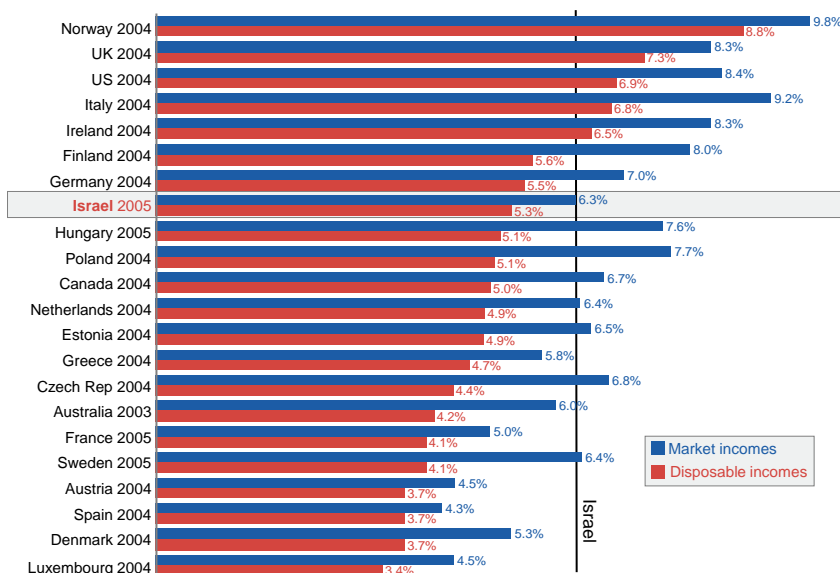
* Deciles calculated according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

A look at the concentration of wealth among the top 1 percentile in each country reveals even less of a concentration of wealth at the very top in Israel (Figure 14). Here, the range is from 8.8 percent (Norway) to 3.4 percent (Luxembourg) in terms of disposable income, with Israel ranked eighth from the top, with the wealthiest 1 percent of the Israelis receiving 5.3 percent of its total disposable income. Norway also tops the list with the share of total market incomes received by the top 1 percentile, reaching 9.8 percent. This is over a half more than fifteenth ranked Israel's 6.3 percent. Norway is followed by Italy (9.2 percent) and the United States (8.4 percent). Spain closes out the list, with its wealthiest receiving 4.3 percent of total income.

Figure 14
Top 1 percentile as a fraction of total income*
 22 OECD countries, mid-2000s



* Percentiles calculated according to National Insurance Institute method.
 Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

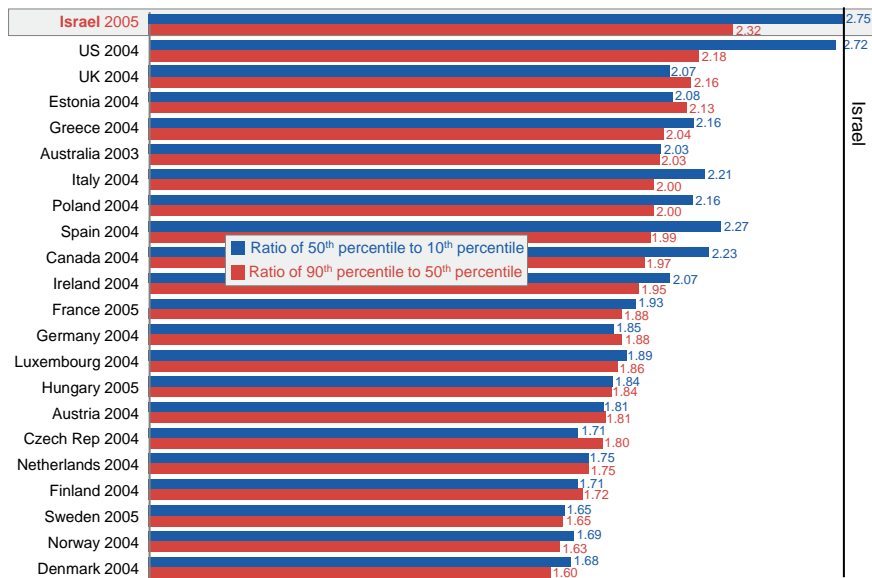
Income Gaps Without the Extremes

Removing the top and bottom income deciles eliminates the extremes from the inequality discussion and can sharpen the focus. Specifically, the ratio of disposable income per standardized person between the 90th percentile individual and the 50th percentile (i.e., median) individual gives a glimpse at the top income gap – between the top end of society (minus the very wealthiest) and its mid-point (Figure 15). The ratio of 2.32 places this gap within Israel above all of the remaining countries, including the United States (2.18) and the United Kingdom (2.16). The smallest gap between the 90th disposable income percentile and the 50th is in Denmark (1.60), with Norway (1.63) and Sweden (1.65) above it.

Figure 15

Ratios of disposable income percentiles, 90/50 and 50/10*

22 OECD countries, mid-2000s



* Percentiles calculated according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

