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# Israel's implementation of the OECD recommendations

Dr. Roby Nathanson | Hagar Tzameret-Kerthcer | Gilad Brand | Moran Navon

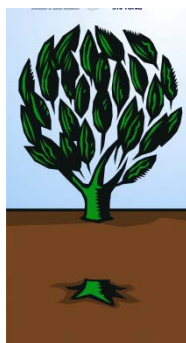


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# Table of Contents

Abstract.....	5
Introduction.....	19
An Outline of the Recommendations, Their Implementation, and Effects on the Economy .....	21
OECD Recommendations Untreated by the Government .....	47
Summarizing Table - OECD Recommendations for Israel and their Estimated Budgetary Cost versus the Effective Expenditures in the Government Budget .....	48
Conclusions.....	53
Appendix A: Nationwide Implementation of the Income grant - Formerly the Negative Income Tax Law - and its Effect on the Poverty Rate .....	57
Appendix B: The Labor Market, Government Expenditure, and Welfare - a Survey of Recent developments.....	59
Appendix C: Tables and figures .....	61



# Abstract

In May 2010, the Organization for Economic Cooperation and Development (OECD) published a broad review of the labor market and social policy in Israel. This review includes numerous recommendations whose objectives are turning Israel into a more just society, maintaining rapid economic growth, and reducing the gaps between Israel and the OECD members.

The report extensively discusses income distribution gaps, poverty rates, and the low labor market participation rate. Data presented in the report shows that the rate of relative poverty in Israel, currently at 21.3%, is the highest among OECD members. Israel is one of the five countries whose inequality rates are the highest in the organization. The labor market participation rate is lower than the OECD average, with four out of ten working-age Israelis (15-64 years old) being unemployed. In OECD member countries the unemployment rate is 33.3%.

The data presented in the report are for the years 2005-2007, and since then, in the years 2007-2010 the labor market participation rate has increased by 0.8%, mostly following a sharp increase in women employment rates. During the same period, the unemployment rate has decreased, and by the end of the first quarter of 2011 it has been recorded at its lowest level in decades (5.8%). In accordance with these labor market developments, at the beginning of the latest financial down turn , poverty rates increased after several years in which they had been decreasing. Recent data show a decrease in the poverty rate in the first half of 2010, and evaluations suggest that this trend has continued in the second half of 2010.<sup>1</sup>

The increasing trend in income distribution inequality continues in the years 2007-2010. The Gini coefficient of income distribution inequality has increased from 0.369 to 0.379. These trends are seen partially due to an ongoing decline in public expenditure relative to total output and a decrease in direct tax rates. According to a Government Revenue Agency 2009/10 report, in 2008 direct taxes constituted 17.5%

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<sup>1</sup> Daniel Gottlieb and Alex Fruman. "Trends in Poverty Rates and Living Standards in the First Half of 2010." National Insurance Institute of Israel. March 2010.

of output and indirect taxes were 16.2% of output, compared to 22.3% and 10.2% in the OECD member countries, respectively.

Accompanied by high VAT rates and other indirect taxes, the decline in direct taxes may lead to widening social gaps, which are already wide. If implemented, The OECD recommendations should dampen the negative impact of these policies on social gaps and encourage continued increase in employment rates.

The following are the OECD recommendations and main government policies as of June 2011:

- **Spreading the negative income tax program nationwide.** In 2008, grants for low income workers were given only in areas where the "Lights for Employment" program was running. In 2012 this income grant will be applied to all low income workers in the country (based on earnings from 2011). Under the current form of the program, however, the incentive to enter the labor market is small, the rate of individuals who redeem their entitlement out of those who are eligible is low, and part-time labor is not sufficiently worthwhile. It is therefore expected that the program in its current form will only have a slight impact on poverty and employment rates.
- **Removing labor market barriers for minority groups using investment in education.** The Ministry of Education budget as a fraction of the government budget has increased since 2008 by 1%, and public expenditure per student (relative to output) has increased in the past year by 0.1%. Moreover, several significant reforms are active, for example, Ofek Hadash (New Horizon), which has already been implemented, and Oz Latmura (Strength for Compensation), whose principles have been recently laid out. These reforms are based on lengthening school days and increasing teacher's wages. Yet even given that many resources will be invested in education as a result of recent reforms, their contribution towards removal of labor market barriers is projected to be small.
- **Effectively enforcing employment legislations.** In attempt to strengthen the enforcement of labor laws, the number of inspectors in the enforcement department of the Ministry of Industry, Trade, and Labor (ITL) has increase from 16 to 45 in the past year, and more part time students were employed by

the department. The number of inspectors in 2010 implied a ratio of one inspector per 40,000 jobs. This ratio, which is not expected to change significantly in the coming year, is four times lower than the world average (one inspector per 10,000 jobs).

Along with increasing the number of labor inspectors, the sixth amendment to the law governing employment by manpower agencies has been legislated. Its aim is at making employment without granting workers their full rights more difficult for service firms in the security and cleaning fields. Another regulation set by the ministry conditions assistance and aid on the receiver never being convicted or fined for violating labor laws.

- **Changing policies regarding the exemption from military service given to full time rabbinical students. Specifically, cancelling the stipulation which conditions receiving an exemption on studying in a program that does not enable full integration in the labor market.** Firstly, the minister of education has signed a bill which reduces the number of weekly hours required for full time rabbinical to receive a stipend from 35 to 18 weekly hours. This bill enables partial integration of full time rabbinical students in the labour market without losing the entitlement. Secondly, the initiative of drafting ultra-Orthodox Jews into the IDF and the civil service was confirmed on January 2011. The purpose of this initiative is to promote integration of ultra-Orthodox Jews in the labour market, and therefore, a program which will aid ultra-Orthodox Jews who serve in the IDF or in the civil service in this integration process when they finish their service period has been formulated.
- **Reducing commissions charged by mediating firms who recruit foreign workers using, among other methods. Bilateral foreign human resource recruiting agreements.** There are countries in which workers pay between \$3,000 and \$10,000 to be allowed to work in Israel. This amount is shared between the manpower firms in the worker's country of origin and the local mediators in Israel. The Administration of Border Crossings, Population, and Immigration is currently promoting signing accords with countries in which the foreign workers originate, attempting to shrink the prevalence of this phenomenon. So far, the only agreement that has been signed was vis-à-vis Sri Lanka, bringing 300 agriculture workers. Moreover, the objective of bilateral



agreements for importing foreign labor has been stated in government resolution number 1274 from January 2010.

- **Preferring foreign workers wage earners proceeding from neighboring countries, such as residents of the Palestinian Authority (PA), over workers from more distant countries.** The number of non-Israeli workers has mildly increased in the past year, following a steady increase in the past several years. The share of PA workers out of total labor inputs in the commercial sector has grown in the past year after a significant decline in 2009. This increase is mostly attributed to a policy conducted by the Ministry of Defense, which supported increasing the number of Israeli working permits to Palestinians who reside in the West Bank. In 2011, The Economic Cabinet has decided to add roughly 5,000 permits for such workers.
- **Extending active policymaking in the labor market.** Among other measures, by expanding professional training programs, extending daycare, performing structural changes, and running the Wisconsin program nationwide. The budget for daycare subsidies has increased in the past year, contributing to an approximately 90% increase in real terms over the past six years. It should be noted, however, that the budget of the department of professional training has decreased by 3% in 2011 (compared to last year). The Wisconsin program, which was originally planned to be implemented nationwide, and in October 2010 even passed the first round of legislation in its new form, was terminated in 2010. The program was later implemented as a part of the Arrangements Law, but has since been removed from it. During January 2011, it was decided to increase the minimum wage. Aimed at decreasing poverty rates and wage gaps among workers, this decision causes employment rates to diminish in some sectors<sup>2</sup>, thereby contrasting the OECD recommendation to gradually erode the minimum wage level.
- **Reduce tax credit towards voluntary private pension saving, and use the funds to introduce pension credit for low income workers.**

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<sup>2</sup> Flug, Kleiner, and Rubinstein. "The Effect of a Minimum Wage on Employment in Selected Low Skilled Labor Intensive Sectors in the Israeli Economy". Bank of Israel. 2000.

The existing pension agreement, in effect since 2008, states that salaried employees should transfer 15% of their salary to pension savings.<sup>3</sup> These savings are accompanied by significant tax benefits, however, the vast majority of those savers who have increased their saving rates have an income which is below the lower bracket of taxable income, and therefore they have no gain from these benefits. A committee whose objective is reexamining the mandatory pension agreement and increasing its equitability has been established in the Ministry of Finance.

- **Gradual equalization of standard retirement age across the sexes at 67.** Following increases in life expectancy, which lead to a projected increase in expenditures on supporting the older generations, the OECD recommends raising the retiring age. The retiring age has increased stepwise, being 67 for men and 62 for women. The female retiring age is expected to increase gradually up to 64, subject to the decision made by a public committee which debates this topic in March 2011. The committee is required to submit their conclusions to the minister of finance by the end of 2011, whereas if its conclusions are not submitted by that time, the female retiring age will automatically be increased to 64 in the beginning of 2012.
- **Toughening the requirements for employing foreign labor.** The OECD recommends implementing this objective by conditioning employment of foreign workers on local employment examination, invalidating employers employing licenses if they fail to provide minimal working conditions and invalidating firms licenses if they refuse to employ domestic labor.

The actions taken by the Israeli government in this field are as follows:

- Increasing the tax levied on employers for employing foreign labor.
- Enacting regulations which increase enforcement around unlawful employers of foreign workers, improving the efficiency in enforcement, reducing and deportation of illegal foreign nationals, and imposing constraints on issuing working permits and legal statuses, on the sector in which foreign workers are employed, and on the location in which foreign workers from the nursing industry.

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<sup>3</sup> Full implementation of the gradual stepwise agreement and a transfer rate of 15% are expected to be in effect only in 2013.

- Reducing the incentive to import foreign labor and addressing unlawful charging of mediation fees issue.
- In February 2011, the Administration of Border Crossings, Population, and Immigration have initiated a wide-coverage campaign of locating unlawful employers of unpermitted foreign workers in various industries. Additionally, the campaign includes attempts of locating permitted foreign workers employers who fail to adhere to the working conditions prescribed by the law.
- **Accelerated infrastructure development (roads and public transportation) in the periphery and in Arab communities.** Much attention was paid to the issue of roads and public transportation in 2011; however, the focus was mainly on Central Israel and the metropolitan areas and not in the periphery or in Arab communities. An example is the reform in Dan (the main transit firm of the greater Tel Aviv area), whose goal was raising the rate of public transit users in the areas in which Dan operates. Another example is the forming of a national authority for public transit operation in two stages. The first stage is the establishment of metropolitan authorities, and in the second stage a national authority which will run the country's transportation systems. The "Netivei Israel" (Routes of Israel) program includes founding an extensive continental transportation infrastructure. This program is projected to be executed within the next decade.
- **Implementation of the Goldberg Committee's recommendations.** The committee discussed Bedouin housing in the Negev, and in Bedouins living in illegal habitats and townships. It called for recognizing a substantial amount of these townships and classifying illegal habitats as "grey buildings", a classification which enables both their legal admission into development master plans, and their attachment to regional infrastructure. In May 2011, the document describing recommendations for implementation of the Goldberg reports conclusions. This document suggests an outline for regularizing Bedouin habitats in the Negev, solving the conflict over the ownership of properties in the Negev, and advancing the development of local industries.
- **Adopt policy measures for improvement in the levels of education and professional training in the Bedouin sector.** This topic is noted in the

2011 government ministries working plan, but it is has not been mentioned the government budget.

**We have concluded that government policies and actions during 2010 and in the first half of 2011 (prior to this paper, written in June 2011) are only partially synchronized with the OECD's recommendations. The budget cost of policies proposed by government is roughly 4.9-5.5 Billion NIS, whereas we believe that an additional investment of approximately 7.4-11.1 Billion NIS if it attempts inflicting a significant decrease in the poverty rate. The current trend can be changed in the short and medium term only if the government's objective in the next five years and afterwards will be reducing the poverty rate by 25%.**

**The poverty rate can be reduced using, among others, the following measures:**

- **Improvements in the negative income tax program.** The tax benefit grant paid to the employee in the program is low compared to the equivalent tax benefits in, for example, the UK or the USA, resulting in a low rate of eligible workers who use their eligibility. Therefore, a significant increase in the tax benefit. A report aimed at implementing of the program shows that in order to significantly increase the impact of the program on poverty rates, the level of the tax benefit paid out has to be raised considerably. For example, raising this tax benefit by 44% can reduce the poverty rate among eligible workers by roughly 10% (nationwide), which will lead to about 4,700 families to be raised beyond the poverty line.
- **Changes in the structure of the negative income tax benefits in attempt to stimulate integration in the labor market as a part time worker.** Under the current system, the incentives for part-time work are weak since the benefit granted to employees who earn less than the minimum wage is small. A part-time job can constitute a first step towards gaining experience in the labor market, and it takes into account the fact that it is difficult for some people to join the labor market as a full-time worker for many different reasons. The reason may be cultural obstacles (for example, among Jewish ultra-Orthodox men, or Arab women), or needing to spend time on household work. The stepwise increase in the tax benefit should be decreased and the grant should be given in high levels even in part-time work income levels, thereby

significantly promoting part-time job entry as it is the case for full-time jobs. The rate of the negative income tax should be simultaneously increased.

