

## Chapter 8

# Issues in Welfare Policy

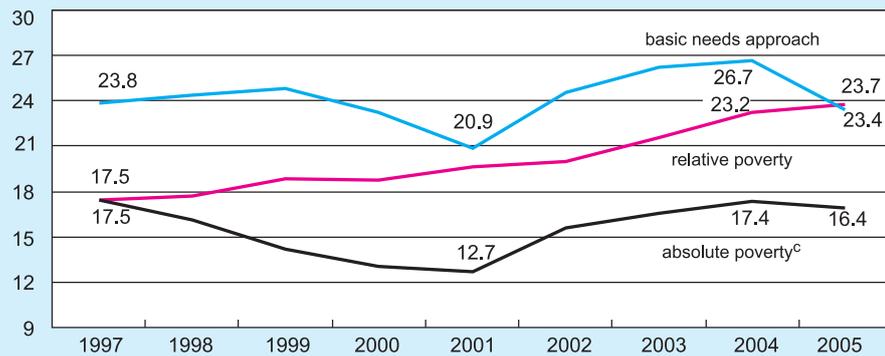
- ◆ The incidence of poverty, as measured by the relative index customarily used in Israel, rose in 2005 to a level of 24.7 percent. Some reduction in poverty was evident in 2006, however, and in the year to June 2006 it reached 24.4 percent.
- ◆ Alternative poverty indices which consider a household poor if its income is lower than that required to buy a basic basket of goods, also indicate a decline in poverty in 2005, after rising in the previous three years.
- ◆ Forty percent of the poor manage to consume more than the amount indicated by the poverty line, but the high rates of poverty prevailing for years make it difficult for the weaker sections of the population to maintain a reasonable standard of living, so that the level of consumption of sixty percent of the poor, as well as their income level, is below the poverty line.
- ◆ The incidence of poverty is high and has risen over the years among large families, those with low levels of education, and families with few breadwinners, especially among Arabs and the ultra-orthodox (Haredi).
- ◆ Growth contributes to the reduction of poverty among those well integrated in the labor market, but no such effect is evident among those with low rates of participation.
- ◆ The extent of poverty is a forceful reminder of the need for an ongoing policy of reducing poverty, together with fiscal discipline that supports sustainable growth. The policy should be directed towards encouraging those capable of working to join the labor force, increasing the return to labor for those on low wages, and directly supporting the poor who have low earning power.
- ◆ At the beginning of 2007 the government decided on steps intended to narrow social gaps in Israel and to increase the rate of participation in the labor market. These steps included the introduction of earned income tax credits (EITCs), compulsory pension schemes, increased enforcement of labor laws, and subsidy of day centers and nurseries to enable mothers to go out to work. These measures are intended to be introduced gradually, by 2010.
- ◆ The health basket available to the public in Israel is generous relative to those in the developed countries, and it includes very expensive life-saving drugs not included in the baskets of those countries.
- ◆ The process of updating the basket is not based on cost-effectiveness considerations but purely on the medical aspect. As the resources available to the health system are limited, the activities of the health basket committee should be expanded to include checking the economic aspect as a condition for the inclusion of new medical technology in the basket.
- ◆ The basket includes hidden reserves that enable the Health Funds to provide such new technology that is not part of the basket.

1. INTRODUCTION<sup>1</sup>

The incidence of poverty, as measured by the relative index, continued to rise in 2005.

Poverty in Israel has reached a high level in recent years, high also by international comparison.<sup>2</sup> In 2005 poverty among individuals, using the system that measures poverty in relative terms, continued to rise, and reached 24.7 percent.<sup>3</sup> However, according to indices that reflect the ability to buy a basket of essential goods and services or a fixed basket of such items, poverty fell in 2005, after rising in the three years 2002–04 (Figure 8.1). Economic growth improved the economic condition of some of the poor, but to a lesser degree than that enjoyed by the rest of the population. As growth persisted, relative poverty also declined in the first half of 2006, by 0.6 of a percentage point. The high incidence of poverty over the years made it difficult for the weaker sections of the population to maintain a reasonable standard of living, and for about 60 percent of the poor the level of consumption, as well as the level of income, is below the poverty line. The extent of poverty highlights the need for a sustained policy to reduce it. The policy should encourage those capable of working to find

**Figure 8.1**  
Incidence of Poverty among Individuals<sup>a</sup> by Different Approaches,<sup>b</sup>  
1997-2005



<sup>a</sup> Not including Arabs of East Jerusalem.

<sup>b</sup> The relative poverty line is calculated according to half the median equivalized income. The basic needs poverty line is that defined by the Canadian Market Basket Measure (MBM) and the American (NAS) measure. This includes essential spending on food, accommodation, education, transport and personal products. Disposable income includes income from all sources and is after tax and essential family health expenses, and expenses associated with going out to work (See Box 8.1).

<sup>c</sup> Incidence of poverty relative to the (real) poverty line of 1997.

SOURCE: Based on Central Bureau of Statistics' income and expenditure surveys.

<sup>1</sup> The analysis in this Chapter relates in the main to data up to 2005, as those are the latest data available to the Bank of Israel from the Income and Consumption Surveys. The data shown for 2005 relate to the whole population, except in analyses of long-term developments. In these cases the data do not include the Arabs of (East) Jerusalem, as no information regarding their income and consumption is available for the years 2000 and 2001.

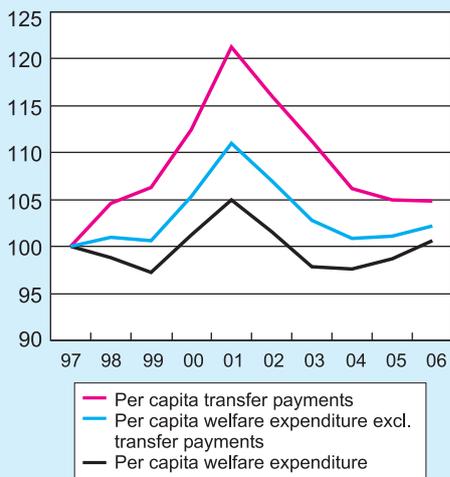
<sup>2</sup> For an international comparison of relative poverty see the Bank of Israel's Recent Economic Developments, No. 115, November 2006, 26–29.

<sup>3</sup> According to the relative measurement used by the National Insurance Institute, a household is poor if its money income is less than half the net median income, adjusted for family size.

employment, and to offer direct support (via transfer payments and transfers in kind) to the poor with low earning power.

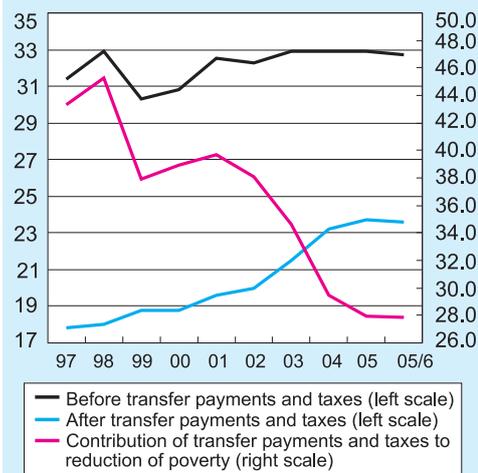
Per capita welfare expenditure<sup>4</sup> amounted to about NIS 22,000 in 2006, about 1.1 percent higher in real terms than in 2005, when it remained constant. This expenditure and its composition have undergone marked changes in the last few years, particularly the transfer payments component (Table 8.1 and Figure 8.2). Transfer payments have a vital role to play in reducing poverty calculations carried out by the National Insurance Institute show that in the period from July 2005 to June 2006 transfer payments and taxes reduced the number of the poor by 27.2 percent. The relative contribution of transfer payments to the reduction of poverty has fallen since 2001, however, due to the sharp cutback in these payments (Figure 8.3).<sup>5</sup> Thus, although the incidence of poverty based on personal income before tax and transfers has hardly changed since 2001, poverty measured by income after transfer payments and taxes has risen continuously. Nevertheless, the cut in transfer payments encourages entry

**Figure 8.2**  
Development of Total Per Capita Transfer Payments and Other Per Capita Welfare Expenditure, 1979-2006  
(Index at constant prices, 1997=100)



SOURCE: Based on Central Bureau of Statistics

**Figure 8.3**  
Incidence of Relative Poverty among Individuals and the Effect of Transfer Payments and Taxes,<sup>a</sup> 1979 to June 2006  
(percent)



<sup>a</sup> Not including Arabs of East Jerusalem.  
SOURCE: National Insurance Institute.

<sup>4</sup> Expenditure on education, health, social insurance and welfare, housing, community services, culture, entertainment, sport and religious services.

<sup>5</sup> This calculation does not take into account the effect of the tax system and allowances on behavior in the labor market and hence on the incidence of poverty by income.

**Table 8.1**  
**Social Expenditure, 1980-2006**

	(percent)		
	Welfare expenditure <sup>a</sup>		Transfer payments to households
	Share of expenditure of government <sup>b</sup>	Share of GDP	Share of GDP
1980	32.2	22.7	7.2
1985	34.6	22.3	8.2
1990	44.3	24.3	9.9
1995	52.0	27.1	9.8
1996	53.4	27.7	10.1
1997	54.0	27.6	10.3
1998	54.0	27.2	10.5
1999	53.9	26.8	10.6
2000	55.0	26.5	10.5
2001	56.2	28.6	11.7
2002	55.2	28.6	11.6
2003	54.3	27.8	11.2
2004	53.9	26.4	10.4
2005	54.7	25.7	10.0
2006	54.3	25.2	9.7
	current NIS million		
2006	157,117		60,239

<sup>a</sup> Education, health, social insurance and welfare, housing, community services, culture, entertainment, sport and religious services.

<sup>b</sup> Including national institutions, municipalities, and nonprofit organizations, most of whose expenses are financed by the government

SOURCE: Based on Central Bureau of Statistics data.

into the pool of employment, so that in the long run poverty is likely to decline.<sup>6</sup> (For a discussion of transfer payments and further discussion of their effects on poverty and inequality, see Chapter 6 in this Report and Chapter 8 in the 2005 Bank of Israel Annual Report.)

Poverty in Israel is particularly high among the Arabs, specifically the Bedouin (Box 8.2), and the ultra-orthodox Jewish population. The Arabs and the ultra-orthodox account for some 60 percent of all the poor. Poverty is high among large families, among those with low levels of education, and among families with a low number of wage earners. (Table 8.2).<sup>7</sup> The problem of poverty in the groups where its incidence

<sup>6</sup> According to a study by K. Flug, N. Kasir (Kaliner) and I. Meidan, "The Single-Parent Families Law, Work Supply and Poverty," *Economic Quarterly*, Year 53, 463–516 (Hebrew), the increase in allowances to single mothers contributed to the rise in poverty in the short term, and to the decline of employment in the long term.