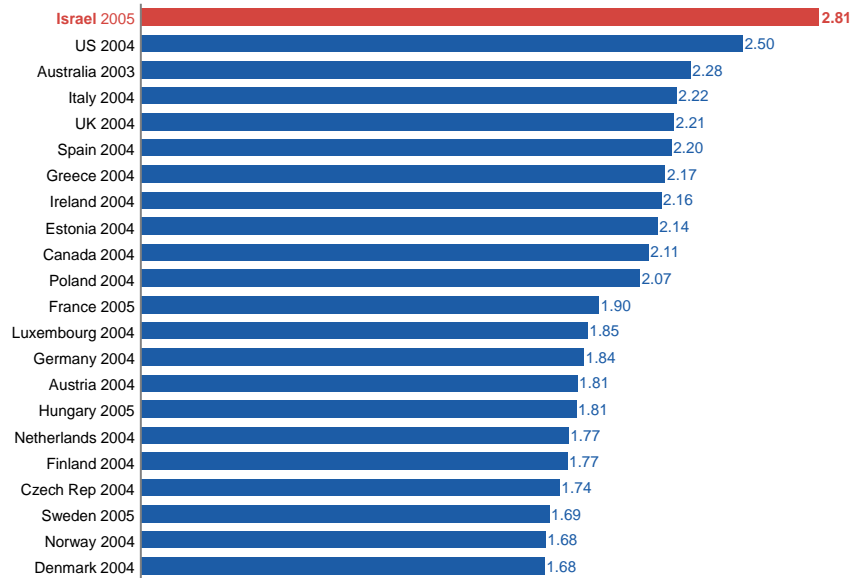
Data: Luxembourg Income Study

The income ratio between the 50th percentile individual and the 10th percentile provides an indication of the gap at the bottom rungs of disposable incomes – between the middle part of the income ladder and the bottom part of it (excluding the smallest incomes in the lowest income decile). Here too, Israel leads the list. Median Israeli incomes are 2.75 times the disposable income of the individual at the 10th percentile – a much larger gap than exists between the top and middle Israeli incomes. It is not a given that the bottom income gap is larger than the top income gap in all countries. In one-third of the cases (8 of the 22 countries), the top income gap is actually the larger gap.

In Israel's case, this is not just an issue between rich and poor. Even the gap between what could ostensibly be considered upper middle class and lower middle class is higher in Israel than in any of the other countries (Figure 16). The incomes of individuals at the 75th income percentile are 2.81 times the incomes of individuals at the 25th income percentile. This income gap is 12 percent greater than the number two country, the United States (with a 2.50 ratio), an almost a quarter more than Australia, the country with the third highest middle class income gap (2.28).

While Israel's income inequality problems appear to be endemic and cut across all sections of the income spectrum, they are less severe – relatively speaking – when it comes to income concentration at the very top (i.e., the top percentile, and even the top decile). The smaller income gap between the 90th percentile and the median, as opposed to the larger income gap between the median and the 10th percentile, suggest that the focus should move to a key component of Israel's income inequality – poverty at the bottom of the income ladder.

Figure 16
Ratios of disposable income percentiles, 75/25*
 22 OECD countries, mid-2000s



* Percentiles calculated according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

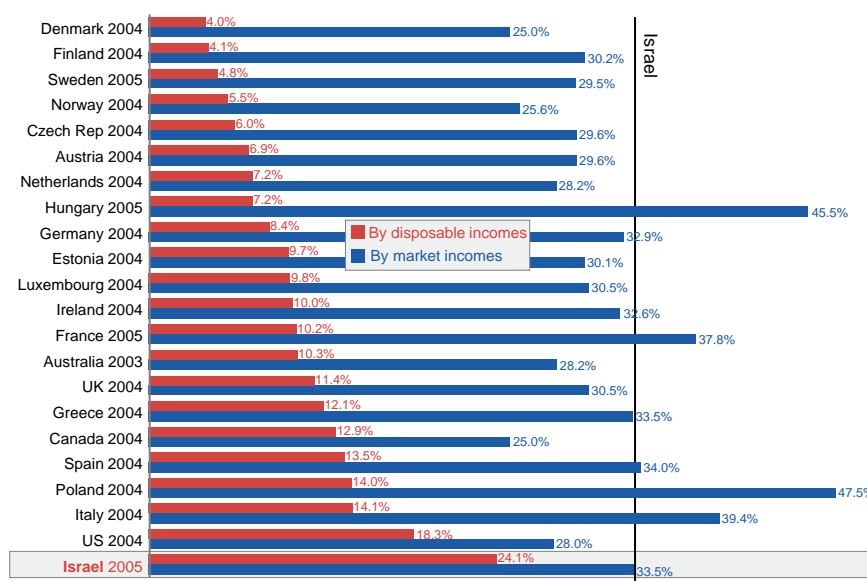
Data: Luxembourg Income Study

3. Poverty: International Comparisons

For comparison purposes, the poverty lines in each of the other 21 countries were calculated here in the same way that Israel calculates its poverty line – at 50 percent of each country's median disposable income per standardized person. In terms of disposable income, 24 percent of all Israelis live beneath the country's poverty line (Figure 17). That is nearly

one-third more than the number two country, the United States – and almost two and a half times the poverty rate in the middle countries of this sample, Luxembourg (9.8 percent) and Estonia (9.7 percent).

Figure 17
Percent of individuals under the poverty line*
 22 OECD countries, mid-2000s



* Calculations according to National Insurance Institute method.
 Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

A full one-third of Israelis would have lived under the poverty line had a social safety net not existed. While this rate of poverty in market incomes is high, it is even higher in 5 of the 21 remaining countries (Poland, Hungary, Italy, France, and Spain). This raises a question

regarding the effectiveness of Israel's combined welfare and income tax programs in reducing market income poverty compared to the other countries.

For comparison purposes, Appendix Figure 2 provides a comparison of poverty rates on the basis of households, as opposed to the Figure 17 comparison on the basis of individuals. Basing the calculations on households, shows that poverty rates in terms of market income are lower than individual poverty rates in all countries except in Israel. The difference between households and individuals is negligible: 33.1 percent versus 33.5 percent. In terms of disposable income poverty, the picture is reversed. For all of the countries with higher rates of disposable income poverty, poverty rates according to households are a bit lower than according to individuals, although in Israel's case, the drop is sharper – from 20.4 percent to 24.1 percent – which is still the highest among all of the countries. The reason for this difference is that there are many small, poor, elderly households in the other developed countries while in Israel there are many large, poor households with many children. As a result, Israel's market income poverty rate among households drops it in twentieth place among the 22 countries, compared to the sixth highest market income poverty rates when the basis is individuals.