- **Improvements in policies governing foreign workers in the nursing/caregivers market (which is the foreign workers main employment field) using demand side incentives.** For example, recipients' nursing hours can be increased if they replace their foreign worker by an Israeli. Another method is encouraging nursing treatments within the community (mainly among Arab population), for example, by enabling a family friend to take care of the nursing recipient, thus creating income among weakened segments of the population.
- **Abolishment of the income tax exemption on savings, and using the resulting payment stream to encourage savings in a more equitable manner.** The government grants tax benefits every year to pension saving deposits as an incentive given to individuals who save for pension. According to Bank of Israel estimates<sup>4</sup>, the tax benefit amounts to roughly 9 billion NIS, while the main benefactors are from the high income deciles. It is possible to reduce the existing distortion by applying a model that enables savers to enjoy the tax benefits in a more flexible manner during their working years, and making the tax benefit feasible to those who do not receive it currently. Another option is subsidizing savings of workers that fall below the taxable lower bracket, constituting an estimated 1.2 NIS budgetary cost, which can be financed by reducing the tax benefit on pension savings to 27%.<sup>5</sup>
- **Income support for single mothers:** poverty rates among single parented families are high, while also having high employment rates compared to the rest of the population.<sup>6</sup> This situation arises because, among other reasons, earning abilities are limited to one worker. For example a single mother who gets an allowance for two kids, works full-time earning a minimum wage will achieve a disposable income which is 16% below the poverty line (according to 2009). Therefore even working full-time does not elevate a single parented family from poverty. The situation is worse than in previous

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<sup>4</sup> Brander, A. "The First Year of the Mandatory Pension Arrangement: the Adhering to the Arrangement and Potential Consequences on Labor Supply". Working paper series, Bank of Israel. May 2011.

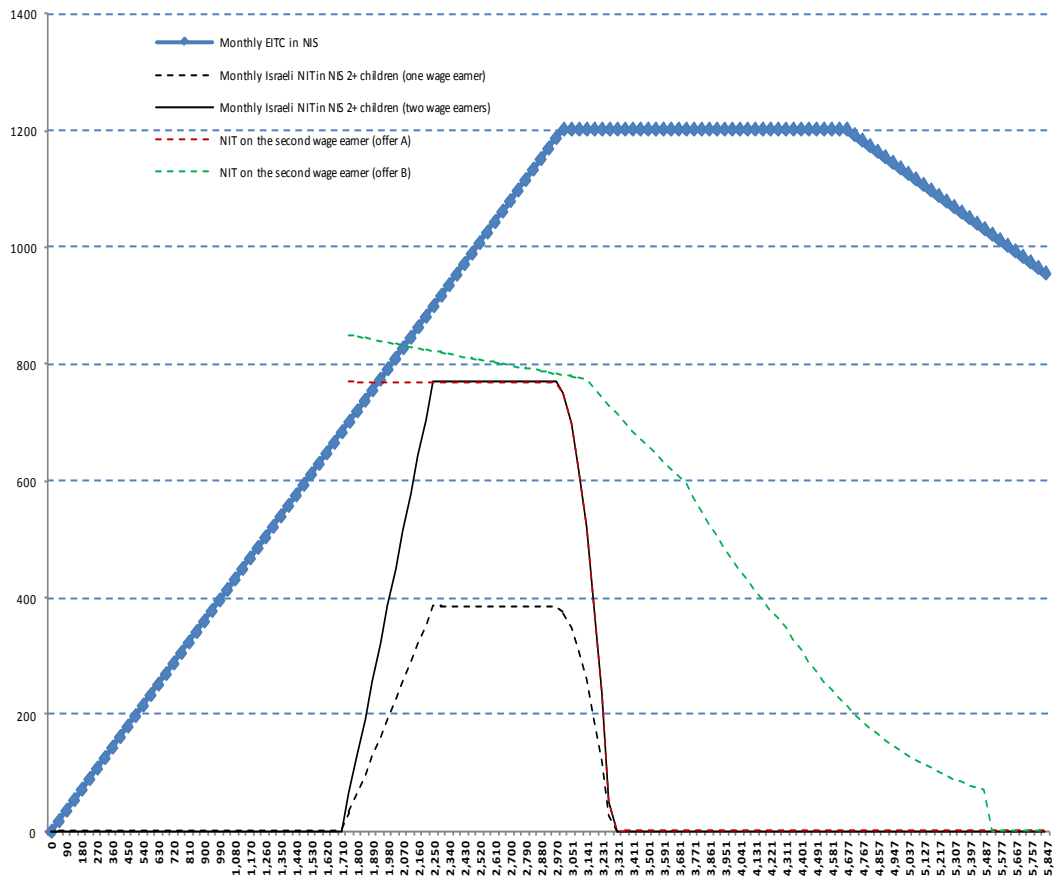
<sup>5</sup> Ibid.

<sup>6</sup> 2008 Yearly review, National Insurance Institute of Israel. June 2009.

years - in 2005, the income of a family with the same characteristics reached 13% below the poverty line, and 3% below the poverty line in 2002. The current status of single-parent families can be improved by raising the income level which is disregarded when applying for unemployment benefits, separating alimony payments from unemployment insurance, so that alimony will be fully added to the income of females who earn less than the average wage. Another option is increasing the earning ability of single mothers using the negative income tax.

- **Improving the calculation of income requirements for receiving unemployment benefits for families at working age:** taking net housing income for homeowners into account.
- **Raising the minimum wage.** An increase in the minimum wage is expected to increase the income in the low deciles, and strengthening the incentive for labor market integration. In order to achieve an effective raise in the minimum wage, labor laws should be enforced more effectively.
- **Raising children's allowances.** Together with this raise, the earning ability of workers who finance the household in large families and of their children who will finance the household in the future.
- **Reinstating progressive income tax as an inequality reducing mechanism.** Reversing the trend of ongoing increases in direct taxes along with decreases in indirect taxes.
- **Every distorting subsidy must be weighed against the damages to social solidarity.**

## Negative Income Tax Credit (NITC) Comparison between Israeli and American structures

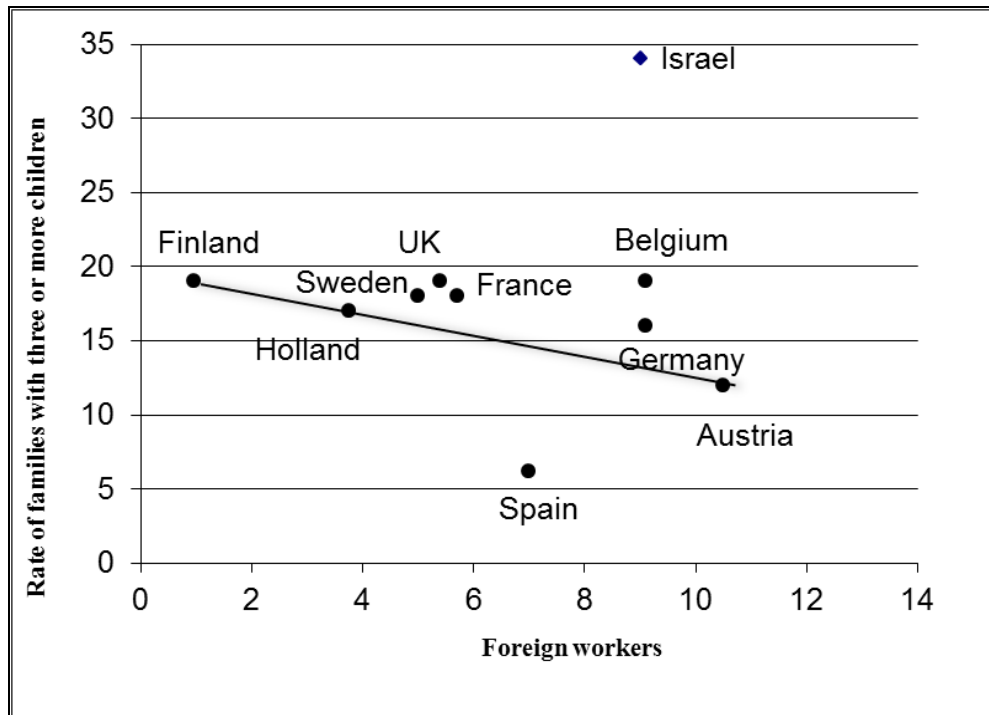


The data are PPP adjusted using a 3.60 USD rate. Central Bureau of Statistics (CBS), 2009.

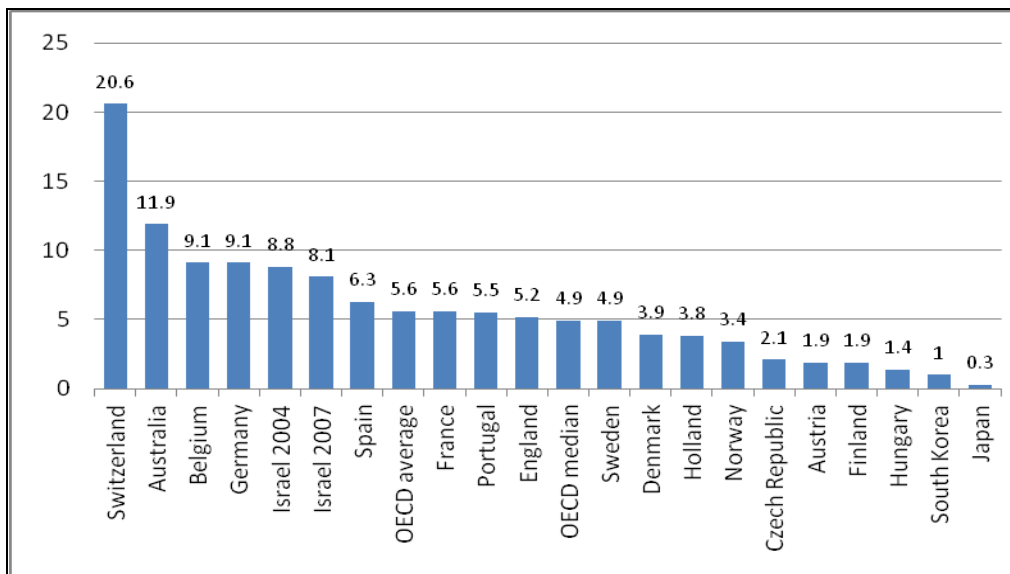
Source: National Insurance Institute of Israel, 2009 yearly review.

Increasing the effectiveness of the income grant can be achieved by, for example, raising the grant of a second wage earner to a horizontal or even decreasing path in order to amplify the incentive of a second wage earner to integrate in the labor market.

**Foreign Workers Rate Relative to the Rate of Families with Three Children and More - Israel in an International Comparison, 2004**



**Foreign Workers Rate, International Comparison, 2004**





From the charts it can be seen that the rate of young people is high compared to other developed countries, but also the foreign workers rate is high, contrasting the trend line which implies an inverse relation between the two.

The following table illustrates how appropriate government policies regarding employment and welfare can have an impact:

<b>Government Action</b>	<b>Date of Execution</b>	<b>Long-Term Result</b>
Mandatory pension law	Enacted in 2008, currently is revisited by the Ministry of Finance	A decrease of 15,000 in the labor force <sup>7</sup>
Increase in the minimum wage	Was accepted by the Knesset, first increase is expected to occur July this year	A 0.1% decrease in the poverty rate <sup>8</sup> , a 3,000 increase in employed individuals <sup>9</sup>
Applying the NITC nationwide	Was accepted by the Knesset, will be in effect 2010 (based on earnings from 2011)	2,300 families rising above the poverty line <sup>10</sup> , and an increase of roughly 15,000 workers <sup>11</sup>
Extending subsidized daycare	A significant budget increase is required	An approximate increase of 20,000 workers <sup>12</sup>
Administer the integration of pension receivers in the labor market program nationwide	Not expected in the near future	An approximate increase of 30,000-50,000 workers <sup>13</sup>
Strict enforcement of the minimum wage law.	Not expected	A 0.7% decrease in the poverty rate <sup>14</sup>
<b>Total:</b>		An employment increase of 80,000-90,000 workers, which are roughly 3% of total employment, and a decrease of at least 0.7% in the poverty rate <sup>15</sup>

<sup>7</sup> Brander, A. "The First Year of the Mandatory Pension Arrangement: the Adhering to the Arrangement and Potential Consequences on Labor Supply". Working paper series, Bank of Israel. May 2011.

<sup>8</sup> Taken from a press release of the Bank of Israel: a segment from a review of the economic developments in recent months, which will soon be available; the minimum wage raise in the years 2011-2012. June 2011.

<sup>9</sup> An estimate prepared by the Macro Center for Political Economics, assuming that the policy will not lead to negative effects on labor demand.

<sup>10</sup> "Negative Income Tax, Results from the First year of Enactment", presented by the research team which follows the implementation of the negative income tax law (Bank of Israel, the Brookdale Institute, the Tax Authority, and the National Insurance Institute of Israel). June 2010.

