TAUB CENTER
for Social Policy Studies in Israel

POLICY BRIEF

Pensions, Poverty, and the Elderly in Israel

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Israel's population is relatively young. Only 9.9% of the Israeli population is over 65 years of age, relative to an average of 16.1% of the population in 21 other developed OECD countries (Ben-David and Bleikh, 2013). Nonetheless, the problem of poverty among the elderly in Israel is particularly pronounced. One in five elderly Israelis lived under the poverty line in the mid-2000s, a higher rate than in any of the 21 OECD countries examined.

With regards to poverty, Israel stands out among this group due to a unique dichotomy. On the one hand, if governments did not intervene and the elderly in these countries were left to fend for themselves, Israel's over-65 population would be in good shape – relatively speaking – compared to the rest of the developed world (Ben-David and Bleikh, 2013). Based only on "market income" or income from work, capital, and private pensions, an average three-quarters of the elderly in the 22 countries examined would live under the poverty line (Figure 1). In contrast, about half of elderly Israelis fall under the market income poverty line.

The picture changes dramatically once government gets involved. Only 5.9% of the elderly in the 21 OECD countries live below the poverty line based on the "disposable income" indicator that includes market income, taxes, and government transfers (Ben-David and Bleikh, 2013). In Israel, this figure is a considerably higher 20.7%.

Given the extreme levels of poverty that would afflict the elderly without any societal help, governments worldwide play an active and important role in ensuring a minimum standard of living for the retired in their societies. Welfare and social security policies eliminate almost 90% of elderly poverty in the vast majority of countries examined, but have much less of an impact in Israel. This brief examines this surprising dichotomy: why do Israel's elderly have the second lowest poverty rates in terms of market income, but the highest poverty rates in terms of disposable income relative to the 21 OECD countries?

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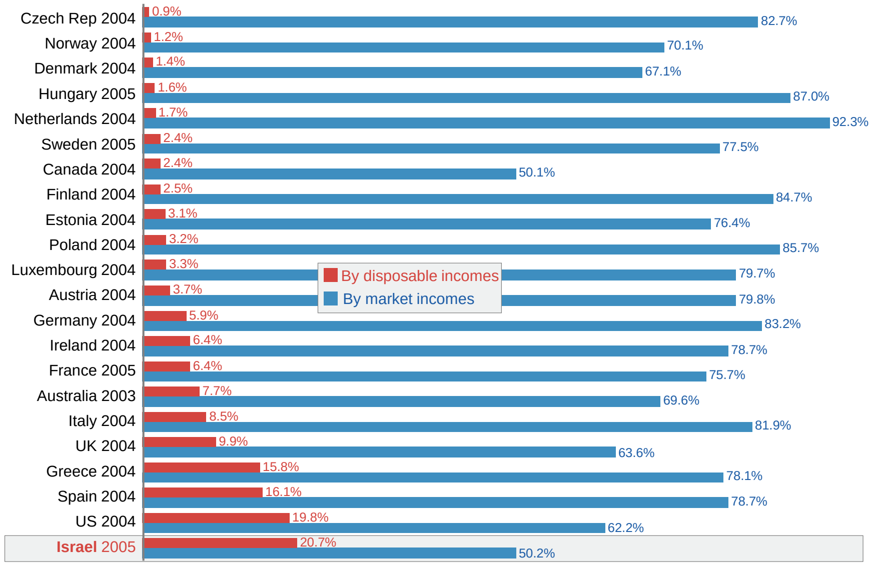
Figure 1

Percent of elderly under the poverty line*

22 OECD countries, mid-2000s



* Calculations by individuals using the National Insurance Institute method. Israel data includes East Jerusalem.

Source: Ben-David and Bleikh (2013), Taub Center

Israeli men and women are entitled to receive public pension benefits beginning ages 67 and 62, respectively, compared to averages of 63.3 and 61.9, respectively for the 34 OECD countries. The Knesset has postponed by five years a planned increase in women's retirement age to 64 (MITL, 2012).

Why does Israel have relatively low market income poverty rates among the elderly?

Israel has a strong history of private, employment-based pensions, with coverage rates long among the highest in the OECD. The Histadrut labor federation first established employment-based pension funds in the 1940s, and they became commonplace for employees of larger organizations, companies, or the government.[1] About 50% of the Israeli elderly received income from private pensions in 2011 (Central Bureau of Statistics data, 2013, analysis by Kyrill Shraberman). About 50% of Israel's household income for those Israelis who do receive private pensions came from this source (Central Bureau of Statistics data, 2013, analysis by Haim Bleikh). Due to differing employment characteristics, including employer type, occupation, contractual arrangement, and years worked there are large disparities in private pension ownership among the population. Only about a fifth of working men and a third of working women in the lowest three income deciles contributed to a pension in 2007, compared to near universal contribution rates at the top decile (Brender, 2009). Households headed by Arab Israelis, women, and those who immigrated from the former Soviet Union at an older age have lower pensions than their counterparts (Central Bureau of Statistics data, 2013, analysis by Haim Bleikh). Private pensions account for only 13% and 7% of the gross incomes of elderly Arab Israelis and elderly Russian immigrants, respectively, compared to 36% for native elderly Israelis, on average.[2]

Many countries have policies that encourage the elderly to keep working, either through restricting early retirement or providing tax credits or other incentives for later retirement (OECD, 2012a). Similarly, the Israeli government increases an individual's public pensions by 5% annually until age 70 for each year that an individual defers his pension (OECD, 2011b).