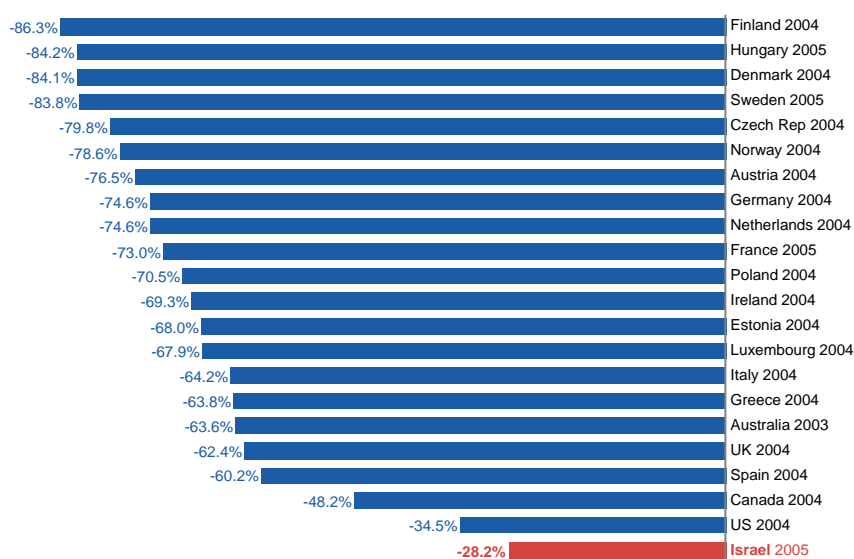
The reduction in Israeli poverty rates from market income to disposable income poverty (Figure 18) is in fact the slightest of the countries, with disposable income poverty rates only 28 percent below the market income poverty rates. The American combined tax and welfare programs – ranked second least effective here in reducing poverty rates – eliminate just over one-third of the market poverty rate in the United States. Canada's disposable income poverty rate is just over half the country's market income poverty rate, placing it in third place. The tax and welfare programs in nearly all of the remaining countries are

able to reduce market income poverty rates by two-thirds and up – reaching more than 80 percent reductions in Sweden, Denmark and Hungary (84 percent each). Finland’s disposable income poverty rate of 4 percent is a full 86 percent below its market income rate of 30 percent.

Figure 18

Percent reduction in poverty rates*

from market income poverty to disposable income poverty, mid-2000s



* Calculations on the basis of individuals according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

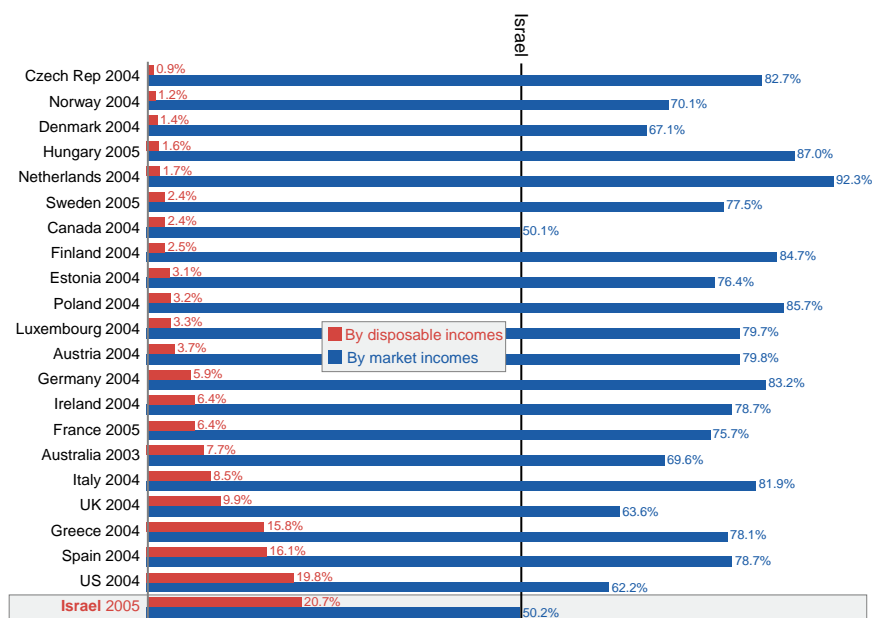
Data: Luxembourg Income Study

International Poverty Comparisons Among the Elderly

Not just in Israel are elderly and children two of the primary groups where poverty is concentrated. As noted previously, this is not surprising since these are groups that are generally either above or below the working age. The case of poverty among the elderly – those aged 65 and over, who are at or above what is generally still considered retirement age in most countries – provides what is perhaps the most striking illustration of the ineffectiveness of Israeli tax and welfare programs in reducing poverty. In a sense, the problem of poverty among the elderly is considerably greater in the rest of the developed world than it is in Israel. After the social safety net is spread, though, that is, after the steps that are put in place to improve the situation of the elderly are taken, the situation simply reverses and disposable income poverty among the elderly in Israel jumps to the top of the list among Western countries.

The share of elderly people living in poverty according to their market incomes is lower in Israel than it is in 20 of the 21 other countries. In fact, while 50.2 percent of Israel's elderly would have lived under the poverty line had they been dependent only on market income (Figure 19), over three-quarters of the elderly would have lived under the poverty line in 15 of the other 21 countries. In other words, a smaller share of Israel's population is elderly, and a smaller share – considerably smaller compared to some countries – of Israel's elderly would have lived under the poverty line if left to their own devices.

Figure 19
Percent of elderly under the poverty line*
 22 OECD countries, mid-2000s



* Calculations on the basis of individuals according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

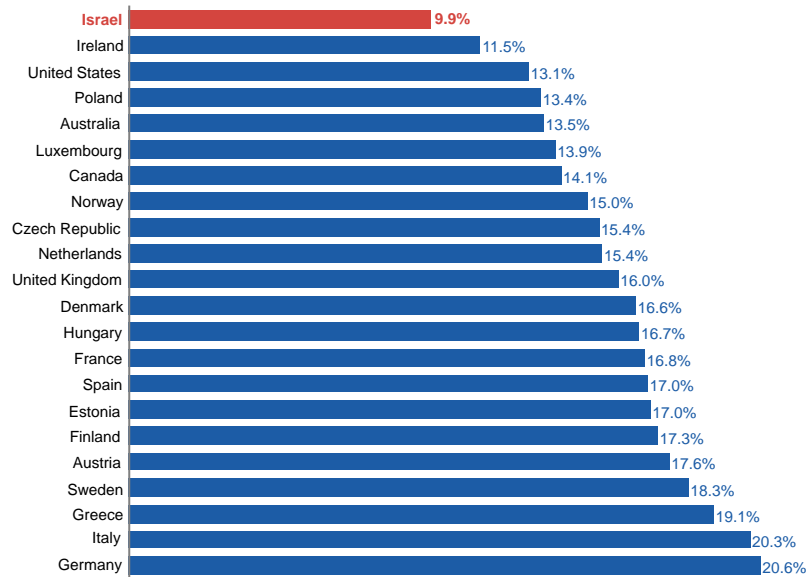
Data: Luxembourg Income Study

The paradox of social assistance to the elderly in Israel is even more striking since to begin with, the share of those aged 65 and over in the Israeli population is relatively low, only 9.9 percent (Figure 20). In each of the other 21 countries, this share ranged from 11.5 percent in Ireland to 20.6 percent in Germany, averaging 16.1 percent in all 21 countries. So if all else were held constant – i.e., if market income poverty rates were identical in each of the countries and all 22 countries desired to reduce

poverty by the same degree in disposable incomes – then it would cost less in Israel to achieve this goal because there are fewer individuals at that age (relative to the entire population) in need of assistance.