<sup>11</sup> Taken from "The Committee Examining Employment Policy, Final Report." The National Economic Council, Bank of Israel. June 2011.

<sup>12</sup> Ibid.

<sup>13</sup> The product of the total recipients of employment insurance in Israel and the proportion of the program's effect on the change in the employment rate.

<sup>14</sup> Taken from a press release of the Bank of Israel: a segment from a review of the economic developments in recent months, which will soon be available; the minimum wage raise in the years 2011-2012. June 2011.

<sup>15</sup> Assuming that a reform in the mandatory pension law will be carried out and will not lead to a decrease in employment rates.



# Introduction

The OECD was formed in 1948 as the OEEC - Organization for European Economic Cooperation, aiming at implementing the American economic aid to Europe after World War Two (the "Marshall Plan"). In 1961 was renamed and is referred to as the OECD ever since, following the joining of non-European countries. The organization has been also known as the "Group of Strong Countries" or the "Group of Wealthy Countries", which explain the prestige attributed to member countries. Israel joined as the 32<sup>nd</sup> member in 2010. Its acceptance to the organization confirms that Israel is among the most developed and advanced countries in terms of the economy, civil rights, the legal system, and its social policy.

Israel's joining to the OECD serves as a "quality assurance", and as such it should encourage foreign investments, improvements in its credit rating, and will open new channels of discussion with other countries.

As a part of the joining process, the organization's research department pays close attention to analysis of the Israeli economy. The OECD is not only presenting the data, but also it provides recommendations for policymaking.

In May 2010, the organization published a book titled "Reviews of Labor Market and Social Policies", which includes social and economic recommendations for Israel. Its main recommendations are as follows:

- Raising the labor force participation rate, especially among ultra-Orthodox Jews and the Arab minority.
- Reducing poverty rates among working families.
- Investing, expanding, and further spreading the existing human capital.

This research was conducted as a part of the Zichron Yaakov Initiative, the objective of the Initiative is to form an action plan for realizing Israel's social-economic potential. In Israel today, there is no comprehensive, rational, effective and well-defined conception of social policy, and the Initiative's aim is to form such a conception. The Initiative's work will focus on a number of key issues:

- The labor market – creating jobs and finding solutions for inequalities caused by the free market.

- Welfare policy – streamlining the existing frameworks and creating alternative solutions for weakened populations.
- Social gaps, poverty, and unequal growth.
- Rehabilitating personal economic security.

### **The Research Objective**

In this paper we examine which of the OECD's recommendations for Israel are in stages of planning or implementation, and whether the budgetary cost that the state is willing to incur will lead it to the required target, as defined in the OECD report. We therefore present the OECD recommendations for Israel and elaborate on government actions aimed at implementing the suggested policies. Afterwards we present an examination implementation costs and the resulting effects on the economy.

### **Research Method**

The information regarding government actions was taken from the 2011-2012 government budgets, press releases and publications of various government ministries and the Israeli Tax Authority, government decisions, enactment proposals, Bank of Israel publications, and the government ministries working plan for the year 2011. We also use data from the Central Bureau of Statistics (CBS), the National Insurance Institute of Israel, and other sources.

We rely on the above sources and various researches to calculate the different costs, and then we perform estimations and economic analysis. With some assumptions on the economy we run simulations, which pin down the costs of the policies.

### **Structure of the Paper**

Along with every recommendation from the OECD report regarding Israeli social and economic policies, we describe government actions in the respective fields (legislations, decisions, working plans, committees, etc.), estimated costs, and the impact of implementing the recommendations. Following presentation of the recommendation, a table describes the costs (our estimation versus the expenditure which government allocates for each topic).

# An Outline of the Recommendations, Their Implementation, and Effects on the Economy

The OECD outlines four main targets that will reduce the existing gaps between Israel and other member countries, and will turn Israel into a more equitable society while maintaining a rapid economic growth rate.

The four main targets discussed in the report are:

- Securing medium term, non-inflationary growth and counteract adverse economic shocks.
- Raising the labor force participation rate, especially among ultra-Orthodox Jews and the Arab minority.
- Lowering poverty rates among working families.
- Investing, expanding, and further spreading the existing human capital.

In this section we describe the OECD recommendations, government actions in the respective fields (legislations, decisions, working plans, committees, etc.), the resources allocation and cost estimation for the recommendations implementation. Firstly, we focus on the first target as it is presented in the report. The remaining targets will be then reviewed, paying attention to all of the report's recommendations in detail.

1. *Guaranteeing long term growth while keeping inflation low and erecting institutions which dampen external economic shocks.*

In the years 2009-2010, Israel has experienced faster economic growth compared to any OECD country, however, Israeli GDP per capita is still only 84% of the average among member countries.<sup>16</sup> There are currently several factors which support fast economic growth and economic stability, particularly the economy's stability when facing external shocks. Some of these factors are: an ongoing increase in employment rates (which we will discuss in detail), surplus in the current account, responsible monetary policy, and a gradual reduction in public debt. In order to guarantee continued reduction in public debt while encouraging economic growth, a new fiscal

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<sup>16</sup> Chapter 1 in "The Economy and Economic Policy." Bank of Israel report, Jerusalem. 2010.

rule was approved in 2010 for calculating a government expenditure constraint which maintains the legal deficit ceiling (the deficit reduction and government's expenditure bounding law). According to the new rule, the growth rate of total public expenditure will be based on average growth in the past decade, accounting for the target ratio of debt to output (60%). The rule outlines a path of diminishing government deficit, where if the ceiling has been surpassed, the government must choose between increasing revenue and decreasing expenditure to the level assigned by the rule.<sup>17</sup>

Compared to its predecessor, the new rule sets a higher expenditure ceiling, however, as stated in a 2010 Bank of Israel report, "achieving the deficit reduction targets set by government will not be challenging task [...] the implied expenditure levels on security, education, welfare, and infrastructure in 2013 is already slightly higher than ceiling set in the law, which lowers the chance of lowering the growth in expenditure in order to assist in deficit reduction",<sup>18</sup> and according to Dr. Michel Stravchinski, deputy manager of the research department of the Bank of Israel, "The deficit targets can only be reached when the economy grows at a pace of 5% per year or more".<sup>19</sup> It should be noted that the 2011 projected growth rate is indeed satisfying this requirement, however, it is highly unlikely that similar economic growth will be recorded in following years.

These limitations on the deficit and public expenditure which supports a gradual decrease in debt relative to output are vital for sustainable economic growth. The debt to output ratio has decreased in the end of 2010 to a level lower than it was just before the 2008 financial downturn, however, its level is still high (76.2%). And a further delay in the reduction of the government deficit is likely to have an extensive negative impact on the economy.

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<sup>17</sup> Chapter 6 in "The Broad Government, its Services, and the Financing of Services." Bank of Israel report. Jerusalem, 2010.

<sup>18</sup> Chapter 6 in "The Broad Government, its Services, and the Financing of Services." Bank of Israel report. Jerusalem, 2010.

<sup>19</sup> Press release: main parts of Dr. Michel Stravchinski's speech at the Falk Institute seminar in the Hebrew University on May 5, 2011. Bank of Israel – the Department of Spokesmanship and Publicity.

2. *Promoting effective enforcement of labor laws, especially minimum wage, employment conditions, and increasing the pool of available resources (for example, the number of employment inspectors) which will enable closer supervision.*

The government has acted in various fields in attempt to implement a more rigorous enforcement: increasing inspections in the enforcement department, legislation, and providing guidelines.

- 70 inspectors are currently employed in the enforcement department, following an increase from 16 to 45 in inspector positions and 57 additional part-time positions for students. This number of inspectors implies that there is an inspector per 40,000 jobs, a small number relative to the world standard which is currently one inspector per 10,000 jobs.<sup>20</sup>
- The sixth amendment to the law governing employment via human resource companies<sup>21</sup> states that human resources agencies and head hunters in the security and cleaning fields must get a permit from the Ministry of ITL. One of the requirements for receiving such a permit is that candidates provide appropriate collateral for guaranteeing that their employees get their full rights. Set by the labor committee, the collateral rate will be evaluated according to labor contractor's monthly expense on wages. The permit and collateral (which can be confiscated by the ministry in an administrative decision) requirements, are attempting to prevent firms in these sensitive fields from employing workers without providing them with all of their lawful rights, and to strengthen the supervision on labor contractors and making sure that weaker workers receive their full rights.
- Another regulation whose objective is deterring violation of workers rights in the labor market has been set by the Ministry of ITL in June 2010. According to the regulation, support from the ministry will be conditional on the candidate never being convicted or fined for violating certain labor and foreign workers regulations, and on employer's obligation to provide their workers with all of their legal rights during the period of receiving support from the ministry.

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<sup>20</sup> Chapter 8 in "Topics in Welfare Policy." Bank of Israel report. Jerusalem, 2010.

<sup>21</sup> This amendment has been in effect since October 2010.



**Implementation costs:** The budget for inspection of labor laws grew in 2011 by 2,126,000 NIS to a total of 10,419,000 NIS<sup>22</sup> (an additional 25% compared to 2010). This addition is significantly lower than what is needed – According to our estimates, the budget has to be increased by 27 million NIS to comply with the world standard. In 2010, 5,770,000 were allocated to enforcing the law governing employment by human resource agencies (remark: this law compels labor contractors to obtain permits. The responsibilities involved have been transferred to the Ministry of the Interior). This expenditure does not appear in the 2011 budget. The expenditure which appears instead are: promoting regularization and enforcement of labor laws (6,116,000 NIS), and supporting public institutions that provide workers with information and assistance regarding their rights (1,000,000 NIS).

**Social and economic impacts:** The total budgetary cost of enforcing labor laws was roughly 10.5 million NIS in 2011. The lion's share of these costs will be offset by revenue streams from fines. According to enforcement data from the enforcement department of the Ministry of ITL, 831 fines have been imposed during 2010, providing 9.5 million NIS in revenues versus 8.3 million NIS in budgetary cost in that year. Therefore, the resources allocated to administering labor laws are low, and moreover, they create a surplus when accounting for fine revenues, hence there is no conceivable explanation for why the state does not allocate more resources in order to enforce labor laws.

More rigorous inspection of labor laws will lead to a reduction in the poverty rate. For example, if the minimum wage law will be fully enforced, the poverty rate is expected to decline by 0.6%.<sup>23</sup> In addition, the enforcement of labor laws will result in a greater incentive to join the labor market. On the other hand, the increase in labor costs is expected to decrease the demand for low skilled workers.

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<sup>22</sup> Taken from the 2011-2012 government budgets - the Budgeting Department at the Ministry of Finance.

<sup>23</sup> Taken from "A Survey of Economic Developments in Recent Months." Bank of Israel. June 2011.

3. *Extending the active policy in the labor market using broader application of professional training, extending day care (especially making day care more available to families whose income depends on participation in a program which encourages labor, such as the Wisconsin Program), nationwide implementation of the Wisconsin Program following structural changes in the program. Examples of such structural change is increasing competition between different human resource firms who participate in the program, and changing the programs incentive policy. Another recommendation is to enable participation of human resource firms, non-governmental organizations, and local municipalities in the program.*

#### **Increasing the investment in raising the labor force participation rate:**

- There has not been a significant change in government expenditure on employment encouragement. The budget of the department of female employment has increased by 46.2% in 2011, currently totaling one billion NIS, where the increase is mostly due to a significant increase in daycare subsidization. The budget allocated to daycare subsidization grew by 277 million NIS to a total of 929 million NIS. The budget of the Department of Professional Training has decreased by 3% in the past year, currently totaling 601 million NIS. The budget of the Employment Service has remained unchanged, currently totaling 136 million NIS.<sup>24</sup>
- During January 2011, the Histadrut (the General Federation of Laborers in the Land of Israel) and the Coordination Bureau of the Economic Organizations have agreed on raising the monthly minimum wage to 4,300 NIS. This agreement will be applied to all workers in the economy, according to the settlement between the minister of finance and the chairman of the Histadrut. There will be two stages to the increase: the first stage will take place on July 1, 2011 and will increase the monthly minimum wage from 3,890 to 4,100 NIS. The second stage will take place on October 1, 2012 and will raise the minimum wage to 4,300 NIS. The agreements estimated budgetary costs in the years 2011-2013 is estimated to range

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<sup>24</sup> All data presented in this section are taken from the 2011-2012 government budgets - the Budgeting Department at the Ministry of Finance.

between 700 million NIS and 1.2 billion NIS. Another estimate is a net cost of 570 million NIS (accounting for the budget savings from changes in the minimum wage agreement with the Histadrut).<sup>25</sup>

- Other policy tools whose goal is to encourage labor market integration include the negative income tax, enforcement of labor laws, and reducing the number of foreign workers. We will elaborate on these measures.