Following an agreement between the Histadrut and private employer organizations, the Israeli government issued an administrative order in 2008 mandating employment-based pensions for all salaried employees. Starting January 2014, at least 17.5% of salary up to the average wage must be contributed, approximately two-thirds from the employer and the remaining from the employee (OECD, 2012a; MITL, 2012).[3] Employer contributions are non-taxable, and various levels of tax credits are granted on employee contributions and upon withdrawal (Brender, 2009). As of 2010, private pension enrollment has increased to 76% among the working population, which is expected to reduce elderly poverty rates down the road (OECD, 2009; MITL, 2012). The prevalence of private pensions and their relatively high payout during retirement contribute to Israel's low market income poverty rate among the OECD.

Why does Israel have relatively high disposable income poverty rates among the elderly?

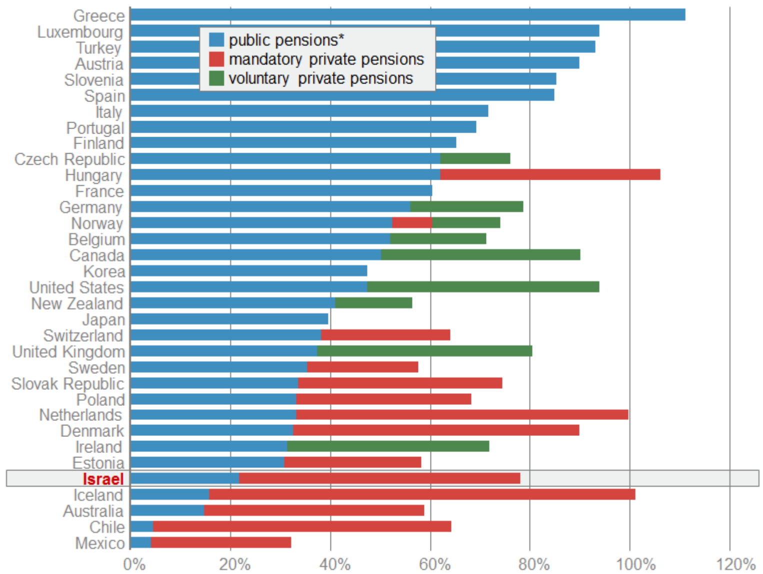
Israel's historical reliance on private pensions has been accompanied by relatively low governmental support for the elderly. Israelis between 65-74 and 75+ receive about 31% and 48% of their income from government transfers, respectively (Kimhi and Shraberman, 2013). Much of this amount is in the form of old-age allowances. Among the 34 OECD countries, a man who enters the workforce today and earns the average wage throughout his life can expect his public pension income to equal about half his average lifetime retirement (wage replacement rate) (OECD 2012a). In contrast, the average Israeli male wage earner entering the market today can expect only 22% wage replacement from his public pension upon retirement (Figure 2). Following Australia, Iceland, Chile, and Mexico, Israel has the fifth-lowest public pension replacement rate among the 34 OECD countries.[4]

Israel has an elderly income supplement program. The income supplement is sufficient to raise elderly individuals or couples who have made National Insurance Institute contributions for a full career above the poverty line (OECD, 2009). However, means-based eligibility restrictions greatly limit access to such support for most Israelis. Only 24% of the elderly receive income support, a figure which includes the vast majority of older immigrants who rely extensively on such support (NII, 2011). Qualifying for income supplements requires that one not own land, have little savings, and meet particularly strict rules limiting vehicle ownership (though owning one's primary residence is not a disqualifier). These restrictions may be particularly limiting for Arab Israelis living in agricultural villages, who may be more dependent on vehicle or land ownership (Stier and Lewin, 2003). As such, Israel's low old-age allowances and limited access to income supplements contribute to its relatively higher rates of disposable income poverty.

Figure 2

Net pension replacement rates for males earning the average wage, 2011

as a share of lifetime average wage, by source



* Public pensions are those administered by governments – e.g., social security benefits – to provide minimum benefits to the general elderly population. In Israel, public pensions refer to old-age allowances and old-age income supplements.

Source: Liora Bowers, Taub Center
Data: OECD

What level of income support do public and private pensions provide for Israel's elderly?