Figure 20

Percent of 65+ year-olds in the population, 2010

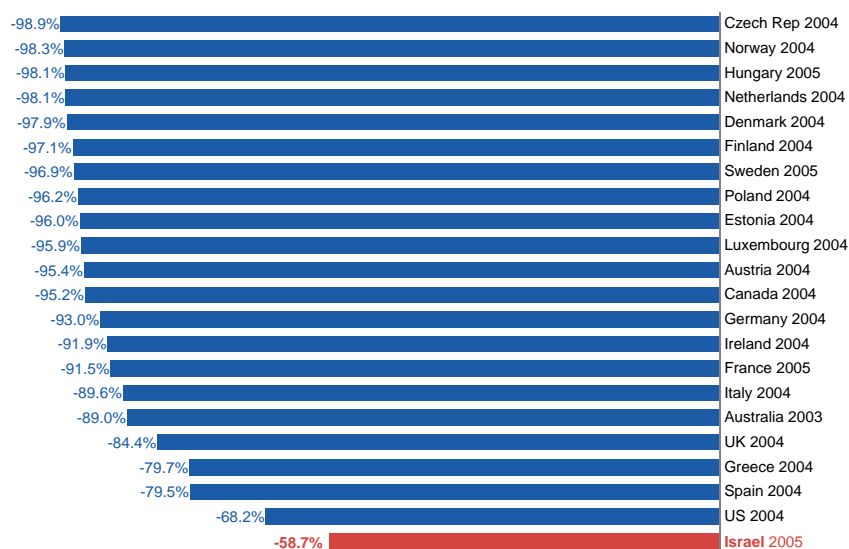


Source: Dan Ben-David, Taub Center for Social Policy Studies in Israel

Data: OECD

Despite the relatively large elderly populations in the other countries, the assistance provided to the elderly is substantially more effective in reducing poverty elsewhere than it is in Israel (Figure 21). The differences between Israel and the other countries regarding poverty reduction among the elderly are huge. Welfare and tax policies nearly eliminate poverty among the elderly in 12 of the 22 countries, with 95 percent and greater reductions in the rate of poverty from market incomes to disposable incomes.

Figure 21
Percent reduction in elderly poverty rates*
 from market income poverty to disposable income poverty, mid-2000s



* Calculations on the basis of individuals according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

All but two of the 22 countries – the United States and Israel – are able to reduce poverty rates among the elderly by at least 80 percent. By comparison, the United States reduced poverty among the elderly by 79 percent. Israel – with the smallest elderly poverty issue in terms of the extent of market income poverty rates and the relatively small size of the country’s elderly population – only reduced its elderly poverty rates by 59 percent. Consequently, the share of elderly Israelis remaining under the poverty line after taxes and welfare is 21 percent, the highest in all of the countries.

There are a number of reasons for the large discrepancies between Israel's relative levels of market income poverty versus disposable income poverty among the elderly. As Bowers (2013) points out, Israel has traditionally had one of the highest rates of private pensions among OECD countries – about 50 percent of Israel's elderly had a private pension in the mid-2000s – which has contributed to the relatively low rates of market income poverty among them. Israel's average “replacement rates” (combining both private and public pensions) are slightly above the OECD average, meaning that the mean wage will yield a retired Israeli 78 percent of the pre-retirement wage, compared to an average of 69 percent in the OECD.

On the other hand, public pensions provide 20 percent of an average worker's earnings in Israel, compared to an average of 42 percent in the OECD. As Bowers notes, public transfers in the OECD contribute 61 percent of an elderly person's income – even more in Western Europe – and less than 50 percent in Israel.

Domestic politics play a double role in yielding these outcomes. First, the share of elderly in the entire poor population is substantially higher in the other developed countries than it is in Israel. So when the other countries implement welfare programs designed at reducing national poverty rates in disposable incomes, it is not surprising that they tend to focus more on reducing poverty among the elderly because that is where they see a more effective outcome for their investment.

A second aspect of the political dimension is that the demographics of the elderly are simply working against them in Israel. The large elderly populations abroad wield a sizeable share of the voting population, so it is probably no coincidence that they are able to channel this political power towards benefits that almost eliminate poverty among the elderly in some countries. Israel's elderly had a brief and very limited period of greater political influence between the rise and fall of a “pensioner's party.”

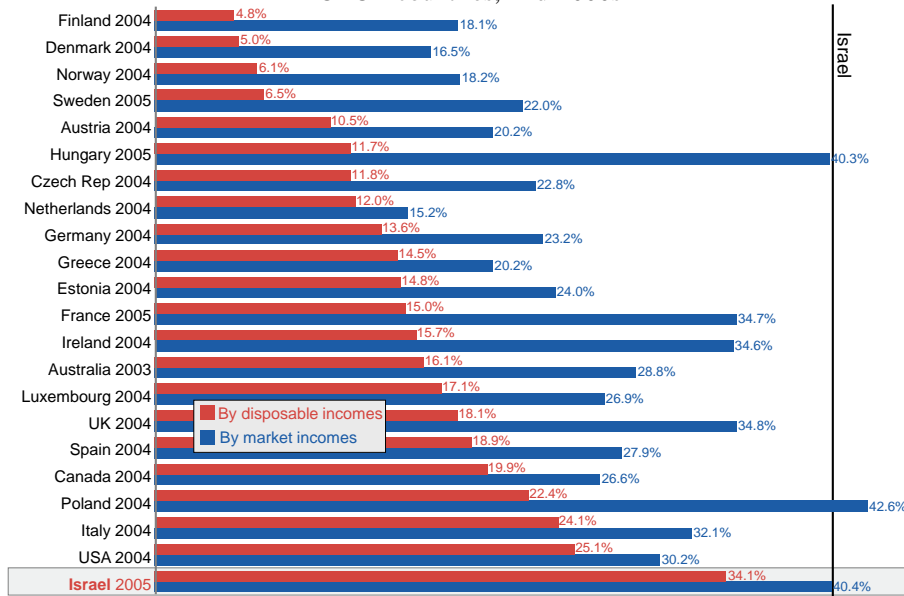
International Poverty Comparisons Among Children