**Cost:** The bank of Israel has estimated that the additional budgeting cost resulting from the increased minimum wage to be at least 427 million NIS in the years 2011-2013.<sup>26</sup> This estimate is lower than the Ministry of Finances estimate (570 million NIS). Using these estimates under similar assumptions, we estimated the cost in 2011 to be 135-175 million NIS.<sup>27</sup>

**Socioeconomic effects:** The increase in the minimum wage is expected to increase incomes in the low income deciles, however, the effect on the poverty rate will be low (an estimated decrease of 0.1%) in the absence of an improvement in adhering to labor laws.<sup>28</sup> The negative short term impacts on labor demand will be limited, at least from the standpoint of employers who are relevant to the agreement between the representatives of employers and workers. Updating the minimum wage entails a significant budgetary cost increase because it will raise salaries in the public sector.

The budget of the department of female employment has grown significantly in recent years, and the female labor force participation rate has simultaneously increased. This can be seen as a result of a consistent increase in the investment on female labor encouragement.

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<sup>25</sup> Taken from the minimum wage law draft, the ministers' legislation committee. 2011.

<sup>26</sup> Taken from "A Survey of Economic Developments in Recent Months." Bank of Israel. June 2011.

<sup>27</sup> Assuming that the increase in the minimum wage will not lead to a change in employment, and that if it were not raised, the minimum wage would have been adjusted following increases in the average income, as it is set by law (the minimum wage must be at least 47.5% of the average income).

<sup>28</sup> Taken from "A Survey of Economic Developments in Recent Months." Bank of Israel. June 2011.

### **Implementing the Wisconsin Program nationwide after performing structural changes in the program:**

According to government decision number 3994 from August 2008, nationwide implementation will begin during 2010, operating in all parts of Israel simultaneously. The participants will be invited for training in set dates during a period of 24 months which will end during 2012. It has also been decided that the program will be extended to include also participants beyond the age of 45. As determined by government decision number 159 from May 2009, gradual implementation will be completed in one year since its debut, and not two years as it was earlier decided. Government decision number 2002 from July 2010 states that nationwide implementation is subject to changes agreed upon by the minister of finance and the minister of finance.

The Wisconsin Program has continued operating in its limited form until the temporary law expired on April 29, 2010. The law expired because the Knesset's committee of labor, welfare, and health refused to prolong the program in its current form. Therefore, and according to government decisions to extend the program to nationwide coverage, a new program has been proposed.

**Proposition to enact a law which regulates the labor market integration of pension recipients** <sup>29</sup> Under its new name, "labor market integration of pension recipients", this Program passed the first legislative procedure in October 2010, and was even a part of the Arrangements Law (The "hesdrim" law) although it has eventually been removed from it. It has been suggested that the program will be extended to achieve nationwide coverage, and that it will be run by subcontractors which will report to the government<sup>30</sup>. There have been several changes in the new program which are aligned with the OECD recommendations, mainly linking subcontractor's payoffs for job placement of pension recipients to the cumulative additional labor income of supplements recipients throughout their participation. In fact, subcontractors are incentivized to provide long-term placements at high salaries, and not only to maximize the number of placements. Another OECD recommendation which is implemented under the new program is that program encourages

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<sup>29</sup> Taken from an explanation of the legislative proposal, which can be found in the government's services and information portal. <http://www.shituf.gov.il/discussion/316>.

<sup>30</sup> Based on government decisions no. 159 and 3994.

participation of public entities and non-profit organizations. The law was supposed to be implemented on January 2012, but confirmation of the program has yet to be approved as of the writing of this paper.

**Costs and socioeconomic effects:** 150,305,000 NIS of the Ministry of ITL's budget have been allocated to the Mehalev (From the Heart) program, however, in the years 2011-2012 only 20,426,000 NIS have been allocated to nationwide application of the program. And additional 15 million NIS have been assigned to develop programs of labor market integration.

The concluding report of the research<sup>31</sup> that followed the program and the committee of employment policy examination both conclude that employment rates among the programs participants have significantly increased<sup>32</sup> (from 41.8% to 52.2%), and that their monthly salary has substantially improved (a 32% increase). According to the committee, extending the program to nationwide coverage will increase employment by 30,000 employees in roughly four years, and this benefit will offset its budgetary cost in 2.5 years since its inception due to the savings in income supplements arising from the program.

There exists, however, criticism towards the program, this criticism is aimed at the programs emphases on entry to the labor market and the reduction of government transfers. One of the arguments is that the program does not balance appropriately between these goals and the need to protect incomes of pension receivers. Moreover, the program does not provide jobs which fit individual workers skills, and by directing workers to private entities the government shrugs off its responsibility of guaranteeing social security.<sup>33</sup>

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<sup>31</sup> A report by the committee for examination of the Mehalev program, prime minister's office, June 2007, and the Mehalev program evaluation research – final report of the Brookdale Institute and the Institute of National Insurance, 2010.

<sup>32</sup> A report by the committee of employment policy examination, headed by Professor Eckstein, final report. June 2009.

<sup>33</sup> Taken from the protocol of the budgeting committee's discussion of the Orot Lataasuka program. June 1, 2009.

4. *Removing minorities labor market barriers using investment in education (for example, equating the pupil per teacher ratio to the Israeli average, and implementing identical core classes for all Israeli children).*

In its working plan for 2011, the Ministry of Education stated that one of its objectives are raising test scores, and therefore it will be running various programs which prepare High school students to the Bagrut (matriculation) exams. Another goal is to reduce gaps in education. The means of achieving reaching this goal are: decreasing the number of pupil per classroom to 32 (giving higher priority to low income students), increasing the aid to peripheral schools implementing program to identify students at the risk of dropping from school, assisting weaker students using the tutoring hours assigned by the "Ofek Hadash" program, applying the mandatory schooling law in grades 11-12, and enabling adults to complete high school education in the periphery, where 50 peripheral schools are expected to participate in this program.

**Cost:** Out of the total Ministry of Education budget for 2011, 66,792,000 NIS have been allocated to decreasing the number of pupils per classroom in elementary schools, and 139,663,000 NIS have been allocated for the same goal in grades seven and up. This amounts to a total expenditure of 206,425,000 on the topic, an amount which is significantly lower than what is necessary for sticking to the government target, as stated in its working plan. According to a research conducted by Nachum Beles on reducing classroom size, the total cost of reducing classroom size to 32 pupils ranges between 5.7 and 9.3 billion NIS, out of which 2.1 billion NIS are for ongoing expenses, and the rest is for one-time expenses such as adding classrooms (an estimated 7,500 classroom should be added: 5,800 in elementary and junior high schools, and 1,650 in high schools), and teacher training expenses.<sup>34</sup>

In the absence of increasing the number of teaching hours and other hours allocated for educational purposes, the reduction in classroom size will compel an increase of between 9,000 and 17,000 teachers (7.5%-14% of the current teaching force). Reducing classroom size may lead to decreases in other costs, such as special education and remedial teaching.

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<sup>34</sup> Beles, N. "Lowering Classroom Size – Budgetary and Educational Implications." March 2008.

The budget of the Ministry of Education has been increasing in recent years: it has been about 27.5 billion NIS in 2009 (25,000 NIS per student), 30.3 billion NIS (27,000 NIS per student) in 2009, 32.4 billion NIS (28,000 NIS per student) in 2010, and in 2011 the budget has been raised by 5%, totaling 34 billion NIS (29,000 NIS per student). Public expenditure per student relative to output was 0.2% in 2006, 0.19% in the years 2007-2009, and 0.2% in 2010.

310 million NIS have been allocated to implementing the "Ofek Hadash" reform, that is, 3,829 NIS per student. 13.265 million NIS have been allocated to assisting weaker students. The cost of teaching core classes among ultra-Orthodox Jewish students is roughly 19 million NIS. However, the expenditures discussed earlier on have not been mentioned.

In May 2011, the founding principles have been laid out for a program similar in substance to the high school "Ofek Hadash" program. Titled "Oz Latmura", the new program grants high school teachers a gradual wage increase of 51% in exchange for working longer hours. The cost of fully implementing the program (until 2015) includes an estimated 3 billion NIS increase in teacher salaries, and hundreds of millions in improving physical conditions in schools.<sup>35</sup> According to the Ministry of Finance, the estimated cost of implementing the program in 2011 is 210 million NIS.<sup>36</sup> 130 million NIS from the revenue surplus of Mifal Hapais (Israel's public gaming and gambling agency) will be directed to building more than additional classrooms, with higher priority given to schools in the periphery.<sup>37</sup>

**Socioeconomic effects:** "The resource gaps from which the Arab education was suffering have been considerably narrowed. However, there still exists a gap between the resources allocated to Arab school versus Hebrew schools [...] as a result; the average educational level of young Arabs is lower than that of young Jews".<sup>38</sup> Educational investments have a significant effect on the economy and on decreasing the existing gaps in the Israeli society. The Israeli labor market is becoming more sophisticated and the demand for educated, specialized workers is increasing.

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<sup>35</sup> "The Education Reform is Underway – More for Teachers, More for Students." The Department of Spokesmanship in the Ministry of Education. May 2011.

<sup>36</sup> Taken from a document published by the prime minister's office: "Two Years of the Current Government, Discussing the Facts" - a survey of actions taken by the Ministry of Finance. March 2011.

<sup>37</sup> Ibid.

<sup>38</sup> Eckstein, Zvi and Dahan, Momi. "Young Arabs in Israel". June 2011.

Furthermore, educational investments are means of providing future employees the right tools for integrating in a modern labor market, thereby reducing labor market entry barriers. Better achievements in school is expected to lead to positive results during pupils adult life, and contribute, among other things, to increasing their future wages, to abridging the existing gaps, and to encouraging participation in the labor force.

5. *Reduce tax credit towards voluntary private pension saving, and use of the recourses to introduce pension credit for low income workers.*

Effective since 2008, the mandatory pension agreement states that every salaried employee must deposit 15% of his salary to a pension savings fund (up to the average wage in the economy). Implementation of the agreement is gradual, and therefore the full pension savings rate will be in effect only in 2013. Currently there are tax benefits for pension savings up to four times of the average salary (about 32,000 NIS per month). These benefits carry an expenditure of 9 billion NIS yearly, where the main beneficiaries are from the high income deciles.

- A committee whose mission is examining the model of tax benefits for pension savings has been formed in the Ministry of Finance, where the objective is increasing equitability in the distribution of tax benefits.<sup>39</sup> A model called "Circle of Life" was suggested in the committee, and its features are that it enables the saver to receive the tax benefits in a more flexible manner over his employment period, and it grants these tax benefits to those that are currently not eligible.
- The Histadrut and the employers' associations have agreed on increasing the pension deposit rate to 17.5% of the income of a salaried employee starting January 2014. The minister of ITL has signed an extension warrant which formalizes this increase in a juridical manner.

**Cost:** The government grants tax benefits on pension savings as an incentive given to pension savers. Total expenditure on these tax benefits has been estimated by the

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<sup>39</sup> Taken from a press release: the minister of finance has appointed the ministry's executive to be the chairman of a committee for examination of pension savings tax benefits. The Department of Spokesmanship in the Ministry of Finance. February 2011.



Ministry of Finance to sum total 9 billion NIS annually.<sup>40</sup> The OECD recommends decreasing these benefits and directing resources to full subsidization of pension deposits for workers whose salary is below the taxable lower bound. Such subsidization has been estimated by the Bank of Israel to be 1.2 billion NIS per year, and its financing requires reducing the tax refund on pension savings to 27%.<sup>41</sup>

**Socioeconomic effects:** The mandatory pension agreement guarantees future income to the current generations employees. Adequate income from pension savings will prevent senior citizens from needing government support beyond the universal old age stipend. Therefore, the agreement will allow for future savings in the government budget by reducing transfer payments to seniors. On the other hand, the agreement has negative adverse effects on a substantial part of workers from weaker social groups in the labor market. Brander (2010)<sup>42</sup> found that savings result in a net loss for many low-income households, unsmooth their consumption and lead to "too high" post-retirement net replacement rates. One of the reasons is that they will not be eligible for an income completion for low wage in the same manner. Moreover, the current arrangement worsens the status of weaker workers relative to unemployed individuals since the latter group will continue to receive income completion. Therefore, implementing the suggested recommendation should decrease the exiting distortion, thereby increasing the disposable income of those individuals whose living standards are significantly adversely affected by mandatory savings.

#### *6. Gradual equalization of standard retirement age across the sexes at 67.*

The retiring age has been gradually raised up to 67 for men and 62 for women in 2009 following the increase in life expectancy the projection of higher expenditure on pension and other transfers to support the elderly.<sup>43</sup>

- The female retiring age is expected to gradually increase to 64 subject to the decision of a public committee which has been formed to discuss the issue in March, 2011. The discussions are expected to be completed by the end of June.

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<sup>40</sup> Brander, A. "The First Year of the Mandatory Pension Arrangement: Adhering to the Arrangement and Potential Consequences on Labor Supply". Working paper series, Bank of Israel. May 2011.

<sup>41</sup> Ibid.

<sup>42</sup> Brander A. "Bank of Israel Survey no. 84: the Effect of Israeli Pension Savings Arrangements on Income Distribution". December 2010.

<sup>43</sup> The retiring age law. 2004.

After the committee completes its duties and presents its conclusions to the minister of finance, it will hand its recommendations over to the monetary committee, which in turn is supposed to submit its suggestions by the end of 2011. If the committee fails to do so, the female retiring age will be automatically raised to 64 in the beginning of 2012.