<sup>7</sup> In some groups in the population some of the characteristics are correlated, thereby intensifying their effect on poverty.

Poverty is particularly high among Arabs and the ultra-orthodox, and the situation has worsened in the last few years.

**Table 8.2**  
**Indices of Relative Poverty among Individuals by Various Measures and Selected Groups in the Population**

(percent of the population, 2005)<sup>a</sup>

	Poverty indices			Distribution, percentage of	
	Incidence of poverty	Income gap <sup>b</sup>	Sen index <sup>c</sup>	the poor	the population
<b>Total</b>	<b>25</b>	<b>33</b>	<b>0.114</b>		
<b>Years of education</b>					
Up to 8	53	35	0.253	25	12
9–10	36	32	0.161	14	10
11–12	25	32	0.111	31	31
13–15	19	33	0.088	18	23
16+	12	33	0.056	12	24
<b>Family size</b>					
1 person	22	24	0.082	5	5
2–4 persons	15	31	0.066	30	50
5–6 persons	26	35	0.128	32	30
7–8 persons	52	35	0.243	21	10
9 or more persons	66	33	0.286	12	5
<b>Number of wage earners<sup>d</sup></b>					
0	78	48	0.474	36	11
1	36	26	0.129	47	33
2+	4	23	0.013	7	47
<b>Householder aged 65+</b>	26	18	0.069	9	8
<b>Population group</b>					
Ultra-orthodox <sup>e</sup>	63	36	0.306	16	6
Arabs	55	35	0.267	44	20
Population excl. ultra-orthodox and Arabs	13	29	0.057	40	74
Single-parent families	34	33	0.155	6	4
Immigrants	20	27	0.075	13	17

<sup>a</sup> Including the Arabs of East Jerusalem.

<sup>b</sup> Average gap between poverty line income and income of poor families.

<sup>c</sup> The Sen index combines the incidence of poverty, the income gap and inequality among the poor.

<sup>d</sup> In families where the head of the household is less than 65 years old.

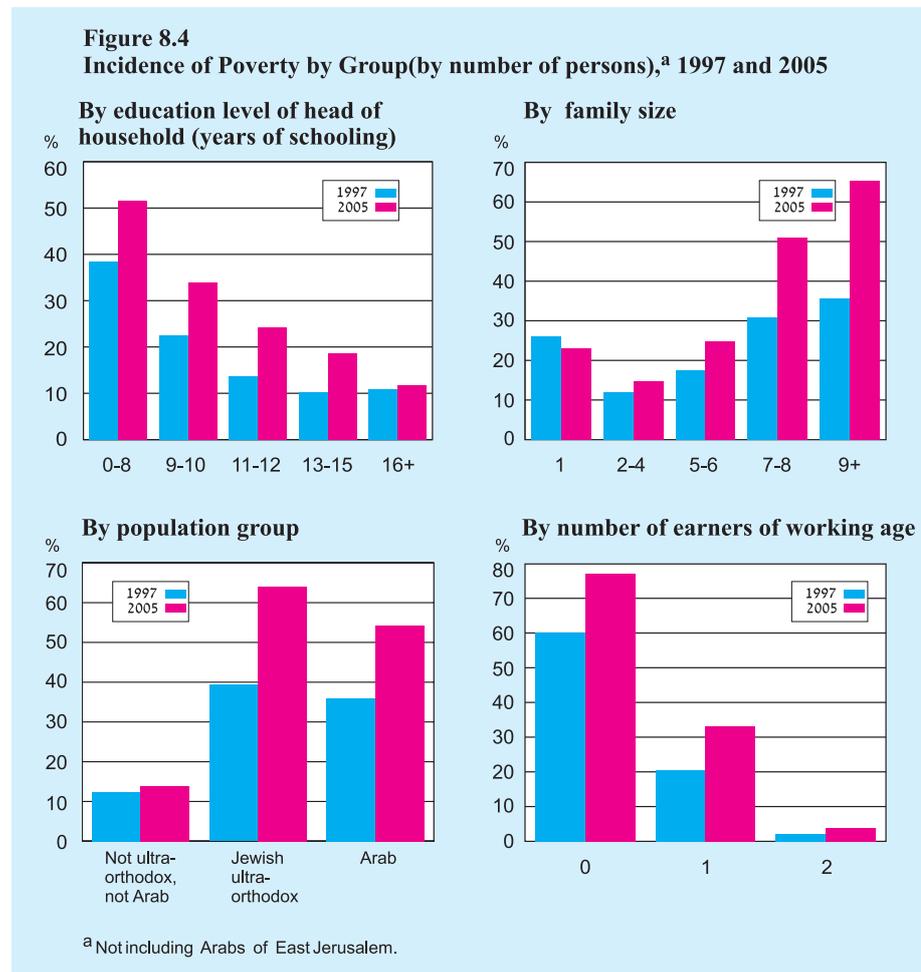
<sup>e</sup> There is a problem of identifying the ultra-orthodox in the Income Survey. Here they are identified as families in which the last educational institute attended by one or more male members of the family was a post-secondary school talmudic college.

SOURCE: Based on Central Bureau of Statistics Incomes Survey, 2005.

is high is more acute than is indicated just by the incidence of poverty, because in most of those groups the depth of poverty is also greater. Differences between poverty in the various groups arise partly from decisions regarding participation in the labor force and family size. These decisions reflect families' personal choices, which are greatly affected by their individual cultural environments. Child poverty rose by 2 percentage points in 2005 to an unprecedented 35.2 percent, which is high also by international

comparison.<sup>8</sup> The high rate of child poverty adversely affects the creation of human capital, which is important for future earning power.<sup>9</sup>

Over the longer term it can be seen that the extent of poverty worsened especially in those groups in which it was high to start with (Figure 8.4). That was due to (a) the wide-ranging cuts in transfer payments from 2002 which affected those groups—which are heavily dependent on those payments—in particular, and (b) the reduction in those groups’ participation in the labor force. This reduction was expressed by a fall in the share of those employed and in the share of those employed full-time (among the employed in those groups). In some of the weaker groups, however, for example those with low levels of schooling, their involvement in the labor market increased slightly in 2005.



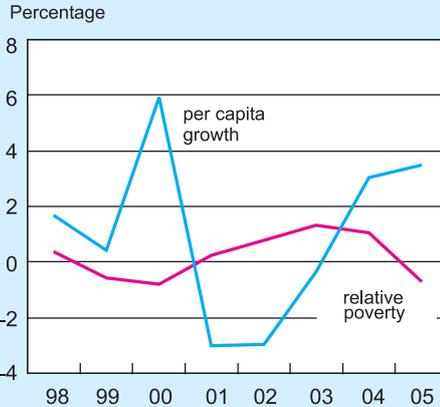
<sup>8</sup> See the National Insurance Institute Annual Report, 2005 (Hebrew).

<sup>9</sup> This is because of the high weight of private expenditure in total national expenditure on education, which reached about 25 percent in 2004. See the press release of the Central Bureau of Statistics dated 25 July 2006, “National Expenditure On Education In 2002–2004.”

The incidence of relative poverty in the total population rose steadily in the years from 1997 to 2005, despite the fact that for a significant part of that period there was economic growth, at times even rapid growth. Table 8.3 shows that growth reduces poverty among those with a high rate of participation in the labor market. Thus, in the general (non-ultra-orthodox) Jewish population, whose participation rate in the labor market is high, the incidence of poverty declined as GDP increased until 2000, and rose during the 2001–03 recession (Figure 8.5). When the rate of growth picked up in the middle of 2003, at first there was a slowdown in the rise in poverty, and then poverty actually declined. In contrast, the growth was not reflected in the rate of poverty among the Arab and ultra-orthodox Jewish populations, which are less represented in the labor market. As a result of their lesser involvement in the labor market, the growth improved their conditions less noticeably, and for the same reason they were less affected by the recession. Also, as growth is education biased, it enhances only marginally the economic situation of groups which have a large proportion of people with low levels of education, or whose education does not sufficiently tally with the requirements of the labor market.

It is natural that the groups that are less involved in the labor market are more dependent than others on the welfare system. Thus the incidence of poverty among them was greatly affected by the changes in transfer payments, such as the implementation

**Figure 8.5**  
Annual Economic Growth per Capita and Change in Relative Poverty among Non-ultra-orthodox Jewish Population,<sup>a</sup> 1997-2005



<sup>a</sup> From 2001, the Jewish non-ultra-orthodox sector includes non-Arab non-Jews. (a small percentage).  
SOURCE: Based on Central Bureau of Statistics, income Surveys, population data and National Accounts data.

Growth helps to reduce poverty in the Jewish, non-ultra-orthodox segment of the population, which is much involved in the labor market, but less so among Arabs and the ultra-orthodox, whose participation rates are low.

**Table 8.3**  
Employment Rate and Average Wage per Employee Post by Population Group,<sup>a</sup> 2005

	Employment rate (%)		Average wage (NIS)	
	Men	Women	Men	Women
<b>Total population</b>	<b>60.9</b>	<b>52.2</b>	<b>8,565</b>	<b>5,417</b>
Arabs	55.6	15.9	5,347	4,101
Ultra-orthodox <sup>b</sup>	23.4	44.2	5,476	3,791
Population excluding ultra-orthodox and Arabs	65.8	60.9	9,228	5,494

<sup>a</sup> Up to age 65.

<sup>b</sup> There is a difficulty in identifying the ultra-orthodox in the Labor Force Survey and the Income Survey. They are identified here by the attendance of one member of the family at a post-secondary school talmudic college.

SOURCE: Based on Central Bureau of Statistics' Labor Force Surveys and Incomes Surveys.

of the Large Families Law (known as the Halpert Law) in 2001, followed by the steep cutback in the various allowances (from 2002). Since the reduction in the allowances did not always coincide with the changes in GDP, the connection between poverty in these groups and growth was a weak one.

Another factor that tends to loosen the link between poverty in the groups that are fairly removed from the labor market on the one hand and growth on the other derives from the definition of the poverty line in relative terms: during periods of growth the poverty line rises due to the increase in labor income around the median, while the income from labor of those less involved in the labor market does not necessarily grow in tandem with it, with the result that using the relative poverty measure, the poverty rate among them is likely to rise.

The rise in the incidence of relative poverty from year to year comprises two main effects, an “absolute” effect—that derives from a change in individuals’ income with a fixed real poverty line—and a “relative” effect, deriving from a real change in the poverty line relative to its level in the previous year. The former is the result of the change in each individual’s economic situation that affects his ability to buy a fixed basket of goods and services (reflected by the real poverty line of the previous year). The relative effect is the outcome of the change in the overall standard of living (represented by the change in the median income), assuming fixed levels of individual income.<sup>10</sup>

An analysis of the contribution of each of these two effects to the rise in poverty shows that in 2005, as in most years, the relative effect acted to raise the incidence of poverty, while the absolute effect worked in the opposite direction. In 2005 too the relative effect was the stronger, so that relative poverty rose (Figure 8.6). The analysis of the two effects shows that although the purchasing power of the poor increased in 2005, it did so by less than the increase for the general population.