While the average OECD family has 1.8 children – well below the 2.1 needed to maintain the same population over time – Israeli families have 3.0 children per family. In the 21 OECD countries other than Israel surveyed here, the share of 0-19-year-olds out of the population ranges from 18.6 percent in Germany to 27.5 percent in Ireland (with an average of 22.6 percent). In Israel, the share of 0-19-year-olds is 35.8 percent of the population – far greater than in any of the other countries.

Gornick and Jäntti (2011) note that many studies on childhood poverty focus on the relationship between household composition and children's likelihood of being poor, with single motherhood receiving the most sustained attention. Household composition is a major factor in Israel, too, with disposable income poverty rates in single mother families reaching 35 percent in 2004-2005 (Stier, 2011b), below the 45 percent in Canada and 42 percent in the United States – and above the 31 percent in the United Kingdom, 25 percent in Italy, and 10 percent in Sweden. That said, the share of single parent mothers out of all mothers was 8.9 percent in Israel, compared to 23.6 percent in England, 20.6 percent in Sweden, 18.9 percent in the United States, and similarly higher shares in most developed countries (though not all, with 8.6 percent in Switzerland, 7.1 percent in Italy and 6.0 percent in Spain).

The primary issue regarding poverty among children in Israel is a bit different than in most of the developed world. The country's birthrates are the highest in the developed world and many of these children are born to large, poor families. Consequently, 40 percent of Israel's children would have lived under the market income poverty line (Figure 22). Only Poland, with 43 percent market income poverty among children, had a more severe problem of market income poverty among children.

Figure 22
Percent of children under the poverty line*
 22 OECD countries, mid-2000s



* Calculations on the basis of individuals according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

After the effects of welfare and taxes are considered, poverty rates among children according to disposable incomes are by far the highest in Israel compared with the 21 remaining countries. Over a third of the country's children (34 percent) live below the poverty line, even after welfare assistance. The country with the second highest rates of child poverty is the United States – far below Israel – with a quarter of its children under the poverty line according to disposable income. The

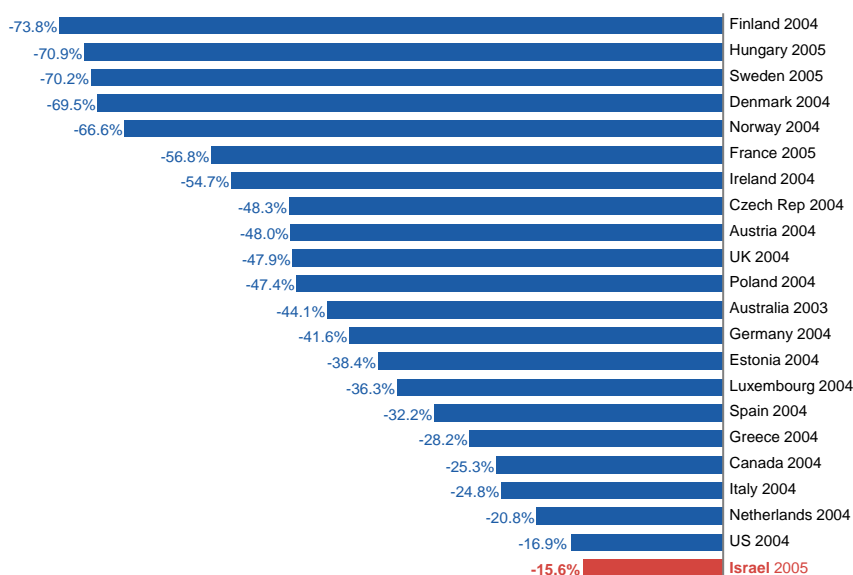
median rate of disposable income poverty among the 22 countries was 15 percent (in France and Estonia) – less than half of the Israeli share.

As was the case among the elderly, the reduction in Israel's poverty rates from market incomes to disposable incomes was the smallest of all the countries, 15.6 percent (Figure 23). By comparison, the two countries in the middle, Australia and Poland, reduced their poverty rates by 44.1 percent and 47.4 percent, respectively. Three countries managed to reduce poverty among children by over 70 percent: Sweden (70.2 percent), Hungary (70.9 percent), and Finland (73.8 percent).

Figure 23

Percent reduction in child poverty line*

from market income poverty to disposable income poverty, mid-2000s



* Calculations on the basis of individuals according to National Insurance Institute method. Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

4. A Plan for Dealing with the Core Problems Underlying Israel's Poverty and Income Inequality

Welfare and taxes provide a means for reducing poverty and income inequality at the symptomatic level, by dealing ex post with symptoms that already exist. While this social safety net is certainly a vital resource of last resort, the fundamental challenge is to reduce poverty and inequality at their source – that is, ex ante, in market incomes – by giving individuals the human capital and physical capital infrastructures that will enable them to find work and thrive in a modern economy.

The Israeli failure with regard to market income inequality is on two fronts. Domestic gaps in educational achievement in core subjects on international exams are consistently greater in Israel than they are in all of the world's developed countries (Ben-David, 2010c and 2011a).¹⁰ Economists often refer to the skill-biased technical change underlying the growth process as a primary factor driving up the demand for skilled and educated workers – and similarly, driving down the demand (in relative terms) for the relatively unskilled and uneducated. The resultant impact in Israel on employment and wages is clearly shown by Ben-David (2011b), Kimhi (2011, 2012), and others.