**Cost and socioeconomic effects:** Lower wages and a shorter pension savings accumulation period than those of men imply that women retire with lower pension savings than men. Deferring retiring age for women will increase their pension savings period and will reduce the gender gaps in pension savings. Increasing female pension savings is important also because women have a higher life expectancy.

Older workers can remain active for a longer period resulting from changes which occurred in recent decades such as increases in living standards, a relative decrease in the quantity of poorly educated individuals who tend to retire early and less physical labor compared to convenient jobs in the services sector. These aged workers might, however, be less able to continue working because, among other reasons, deterioration in their health, but also because they are sometimes considered to be less productive than young workers. Furthermore, they have a higher chance of losing their job, and they also face more difficulties in finding new employment relative to younger workers. This is especially true for workers with a low education level. Women are more likely to be forced to exit the labor force before being eligible for receiving transfer payments for the elderly. Raising this age of eligibility will most likely bring about an increase in the average female retiring age; however, it can also cause many women to live without an elderly stipend for more years until they are eligible.

*7. Changing policies regarding the exemption from military service given to full time rabbinical students whose learning is their profession. Specifically, cancelling the stipulation which conditions receiving an exemption on studying in a program that does not enable full integration in the labor market.*

- The minister of education signed a bill which cuts the number of weekly hours required for full time rabbinical students to get a government stipend from 35 to

only 18 hours.<sup>44</sup> This bill enables full time rabbinical students who are not gainfully employed to partially integrate in the labor market while still receiving the appropriate share of the stipend. This amendment will allow ultra-Orthodox Jews who study in a biblical institute for half of the week to receive entitlement payments for their studies, while being employed when they are not in school.

- A plan determining the number of ultra-Orthodox Jews that will be drafted to serve in the IDF and the civil service in upcoming years has been confirmed on January, 2011.<sup>45</sup> The number of serving ultra-Orthodox Jews is expected to double within the next five years. According to a draft of the ministry's decision on the topic, 2,400 rabbinical students will be recruited in 2011, half of which will be drafted to the IDF, and the rest will perform civil service. One year later, their number will increase to 3,000. In the years 2013, 2014, and 2015, the projected numbers of ultra-Orthodox Jews drafted to the IDF and to the civil service are 3,600, 4,200, and 4,800, respectively. Currently there are two programs for recruiting ultra-Orthodox Jews: the first program is "Shahar" (Dawn) – integration of ultra-Orthodox Jews, and the second one is Stage B – boot camp and shortened military service. The decision aims at encouraging their integration in the labor market, and therefore a program which will support the integration of ultra-Orthodox Jews who engaged in military or civil service when they complete their duties will be formulated.

**Cost:** Military service by ultra-Orthodox Jews is more costly compared to other sectors in the population. Most ultra-Orthodox Jewish soldiers have families, and are therefore eligible for monthly transfer payments of roughly 4,000 NIS.<sup>46</sup> Moreover, there are additional costs relating to forming a separate service environment, and to providing unique religious services such as special kosher food.

The IDF will receive a monthly budgetary compensation of 5,370 NIS for every ultra-Orthodox Jewish soldier, covering expenses on special kosher food and transfer payments. This decision tries to enable the IDF to substantially increase the number of serving ultra-Orthodox Jews without impeding its other activities. The IDF will receive a yearly cost refund of 50-80 million NIS (starting 2011) for recruiting

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<sup>44</sup> The department of Spokesmanship in the Ministry of Education. April 2011.

<sup>45</sup> Government decision no. 2698: Promoting Military and Civil Service in the ultra-Orthodox Jewish Sector. January 2010.

<sup>46</sup> Taken from clarifications of section 4 in government decision no. 2698.

soldiers to the Shahar and Stage B programs. Additionally, the IDF will receive one lump sum 15 million NIS payment for accepting young ultra-Orthodox Jews to its ranks.

**Socioeconomic effects:** Compulsory military service constitutes an obstacle for ultra-Orthodox Jews in terms of labor market integration since their exemption from serving is conditional on enrolling in a biblical studies institute, which prevents them from integrating in the labor market. The employment rate among ultra-Orthodox Jewish males is currently lower than 40%, while the rate of recipients of government stipends is high.<sup>47</sup>

It is highly important to integrate ultra-Orthodox Jews in the labor market since their share in the population is constantly growing. Cancelling the conditioning of military service exemption on biblical studies which does not enable full labor market integration is expected to increase employment rates in the ultra-Orthodox Jewish sector. Labor market integration at an early age will assist in increasing their likelihood of acquiring appropriate professional skills.

8. *Implementing nationwide coverage of the negative income tax program and increasing the tax benefit rates, emphasizing families with many children. Financing of these changes should be financed by reducing transfer payments for families with many children which are electively unemployed, and freezing the minimum wage at its current level.*<sup>48</sup> *Another recommendation is to reduce the tax benefits given to working mothers, allocating these resources to low income families.*

The negative income tax program has initially been implemented in 2008. This program grants tax benefits in the form of an income grant to salaried employees earning low wages in areas where the Orot Lataasuka (Lights for Employment) program is in effect (Jerusalem, Ashkelon, Sderot, Hadera, Netanya, and Nazareth). Since 2010, the income grant includes working mothers to children whose age is up to two years nationwide. The Orot Lataasuka program has been dismissed in May,

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<sup>47</sup> Taken from a Ministry of ITL press release regarding labor market integration of ultra-Orthodox Jews.

<sup>48</sup> When the OECD report was published, the minimum wage was set to be 47.5% of the average salary according to the Minimum Wage Law. The report includes a recommendation to reduce this ratio by keeping minimum wage at its current level.

resulting in the cancelling of income grants for the rest of the year (except for mothers of children whose age is up to two years). The average income grant has fallen by two thirds and the number of recipients has decreased by a third in 2010.<sup>49</sup> The income grant will be applied nationwide in 2012 bas on earnings from 2011.

The income grant is indented for salaried and independent employees whose monthly income ranges between 1,920 and 6,237 NIS (including salaries, business profits, transfer payments, alimony, and interest on savings) who have at least one child under the age of 18. Additional characteristics for being eligible to receive the negative income tax include age, joint household income, family relationship with the employer, number of children, and others. The OECD recommends conditioning government child stipend on employment, however, there has been no change to the eligibility requirements for receive child stipends, on the contrary, these stipends have increased by 1.5 billion NIS in 2010.<sup>50</sup>

**Cost:** An estimation of the cost of nationwide implementation of the negative income tax law is presented in a publication of the research team who follows the application of the law.<sup>51</sup> Based on data from the tax authority and an income survey, the number of individuals who are eligible for receiving negative income tax ranges between 389,000 and 464,000. The budgetary cost of nationwide coverage is estimated to be 393 million NIS, assuming that the rate of those who fulfill their eligibility out of all eligible individuals is identical to that in the first year of implementation of the law. This estimate is slightly lower than the Ministry of Finance's estimate, which is 550 million NIS for the years 2011-2012.<sup>52</sup>

In 2010, 131 million NIS were paid to the 45% of eligible individuals who have fulfilled their eligibility (based on earnings from 2009), the average grant was 2820

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<sup>49</sup> Taken from "A Survey of Economic Developments in Recent Months", Bank of Israel, June 2011.

<sup>50</sup> Taken from a document published by the prime minister's office: "Two Years of the Current Government, Discussing the Facts" - a survey of actions taken by the Ministry of Finance. March 2011.

<sup>51</sup> "Negative Income Tax, Results from the First Year of Enactment", presented by the research team which follows the implementation of the negative income tax law (Bank of Israel, the Brookdale Institute, the Tax Authority, and the National Insurance Institute of Israel). June 2010.

<sup>52</sup> Taken from a document published by the prime minister's office: "Two Years of the Current Government, Discussing the Facts", a survey of actions taken by the Ministry of Finance. March 2011.

NIS in 2010. Most grants (65%) were paid to the weakened sectors in the population – Arabs, immigrants, and ultra-Orthodox Jews.<sup>53</sup>

**Socioeconomic effects:** In its first year, the negative income tax program reduced poverty rates among workers by 4.54%, in addition to a decrease in the depth of poverty. Evidence has been found for increases in the welfare of stipend recipients, which mostly belong to population sectors that do not receive transfer payments.<sup>54</sup> However, cancelling the income grant in the second half of this year will reduce the positive effects of the program. According to the Bank of Israel, "The inconsistency in the implementation of the law will harm its credibility among eligible recipients, who come from a poorly educated low skilled segment of the population. As a result, fulfillment rates among eligible individuals will decline in the future, and the positive effects of the law on the behavior of weaker segments in the labor market will be postponed".<sup>55</sup>

Implementation of the OECD recommendation to increase the level of the grant is expected to significantly enhance the effect of the program on poverty rates. For example, a 44% increase in the level of the grant can reduce poverty rates among eligible individuals by roughly 10% (nationwide).<sup>56</sup> However, as stated in the most recent Bank of Israel report, "The negative income tax encourages labor market integration with no cost to the employer, but it does not equip workers who have a hard time integrating into the labor market with tools to increase their future productivity, and therefore the program is merely a partial solution".<sup>57</sup>

*9. Accelerated development of infrastructure (roads and public transportation) in peripheral and Arab communities.*

There are three main projects regarding the development of transportation in Israel:

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<sup>53</sup> Taken from "A Survey of Economic Developments in Recent Months", Bank of Israel. June 2011.

<sup>54</sup> "Negative Income Tax, Results from the First year of enactment", presented by the research team which follows the implementation of the negative income tax law (Bank of Israel, the Brookdale Institute, the Tax Authority, and the National Insurance Institute of Israel). June 2010.

<sup>55</sup> Taken from "A Survey of Economic Developments in Recent Months", Bank of Israel, June 2011.

<sup>56</sup> Ibid.

<sup>57</sup> Chapter 5 in the Bank of Israel 2010 yearly report – "The Labor Market". Jerusalem, 2010.

- Establishing a national authority for the administration of public transportation, which will be responsible to operate all public transportation services in Israel.<sup>58</sup> In the first stage, "metropolitan" authorities will be established: authorities that will administer public transportation within metropolitan areas. A national authority administering all public transportation services in Israel will be established in the second stage.
- The Netivei Israel (Routes of Israel) program<sup>59</sup>: A 27.5 billion NIS program which will take place over the next decade. Under this program, a continental inter-city transportation infrastructure will be laid out, connecting Kiryat Shmona and Nahariya in the north to Mashabei Sadeh and Eilat in the south, in attempt to populate the Negev and Galilee areas. The infrastructure will include length paths of main rails and roads and several width axes as well. The program includes developing a road network in the north, building railroad tracks to Karmiel, Afula, and Beit She'an, electrification of the train system, purchasing mobile train equipment, a southern continuation to route 6 (Hotze Israel), and promoting the planning of additional projects.
- Reform of bus routes in Dan metropolitan area: The rate of public transportation users has been diminishing in recent years, and individuals who do still use public transportation do so because they do not have a driver's license or a car, and not in order to save time or money.<sup>60</sup> The reform will be in effect starting July 1, 2011 and will foster a ticket which will enable unrestricted pass between routes and bus companies. 2,000 stewards will accompany transit users and provide information during four days prior to the reform implementation and five days after its initiation.

**Cost:** The Ministry of Transportation will allocate 375 million NIS to the Tel Aviv metropolitan area for the years 2011-2012. This sum is provided, among other uses, for planning the public transportation array, establishing main station, and reorganizing public transportation in the Tel Aviv metropolitan area. 939 million NIS

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<sup>58</sup> Taken from an announcement by the executive of the Ministry of Transportation, Dan Harel. February, 2011.

<sup>59</sup> Government decision no. 1421: "Netivei Israel – a Transport Program for Developing the Negev and Galilee areas". February, 2010.

<sup>60</sup> Taken from a press release by the economy committee of the Knesset: changes in Dan routes. May 2010. Notice that the word "Dan" refers both to the Tel Aviv metropolitan area (usually called "Gush Dan") and to the bus company which operates in this area.

are allocated to the transportation system in Jerusalem. 474 million NIS are allocated to nationwide transportation, mainly in Nazareth, the Sharon area, Be'er Sheva, Netanya, and the greater Haifa area. The budget of the Ministry of the Interior includes 6.3 million NIS for the national infrastructure planning committee.<sup>61</sup> The expected yearly investment in the Dan metropolitan area is roughly 200 million NIS.

*10. Implementation of the Goldberg Committee recommendations (formal recognition of Bedouin towns and villages and development of water and sewage infrastructures in these areas)*

- The Goldberg Committee has been established following a dispute over Bedouin settlement in the Negev. In 2008, 62,487 Bedouins were living in unrecognized villages in the Negev. In the same period, there were roughly 50,000 illegal buildings in the Negev in addition to the unrecognized villages. The committee called for legally recognizing most of these settlements, and defining illegal structures which do not harm the implementation of state building plans as "grey buildings", a definition which enables their legal integration into state master plans and connecting them to infrastructures.<sup>62</sup>
- The prime minister's office has outlined several tasks for regularizing Bedouin settlements in the Negev: formalizing the implementation layout of the Goldberg Committee, preparing for the execution of the implementation layout, making plans for enhancing economic growth and development of the Bedouin population in the Negev, and promoting comprehensive consulting with the Bedouin population in the Negev.<sup>63</sup>
- The Goldberg Committee's implementation team has suggested a layout for the regularization of Bedouin settlements in the Negev, solving the dispute over land ownership in the Negev, and encouraging economic growth and development of the Negev population.<sup>64</sup>

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<sup>61</sup> Taken from the government's budget for the years 2011-2012.