Based on the essential-needs approach, poverty declined in 2005 by about 3 percentage points to 23.4 percent (Box 8.1 below).<sup>11</sup> The reduction encompassed broad sections of the population. The improved poverty situation reflected mainly a rise in income deriving from economic growth, and a small fall in the poverty line.<sup>12</sup> Viewed over the longer term, poverty fell from 23.8 percent in 1997 to 20.9 percent in 2001, due to growth and the rise in transfer payments, and rose thereafter until 2004

The purchasing power of the poor increased in 2005, but by less than the increase for the general population.

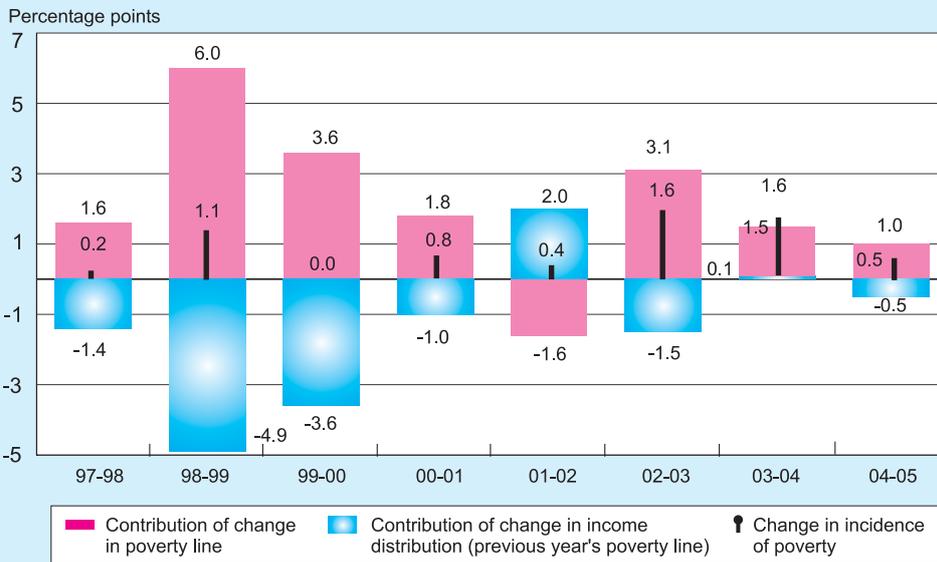
Based on the essential-needs approach, poverty declined significantly in 2005.

<sup>10</sup> The change in the incidence of poverty comprises three elements: an absolute component, a relative component, and a combined component. The third component is negligible, and here it is incorporated into the relative component.

<sup>11</sup> Not including the Arabs of East Jerusalem. If they are included, the poverty rate of individuals declined from 27.9 percent in 2004 to 24.2 in 2005. Gottlieb and Manor (2005) take, in addition to the poverty line, an estimate of private essential medical expenses not included in the health basket. According to that calculation the incidence of poverty among individuals declined from 30.3 percent to 26.9 percent (including the Arabs of East Jerusalem).

<sup>12</sup> The decline in the poverty line reflects a drop in expenditure on the education, transport and personal goods components, which was partly offset by increased expenditure on food, housing, and clothing and footwear.

**Figure 8.6**  
**Contribution to Changes in Incidence of Poverty among Individuals,<sup>a,b</sup>**  
**1997–2005**



<sup>a</sup> The contributing effect of a change in the poverty line on incidence of poverty is calculated here as the difference between total change in incidence of poverty and the change that stems from a shift in distribution assuming no change in the poverty line.

<sup>b</sup> Data do not include Arabs of East Jerusalem.

SOURCE: Based on data from Central Bureau of Statistics and income surveys.

to a record level of 26.7 percent, at first mainly due to the recession and later due to the cuts in allowances.

The rest of this Chapter deals with several aspects of welfare policy. Section 2 distinguishes between households suffering from intense poverty, whose consumption as well as their income is below the poverty line, and households who manage to consume more than the poverty line although they are poor. Section 3 discusses proposals for reducing poverty, and Section 4 deals with the health basket.

**Box 8.1**

**Calculating the poverty index based on the basic-needs approach**

The professional literature on poverty indices distinguishes between a relative measure, according to which someone is considered poor if his standard of living is significantly lower than that of the population in general, and an absolute measure, which defines the poor as those who are unable to buy a fixed basket of goods and services reflecting basic needs. In the last few years

another type of index has been developed in the US and Canada, that combines the two approaches (see Chapter 8 in the Bank of Israel 2005 Annual Report).<sup>1</sup> These indices focus on the ability to obtain basic needs, similar to the absolute approach, but with the level of the consumption components determined on a relative basis, according to the composition of each component in the overall population.

The poverty line that reflects essential consumption calculated in this chapter consists of food products, clothing and footwear, housing, expenditure on energy and water, and certain private expenditure on education. To these are added, by means of a (small) multiplier, certain items of personal expenditure such as transport and minimal leisure expenditure.

As far as the expenditure level for each of the essential items is concerned, the food basket is determined objectively, in a manner similar to that used in Canada (the market basket measure, or MBM)<sup>2</sup> based on the minimum nutrition values needed to maintain health, taking into consideration the age and sex composition of the family.<sup>3</sup> The other elements in the basket of essentials are quantified according to the average of the relevant expenditures of the 30th to 35th percentiles, similar to the method developed by the the National Academy of Science, NAS.<sup>4</sup> The share of standard total per capita expenditure on essentials that is spent on food at the poverty line is about 30 percent, and on housing, about 50 percent (see table).

In determining whether a particular household is poor, its money income is taken into account together with income in kind (in contrast with the official relative approach, in which only money income is considered), and then the following are deducted: compulsory payments, expenses related to going to

<sup>1</sup> See D. Gottlieb and R. Manor (2005), "On the Choice of a Policy-Oriented Poverty Measure," Discussion Paper Series, Monaster Center for Economic Research, Ben Gurion University of the Negev. For alternative calculations of poverty according to essential requirements see Y. Alfandari and T. Kaplan (2003). "Proposal for an Absolute Measurement of the Poor in Israel", August, 1 to 57; M. Sabag-Endweld and L. Achdut (2004) "Developing An Experimental Poverty Index In Israel Based On Household Expenditure," Special Research and Surveys, the National Insurance Institute, No. 82.

<sup>2</sup> Human Resources Development Canada (2003). "Understanding the 2000 Low Income Statistics Based on the Market Basket Measure," May, Applied Research Branch, Strategic Policy, SP-569-03-03E, Canada.

<sup>3</sup> See D. Nitzan-Kaluski (2004) "Proposed method for calculating the costs of foods vital for infants, children and adults, by age and sex." Ministry of Health, Jerusalem, 1-9 (Hebrew).

<sup>4</sup> C.F. Citro and R.T. Michael, eds. (1995). "Measuring Poverty: A New Approach," National Research Council, N.A.P. Washington DC. A direct calculation of expenditure on basic needs in the US is consistent with the expenditure of families in the 30th to 35th percentiles; see B.R. Bergmann and T. Renwick 1993, "A Budget-Based Definition of Poverty With an Application to Single-Parent Families," The Journal of Human Resources, 28, No. 1, Winter, University of Wisconsin, Madison, WI, USA, 1-24.

work (child-care where both parents work or in case of a single mother, and travel costs), self-financed health expenditure, and alimony.

**Components of the Poverty Line by the Basic Needs Approach, 2005**

Items of basic needs in the poverty line	NIS	%
Food	771	30.4
Housing	1,241	49.0
Clothes and footwear	116	4.6
Education, transport and personal effects	405	16.0
<b>Poverty line</b>	<b>2,533</b>	<b>100.0</b>

SOURCE: Based on Central Bureau of Statistics, Expenditure Survey 2005.

**Box 8.2**

**Poverty among the Bedouin**

The Bedouin population in 2004 totaled about 180,000, according to data from the Galilee Association.<sup>1</sup> About 70 percent of them live in recognized settlements, and the other 53,000 in settlements not recognized by the State of Israel due to disputes over land ownership.<sup>2</sup> Most of the Israeli Bedouin live in the southern part of Israel.<sup>3</sup>

<sup>1</sup> Based on research in progress by S. Abu-Badar and D. Gottlieb, "Poverty among the Bedouin and in the general Arab society in Israel", the Van Leer Institute, Jerusalem (Hebrew). The source of the data in this box is the Galilee Association.

<sup>2</sup> The State claims that it owns the disputed land. Furthermore, in 1984 the High Court of Appeal, basing itself on the 1858 Ottoman Land Order, ruled that the disputed land belonged to the State. The Bedouin claim ownership of a large part of the land, and argue that many Bedouin did not take to trouble to obtain the deeds proving their ownership in the time of the Ottoman rule and the British mandate, as they (the Bedouin) had their own system of ownership. In 1969 the government started establishing villages intended to serve the Bedouin as permanent settlements. The dispute was not settled, as there was no agreement over the amount of compensation to be paid to the Bedouin. For a more detailed discussion see Swirski and Hasson, 2005, "Invisible Citizens in Israel, Government Policy toward Negev Bedouin," the Adva Center, Tel Aviv.

<sup>3</sup> According to the 2004 Statistical Abstract, the Bedouin settlements in the Negev, the desert region of southern Israel, accounted for about 160,000 Bedouin in 2002. This number is higher than that obtained from the 2004 Galilee Association survey (130,000). The latter is less reasonable, taking into account the high natural population growth rate of the Bedouin.

In 2004 there was a very high incidence of poverty among the Bedouin, 66.4 percent; among those living in non-recognized settlements it was almost 80 percent.

The statistical data gathered by the Central Bureau of Statistics hardly relates to the Bedouin in non-recognized settlements. In particular they do not feature in the data on poverty. Hence the data herein is based on an extensive data-collection project carried out by the Galilee Association among Arabs, with a focus on the Bedouin who live scattered over a wide area.

There is a very high incidence of poverty among the Bedouin; in 2004 it was 66.4 percent, and among those living in non-recognized settlements it was even higher, 79.2 percent. The latter account for some 65 percent of all the Bedouin poor. In the non-recognized settlements the depth of poverty, as measured by the income gap of poor families and by the Sen index, was high (see Table 1). The official definition of poverty relates only to money income. Non-financial income from domestic (i.e., home) production constitutes a significant supply source for the needs of the Bedouin, especially so in the non-recognized settlements. It is reasonable to assume, therefore, that poverty as measured using the official definition is slightly higher than the true measure.<sup>4</sup>

**Table 1**  
**Poverty in the Israeli Bedouin Population (Individuals), 2004**

	Incidence of poverty (percent)	Income gap <sup>a</sup>	Sen index <sup>b</sup>
Bedouin	66.4	35.3	0.315
Bedouin in recognized settlements	61.0	32.1	0.267
Bedouin in non-recognized settlements	79.2	41.1	0.425

<sup>a</sup> The average gap between poverty line income and income of poor families.