Herein lies the connection of the growth process to changes in income inequality – and the role for public policy in limiting increases in the gaps, and possibly even reducing them. As Goldin and Katz (2008) point out, the multi-decade accumulation of human capital in the United States, which manifested itself in an increased supply of skilled and educated workers, managed to initially meet much of the increase in demand and to offset much of the increase in income inequality that would have otherwise occurred. But they also add that decay in America's

¹⁰ Haredi boys, who do not study these core subjects, are generally excluded from participating in the international exams. Had they been included, the educational gaps in Israel would be shown to be even wider than is evidenced by the international exams.

educational institutions has been an important contributor to the more recent rise in inequality. This could equally be said of Israel, if not more so.

Alongside Israel's problematic human capital infrastructure is its long-neglected physical infrastructure. It has two and a half times the road congestion of other Western countries – although the number of vehicles per capita in Israel is only about half the OECD average. One of the smallest countries in the developed world has managed to create what have come to be referred to as “peripheries” at distances that would be considered “suburbs” in other countries. These fundamental problems – and others – are manifested in Israel's high market income inequality. The country also provides a social safety net that is the second least effective – after the United States – in reducing the core inequality reflected in market incomes to a substantially smaller disposable income inequality. Stier (2011a) provides evidence of a substantial increase in the number of “working poor” households in Israel since the mid-1990s.

Low wage jobs due to low and poor levels of education – and an accompanying decline in opportunities for low-skilled workers (Ben-David 2011b) – are a key underlying source of Israel's high rates of poverty and income inequality. Kimhi (2011) shows how differences in education have led to much larger wage gaps than are caused by differences in gender or in job experience/seniority – and these are growing more rapidly as well.

Also instrumental in heightening Israel's income inequality are inadequate surrounding conditions such as affordable childcare as well as a lack of a quick, efficient, inexpensive and reliable transportation infrastructure that would increase access to jobs. The prevalence of large families with a relatively low percentage of two earners also contributes to a considerable extent to the high incidence of poverty and income inequality. Barriers to employment, particularly among Arab Israelis, are not always due to low levels of education and poor access. Discrimination, although hard to quantify, certainly plays a role as well.

Goldin and Katz (2008) write that the decay in America's educational system underlies much of the increases in the country's income inequality. They point out that this is a straightforward policy issue that can be addressed – and, if implemented well, could contribute to a substantial change in the magnitude of inequality in the United States. Acemoglu and Autor (2012) conjecture that a major barrier to “reversing America's educational slide” that does not receive sufficient attention is politics. They write: “As it was politics that largely underpinned American schooling exceptionalism [in past decades], fundamental reforms and significantly expanded investments in the U.S. education system would only be possible if the political will is found to support them.” It is hard to overemphasize the importance of this conclusion with regard to Israel.

Israel is in urgent need of a fundamental shift in its national priorities, focusing on three primary policy spheres that are briefly summarized here in outline form. The likelihood of such a shift actually occurring is primarily a question of political wherewithal.

First Policy Sphere: Creating Incentives and Providing Tools

Increasing incentives to work and to employ

- **Replacing non-work incentives with incentives to work**

The share of employed prime working age Israeli men is low compared to other developed countries. Many families with prime working age parents receive sufficient support to facilitate the choice of non-work as a lifestyle. One example of a work incentive is a negative income tax, which has begun to be enacted in Israel, but needs to be made more substantive and barriers to its receipt need to be brought to a minimum.

- **Substantially reducing the number of foreign workers**

On one side of the dichotomy are individuals able to choose non-work lifestyles. On the other side are the many employers who are allowed

to avoid having to deal with the Israeli workforce by receiving permits to import large numbers of unskilled and uneducated workers, although these exist in abundance in Israel. The possibility to import foreign workers needs to be reduced considerably.

- **Providing tools and conditions – a comprehensive employment package**

A better employment incentive structure can only be successful in increasing employment if it is merged with a modular program that will improve the level of education and the skill set of the Israeli worker so that employment rates, productivity, and incomes will increase. This might include a “second chance” program for completion of high school and college, vocational training coordinated with the needs of the private sector, and job placements with incentives based on the workers’ success

Second Policy Sphere: Creating a Supportive Environment

Elements that help create a supportive environment

- **Extended school days and subsidized afternoon youth enrichment programs**

For those at the bottom end of the skill and wage ladder, the provision of incentives and skills will be only partially effective, if there is little or no arrangement for their children. Longer school days – post-reform, to ensure quality improvements rather than babysitting – with enrichment programs in the afternoon will not only release parents to work, but will serve to better prepare these children for their futures.

- **Substantial upgrade of the transportation infrastructure**

Provision of fast, cheap and readily available transportation throughout the country is necessary for increasing access from the periphery to jobs in the cities. Some progress has been made in this

regard in recent years, but it has proven to be much too little and much too slowly given the huge gap in infrastructure between the developed world and Israel that was allowed to dramatically increase since the 1970s.

The combination of longer school days and better schools in the periphery with a transportation infrastructure that will bring nearly all of Israel's population to within 30 minutes of one of its major cities will not only reduce the current housing crisis for young families by making larger apartments available for lower prices in areas that they would not consider living in today. It would also provide better schooling for those children already living in the periphery – with the potential of a better future for them – while providing their parents with greater access to jobs. This will not only reduce poverty and income inequality in market incomes today, it will also put the country on a path to their future reduction.

Third Policy Sphere: A Multi-Year Strategic Plan

While rear-guard actions of the type outlined thus far are essential, it is no less important to realign Israel's national priorities to favor the good of the general public over the long run rather than current prioritization of sectoral interests and short-run gains. The government budget needs to be redone from top to bottom, in accordance with budgetary requirements derived from a new national agenda that should include:

- **Significant increase in budgetary transparency**

It is not possible today to know what Israel's national priorities actually are, how much money is being allocated to whom, and on the basis of what criteria. This is a process that the Ministry of Finance can implement within months – if it so desires.