<sup>62</sup> The Goldberg Committee's report regarding the regularization of Bedouin settlements in the Negev. May 2011.

<sup>63</sup> Taken from the government's offices working plan for 2011.

<sup>64</sup> Implementation recommendations of the Goldberg Committee report for the regularization of Bedouin settlements in the Negev. May, 2011.



**Cost:** Even though the government's working plan classifies regularization of Bedouin settlements in the Negev as an objective for the prime minister's office, it appears as the Ministry of Housing and Construction's responsibility in the government budget with only 5,775,000 NIS allocated for this issue. Additionally, the Ministry of Housing and Construction's budget includes additional clauses relating to this topic. These include: infrastructure for new buildings for the Bedouins in the south (roughly 400 million NIS), development of the existing Bedouin infrastructure (roughly 3 million NIS), completion of the development of Bedouin towns and villages (roughly 4 million NIS), erection of public institutions for Bedouins in these areas (roughly 2 million NIS). The Ministry of Finance estimates that total cost for regularizing Bedouin settlements in the Negev amounts to billions of NIS (a more precise estimate has not been carried out).<sup>65</sup>

*11. Application of mandatory reporting of workforce structure in large firms, and extending the activity of the "Commissionership of Equal Opportunity in the Labor Market" which will run estimates and submit recommendations regarding the integration successfulness of the entire population in the labor market.*

The commissionership has been established in 2008 as an independent unit in the Ministry of ITL responsible for enforcing the equal opportunities in the labor market law and other laws regarding this topic. Former minister Binyamin Ben-Eliezer has classified the commissionership as an independent authority, which has extended its organizational structure by increasing its budget and its number of employees from nine to thirty three.

**Cost:** 744,000 NIS are allocated to operating the commissionership, taken from the budget of the Ministry of ITL

*12. Taking steps towards improving the levels of education and professional training in the Bedouin sector.*

One of the objectives for the upcoming year, as stated in the Ministry of ITL's 2011 working plan, is increasing employment among population segments with low labor

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<sup>65</sup> Taken from a document published by the prime minister's office: "Two Years of the Current Government, Discussing the Facts", a survey of actions taken by the Ministry of Finance. March 2011.

force participation rates. Several means of achieving this goal have been referred to, including professional training of Bedouins, similar to professional training of special population segments, and operating a program for admission of Bedouins to professional training GITTS colleges (Government Institute for Training in Technology and Science).

**Cost:** 8,232,000 NIS are allocated to professional training for all special population segments, and the governmental training centers (including GITTS colleges) receive a total budget of 9,463,000 NIS. There is, however, no specific information regarding the cost of programs for Bedouins.

*13. Preferring foreign wage earners proceeding from neighboring countries, such as residents of the Palestinian Authority (PA), over workers from more distant countries.*

The number of non-Israeli workers in the Israeli economy has grown in moderate rates during the past year, reaching 60,000 workers, following additional increases in previous years. This increase is mainly a result of the Ministry of Defense's policy of raising the number of working permits granted to Palestinians who reside in the West Bank. In the beginning of 2011, the economic cabinet has decided to add 5,000 permits for such workers, and the contractors' union aims at substantially increasing the number of permits granted to Palestinians and other foreign nationals.

The estimated number of foreign workers has remained stable at roughly 210,000 and the rate of non-Israeli workers in the commercial sector has been 12% in 2010, as it has been in 2008 and 2009.<sup>66</sup> According to data from the Ministry of the Interior, roughly 14,000 infiltrators have been caught during 2010, and the number of infiltrators who have been registered as residing in Israel in January 2011 was 34,000. These infiltrators supposedly increase the number of foreign workers in the economy by 10%. Following the recommendations of the committee for examination of labor policy in Israel, an inter-ministerial team headed by the deputy governor of the Bank of Israel has been formed, aiming at regularizing, enforcing, and supervising the employment of Palestinians and Jordanians.

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<sup>66</sup> This estimate from CBS data does not include border infiltrators, mostly arriving from Sudan and Eritrea via the Egyptian border.

**Socioeconomic effects:** Employing Palestinians has advantages over employing other foreign nationals. Palestinians who reside in the occupied territories do not relocate to Israel, and they are not bound to their employers by high labor mediation fees paid to human resource companies. Wages of Palestinian workers are higher than those of other foreign nationals, but their employment reduces employment rates among Israeli Arabs. The employment of Palestinians in Israel bears extensive political consequences since while the Palestinian economy is positively affected; it becomes more dependent on the Israeli economy.

*14. Toughening the requirements for employing foreign labor and conditioning such employment on local labor examination, invalidating employing permits of employers who fail to provide minimal adequate working conditions for their foreign workers, and invalidating permits of firms who refuse to hire local workers.*

- In January 2010, the tax which employers bear for hiring foreign workers has been raised to 20% of the labor income paid to these foreign workers.<sup>67</sup> The corresponding tax in the agriculture sector is kept at 10%, and in the construction sector the tax will be 15%.

The tax in the restaurant and food catering industries will gradually increase: 10.75% in fiscal year 2010, 13.75% in fiscal year 2011, and 15% in fiscal year 2012 and onwards. Incomes of the following employees are exempt from taxation: Palestinians residing in the West Bank and the Gaza strip, citizens of neighboring countries who return to their country at the end of every working day, and foreign workers in the caregiving industry.

- There have been other acts whose goal is to regularize the employment of foreign workers in Israel, and to limit their numbers.<sup>68</sup> These acts include: stronger enforcement of labor laws regarding unlawful employers of foreign wage earners and streamlining this enforcement, reducing the number of foreign residents,

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<sup>67</sup> According to the law governing the plan for recuperation of the Israeli economy.

<sup>68</sup> Government decision no.1274 regarding government policy with respect to foreign workers. January, 2010.

deporting illegal residents and workers (in particular, restricting the granting of working permits and legal status for those who illegally reside in Israel), restricting the employment industries and the locations in which foreign wage earners may be employed as caregivers, and examining the employment of Palestinian and Jordanian workers in Israel.

- Starting January 1, 2011, the department of labor laws enforcement will ensure that foreign workers receive their full workers' rights according to Israeli labor laws and employers who will fail to comply with labor laws will be prosecuted or heavily fined.<sup>69</sup>
- In February, 2011, the Administration of Border Crossings, Population, and Immigration will initiate a comprehensive operation for identifying unlawful employers of unpermitted foreign workers in various occupations such as babysitting, household chores, construction and housing renovation. Additionally, the operation will include locating employers of permitted foreign workers who do not adhere to the law regarding adequate working conditions. While the enforcement operation takes place, the administration will run a campaign regarding the prohibition of employing foreign workers without the appropriate permits.

On October 24, 2010, government decision no. 1274 regarding foreign workers policy has been adopted, and its main clauses are as follows:

- Obliging employers to transfer foreign workers salaries into a bank account under the worker's name. Employment permits will be taken away from employers who have been caught employing foreign workers without legal status.
- Deporting and reducing the number of illegal residents and of illegal foreign workers. The means for achieving this end include: determining the occupations in which permitted foreign workers may work, authorizing inspectors of the Administration of Border Crossings, Population, and Immigration to apply for court warrants which will enable them to enter private homes if they suspect that violation of the foreign wage earners law is taking place in these houses.

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<sup>69</sup> Taken from a press release by the Ministry of ITL.  
<http://www.tamas.gov.il/NR/exeres/3A714A6B-5840-41EA-A9C1-9589F1CC4DE5.htm>.

- Weakening the incentive for importing foreign labor, and enforcing illegal charging of mediation fees by implementing new employment methods in the agriculture and caregiving industries.
- Following and supervising government decisions regarding foreign wage earners using data updating by the immigration authority, and informing ministers and other professionals in governments offices of these updates. A discussion on the implementation of government decision by the ministers committee for regulation of foreign labor will take place every quarter.

**Cost:** The entry and exit of foreign nationals is under the supervision of the Administration of Border Crossings, Population, and Immigration in the Ministry of the Interior. Roughly 86 million NIS out of the current budget are allocated to the enforcement department, out of which 8,353,000 NIS are destined for treating banished individuals. The budget of the Department of Publicity and Information is 792,000 NIS.

**Socioeconomic effects:** Foreign wage earners are willing to supply labor for a lower wage than local workers, which leads to a decrease in employment rates and wages of unskilled workers, and an increase in inequality in the economy. Toughening the requirements for employing foreign wage earners is expected to increase employment rates among local workers, and it will also solve the decline in wages and the increase in inequality. Maintaining foreign wage earners rights is expected to decrease the demand for their labor, and increase the demand for local workers correspondingly. Data provided to the tax authorities and the National Insurance Institute of Israel have demonstrated a link between entry of foreign workers to a certain industry and decreases in the employment of Israelis in this industry.<sup>70</sup> These claims are validated by a statement given by the deputy governor of the Bank of Israel in 2010: "The significant decrease in the quantity of foreign wage earners in the construction sector workers goes hand in hand with a dramatic increase in the number of Israeli workers, including 'wet' jobs, and with the industrialization of this sector. The exit of foreign wage earners from the construction sector has significantly increased the wages of Israeli workers, thereby contributing to entry of Israeli workers and to the

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<sup>70</sup> "Treatment of Mediation Fees Collection from Illegal Workers". The Knesset's research and information center. January, 2011.

industrialization of the sector."<sup>71</sup> However Israeli wage earners are still reluctant to join the construction as well as the agricultural sector.

In addition to lower employment costs, and as a result of a real decrease in consumer prices, foreign wage earners have long term positive impacts on the labor market. For example, it is reasonable to anticipate an increase in the employment status and wages of Israeli workers in sectors where there is an extensive use of foreign labor, as it was the case with the entry of Palestinian workers since 1967.

*15. Reducing commissions charged by mediating firms who recruit foreign workers using, among other methods. Bilateral foreign human resource recruiting agreements.*

Charging mediation fees from foreign wage earners for job placement services by human resource agencies has been outlawed. Despite the illegality of such conduct, foreign workers are still being charged mediation fees ranging from an average of 8,000 USD for caregivers to an average of 30,000 USD for Chinese construction laborers.<sup>72</sup>

The 2003 report issued by the state comptroller discussed the mediation fees issue: "Foreign wage earners pay, in some countries, amounts ranging between 3,000 and 10,000 USD for working in Israel. This amount is divided between human resource firms in their country of origin and human resource mediators in Israel."

The Administration of Border Crossings, Population, and Immigration is promoting agreements with foreign workers countries of origin in attempt to reduce the scale of the mediation fees phenomenon. As of January 2011 the administration is acting towards implementation of the agreement with the Thai government regarding supervision of foreign workers recruitment, with assistance from the International Labor Organization. So far, only one arrangement has been agreed upon - the agreement with Sri Lanka to bring 300 seasonal agriculture laborers.<sup>73</sup> It should also be noted that reaching bilateral agreements regarding importing foreign workers has been declared a national target in government decision no. 1274 from January 2010.

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<sup>71</sup> Taken from a press release of the Bank of Israel: "A Summary of Prof. Eckstein's Speech at the Foreign Workers Knesset Committee." June, 2010.

<sup>72</sup> "Treatment of Mediation Fees Collection from Illegal Workers". The Knesset's research and information center. January, 2011.

<sup>73</sup> Ibid.

**Socioeconomic effects:** The inter-ministerial committee concerning foreign workers and the Immigration Authority have described the situation in the market of foreign labor as follows: "Granting free permits at a quantity that does not meet the demand, and the mediations firms obvious economic incentive to import additional foreign labor to Israel lead to phenomena such as corruption, bribery and even slave trade." The option of charging commissions from foreign workers for providing work permits creates an incentive for filing more applications for permits than what is needed and trading them for profit.

It is reasonable to expect that weakening the incentive for foreign labor recruitment will reduce foreign wage earners imports and will increase the period of employment of the existing workers. Such incentive weakening may have social consequences since longer stay of foreign workers will most likely lower the chances of them returning back to their countries of origin in the future. Lowering the commissions is also expected to reduce the cost of employing foreign workers, and harm the competitiveness of the local unskilled labor force

## **OECD Recommendations Untreated by the Government**

We have heretofore described the recommendations which appeared in the OECD report on Israel for which we found government actions and effective programs that may promote the content of the recommendations. We found six recommendations which have not been addressed by concrete policy measures:

16. Increasing employment rates and strengthening incentives for employment among workers whose transfer payments eligibility is conditional on their participation in a labor market integration program.
17. More effective supervision of pension savings and stronger enforcement among employers who fail to comply with the existing pension laws.
18. Supervision of transfer payments to disabled individuals and encouragement of their labor market integration.
19. Increasing the representation of the Arab minority in the public sector, stricter monitoring of the job quota for the Ethiopian and Arab minorities in the public sector, and granting preference in government auctions to firms who maintain equal and fair employment to all segments of the population.
20. Establishing a mechanism which will grant permanent stay permits to foreign workers, similar to other OECD member countries, either by changing immigration statuses from temporary to permanent or according to ongoing labor market shortages. Another recommendation is to regularize immigration channels and determining a clear immigration policy.
21. Modification of the requirements for receiving unemployment insurance and removal of the vehicle ownership criterion for eligibility.