<sup>b</sup> The Sen index combines the extent of poverty, the income gap and inequality among the poor.

SOURCE: Abu Badar and Gottlieb, 2007 (research in progress); data for calculations, the Galilee Society.

Among the main reasons for poverty in this population are the low rates of participation in the labor force and employment among Bedouin women, and the high rates of unemployment and discouragement from searching for jobs. According to labor market data on the Bedouin in the South, only about 7 percent of Bedouin women aged 15 and over are employed, and among the men 22 percent of the labor force are unemployed (Table 2). It was also found that the proportion of men outside the labor force who despaired of finding work was 11

<sup>4</sup> According to the 2003 Social Survey of the Central Bureau of Statistics, which enables calculation of poverty to be made using the subjective approach, about a third of the Bedouin aged twenty and over living in the South (in recognized settlements) felt poor, and as stated, the rates obtained using the official calculation are far higher.

percent (the discouraged worker effect). Women's low rate of participation in the labor force is related to the cultural convention in Bedouin society that, to a greater degree than in other groups in the population, married women do not work outside of their home, and if they do, not outside their settlements.

**Table 2**  
**Participation Rate, Employment and Unemployment among Bedouin in Southern Israel, 2004**

	(percent)		
	Total	Men	Women
<b>Rate of participation in labor force</b>	<b>32.2</b>	<b>55.5</b>	<b>8.8</b>
Employed full-time	70.7	72.0	62.6
Employed part-time	8.1	5.9	22.0
Unemployed (unemployment rate)	21.2	22.1	15.4
<b>Employment rate</b>	<b>25.4</b>	<b>43.3</b>	<b>7.4</b>

SOURCE: Socioeconomic Survey of the Galilee Association.

The absence of certain basic infrastructures in their settlements, for instance, education and transport, is one of the reasons for the very low standard of living among the Bedouin, and it also renders their labor market participation difficult. The situation is to a great extent the outcome of the land-ownership dispute between the Bedouin in the non-recognized settlements and the State (see footnote 2 below). As a result, there is no public investment in those settlements, either in road construction or in other essential infrastructures. This state of affairs also deters private investment in those settlements.

Another element among the causes of poverty is the large number of children per family, which lowers the current standard of living. In addition, the low rates of schooling and problems with the level of education have a direct bearing on future poverty, which is affected by the ability of the young to accumulate human capital appropriate to their future absorption in the labor market. Thus, 10.7 percent of the youth aged 15 to 17 from the Bedouin settlements in the South are outside the education system. A large proportion, 15 percent, of the Bedouin in the South are illiterate. Among women the figure is even more striking—21.7 percent. Nevertheless, the age composition of the illiterates indicates a marked improvement in basic education over the years: thus, for example, the rate of illiteracy among those aged 60 years or more is 32.8 percent, while among the 15–24-year age group the rate is one percent.

The persistent state of poverty among the Bedouin causes them, and particularly their children, long-term damage. It is very important to reduce the high and persistent rates of poverty among them. A central element

in alleviating their hardship should be a decisive increase in investment, especially in the infrastructure. Lack of a proper transport infrastructure makes it difficult for them to go to work, and to receive health and education services, thereby deepening their poverty. The connection between the land dispute and the shortfall in investment highlights the great importance of finding a quick solution to the dispute acceptable to both sides. To reduce the incidence of long term poverty by increasing employment, the level of education must be raised and the high drop-out rate from the education system at all age levels must be cut. In the light of the cultural obstacles that prevent many women from going out to work, frameworks should be devised that are appropriate to the employment needs of that population.

## 2. POVERTY AND CONSUMPTION

The poverty of families whose consumption as well as their income is below the poverty line is more severe than that of families who despite their being poor use savings and loans to achieve consumption above the poverty line.

In the light of the high rates of poverty in Israel and the resultant need to formulate a policy to reduce them, it is important to distinguish between households whose poverty is particularly acute and the rest of the poor. Families whose consumption, and not only their income, is below the poverty line suffer from more severe poverty than those whose consumption, despite their being poor, is above the poverty line. Consumption in excess of income at low income levels is often incurred among families that possess property and have suffered temporary income loss, thereby being temporarily poor; by using their savings and property or taking loans they maintain a relatively reasonable level of consumption in the short term, to smooth income fluctuations. Indeed, average consumption is higher than average income among the lower income deciles.<sup>13</sup> Another reason for this may be a possible downward-bias in income reporting compared to the reporting of expenditures.

Poor households whose consumption is below the poverty line may be viewed as persistently poor (see Box 8.3). Persistent poverty is generally measured by longitudinal surveys of a fixed group of families whose economic situation has been monitored for years. Such surveys are typically performed in developed countries, but do not yet exist in Israel. In practice, the extensive surveys published together with the population census about once every eleven years may in some sense be considered as a survey with longitudinal information, albeit of very low frequency. A study of persistent poverty carried out on the basis of the census results of 1983 and 1995 for those families that appeared in both surveys (Shayo and Vaknin, 2000)<sup>14</sup> shows

<sup>13</sup> Average expenditure on consumption adjusted for household size in 2005 was about 160 percent higher than average disposable income in the lowest decile, about 80 percent higher in the second-from-lowest decile, and about 40 percent higher in the third.

<sup>14</sup> M. Shayo and M. Vaknin, 2000, "Poverty Persistence in Israel: Results from the Linked 1983 and 1995 Census Data," *Economic Quarterly*, Year 47, December, 597–628 (Hebrew).

that 35 percent of those who were poor in 1983 were still poor in 1995, and that the probability of being poor in both years was higher among Arabs and the low-educated than for the rest.

As there are no ongoing longitudinal surveys in Israel, alternative indicators of persistent poverty must be used. The fact that a family is unable to smooth its consumption in response to fluctuations in its income is evidence of acute poverty, and the lack of ability to avail itself of the loan market or of assets and savings from the past in order to maintain consumption above the poverty line points to permanent poverty.<sup>15</sup>

### **Box 8.3**

#### **Income and consumption as indicators of family poverty**

In most cases poverty is measured in money terms. It is usually measured by current income, which is taken as representing the ability to realize a given standard of living. Such a measure reflects poverty at a point in time. The question arises as to whether it genuinely reflects the standard of living, and in particular, the permanent standard of living. In this context a second question arises: does income properly express the economic situation of the household, or ought consumption also be examined? Families' current expenditure on consumption is taken as an approximation of consumption at the level of the individual.

Several claims are made in support of consumption rather than income in measuring the sources available to a household; the main ones are described below.

The main claim made in favoring consumption over income in defining the sources available to a household is that the former constitutes a better estimate of the ongoing standard of living. This approach derives from Milton Friedman's permanent income hypothesis (1957), according to which current income and expenditure consist of a permanent and a temporary component. Most current consumption is determined by permanent income, with the temporary component of income accounting for a relatively small part of consumption. In other words, consumption is more stable than income. Thus, a temporary fall in income will be expressed by a smaller decline in consumption, by falling back on savings or taking loans. Also families whose current income is lower than their average income over their lifetime (the young and the elderly) will

<sup>15</sup> See also E. Menirav, 2002, "The Measurement of Poverty: A Methodological Note," *Economic Quarterly*, Year 49, June, 321–354 (Hebrew).

consume according to their long-term income.<sup>1</sup> We would therefore expect that families whose income temporarily falls below the poverty line, and the young and the elderly whose current income is below the poverty line will consume at a level above their current income, provided they have the ability to borrow or to realize assets. Thus the standard of living of such families is not necessarily low, although their current income indicates poverty. On the other hand, poor families unable to draw on savings or to obtain loans must adjust their consumption on an ongoing basis to their current income, and thus have a low standard of living.

Another claim supporting the preference of consumption over income as an indicator of standard of living is that the reported income is less reliable than reported expenditure, particularly among the self-employed.<sup>2</sup> This is so because some households with undeclared sources of income avoid submitting true details of their income out of fear that the information will reach the tax authorities (in the case of tax evaders) or to the welfare institutions (in the case of receipt of support payments by fraudulent claims). As a result, indices of poverty are likely to suffer from some bias when the economic situation of a household is assessed via its income.

Against these arguments, the following considerations support the use of income rather than consumption data:

A family whose expenditure is below the poverty line is not necessarily poor: it may be saving part of its income. If its income is above the poverty line it is not defined as poor, even if its consumption expenditure is low.

Poverty measures based on income reflect current poverty, which includes families that are poor temporarily, as well as those permanently poor. Clearly, permanent poverty is a more serious problem than temporary poverty, but the temporary poverty, too, is a problem that must not be ignored.

Expenditure data also suffers from certain problems, among other reasons because of the short time period for which the families sampled are asked to report—only two weeks, compared with three months in the case of income. In addition, the available data relate to nominal expenditure, and not to the more relevant real consumption.

Official poverty indices world wide view family poverty via income and not expenditure, which probably indicates a certain revealed preference for the income variable. Nevertheless, as is shown above, viewing family poverty from the aspect of consumption expenditure can also be justified.<sup>3</sup> Many researchers have focused on expenditure to examine poverty, and they found significant differences between the results obtained using the two definitions of poverty.<sup>4</sup>

<sup>1</sup> F. Modigliani and R.H. Brumberg, 1954, "Utility analysis and the consumption function: an interpretation of cross-section data," in K.K. Kurihara, ed., *Post-Keynesian Economics*, New Brunswick, NJ. Rutgers University Press, 388–436.

<sup>2</sup> See for instance A. Deaton, 1992, *Understanding Consumption*, Oxford, Clarendon Press.