- **Comprehensive and system-wide education reform**

Such a reform should concentrate on determining a much more focused and uniform core curriculum for all of the nation's children. It should substantially improve the way teachers are trained and compensated. Such a reform needs to greatly improve the efficiency of the cumbersome and byzantine bureaucracy of the Ministry of Education.

- **Heightened law enforcement by upgrading and increasing efficiency of the police and court systems**

Roughly one half of Israeli's eligible for the minimum wage do not receive what they are entitled to by law. In addition, Israel's shadow economy is one of the largest in the developed world, accounting for about one-quarter of its GDP – over 200 billion shekels each year. A large number of transactions go unreported, court trials can last many years, and the resultant situation favors the unruly at the expense of those who abide by the laws – at a tremendous national cost.

- **Health system ensuring quality medical care for all**

While coverage is universal and life expectancy among the highest in the world, the conditions for patients in Israel's hospitals are poor, with the lowest number of hospital beds per capita in the developed world. Physicians who are among the best in the world are compensated far below what they could earn abroad, or in other professions requiring similar skill sets in the private sector. While the stock of physicians per capita is still relatively high – due to the massive immigration from the former Soviet Union in the 1990s – the annual flow of both new physicians and new nurses is quite low, indicating potential supply problems in the future.

- **Welfare policy ensuring a quality social safety net that will enable adequate living standards for those who truly need it**

Among its current inequities, the same social welfare safety net that leaves a greater share of Israelis above retirement age in poverty

(according to disposable incomes) also provides sufficient benefits for working age individuals to choose non-work lifestyles at rates unparalleled in the developed world.

These policy spheres comprise the three primary components of a systemic plan to deal with the fundamental causes of poverty and income inequality – as well as spurring productivity and economic growth – together with the symptoms after these problems have already manifested themselves. The primary idea is that policy makers need to see the big picture, understand the underlying problems and concentrate on reducing them over the long run, while utilizing the opportunities provided by short-term crises to deal with the deeper longer term problems. A specific example can highlight how this might work.

In the months following Israel's national elections in 2013, it became apparent that the new government faced a huge budget deficit reaching roughly NIS 40 billion. The common Israeli solution to such problems is to increase taxes while implementing across the board cuts in the budgets of the various ministries – with very little reprioritization. It is possible, however, to do things differently.

A case in point involves universal child benefits given to every family, regardless of the parents' income or work status. These benefits have a dual objective – to encourage childbirth and to reduce poverty in disposable incomes. Studies by Cohen, Dehejia, and Romanov (2007) and Toledano, Frish, Zussman, and Gottlieb (2009) show that the impact of the child benefits on fertility has not been evident anywhere except – in varying degrees – among Haredim and Bedouin Arab Israelis, two of the habitually poorest segments of Israeli society. In addition, there is a question regarding their effectiveness as a tool for reducing poverty – not to mention questions regarding their long-term impact.

Child benefits equal NIS 175 or NIS 263 per child each month (the size of the benefit depends on the total number of children in the household) and is provided universally to all families. While this translates into about NIS 6 or NIS 9 (roughly \$1.60 and \$2.40) per day per child, the entire program costs the country NIS 7 billion each year. In

light of the NIS 40 billion deficit that needs to be dealt with, this could be a prime time to rethink the entire child benefit issue.

As suggested in Ben-David (2013), the government could take NIS 2 billion from the NIS 7 billion to help reduce its deficit while redirecting the remaining NIS 5 billion exclusively toward the poorer Israeli neighborhoods and towns in the form of hot lunches in schools whose school days will be lengthened and lunchrooms built. This will mean considerably more money directed toward each child in these areas than would otherwise have reached that child, but it will be in the form of ensuring at least one nutritious meal a day. One additional vital requirement should be made: the schools must be a part of the systemic nationwide education reform outlined in the third policy sphere, and they must provide their pupils with a comprehensive core curriculum in the basic subjects. In this way, Israel will also begin to deal with the long-run issue of inequality in opportunities and incomes. Parents will no longer be able to choose to deprive their children of a basic education – as is currently the case in most Haredi schools – while receiving child benefits from the government that contribute to their ability to choose not to participate in the labor force.

5. Conclusions

Israel has some of the highest rates of market income inequality and poverty in the developed world. While the very wealthiest – the top percentile – in Israel receive a very high share of the country's total income, that share is not particularly large when compared to other developed countries. That said, the ratio of standardized per person incomes between the 90th income percentile and the median income (the 50th percentile) is the highest of all 22 developed countries examined here. The income gap between the median income and the 10th income percentile is even larger – and here too, it is the highest of the 22 countries.

The primary problems are manifested in low market incomes that are due to an underlying lack of necessary skills, education and surrounding conditions of a very large portion of Israeli society. These problems are particularly prevalent in the country's large and growing Haredi and Arab Israeli population groups – but they are by no means confined to these groups.

Israel's redistributive social safety net of welfare and taxes is not nearly as effective as the social safety nets in other developed countries in reducing poverty and inequality in disposable incomes. This is a major problem in general, and its severity is particularly striking in the case of the elderly. Israel's market income poverty rate among the 65 and over population is actually one of the lowest in the developed world and declining (although still very high compared to the general population). However, the disposable income poverty rate for this age group is by far the highest among developed countries. Most of these individuals are beyond the age where working is an option, so they are totally dependent on the system to keep them above the poverty line – and in Israel, this system has failed them more than in any other country.¹¹

Poverty among children has risen in Israel, both in market incomes and in disposable incomes. The severity of the problem and the magnitude of the increase have been much stronger for the entire child population than for the sub-population that excludes Haredim and Arab Israelis. In light of the low levels of human capital and physical capital currently being provided for these two groups, it is hard to see how the policies being enacted today will reduce this problem in the future when these children grow up and their share of the adult population will reflect existing proportions of the young population.

While the poverty and inequality problems are most severe with the inclusion of Haredim and Arab Israelis, it would be far too simplistic – and erroneous – to conclude that their existence in the rest of the

¹¹ Recent attempts at implementing a mandatory pension system are intended to allay this problem in the future, but are not relevant for those who have already reached retirement age.

population is minimal. It is not. Even without Haredim and Arab Israelis in the sample, Israel's rates of poverty and inequality in disposable incomes are very high in comparison with the developed world. So high, in fact, that a systemic reordering of Israel's national priorities needs to be considered and implemented. The key problems underlying Israel's severe poverty and inequality rates are the same human capital and physical capital problems underlying the country's very low levels of productivity, despite its international recognition as a "Start-Up Nation" – levels that have been rising more slowly than in the leading G7 countries since the 1970s.