When combining both private and public pensions, Israel has relatively high replacement rates at retirement.[5] An Israeli male entering the labor force in 2011 and earning the average wage throughout his career will receive 78% of his wage from his pensions upon retirement(70% for an Israeli woman), while a similar male in the 34 OECD countries would receive an average of 68%. An Israeli male entering the labor force in 2011 and earning half the average wage can expect a replacement wage of 103% at retirement (94% for women), compared to the OECD rate of 83% (OECD, 2012a). If pension systems do not change, the future elderly in Israel would have higher relative income in retirement as compared to the future OECD elderly, as the private pension system's relatively high replacement rate is projected to more than offset the lower rate from public pensions.

What are some key policy implications of Israel's current pension system?

1) Older Immigrants, Israelis employed in temporary or contract positions, or those who spend fewer years in the formal workforce will accrue far smaller private pensions. Improving employment continuity, stability, and pension "catch-up" opportunities (e.g., allowing for larger, tax-free contributions in older age) for low-income and immigrant households is critical for ensuring an adequate pension and a good standard of living in old age.

2) Mandatory pension contributions reduce the current income of low-wage workers. Israel's pending 17.5% contribution rate will lead to high replacement wage rates in old age for future retirees, relative to the OECD. Particularly for lower-income and single-income families, estimated future retirement replacement wage rates – well above 140% – are quite high relative to the immediate financial situation (BOI, 2009). Families facing housing and child-related expenses may benefit from lower pension contributions and higher take-home pay today in exchange for more modest replacement rates (or additional public support) upon retirement. Furthermore, if the pension mandate is complemented with reduced funding for public income supplements, lower-income individuals may be worse off overall than they would have been without the mandate. A 2009 Bank of Israel analysis found that the pension mandate imposes a net loss on low-income households, due to the resulting reduced income support in old age.

3) Now that minimum pension contributions are mandated, income tax credits to incentivize pension savings are no longer necessary. Conversely, they serve no value to the 45% of employees who fall below the income tax threshold (OECD, 2011a; BOI, 2009). The OECD recommends providing tax credits only on pension benefits above the mandated level and making such credits universal, i.e., given as a refund to those who do not owe taxes. The BOI has suggested allowing families to postpone contributions until they have taxable income or to permit couples to optimize contributions based on eligibility for tax credits (BOI, 2009).

4) The difference in the "effective" retirement age in 2011 – the average age workers withdraw from the workforce – between Israeli men (67.7) and women (64.1) is 3.6 years. This is in contrast to the 1.1 year gender differential among the 34 OECD countries, at 63.9 for men and 62.8 for women (OECD, 2012b). Raising Israel's relatively low official retirement age for women (62) could address gender equity concerns, differential life expectancies, and the fiscal strength of the National Insurance Institute. In addition, it could help increase labor force participation and the low relative private pension savings for women down the line.

5) Israel's greater reliance on private pensions increases the risk of insufficient savings due to capital market swings and life expectancy changes, relative to a publicly-guaranteed pension. Israel can consider several options to reduce this risk, including increasing access to income supplements in old age and increasing the share of pensions invested in guaranteed-return government bonds (Spivak, 2013).

Conclusion

Israel has capitalized on its historical roots, mandating and incentivizing private employment-based pensions while relying to a lesser extent on public pensions. This has led to the dichotomy seen today, wherein Israel has relatively low market income poverty but high disposable income poverty. The mandatory pension scheme is an important effort to build on existing institutions, to both ensure minimum living standards for future retirees while reducing the burden on government. However, the further economic squeezing of low-income households via high contribution rates, the regressive impact of pension tax incentives, and the perpetuation of labor market disparities into old age are of concern. To ensure a good standard of living for both its working population and those in their golden years, Israel must address these concerns.

Endnotes

1 This brief uses the international definition of pensions, which includes public and private plans. Public pension plans are those administered by governments – e.g., social security benefits – to provide minimum benefits (either flat or earnings related) to the general elderly population. In Israel, public pensions refer to old-age allowances and old-age income supplements. Private pensions are occupational or personal plans administered by a private entity. Since Israel's 2001 pension reform, civil servants' pension plans are considered private (Shalev et al., 2012).

2 In this analysis, "Russian immigrants" are limited to those who arrived after 1990. "Native" Israelis also includes all immigrants to Israel prior to 1990.

3 Six percentage points of the required 17.5% is for severance payment insurance, which is accessible prior to retirement in the case of separation from a workplace.

4 International comparisons of the replacement rate are challenging, because they make certain assumptions that are not true across the board (e.g., that one is employed continuously from age 20 until the retirement age and that the pension is on the entire salary). In Israel, it is estimated that pensions accrue on only about two-thirds of the salary, as car payments, shift work, and other financial benefits may not accumulate in the pension (Spivak, 2013). Wage replacement rate calculations are also very sensitive to assumptions such as rate of return, pension fund management fees, and years of participation in the labor force.

5 This data refers to "net wage replacement," which accounts for the effect of income and social security taxes paid, both throughout a career and during retirement. Several recent reforms, particularly in Greece, are expected to further lower the replacement rates of other OECD countries.

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