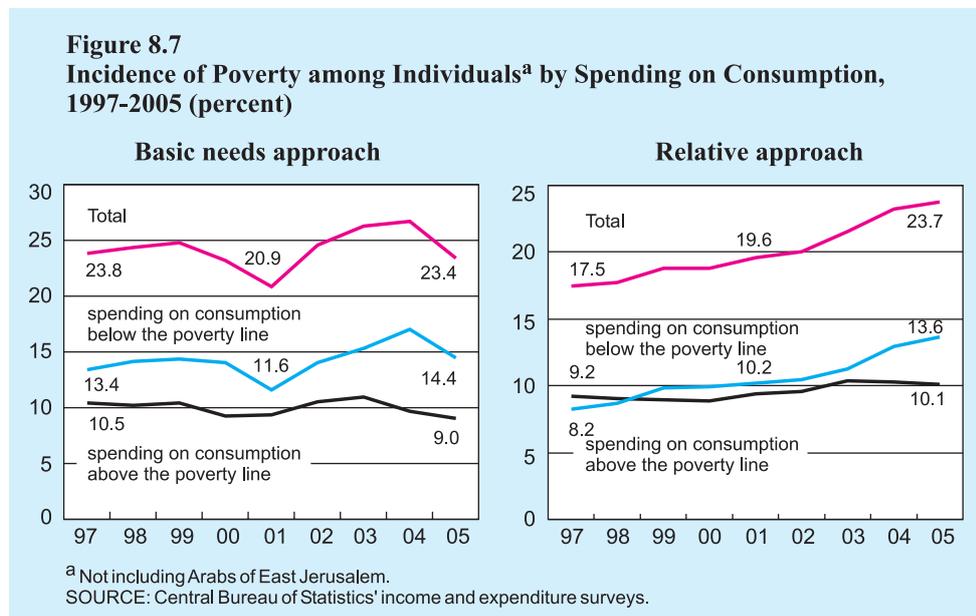
<sup>3</sup> D.S. Johnson, 2004, "Measuring Consumption and Consumption Poverty: Possibilities and Issues," American Enterprise Institute, November, U.S. Bureau of Labor Statistics, 1–31.

<sup>4</sup> Abul Naga Ramses, 1994, "Identifying the Poor: A Multiple Indicator Approach, London School of Economics, DARP/9, 1-25. . Meyer Bruce D. and James Sullivan, 2006, "Three Decades of Consumption and Income Poverty", Working Paper, #06-35, September, 1-43.

The current standard of living in 2005 (as expressed in consumption expenditure) of 40 percent of the poor was relatively high (i.e., above the poverty line), despite their low level of income. Both methods give the result that the poor whose consumption was below the poverty line (the “very poor”) constituted 14 percent of Israel’s total population.

In 2005 the current standard of living of 40 percent of the poor was above the poverty line, despite their low level of income.

According to both the relative and the basic needs approaches, the poor whose consumption was above the poverty line (the “less poor”) constituted around 10 percent of the population (Figure 8.7). This consistency suggests at frictional poverty caused by families’ exposure to temporary shocks to their income. The relatively short time that these shocks continue makes it easier for families to smooth consumption over time.



The proportion of the very poor, however, changed: according to the relative approach it rose, by 5.4 percentage points, in the period from 1997 to 2005; according to the basic needs approach the proportion of the very poor in 2005 was only one percentage point higher than in 1997, reflecting a reduction up to 2001, followed by a rapid rise till 2004, and a marked decline in 2005. In a long-term perspective, the close link between the change in the incidence of poverty overall and that in the proportion of the very poor is striking.

The severity of poverty among the very poor (whose consumption is below the poverty line) was more acute than among the rest of the poor—an income differential of about 36 percent compared with 28 percent according to the relative poverty approach.

The depth of poverty among the very poor was higher than among the rest of the poor—an income gap of about 36 percent compared with 28 percent according to the relative poverty approach, and 33 percent compared with 27 percent according to the basic needs approach. The families for whom the gap between their income and the poverty line is particularly high are also the families that have difficulty in achieving a level of consumption above the poverty line.

A comparison of consumption relative to income among the very poor shows that some of them manage to consume more than their income, but obviously not more than the poverty line. More than half of the very poor families, however, do not manage to obtain additional loans or use assets to finance their consumption, and even consume less than their income, apparently because of compulsory repayments, such as mortgage repayments.

The social characteristics of the very poor are similar to those of the less poor with regard to the number of years of schooling, the number of breadwinners in the family, and with regard to population sector (e.g., Arabs and the ultra-orthodox). Hence, those populations with a high incidence of very poor also have a considerable incidence of less poor (Table 8.4).

Nevertheless, in those sections of the population with low labor-market participation—those with little schooling, those without, or with few, wage earners, the ultra-orthodox—the very poor constitute an especially high proportion. Among new immigrants too the acutely poor are more highly represented, indicating the difficulty they have in smoothing their consumption due to lack of assets and hence also their difficulty in obtaining loans.

The results described above are common to both the relative and the basic needs approaches. Differences between them arise, however, with regard to two groups—those aged 65+, and new immigrants. The basic needs measure gives a much lower incidence of quite poor among those aged 65 and over, and the share of the very poor is much higher among new immigrants, than the figures obtained by the relative poverty approach. This is because of the high rate of apartment ownership among those aged 65+ and a low rate of ownership among the new immigrants, a factor taken into account in the basic needs approach but not in the relative approach.

The findings in Table 8.4 regarding the incidence of the very poor by characteristics do not provide sufficient information about a relation between the characteristics and acute poverty. This is because of the high correlation between the characteristics themselves. For example, among the ultra-orthodox there is a high incidence of large families with few wage earners, which offers at least a partial explanation for the high share of very poor among them.

In order to examine the marginal contribution of each of the characteristics to the probability that someone who is poor will be very poor, we used a regression to estimate the probability of being very poor.<sup>16</sup> The regression coefficients give the specific effect of each characteristic on the probability that a poor individual will be very poor (Table 8.5).

The analysis shows that the variables that increase the probability that a family will be poor, i.e., low level of schooling, large family, part of the Arab or ultra-orthodox sector, single parent, also increase the probability that it will be very poor.

<sup>16</sup> A regression of this type was estimated in K. Flug and N. (Kaliner) Kasir, 2003, "Poverty and Employment, and the Gulf between them," *Israel Economic Review*, Vol. 1 No 1, 55–80.

The very poor are similar to the quite poor with regard to the number of years of schooling and the number of breadwinners in the family. Nevertheless, in the weak sections of the labor market—those with little schooling, those without, or with few, wage earners, and the ultra-orthodox—the very poor constitute an especially high proportion.

A rise in the level of education is the major factor that lowers the probability of a family being very poor: the probability of being very poor for a family whose head completed 8 years of schooling is four times higher than that for a family whose head has 16 or more years of education.

**Table 8.4**  
**Incidence of Poverty among Individuals and their Characteristics, Distribution by Consumption Levels,<sup>a</sup> 2005**

Characteristic of population	Half of median of disposable income				Market Basket Measure (MBM)			
	Where consumption is below the poverty line		Where consumption is above the poverty line		Where consumption is below the poverty line		Where consumption is above the poverty line	
	Total incidence of poverty	line	Total incidence of poverty	line	Total incidence of poverty	line	Total incidence of poverty	line
<b>Of total population</b>	<b>24.7</b>	<b>14.0</b>	<b>10.7</b>	<b>24.2</b>	<b>14.6</b>	<b>9.6</b>		
<b>Years of education:</b>								
Up to 8	53.4	32.9	20.5	42.8	27.4	15.5		
9-10	35.8	20.4	15.4	32.7	20.0	12.6		
11-12	24.6	13.1	11.5	23.6	12.8	10.8		
13-15	18.8	10.9	7.8	20.8	13.1	7.6		
16+	12.1	6.1	5.9	13.7	8.4	5.3		
<b>Number of people in family:</b>								
1	22.2	11.4	10.8	17.3	10.2	7.1		
2-4	14.8	7.3	7.5	16.1	9.3	6.8		
5-6	26.4	14.8	11.6	25.7	15.5	10.2		
7-8	51.6	34.7	16.9	46.1	30.8	15.3		
9+	66.2	41.2	25.0	62.8	36.5	26.3		
<b>Number of wage-earners of working age in family:<sup>b</sup></b>								
0	77.5	44.9	32.6	72.8	44.2	28.6		
1	35.5	18.7	16.8	33.7	19.4	14.3		
2+	3.9	2.0	1.9	7.4	4.6	2.9		
<b>Head of household is aged 65+</b>	25.8	14.0	11.8	19.3	13.1	6.2		
<b>Selected population groups:</b>								
Ultra-orthodox <sup>c</sup>	63.3	43.3	20.1	56.3	38.0	18.3		
Arabs	55.4	29.7	25.7	52.8	27.3	25.5		
One parent families	34.3	18.4	16.0	38.7	23.3	15.4		
Immigrants (from 1990)	19.6	12.6	6.9	27.7	20.6	7.1		

<sup>a</sup> Including Arabs of East Jerusalem.

<sup>b</sup> Families whose head of household is younger than 65.

<sup>c</sup> There is a difficulty in identifying ultra-orthodox in the Income Surveys. They are identified here as those families where the last educational institution for at least one male member was a post-secondary school talmudic college.

SOURCE: Based on data from the Central Bureau of Statistics Incomes Surveys, 2005.

**Table 8.5**  
**Probability of the Poor being Very Poor, by the Relative Poverty Measure,<sup>a</sup> 2005**  
 Selected results from log regression (explanatory variable: very poor=1, slightly poor=0)

	Coefficient	Chances of the poor being very poor against being slightly poor <sup>b</sup>
<b>Age group (compared to ages 31-45)</b>		
Up to 24	0.870	2.4
25-30	0.188*	1.2
46-64	-0.274	0.8
65+	0.201*	1.2
<b>Years of education (compared to 11-12 years)</b>		
Up to 8	0.802	2.2
9-10	0.306	1.4
13-15	-0.534	0.6
16+	-1.392	0.2
13-15 (religious education) <sup>c</sup>	1.019	2.8
16+ (religious education) <sup>c</sup>	1.281	3.6
<b>Number of individuals in the family (compared to 2-4 individuals)</b>		
1	0.672	2.0
5-6	0.603	1.8
7+	1.178	3.2
<b>Selected population groups</b>		
Ultra-orthodox <sup>d</sup>	1.758	5.8
Arabs	1.008	2.7
Single-parent families	1.058	2.9
Immigrants (since 1990)	0.862	2.4

<sup>a</sup> Including Arabs of East Jerusalem.

<sup>b</sup> Relative to the omitted group.

<sup>c</sup> Where the last place of education was a post-secondary school talmudic college.

<sup>d</sup> There is a difficulty in identifying ultra-orthodox in the Income Surveys. They have been identified here as those families where the last place of education for at least one member of the household was a post-secondary school talmudic college.

\* Not significant.

SOURCE: Central Bureau of Statistics, Expenditure Survey 2005.

The higher the level of education, the lower the probability of being very poor. Thus, the probability of acute poverty for a family in which the head of the household has 8 years of schooling is more than twice as high as that for a family whose head completed 11–12 years of schooling; and for a family whose head has 16 years of education the probability is a quarter of that of the first family above, whose head has 8 years of schooling. The probability of being very poor among those with low levels of schooling is relatively high both because of their difficulties in finding employment and because of the low wages paid to those who work.

The number of children in the family has a strong influence on the probability of poor families being very poor, because the larger the family, the greater the expenditure needed to maintain a reasonable standard of living.

The probability of a poor family being very poor rises with family size.