## Summarizing Table - OECD Recommendations for Israel and their Estimated Budgetary Cost versus the Effective Expenditures in the Government Budget

<i>Recommendation</i>	<i>Estimated cost in NIS</i>	<i>Budgetary expenditure in NIS (2011)</i>	<i>Difference</i>
<b>1. Effective enforcement of employment laws</b>			
1.1 Increasing the number of employment laws inspectors	27,235,200 <sup>74</sup>	3,303,000	23,932,200
1.2 Regularization and enforcement of employment laws		6,116,000	
1.3 Supporting public institutions who provide information and assistance for workers regarding their rights	3,200,000 <sup>75</sup>	1,000,000	2,200,000
<b>2. Extending active policymaking in the labor market</b>			
2.1 subsidizing daycare	2,136.7 million <sup>76</sup>	929,000,000	1,207 million
2.2 Raising the minimum wage <sup>78</sup>	135-137 million <sup>77</sup>		
2.3 Nationwide implementation of the Wisconsin Program	100 million <sup>79</sup>	20,426,000	979,574,000

<sup>74</sup> Compared to the global standard of one inspector per 10,000 jobs.

<sup>75</sup> Including the cost of full matching of contribution (based on the 2008 financial report) to the Kav Laoved (Line for the Worker), and adding 30% of the funds for similar voluntary associations.

<sup>76</sup> Compared to the average expenditure on daycare relative to GDP in OECD member countries. Taken from "Daycare subsidization policy: Israel in an international comparison." Merav Peretz, Na'amat Organization.

<sup>77</sup> This is the addition to the 2011 budget for the increase in wages following the update to the salaries of government employees and workers of firms and organizations which are funded by contractors firms. Sources: 1) "A Survey of economic developments in recent months", Bank of Israel, June 2011. 2) Draft of the minimum wage law, 2011. 3) Edited by the Macro Center for Political Economics.

<sup>78</sup> Contrasting the OECD recommendation of keeping the minimum wage at its current level.

<sup>79</sup> One time expenditures on establishing employment centers under the revised Wisconsin Program. Analysis of the 2011-2012 government budget proposal by the Macro Center for Political Economics.

<i>Recommendation</i>	<i>Estimated cost in NIS</i>	<i>Budgetary expenditure in NIS (2011)</i>	<i>Difference</i>
<b>3. Removing labor market barriers for minority groups by investing in education</b>			
3.1 Reducing the number pupil per classroom ratio	5.7-9.3 billion <sup>80</sup>	206,425,000	5.49-9.09 billion
3.2 Implementing the "Ofek Hadash" and "Oz Latmura" reforms		520,000,000	
3.3 Enacting a long study day law	1 billion <sup>82</sup>	0 <sup>81</sup>	1 billion
3.4 Raising the rate of Bagrut (matriculation) holders		13,265,000	
3.5 Teaching core classes in ultra-Orthodox Jewish schools		19,000,000	
3.6 Building classrooms, with higher priority given to peripheral schools		130 million <sup>83</sup>	
4. Government participation in pension payments for the bottom income deciles <sup>85</sup>	1.2 billion <sup>84</sup>		
5. Gradual equalization of standard retirement age across the sexes at 67.			
6. Changing policies regarding the exemption from military service given to ultra-Orthodox Jews and encouraging their integration in the IDF		50-80 million yearly	
7. Nationwide implementation of the	393-550	550 million <sup>86</sup>	157 million

<sup>80</sup> Beles, N. "Lowering Classroom Size – Budgetary and Educational Implications." March 2008.

<sup>81</sup> Not including a 20 million NIS increase to the budget of the Ministry of Education for boarding schools.

<sup>82</sup> Taken from the 2011-2012 government budgets. Edited by the Macro Center for Political Economics.

<sup>83</sup> Taken from a document published by the prime minister's office: "Two Years of the Current Government, Discussing the Facts", a survey of actions taken by the Ministry of Finance. March 2011.

<sup>84</sup> Brander, A. "The first year of the mandatory pension arrangement: the adhering to the arrangement and potential consequences on labor supply". Working paper series, Bank of Israel, May 2011.

<sup>85</sup> Full coverage of deposits made by workers from the bottom five income deciles.

<i>Recommendation</i>	<i>Estimated cost in NIS</i>	<i>Budgetary expenditure in NIS (2011)</i>	<i>Difference</i>
negative income tax program	million <sup>87</sup>		
<b>8. Accelerating infrastructure development</b>			
8.1 The Netivei Israel program	2.75 billion	1.13	1.62 billion <sup>88</sup>
8.2 Reforming bus routes in Gush Dan		200 million <sup>89</sup>	
8.2 public transportation in the Tel Aviv metropolitan area		375 million	
8.3 A system of transit to Jerusalem		939 million	
8.4 Public transportation <sup>90</sup>		474 million	
8.5 National infrastructure planning committee		6.3 million	
9.a Implementing the conclusion of the Goldberg Committee <sup>91</sup>		413,775,000	
9.b Applying the program of regularizing Bedouin settlement in the Negev	Billions <sup>92</sup>		
10.f Activities of the Commission for Equal Employment Opportunities		744,000	
<b>11. Adopting policy measures for improvement in the levels of education and professional training in the Bedouin sector.</b>			
11.1 Professional training for the		8,232,000	

<sup>86</sup> Taken from a document published by the prime minister's office: "Two Years of the Current Government, Discussing the Facts", a survey of actions taken by the Ministry of Finance. March 2011.

<sup>87</sup> "Negative Income Tax, Results from the First year of enactment", presented by the research team which follows the implementation of the negative income tax law (Bank of Israel, the Brookdale Institute, the Tax Authority, and the National Insurance Institute of Israel). June 2010.

<sup>88</sup> Yearly cost out of the total cost which will be spread over a decade.

<sup>89</sup> Expected yearly investment.

<sup>90</sup> Includes, among others, planning a transit system in Nazareth, the Sharon area, Be'er Sheva, Netanya, Haifa, and the Carmel area.

<sup>91</sup> The required budget will be allocated towards the following: regularization of Bedouin settlements in the Negev, infrastructure for new construction for Bedouins in the south, development of infrastructure for the Bedouin population, completion of development in Bedouin towns and villages, public institutions in Bedouin towns and villages in the south.

<sup>92</sup> Taken from a document published by the prime minister's office: "Two Years of the Current Government, Discussing the Facts", a survey of actions taken by the Ministry of Finance. March 2011.

<i>Recommendation</i>	<i>Estimated cost in NIS</i>	<i>Budgetary expenditure in NIS (2011)</i>	<i>Difference</i>
entire Bedouin population			
11.2 Government auctions for professional training <sup>93</sup>		9,463,000	
<b>Total</b>			<b>7.4-11.4 billion<sup>94</sup></b>

Implementation of all OECD recommendations entails several thorough structural reforms and an investment of tens of billions of NIS. Employment rates are nowadays constantly increasing, and the demand for labor is high. These are convenient conditions for a further increase in employment rates and a decrease in the poverty rate. These conditions can be used to continue encouraging employment by applying aggressive enforcement of labor laws (including the minimum wage law), and further investment in removal of barriers for labor market integration (for example, increasing daycare subsidies). According to our estimates, the cost of these actions is approximately ranging between 1.5 and 2 billion NIS.

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<sup>93</sup> Including GITTs which will administer a professional training program for Bedouins.

<sup>94</sup> Excluding the costs of implementing the Goldberg Committee recommendations, which ranges between six and eight billion NIS, and the Netivei Israel program.



# Conclusions

In this paper we have examined the actions carried out by the Israeli government towards implementation of the OECD recommendations, which have been published in January 2010. The recommendations for which we found that some action was taken by the government can be divided into several main topics:

## **The Labor Market**

The government used various means of extending employment in the past year; however, we found that these are merely partial solutions. For example, consider the enforcement of labor laws. The amount of personnel who engage in enforcement of labor laws has increased, but it is still significantly lower than the world standard.

The labor market participation rate has increased since 2007 by roughly 0.8%, where the male and female participation rates have increase by 1.4% and 0.2% respectively. The budget of the Department for Female Employment increased significantly in recent years, however, the investment in the Professional Training Department has decreased, and investment in the Employment Service has remained unchanged.

Nationwide implementation of negative income tax and the Wisconsin Program, and an increase in the minimum wage are planned in attempt to increase the labor force participation rate. At the moment, however, nationwide implementation of the Wisconsin Program in the near future is doubtful. The aforementioned programs provide incentives to enter the labor market; however, raising the minimum wage weakens employer's incentive to hire workers. Therefore, the OECD recommends financing the negative income tax by freezing the minimum wage at its current level.

Pension savings are also mentioned in the OECD report, whereby it is recommended that the Israeli government will contributes to pension payments for the bottom income deciles. This policy measure is currently being examined by the Ministry of Finance. Moreover, also gradually increasing the female retiring rate, equating it to that of men (67) is being considered. The current female retiring rate is expected to increase to 64; however, a further increase is doubtful.

## **The Labor Market - Unique Population Segments**

The labor force participation rates among ultra-Orthodox Jews is exhibiting an increasing trend in recent years, however, it is still very low compared to the entire population. The OECD recommends accelerating the labor market integration of ultra-Orthodox Jews by changing the criteria for receiving an exemption from military service so that they will not be prevented from entering the labor market. According to a recent government decision, the number of hours which ultra-Orthodox Jews must study for being eligible for a Yeshiva student stipend will be decreased, which will enable them to dedicate more time for working. The OECD advises conditioning eligibility for transfer payment for families with many children on employment; however, these transfer payments have increase by 1.5 billion in the past year.

Bedouins are another unique population segment which has been specifically addressed by government policymaking. Running a professional training program for Bedouins at GITTS colleges and another professional training program for unique population segments are planned for this upcoming year.

## **Education**

Policies which have improved the quality of education include increasing the budget of the Ministry of Education, and initiating reform such as Ofek Hadash which increases employment hours and wages of elementary school teachers, and Oz Latmura, the counterpart of Ofek Hadash in Junior high schools and high schools. Decreasing the number of students per classroom and equalizing it nationwide is also planned, however, the portion of the budget which is dedicated for achieving this goal is very low, certainly insufficient for financing the required investment. It should be noted that public expenditure per pupil relative to output has increase in the past year, following several years where it has remained unchanged.

## **Infrastructure and Transportation**

There are three main plans regarding Infrastructure and transportation: the Netivei Israel program for development of road infrastructure, reform in Gush Dan's public

transportation system, and the establishment of a national authority which will operate public transportation.

The OECD advises to implement the conclusions of the Goldberg Committee, which has discussed the unrecognized Bedouin towns and villages in the Negev, and development of infrastructure in these areas. Some progress has been made in the past year - an outline for the regularization of Bedouin settlements in the Negev has been proposed in May 2011.

### **Foreign Wage Earners**

Three recommendations have been laid out by the OECD for this field: increasing the number of work permits for Palestinians who reside in the West Bank, toughening the employment prerequisites for other foreign nationals, and reducing mediation fees for recruitment of foreign labor. All three recommendations have been partially addressed.

### **The Poverty Rate**

The poverty rate has increased since the OECD has published its report, especially among children in households with one working parent, and among the Arab population. Nationwide application of the negative income tax will is expected to contribute to a reduction in the poverty rate.

**To conclude**, we found that actions carried out by the government are only partially synchronized with the OECD report on labor market issues. Nationwide application of the income grant law (negative income tax), an increase in the budget of the Department of Female Employment, the expected increase in the female retiring rate (if it will indeed increase), and reexamination of the mandatory pension arrangement are some of the policy measures which have been implemented by the government. However their impact is for time being quite modest. Furthermore, the increasing trend in employment rates has slightly increased recently, along with a decrease in unemployment rates. Labor force participation rates has continued to increase



(especially among women), and evidence shows that the ultra-Orthodox Jewish community is more willing to enter the labor market.

If they are fully implemented, these government actions are expected to increase employment rates, decrease income gaps (which have increased since the publication of the report), and lower poverty rates.

Despite its positive effects, government policy regarding the labor market has substantial shortcomings. The Wisconsin Program has been halted during 2010, and its nationwide implementation, which was supposed to be in effect in 2012, is unsure. The resources devoted for inspection of labor laws have only slightly increased. The negative income tax grant has suddenly been paused; harming its credibility after it has been implemented nationwide in 2011.