Such a comprehensive set of policy priorities is suggested here. The primary theme underlying the proposed program is the tight relationship between its various aspects. Incentives to work are insufficient if the tools and conditions are missing. A good education in the periphery without a good transportation infrastructure will lead to a brain drain from these areas instead of a brain gain. Longer school days in a system that provides one of the worst educations in the developed world will be no more than an expensive babysitting service unless it is reformed to become an opportunity to provide children the skills to overcome what they may not be getting from home.

Israel is situated on socioeconomic trajectories that are not sustainable in the long run. Given the kind of neighborhood that Israel is located in, this predicament has major national security ramifications in the future. As the country's population grows and its internal distribution becomes increasingly weighted towards those who are not receiving the skills and conditions to work in a modern economy, the ability to democratically implement a program of the type outlined here will decline precipitously, with all that this implies for the future of Israel, unless comprehensive reforms are implemented while the window of opportunity is still open.

Appendix

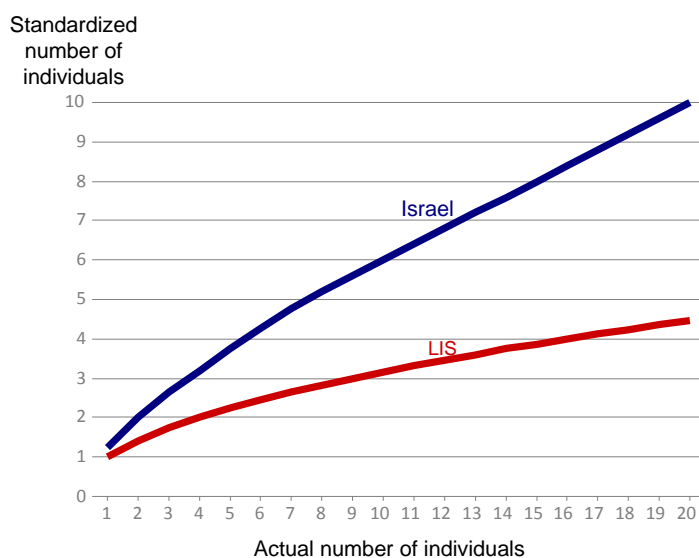
Comparison of Israeli and LIS Definitions and Weighting Methods

LIS determines market incomes a bit differently than the Social Security Institute computations for Israel. Specifically, market incomes in the LIS calculations include private transfers while Israel does not include these. Also, the standardization method for determining family size (also referred to as equivalence scales) differs between Israel's SSI and LIS. The Israeli method uses a sliding scale of declining weights per additional person while LIS uses the square root of the number of persons. LIS calculates the median standardized income on the basis of the distribution of individual weights rather than on the distribution of the household weights. The subsequent differences in weighting schemes can be seen in Appendix Figure 1. The more individuals there are in a family, the larger the number of standardized individuals according to the Israeli method than the LIS method.

In addition, the increase in family size is less and less in the LIS method than in the Israeli method. Consequently, incomes per individual are lower when calculated using the Israeli method than when LIS weights are used. As a result, the magnitude of the welfare benefits that would be needed to raise a family above the poverty line is greater in the Israeli method than using the LIS method and rises faster with family size. Or put differently, the same benefit package would have a greater likelihood of raising a family out of poverty according the LIS method than it would for an identical family using the Israeli method. The bottom line is that poverty among larger households is more common in the Israeli method while poverty among smaller households is more common according to the LIS method.

Appendix Figure 1
**Weights used for standardizing the number of individuals
 in households**

LIS* weights versus National Insurance Institute weights



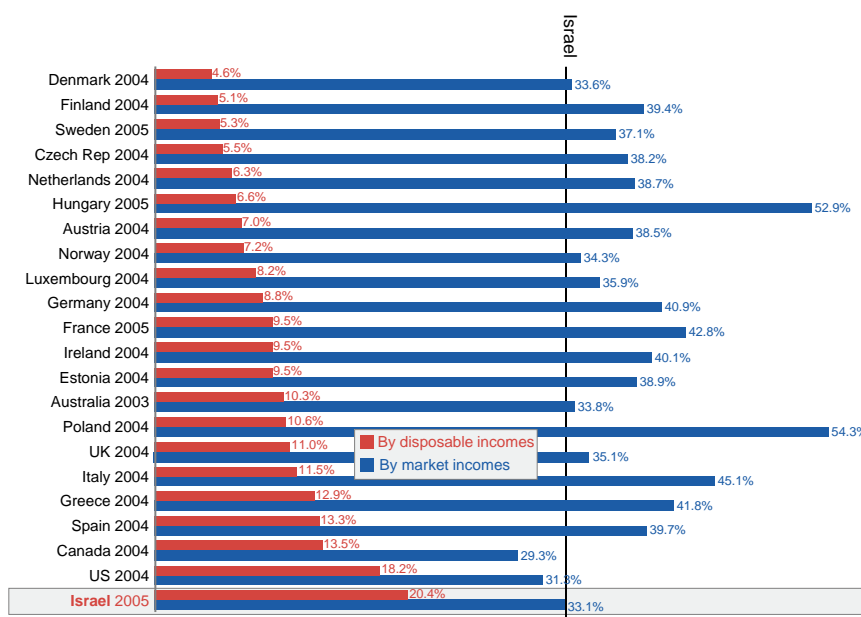
* Luxembourg Income Study.

Source: Dan Ben-David, Taub Center for Social Policy Studies in Israel

Data: LIS, National Insurance Institute

Appendix Figure 2
Percent of households under the poverty line*

22 OECD countries, mid-2000s



* Calculations according to National Insurance Institute method.
 Israel includes East Jerusalem.

Source: Dan Ben-David and Haim Bleikh, Taub Center

Data: Luxembourg Income Study

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