Furthermore, among Arab families and the ultra-orthodox the probability of being very poor is higher than among the rest of the population, over and above the effects of family size, education and age. This is due mainly to cultural obstacles that reduce their participation in the labor force and to problems regarding the quality and content of their education, which are contributory factors to their low wage levels. Among Arabs this is also related to the peripheral location of their settlements, and apparently also to discrimination in employment.<sup>17</sup> As a result of all the above, the probability of being very poor among the Arabs is three times higher and among the ultra-orthodox, six times higher than for the rest. Taking into consideration the quality of ultra-orthodox education, the probability of being very poor is even higher.

The probability of being very poor in the working-age group (i.e., up to 64 years) declines as the age of the head of household rises. Possible reasons include the rise in wages because of experience and seniority in work, and the accumulation of property through savings. At age 65 and over the probability of being very poor rises again. Two other groups with a high probability of being very poor are new immigrants and single-parent families—in the first the probability is twice as high, and in the second, three times as high.

### 3. PROPOSALS TO REDUCE POVERTY AND INCREASE EMPLOYMENT

The high incidence of poverty in Israel highlights the need to adopt a continued policy to reduce poverty, while preserving fiscal discipline, which supports sustainable growth. Sustainable growth is itself necessary, but not sufficient, for reducing poverty, as it trickles down slowly and only partially to the weaker sections of the population. Government intervention is needed to ensure that the benefits of growth also reach those sectors.

The policy should include active measures intended to integrate those capable of working into the labor force, and to increase the wages of the low-paid. In Israel less use is made of active labor market policies than in other developed countries, despite the greater need for such measures than in other countries because of relatively low levels of employment. Intensifying an active policy will reduce poverty in the groups that are under-represented in the labor force, e.g., Arabs and the ultra-orthodox (who account for some 60 percent of the total number of poor), and will enable them to enjoy more of the benefits of growth. For some groups among the poor, individual programs—taking into account their specific cultural values—need to be devised to absorb them into employment

For those incapable of working, or with low earning ability, transfer payments are part of the solution to poverty; at the same time, tests of employability and means tests

Among Arab families and the ultra-orthodox the probability of being very poor is higher than among the rest of the population, over and above the effects of the size of family.

The high rates of poverty in Israel highlight the need to adopt an ongoing policy to reduce poverty, especially as growth trickles down slowly and only partially to the weaker sections of the population.

The policy should focus on active measures to integrate those capable of working into the labor force, and to increase the income of the low-paid. For some sectors of the poor population, particularly the Bedouin and the ultra-orthodox, special programs need to be devised, that take their specific cultural characteristics and values into account.

For those incapable of working, or with low earning ability, transfer payments are part of the solution to poverty.

<sup>17</sup> See R. Klinov, 1999, "Changes in the Wage Structure—Wage Gaps Between and Within Industries: Israel 1970–1997," The Institute for Socioeconomic Research, the General Federation of Labour, Discussion Paper No. 4, August.

should be improved to ensure that welfare funds are directed more efficiently to the genuinely needy.

The government decided on the gradual implementation of “steps to narrow the social gaps and to increase the rate of participation in the labor force.” The steps included the introduction of earned income credits (EITCs), a pension for every worker, stricter enforcement of labor laws, and the subsidization of day care centers and nurseries.

Most of the proposals set forth herein involve budgetary costs, particularly in their first few years. In the long term they enable cost savings to be made, due to the reduction in National Insurance outlays as a result of the reduction in poverty and of the increase in tax revenues following the rise in employment. The costs of these proposals could be met in three ways: (1) by increasing the efficiency of the budget allocation between the various government ministries; (2) by raising the budget allocated to the treatment of poverty at the expense of other items (changing the order of priorities), and (3) by increasing the overall budget framework. Some of the proposals herein hardly involve budget costs, for example the proposals regarding foreign workers and the Minimum Wage Law. The total budget cost of the program to reduce poverty depends mainly on government decisions about their goals and the rate of progress chosen to achieve them.

At the beginning of 2007 the government decided on the gradual implementation of “steps to narrow the social gaps and to increase the rate of participation in the labor force.” The total net cost of these steps to the year 2010 was estimated at NIS 1.2 billion. The steps included the introduction of earned income credits (EITCs), a pension for every worker, stricter enforcement of labor laws, and the subsidization of day care centers and nurseries. It was also decided that the EITCs will be implemented gradually, by 2008, and universal pension coverage no later than 2010.

Alongside the measures to reduce poverty, it is important to set long-term social targets.

Alongside the measures to reduce poverty, it is important to set social targets—a poverty target, an employment goal, and goals in education. Setting targets will help to commit the government to the ongoing struggle against poverty, will influence budget priorities, and will provide a scale against which to measure government activity in these spheres—and will thus help to raise the level of social welfare and to reduce poverty.

#### **a. Families whose head of household is of working age and employable**

**EITCs for those earning low wages.** The purpose of introducing EITCs is to reduce poverty among working families by increasing the return to labor, while encouraging households to take responsibility for their economic situation. It is therefore important that the EITC increase with the number of hours worked and that it be granted up to a certain level of family income. It is also important that larger families, which are generally the poorer ones, receive larger EITCs. EITCs with these characteristics will encourage greater involvement in the labor market among large families, including Arab and ultra-orthodox Jewish families. It is proposed that payment be made directly by the government to the worker.

In February 2007 the government decided to introduce EITCs on a trial basis in 2008 and 2009 in locations where the program to encourage employment is implemented. From 2010 the system of EITCs will be extended to additional areas.

**The Minimum Wage Law.** In order to increase the return to labor for the low-paid, and in the light of the relatively low level of compliance with the Minimum Wage Law, it is important to enforce that law more strictly. The implementation of the February 2007 government decision to increase resources allocated to the enforcement of the labor laws will help to achieve this objective. Enforcement should be tightened by increasing resources via automatically channeling income from fines into the relevant enforcement budget.

It has been agreed that the level of the minimum wage be increased gradually over several years (see Chapter 8 on Issues in Welfare Policy). It was decided that after the rise in the minimum wage in 2007, a joint committee made up of representatives of the government, the employers and the General Federation of Labour (New Histadrut) would decide on the next stages of the increase. It is important that the committee examine the implications of the rises that have already taken place, and that the future rises be taken into account in calculating labor productivity and considering unemployment. At this stage certain additional changes should be made to the Minimum Wage Law: all wage components that are not reimbursement of expenses or incentives for extra work should be included in the minimum wage calculation.

The (automatic) updating of the minimum wage should be based on the median wage and not as at present the average wage, so that the minimum wage will not be affected by sharp changes in specific occupations or industries, and will guarantee the maintenance of a reasonable basic standard of living, which was the Knesset's original intention.

The EITC and the minimum wage both act to raise the return to labor of employees with low levels of schooling. The system of EITCs will have an important role to play even after the expected increases in the minimum wage, because of the poor enforcement of the latter and the fact that the proposed EITCs focus on low-income families. Nonetheless, weak enforcement together with EITCs transfers the responsibility for maintaining a reasonable wage from employers to the taxpayers.

**Non-Israeli workers.** The high proportion of non-Israeli workers (232,900, some 8 percent of the civilian labor force in 2006) and the low cost of employing them pushed Israelis with low levels of education out of the labor force (including Arabs who had worked in construction or agriculture), and increased the incidence of poverty among them. It is therefore important to reduce the number of non-Israeli workers significantly, setting a long-term target. This has become even more important because of the increase in the minimum wage, which boosts the incentive for employers to give jobs to foreign workers, regarding whom the enforcement of labor laws, including the minimum wage, is even slacker.

The number of work permits should be cut, and the enforcement of the limitation on the number of foreign workers should be intensified, while strictly complying with human rights requirements. Households employing foreign workers should be brought into the realm of enforcement.

The system of issuing work permits should be changed, so that the permits are made out directly to the worker and not to others such as the employers or corporations, as

the system of binding workers to particular employers gives the permit holder power that may be misused to pay less than the competitive wage and to give employment under unreasonable conditions. In the construction industry foreign workers are employed via a corporation. In agriculture and care services changes are due to be made in 2007 that will reduce the extent of binding workers to employers.

It is important to make the employment of foreign workers more costly, by (1) stricter enforcement of labor laws, including the Minimum Wage Law, and (2) raising the tax rate on the employment of non-Israeli workers, according to need—i.e., raising the rate as long as the rate of non-Israeli employees is higher than the target.<sup>18</sup> It is proposed that employers of foreign care-workers should continue to be exempt from this tax, in the light of the vital dependence of many of the elderly on this service. At the same time, the entry of Israelis into this work—the demand for which is expanding rapidly and which is appropriate for those with low levels of education—should be encouraged. It is proposed that extra hours of care be granted to those entitled care who employ Israeli caregivers.

**Employment centers (the “Mehalev” or “Wisconsin” program) and the Employment Service.** Their importance lies in their helping to remove obstacles that prevent those outside the labor force and the unemployed from going out to work. It is therefore important to continue operating these centers, and to extend them into other geographical locations, taking note of lessons learned from experience so far. Specifically, the system of incentives should be changed so that the centers would be rewarded mainly on the basis of the number and quality of successful job placements they achieve, and less on the reduction in the number of allowances paid out. In addition, the operators should be encouraged, via incentives, to carry out occupational training. These recommendations are consistent with the program drawn up recently by the Ministry of Finance and Ministry of Industry, Trade and Labor.

The Employment Service should be strengthened too, to improve the job placement of work seekers who do not receive income support payments.

Subsidizing the costs of going out to work. In February 2007 the government decided to allocate NIS 200 million over three years to subsidize day care centers and nurseries by means of tokens that would be distributed to families on the basis of the level of income. It is also recommended that public transport be made more accessible and to subsidize the cost of using it to get to work from high-unemployment locations in outlying districts. The subsidy should not be in the form of tax credit points, to ensure that those earning less than the lowest tax bracket also benefit.

**Professional training and complementing education for adults.** These are important aspects of improving the earning ability of those with low levels of education. In the last few years professional training financed by the government has been slashed, but because of its importance it should be reinstated and expanded. Training should be motivated by employers’ demand for workers and should be appropriate to the

<sup>18</sup> The tax was raised from 8 percent to 10 percent as part of the Arrangements Law to the 2007 budget. This adjustment was relatively minor compared to the original proposal to raise the rate to 18 percent.

participants. Therefore employers should also be involved in determining the content of the training, its planning and implementation. Special training programs should be designed for special groups, such as ultra-orthodox women and Arab women, taking their cultural and other needs into account.

The roles of training and job-finding should be brought together under one roof, as in the Mehalev centers. Those giving the retraining programs should be encouraged by means of incentives based on their degree of success in finding jobs for the participants and in the quality of the job-placements. The program should be monitored closely, so that improvements can be introduced as necessary.