## **Appendix A: Nationwide Implementation of the Income Grant - Formerly the Negative Income Tax Law - and its Effect on the Poverty Rate**

The amount of individuals who are eligible for negative income tax ranges between 389,000 and 464,000, and the rate of those who actually fulfill their eligibility was roughly 45% in the three years following its inception. A simulation presented in the report monitoring the implementation of the law estimates that nationwide application of income grants will reduce the poverty rate by 4.6% (among those who fulfill their eligibility, assuming the current fulfillment rate persists), resulting in roughly 2,300 families rising above the poverty line.<sup>95</sup>

The report shows that the grant amount has to be raised significantly in order to substantially increase the impact of the program on the poverty rate. For example, increasing the grant by 44% can decrease the poverty rate among eligible individuals by roughly 10% (nationwide), implying that 4,700 families will rise above the poverty line as a result.<sup>96</sup>

### **Changes in Poverty Measures Attributed to the Income Grant among Eligible Families**

<b>45% fulfillment rate*</b>			<b>Complete fulfillment</b>	
<b>Poverty rate without the grant</b>	<b>Poverty rate with the grant</b>	<b>Change in the depth of poverty</b>	<b>Poverty rate with the grant</b>	<b>Change in the depth of poverty</b>
25.1%	23.6%	<b>-5.9%</b>	-22.0%	<b>-12.4%</b>

Source: "Negative Income Tax, Results from the First Year of Enactment." Bank of Israel and the National Insurance Institute of Israel. June 2010.

\*The rate of people entitled to an income grant who took part in the program in its first three years.

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<sup>95</sup> "Negative Income Tax, Results from the First year of enactment", presented by the research team which follows the implementation of the negative income tax law (Bank of Israel, the Brookdale Institute, the Tax Authority, and the National Insurance Institute of Israel). June 2010.

<sup>96</sup> Ibid.

The income grant's contribution to the welfare of poor individuals who are unable to escape poverty is seen by the reduction in the depth of poverty (measure by the average distance from the poverty line). The nationwide implementation of the law is estimated to decrease the depth of poverty by 5.9% under the current fulfillment rate and by 12.4% if all eligible individuals fulfill their eligibility, as shown in the following table:

**The Effect of the Income Grant on the Depth of Poverty (30% Depth and above)**

Distribution of eligible poor individuals by poverty gaps			Change attributed to the income grant	
Before the grant	Partial fulfillment (45%)	Complete fulfillment	Partial fulfillment (45%)	Complete fulfillment
35%	30%	26%	<b>-5%</b>	<b>-9%</b>

Source: "Negative Income Tax, Results from the First year of Enactment." Bank of Israel and the National Insurance Institute of Israel. June 2010.

The welfare of some poor individuals will improve by getting closer to the poverty line. For example, the nationwide weight of poor individuals whose depth of poverty exceeds 30% will decrease by roughly 5% and 9% assuming 45% fulfillment rate and complete fulfillment respectively.

## **Appendix B: The Labor Market, Government Expenditure, and Welfare - a Survey of Recent Developments<sup>97</sup>**

- The government's budget deficit has decreased from 5.3% of output in 2009 to 3.8% in 2010. The deficit decrease has increase the debt to output ratio by three percentage points, as opposed to most OECD member countries, which have significantly increased their public debt. The reduction in the debt to output ratio will contribute substantially to the stability of the economy.
- In the past year, the government has adopted a new fiscal rule which sets a higher expenditure ceiling than in the previous fiscal rule. Civil public expenditure relative to output has consequently increased in 2010, following constant increases in public expenditure in recent years.
- Transfer payments (as a fraction of output) has remained unchanged in 2010, following increases in the years 2007-2009.
- Public expenditure per student (as a fraction of output) has increased in 2010 after several years where this ratio has not changed.
- Since the publication of the OECD report, employment rates have rapidly increased, the labor force participation has risen (especially among women), and unemployment rates have decreased in 2010 to levels they were at before the financial crisis, culminating at 6%.
- Despite the rapid increase in the employment and labor force participation rates, the average wage (for salaried employees) has been decreased continuously, completing a 3% real decrease in recent years. The median wage has decrease by in real terms as well, amounting to a 1.5% decrease in the same time period.
- Since the publication of the OECD report, the poverty rate has increased, especially among children, families with one working individual, and the Arab population. The poverty rate among seniors has decreased, however, as well as among ultra-Orthodox Jews at a lesser degree.

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<sup>97</sup> Tables and figures regarding this matter are presented in this appendix.

- The Gini coefficient which measures income inequality has increased in the past year, completing an almost continuous increase in the second half of the past decade. However, the government's contribution towards inequality reduction (measured by taxes and transfer payments which decrease inequality) has slightly increased in the past year, following a constant decrease in recent years.
- The share of non-Israeli workers has remained stable, and has even decreased in the past year, following a sharp increase in the years 2007-2008.
- 12.7% out of all workers were paid less than the minimum wage in 2009, which is a low rate compared to the years 2007-2008.

## Appendix C: Tables and Figures

**Table 1: Main Labor Market Indicators for 2007-2010 (percentage)**

	2007	2008	2009	2010	Total change 2007-2010
<b>Civil labor force participation rate</b>	<b>56.6</b>	<b>56.8</b>	<b>57.0</b>	<b>57.4</b>	<b>0.8</b>
Males	62	62.2	61.8	62.2	0.2
Females	51.4	51.7	52.3	52.8	1.4
Share of foreign workers and Palestinians in the commercial sector	11.2	11.8	12.1	11.9	0.7
<b>Unemployment rate</b>	<b>7.9</b>	<b>6.5</b>	<b>7.5</b>	<b>6.5</b>	<b>1.4</b>
Male unemployment rate	6.8	5.8	7.5	6.8	0
Female unemployment rate	7.3	6.1	7.5	6.7	0.6

Source: CBS.

**Table 2: Labor Inputs in the Commercial Sector for 2008-2010, Annual Rates of Change (percentage)**

	2008	2009	2010
Israeli workers	3.6	0.1	3.1
Foreign workers	9.8	4.0	0.4
Palestinian workers	11.0	<b>-9.4</b>	2.9

Source: CBS and the 2010 Bank of Israel report.

**Table 3: Poverty Rates in Selected Population Segments**

	Individuals	Families	Children	Seniors (65+)	Arabs	Ultra-Orthodox Jews	Working families (one worker)	Working families (two worker)	Total pop. except Arabs and Ultra-Orthodox
2007/8	23.6	20.0	34.3	22.9	53.7	59.7	36.6	3.8	12.00
2008/9	24.3	20.2	35.0	22.1	53.3	60.4	36.4	4.8	13.00
2009/10	24.7	20.1	36.0	20.3	56.9	59.0	40.0	4.6	11.40
<b>Change 2007/8 – 2009/10</b>	<b>1.1</b>	<b>0.1</b>	<b>1.7</b>	<b>-2.6</b>	<b>3.2</b>	<b>-0.7</b>	<b>3.4</b>	<b>0.8</b>	<b>-0.6</b>

Source: CBS income surveys and the 2010 Bank of Israel report (based on income surveys performed in June and July).

**Table 4: Wages of Salaried Employees (Including Foreign Workers) for 2007-2010 (Annual Average)**

	In current prices	In consumer prices (January 1, 2011)
2007	7,628	8,465
2008	7,921	8,411
2009	7,974	8,156
2010	8,247	8,247
Total change 2007-2010	8%	<b>-3%</b>

Source: CBS data based on the National Insurance Institute of Israel

**Table 5: The Gini Coefficient**

	Gini coefficient (based on net income)	Contribution of taxes and transfers to lowering the Gini coefficient*
2006	0.379	24.6%
2007	0.369	25.0%
2008	0.372	24.3%
2009	0.375	23.4%
2009/10	0.379	23.5%

Source: CBS income surveys and the 2010 Bank of Israel report.

\* Calculated as the difference between the gross income Gini coefficient (before taxes and transfers) and the net Gini coefficient.

**Table 6: Indicators of the Scale of Public Services in Israel**

	Civil public expenditure relative to output*	Transfer payments relative to output	Public expenditure per student relative to output per capita
2007	31.80	15.50	0.19
2008	32.40	16.40	0.19
2009	32.80	17.00	0.19
2010	32.90	17.00	0.20
OECD average (2007)	39.30	19.30	0.23
Difference between 2007 and 2010	1.10	1.50	0.01

Source: CBS, and the OECD Fact Book – Education at a Glance. \* Not including interest payments.

**Table 7: Government Budget Deficit\* in 2007-2010 (percentage of output)**

	2007	2008	2009	2010
Government deficit ceiling	2.9	1.6	6	5.5
Effective government deficit	0.1	2	5.1	3.7
Effective deficit relative to deficit ceiling	2.8	<b>-0.4</b>	0.9	1.8

Source: The 2010 Bank of Israel report.

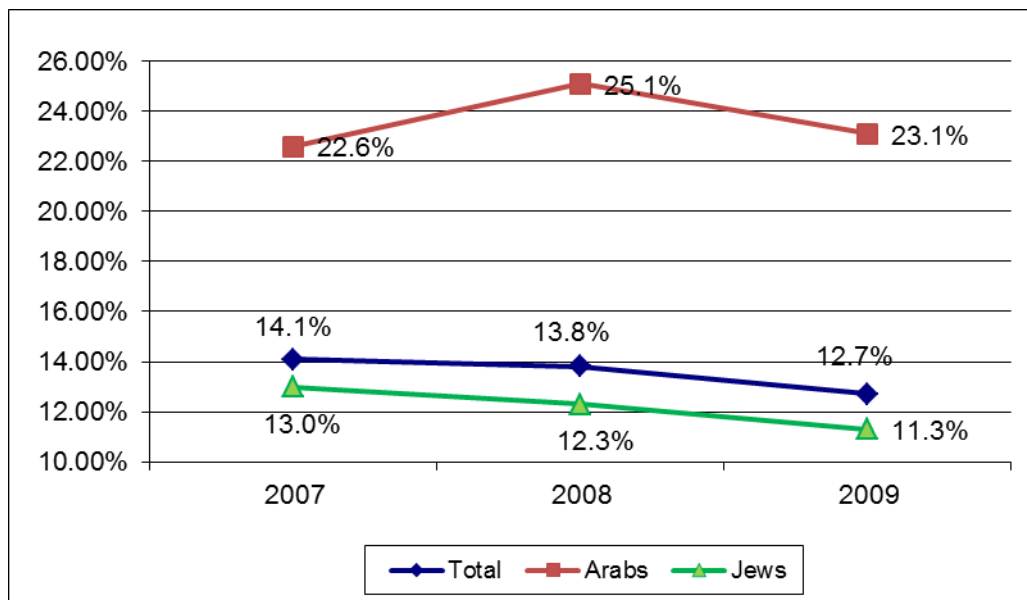
\* Excluding credit transactions.

**Table 8: Real Change in Individuals Income Per Capita in 2008/9 – 2009/10 (Expresses in Rates of Change)**

2008/9	-1.3
2009/10	0.8
2009/10 compared to 2007/8	<b>-0.51</b>

Source: CBS and the 2010 Bank of Israel report.

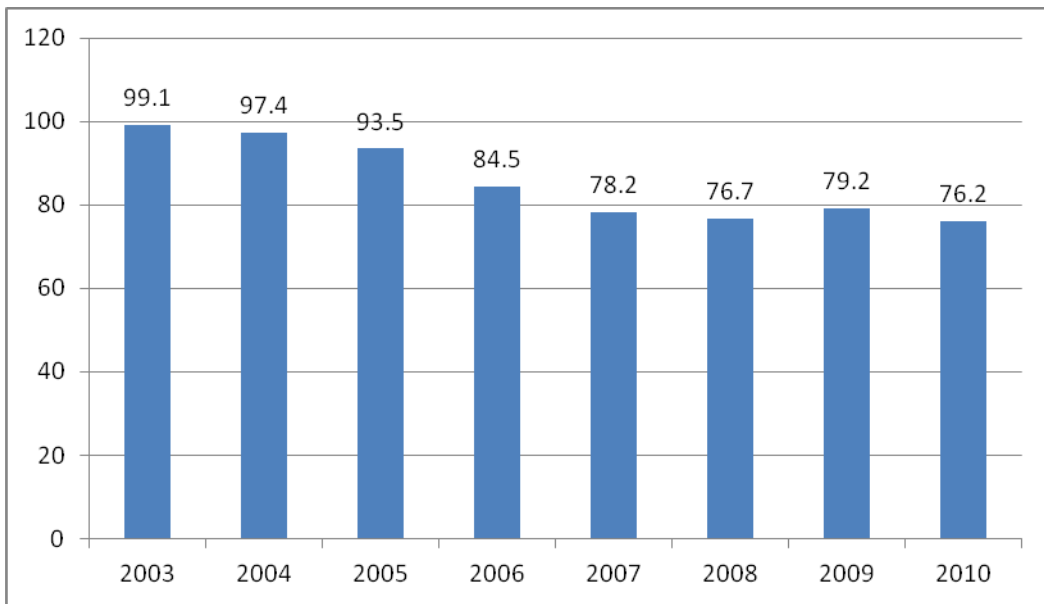
**Figure 1: Rate of Employees who are Paid Less than Minimum Wage in 2007-2009**



Source: Estimates by national insurance using the CBS income survey, by wage per working hour.



**Figure 2: Gross Public Debt in 2007-2009 (percentage of GDP)**



Source: Bank of Israel.