The system for complementing education to the level of 12 years of schooling for adults who have reasonable chances of finding jobs in the labor market should be extended. This would enable those with low education to join professional training programs, thereby easing their absorption and progress in the work place. Moreover, it would have a good influence on their children's schooling.

**The Unemployment Insurance Law.** In the last few years the criteria of the Unemployment Insurance Law have become stricter, and they are severe also by international standards. Hence, in the light of the importance of unemployment insurance in improving employment in the long term, the entitlement criteria should be eased. In particular, the period for accumulating the entitlement to receive unemployment pay should be shortened, and the period of the entitlement itself should be extended. The period spent in professional training should not be counted as part of the period of entitlement to receive unemployment pay. The recent decision to tighten the conditions of entitlement to unemployment pay for the young clearly runs counter to the recommendations described here.

**The Encouragement of Capital Investments Law.** The law should be amended to make it more effective in encouraging employment in outlying areas and will bring the battle against poverty into its orbit. A significant step in this direction is the change in the map of preferential areas to take into account also towns' socioeconomic profile. It is also recommended that benefits be granted for human capital, with a special focus on enhancing the human capital of those with low levels of education.

**Regional employment centers.** These should be developed as a means of reducing the dependence of residents of outlying areas on single factories. It is also important to improve the accessibility to the regional employment centers from the outlying areas by extending the transport system. This would improve the chances of employment in high-poverty locations, in particular in Arab and ultra-orthodox Jewish settlements.

#### **b. Families whose head of household is of working age, but has low earning ability.**

Allowances constitute an important weapon in the battle against poverty among people with low earning ability. The size of the allowance must be such that it allows recipients to maintain a reasonable basic standard of living. The means tests should be improved, so that it effectively identifies those really in need.

**The level of the allowances, and linking them to changes in the standard of living.** The allowances should be adjusted according to the standard of living and changes in it, by indexing them to the median income or to the cost of essential needs.

**Income and employment testing and their enforcement.** A basic condition for the efficient operation of the proposed program, income and employment testing and their enforcement must be improved. The income test should cover income from all sources, including imputed income from living in owner-occupied housing and income in kind. Employment testing should be upgraded continuously in the light of experience gained from the Mehalev program.

### c. The elderly

**Compulsory employment insurance.** This is a very important element in boosting the economic independence of (the future) elderly and reducing their dependence on transfer payments. A government decision of February 2007 specifies that all workers would be covered by a compulsory insurance scheme from 2010. The details of the arrangement have not as yet been finalized.

In order to reduce the adverse effect on workers' current wage and to moderate the increase in the cost of labor, it is proposed to impose a ceiling on the wage that will require a deduction to be allocated to a pension fund. It is important that the ceiling be set at a level that in the long term, together with the old-age allowance, will enable a reasonable minimum standard of living to be maintained. In order to avoid reducing the current income of those earning very low wages even further, bearing in mind that they do not receive the tax benefits on pension savings as they are below the tax threshold, it is proposed that the cost of their insurance premium be subsidized.

### d. Education

Enhancing the school and higher education system is a major tool in reducing poverty and preventing it from becoming permanent. This applies particularly to the weaker sections of the population which find it difficult to finance the additional educational services—over and above the public education—enjoyed by the economically better-off sections of the population. Strengthening public education among poor children is an important aspect of helping them increase their future earning ability. Thus the educational resources allocated to students from low-income families should be increased. The steps proposed include increasing the premium paid to qualified teachers in weaker schools; rewarding teachers according to their students' achievements; reducing the number of children in large classes, introducing the long school day, and extending the supply of hot meals in weak schools. Free pre-school-age education should be expanded in low socioeconomic areas. It is proposed that extra lessons be instituted in essential subjects such as English, mathematics and computers, to increase the students' chances of employment in the future.

#### 4. THE PUBLIC PHARMACEUTICALS BASKET—AN INTERNATIONAL PERSPECTIVE

- ◆ The public pharmaceutical basket in Israel is generous relative to those in the developed countries, but the private sector participates in financing the basket to a greater extent than in those countries.
- ◆ The process of including new medical technologies in the public basket is based not on a structural cost-effectiveness analysis but on the purely clinical aspect. As the resources available to the health system are limited, the activities of the health basket committee should be expanded to include a structural assessment of new technologies as a condition for their inclusion in the basket.
- ◆ The basket includes reserves that enable the Health Funds to provide such new technologies that are not part of the public basket.

Under the National Health Insurance Law, the state provides a pharmaceutical basket<sup>19</sup> for all residents of the country, regardless of their financial situation. Most developed countries provide such a pharmaceutical basket as part of their overall range of public services, but it is not necessarily uniform and available to all the citizens of any particular country. Since the resources available to the health system are limited, and the public basket does not enable it to include all the latest medical advances, most developed countries therefore adopt a structural cost-effectiveness analysis to assess new medical technologies intended for inclusion in the basket. Thus they make maximum use of the budget. In Israel, however, cost-effectiveness indices have not been used hitherto to assess the relation of the cost to the patient to the quality-adjusted contribution of the technology. The public basket in Israel is considered generous in comparison with those of the developed countries, and it incorporates very expensive life-prolonging medications not included in the public baskets of most countries. To ensure that the basket is exploited with the greatest efficiency, the use of quantitative measures to assess the economic contribution of new technologies should be extended. In that way only those technologies whose cost relative to the extra years they offer is shown to be effective will be included in the basket. For this purpose the activity of the health basket committee should be extended so that it operates throughout the year and performs such independent assessments.<sup>20</sup>

<sup>19</sup> According to the definitions generally accepted in the OECD, including use of medicines and medical equipment for use by households and those supplied in hospitals for individual use. The expenditure includes VAT and purchase taxes, but does not include pharmacists' salaries. Source: based on OECD Health Data 2006 and Central Bureau of Statistics data.

<sup>20</sup> Currently the committee meets once a year, prior to the approval of the budget, and it makes its decisions on the basis of information received from the drug companies. With the current composition of the committee and the shortage of manpower in the Medical Technologies Policy Division in the Ministry of Health, the committee is unable to perform worthwhileness tests on new technologies.

### a. The public health basket

Under the National Health Insurance Law which became effective in January 1995, the government undertook to make available a uniform pharmaceutical basket to every citizen of Israel entitled to receive it irrespective of his or her financial situation. The basket defined was that offered by the General Health Fund (Kupat Holim Klalit) prior to the Law coming into effect. The Law also specified that all the health funds had to offer the same basket of services. As well as defining the basket of health services which are the responsibility of the health funds (the Second Addendum to the Law), the Law defines another basket of services for which the Ministry of Health is responsible (the Third Addendum); this basket incorporates personal preventative medical services, psychiatric services, geriatric hospitalization, and rehabilitation equipment.

Israel is one of the only advanced economies in which the public basket of pharmaceuticals is uniform for all citizens.

Israel is one of the only advanced economies in which the public basket of pharmaceuticals is uniform for all citizens. In countries in which the government is decentralized, such as Germany, Canada, Australia and the Scandinavian countries the local governments determine the contents of the health basket, so that residents of different locations are entitled to different standards of health care;<sup>21</sup> in the US the list of medications is determined by the insurance companies and the Health Maintenance Organizations (HMOs). The wide differences between the health policies and methods of prescribing drugs in the industrialized countries makes comparing the extent of their health baskets problematic. One can, however, compare the process of assessing and adding new technologies to the basket.

### b. Updating the basket to include technological advances

Since 1998 the law has defined a mechanism for an annual update of the public health basket within the context of a given budget allocated for that purpose, according to a decision taken jointly by the Minister of Finance and the Minister of Health and taking into account the needs and budgetary preferences. To carry out the update, a public committee was appointed, whose members included representatives of the Ministry of Health and the Ministry of Finance, of the four health funds, and of the public. The committee meets every year and discusses the list of new medical technological advances for possible inclusion in the basket on the basis of clinical criteria (safety, efficacy, and the medical benefit they offer) and social ones, such as the technology's contribution to the patient's quality of life and its appropriateness for special groups in the population. In this way the committee constructs a scale of priorities for the inclusion of new technologies in the basket within the budgetary limitations set by the government. The committee does not perform systematic cost-effectiveness analyses

<sup>21</sup> For example, in the north of the Netherlands only 6 percent of women who needed the drug Herceptin for the treatment of breast cancer received it, compared with 86 percent who received it in another location in the south of the country.

to compare alternatives, with the result that Israel is a trail-blazer in the adoption of life-saving technologies.<sup>22</sup>

Since the committee was appointed in 1998, more than 400 medical technological advances have been included in the basket, at a total cost of about NIS 1.7 billion (Table 8.6); about 60 percent of those added are related to the treatment of oncological and endocrinological diseases, and are very costly.<sup>23</sup> For example, the cost of treatment for certain oncological diseases, for example the drugs Erbitux and Avastin for treating cancer of the colon, and Herceptin for treating breast cancer comes to many thousand shekel a month per patient. The cost of technologies used in the treatment of chronic states deriving from genetic diseases can reach millions of shekel a year for each patient.

Unlike the situation prevailing in Israel, where as stated the health basket committee does not take cost-effectiveness analysis into consideration and, where most additions to the basket consist of very costly life-prolonging technologies, the rise in expenditure on technological advances has led most of the industrialized countries to assess those under consideration for inclusion in the health basket by means of cost-effectiveness indices.<sup>24</sup> The index usually used around the world is The COST/QUALY index, which gives the ratio of the cost to the patient (COST) to quality adjusted years of life of (QUALY) that the technology offers him.<sup>25</sup> The body that assesses whether it is worth adding new technological advances to the public basket is also responsible for determining the budget for the update. Australia, in 1993, was the first country to decide that a drug would be included in the public health basket only after its cost effectiveness was determined. The assessment procedure there makes the addition of a new technology to the public basket conditional on the ability of the individual and the state to finance it. According to that rule, the state does not finance medications whose cost is very high, because they are not economically worthwhile, nor does it finance cheap ones, because patients can finance these by themselves. In the UK the assessment of medication and health services has been carried out since 1999 by the National Institute for Health and Clinical Excellence (NICE). As in Australia, only technologies that meet the strict cost criteria are included in the basket. The assessment mechanisms in Italy, Belgium and the Netherlands are noteworthy for their severity,

In Israel no quality-standardized cost-effectiveness analyses have been performed till now to compare new technologies.

<sup>22</sup> O. Tal, A. Nir, N. N. Hakak, E. Bakshi and G. Fire (2006). "Criteria for early adoption of medical technologies," Gertner Institute for Epidemiology and Health Policy Research. This study examined the criteria for the adoption of new technologies and the dates when three innovative medical technologies, selected randomly, were adopted: Herceptin for treating breast cancer; photo-dynamic therapy using Verteporfin for the treatment of muscular dystrophy; and a coated stent used to hold open an artery that has become too narrow due to atherosclerosis. It found that in all three instances of new technologies, Israel was the first country to adopt them.

<sup>23</sup> Source: A. Luxenburg (2005). "Issues in the Management and Updating of the Basket of Services," in Ten Years with the National Health Insurance Law, 1995–2005, G. Ben-Nur and G. Ofer (eds) (in Hebrew).

<sup>24</sup> A survey carried out by the OECD in 2005 found that most of the developed countries used this method to assess whether it is worthwhile adding any new technology to the basket.

<sup>25</sup> Dickson M., J. Hurst and S. Jacobzone (2003). "Survey of Pharmacoeconomic Assessment Activity in Eleven Countries," OECD Health Working Paper 2003.04.

**Table 8.6**  
**The Number of Technologies Submitted for Inclusion in the Basket, and the Number Confirmed, 1999–2006**

	1999	2000	2001	2002	2003	2004 <sup>a</sup>	2005	2006
Submitted	88	300	316	367	369	..	429	400+
Confirmed	51	118	84	53	35	..	61	65
Addition to health basket (NIS million, nominal)	150	270	200	190	20	40	370	310

<sup>a</sup> The basket committee did not meet in 2004. The addition to the basket, NIS 40 million, was decided in 2003.

which is aimed at halting the rise in the cost of medications by switching to generic drugs. In Canada the state finances only drugs that are administered in hospitals. Germany is considered to have the most generous basket of medication of all the advanced economies, but it is not available to the whole population.<sup>26</sup>

One solution to the problem of the shortfall in the public health basket that is sometimes proposed in discussion is to legislate for a fixed update to the basket of 2 percent a year for technological advances; no such system exists anywhere in the world. Research into the relation between public expenditure on health and the business cycle in the developed countries found that this proposed system does not exist in any of them, and in all of them public expenditure on health is correlated with the business cycle:<sup>27</sup> in periods of boom countries increase their health budgets, and in recessions they do not—some of them actually cut their health budgets in times of recession. Moreover, the proposed system of a fixed annual increase would reduce the government's ability to adjust its fiscal policy according to changes in the business cycle and other requirements.

The public health basket also incorporates four hidden reserves that enable new technologies to be added, over and above the budgeted amount. The reserves derive from four sources: (1) adopting advanced technologies which reduce costs of treatment, without deducting the savings from the budgeted costs; (2) the lowering of drug prices when patents expire, without the budget being adjusted accordingly;<sup>28</sup> (3) technologies no longer used, that have not been removed from the basket; and (4) the arrangements for payment for drugs and services in the basket (a reserve of about

<sup>26</sup> In Germany the National Health Institute (NHI) covers the employed population and the total population that earns up to a maximum income. Eighty-eight percent of the population is covered by the national insurance.

<sup>27</sup> Dreger, C., Reimers (2005), "Health Care Expenditures in OECD Countries: A Panel Unit Root and Cointegration Analysis," *International Journal of Applied Econometrics and Quantitative Studies*, Vol.2(2). This study examines the relation between per capita public expenditure on health and the business cycle in the 21 OECD countries in the years 1975–2001.

<sup>28</sup> According to Ministry of Health data, when their patents expire, drug prices fall by about 30 percent on average in the first year, and by 80 percent in the first three years.

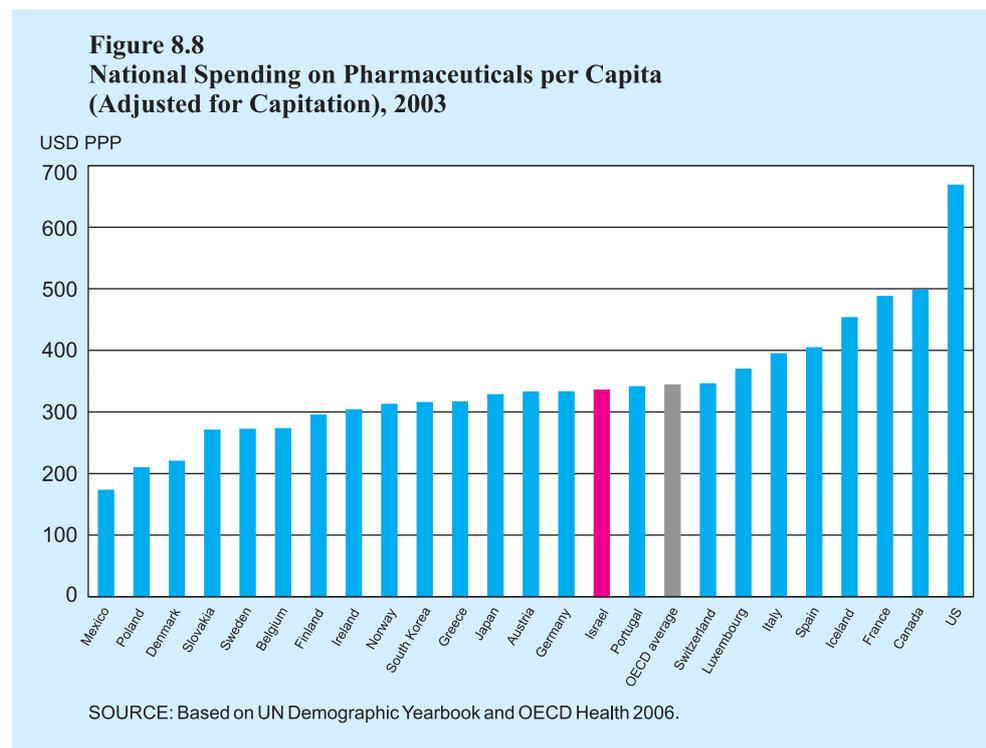
The public health basket also incorporates reserves that enable the Health Funds to provide new technologies not included in the basket.

NIS 250 million a year)—these arrangements enable the funds to charge patients for part of the cost (co-payment) according to the price that is listed in the Ministry of Health and not according to its actual cost. This latter is particularly notable in regard to generic drugs (which constitute some 75 percent of drugs prescribed), regarding which the patient’s contribution is exceptionally high in relation to their cost. These reserves enable the funds to provide drugs not included in the basket defined by the law.

**c. Financing**

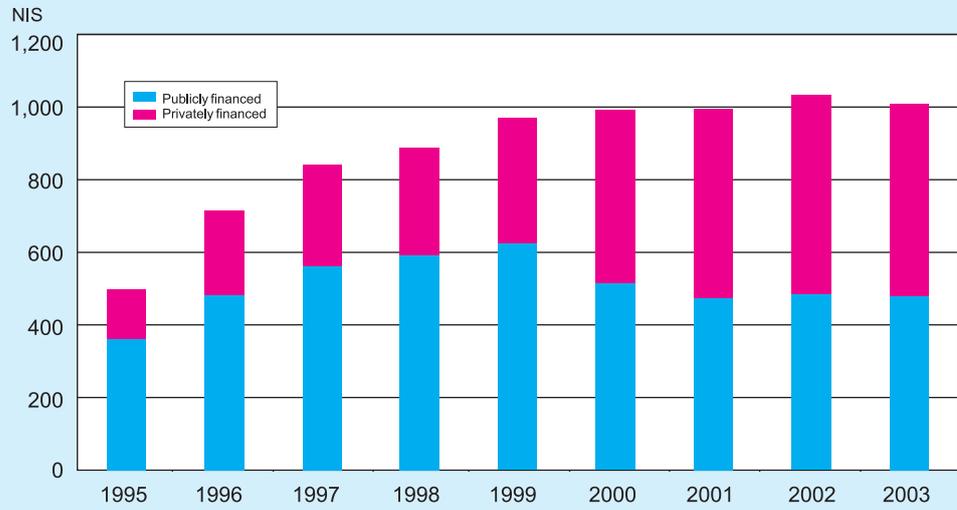
National adjusted per capita pharmaceutical expenditure in Israel (purchasing power parity—PPP) in 2003 was close to the average in the developed countries, but the share financed privately in Israel is far higher than in those countries, 52 percent compared with 39 percent respectively. Only in the US, Canada, Mexico, Poland and Denmark was the share of private expenditure in total health expenditure higher than that in Israel.<sup>29</sup> The cut in the health budget since 2001 reduced the public sector’s share in the financing of the basket, with an increase in the share of the private sector. In 2004 households contributed 33 percent directly to the financing of the health basket.

The private sector participates in financing the basket to a greater extent than in other developed countries.



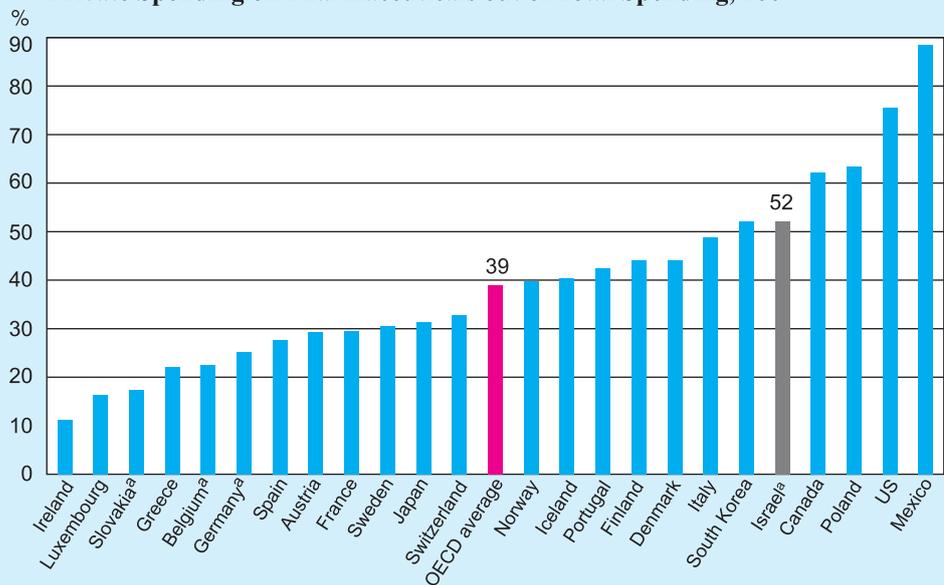
<sup>29</sup> In the Scandinavian countries and in Canada public expenditure includes only central government expenditure, and does not include the expenditure of the local authorities. Thus, actual public expenditure in those countries is higher than that referred to in the above comparison.

**Figure 8.9**  
**National Spending on Pharmaceuticals per Capita (Adjusted for Capitation),**  
**By Financing Sector, 1995-2003**  
**(In 2000 prices)**



SOURCE: Based on data from the Central Bureau of Statistics.

**Figure 8.10**  
**Private Spending on Pharmaceuticals out of Total Spending, 2004**



<sup>a</sup> Data for 2003.

SOURCE: Based on UN Demographic Yearbook and OECD Health 2006.

