Chapter 8
Welfare Policy Issues*

- In an international comparison of welfare, Israel does remarkably well in the macroeconomic employment indices and in a number of healthcare indices. Its most prominent weaknesses include the high number of work hours, high levels of poverty and social gaps, and low educational achievements.
- The Committee to Fight Poverty and the Advisory Committee for Strengthening the Public Health System submitted their recommendations in 2014. Had those recommendations been implemented, it would have required the allocation of resources, whether through cuts in other expenditures or through an increase in public expenditure as a share of GDP and increasing revenues accordingly.
- The disposable income of most households in Israel increased at a steady pace since 2004. Among those with low incomes, the increase was mainly the result of increased supply of labor, and among those with high incomes, it was mainly the result of reductions in direct taxes.
- Inequality between households by financial income declined in recent years, due to the increase in the employment rate.
- Inequality by equivalized disposable income is high—both compared to other countries and compared to its level at the beginning of the century—because government intervention in the distribution of income is relatively low and because poor households include many individuals.
- In the past decade, there was a sharp decrease in income tax rates, while overall indirect tax remained unchanged. Therefore, the tax system is currently less progressive than it was at the beginning of the century.
- Housing assistance, including public housing, has declined greatly over the years. It is low by international comparison, even though the housing expenditure burden is high. A proper supply of homes in public housing for population groups with particularly low earning power must be ensured.

* According to the 2013 Family Expenditure Survey, the poverty and inequality rates declined markedly in that year, and the calculation is based on an exceptional increase in the employment rate—by 9.6 percent. However, according to the Labor Force Survey, growth in the employment rate was only 2.6 percent. The Central Bureau of Statistics examines the employment rate according to the Labor Force Survey. Moreover, there have not been significant differences thus far between the two surveys in the change of the employment rate. Finally, administrative data on the number of salaried employees in the economy also show that employment grew at a similar rate to that in the Labor Force Survey. Due to the lack of clarity concerning the data and findings, Chapter 8 this year does not specifically discuss developments that took place in these areas in 2013.

1. WELL-BEING INDICES AND SOCIAL POLICY

This sections provides an outline of the state of welfare in Israel relative to the other OECD countries, according to a number of main indices. The discussion examines output—in the areas of income and its distribution, employment, and public services—and input, meaning social policy. It is worth noting that there is not always a causal connection between policy and products, and that sometimes there is only an indirect connection. All the data in the section, including the data on Israel, are taken from the OECD's databases.

a. GDP, employment and the distribution of income

Per capita GDP was about 14 percent lower in Israel than the simple average of the OECD countries.

GDP: Per capita GDP and GDP per hour of work (productivity) in 2013 were about 14 percent lower in Israel[1] than the simple average of the OECD countries, and the gap in labor productivity has not narrowed since the 1970s. GDP per employee is similar to the OECD average, since the average number of work hours in Israel is 10 percent higher than in the OECD. The proportion of the population made up of those aged 25–64 is at the bottom of the rankings, which is one of the main factors for Israel's per capita GDP being ranked lower internationally than its GDP per employee.

The employment rate in Israel among the primary working ages is slightly higher than the OECD average.

Employment: The employment rate in Israel among the primary working ages is slightly higher than the OECD average, and in recent years, the unemployment rate has been lower as well. Israel is also characterized by a relatively low rate of individuals involuntarily holding part-time positions.[2]

Public expenditure and tax policy encourages employment. In particular, from the standpoint of the mix of public expenditure, Israel is characterized by a particularly low rate of transfer payments[3] which, as a share of GDP, are about 7 percentage points lower than the average among advanced economies. From the standpoint of the tax mix, Israel is characterized by high indirect tax rates and low direct tax rates, and the ratio between them is the highest in the OECD (0.91 compared to an OECD average of 0.66, according to 2013 data).

Israel provides incentives to work but invests little in active policy in the labor market.

The low rates of direct taxes[4] and transfer payments create a tremendous incentive to work[5], and working can, in the medium term, extract households from poverty or at least lower their dependence on benefits. These incentives—and with them the opening of the colleges and the increase in the educational level of the labor force—have led Israel to achievements. This is clear from the fact that the labor

1 According to purchasing power parity (PPP).

2 Less than 30 hours per week.

3 Transfer payments are payments from the National Insurance Institute to the elderly, those with low incomes, or those whose health, family or employment status does not enable them to earn sufficiently.

4 Direct taxation is particularly low among workers earning the average wage or less. Tax benefits are also given to women.

5 The government also adopted quantitative targets for both the general employment rates and the rates among certain population groups.

force participation and employment rates have increased greatly in the past decade. The success is not only in comparison to the past, but also in comparison to the other members of the OECD. Even when breaking down the data according to level of education, Israel has narrowed the gaps in the employment and participation rates in the past decade, although it has narrowed the latter to a less significant extent. The change in employment rates has been reflected in a change in the distribution of households by the number of employed persons[6]: From 2004 to 2012, the rate of households with two or more breadwinners has increased from 46 percent to 52 percent, and the rate of households with no breadwinner declined from 14 percent to 9 percent.

However, despite the fact that Israel has adopted policy that incentivizes people to go to work, public investment in active policy in the labor market is relatively low—about 0.2 percent of GDP, compared to an average of 0.6 percent in the OECD countries.[7] This is one of the causes of the fact that there are workers who lack the necessary qualifications for the labor market[8], and it is reflected in low productivity and wages, particularly among some of the workers who have joined the market and are part of the population groups that are characterized by low rates of employment. Among those employed full time, a relatively high rate earn low wages—below two-thirds of the median wage for a full-time employee—and going to work therefore does not guarantee emerging from poverty.[9]

Israel is close to the OECD average in terms of the inequality of financial income per household.

Inequality and poverty: Israel is close to the OECD average in terms of the distribution of financial income per household.[10] Therefore, the poverty rate by government intervention is in the center of the distribution of poverty rates in the OECD. Even so, the distribution of wages in Israel is not equal: Israel is ranked high in terms of the ratio between the various percentiles of gross wages.[11] However, in the OECD, inequality in wages explains only 16 percent of the variance in economic inequality between households.

6 Households where the head of household is between 25–64 years old, meaning within the primary working ages.

7 The evaluation included 6 categories, all of which are part of active policy in the labor market: public employment services; training; employment incentives including earned income tax credits (negative income tax); rehabilitation, protection and support for employment among the disabled, the creation of workplaces; and incentives for startup companies. Not included were support and income supplement payments outside of employment, including unemployment benefits.

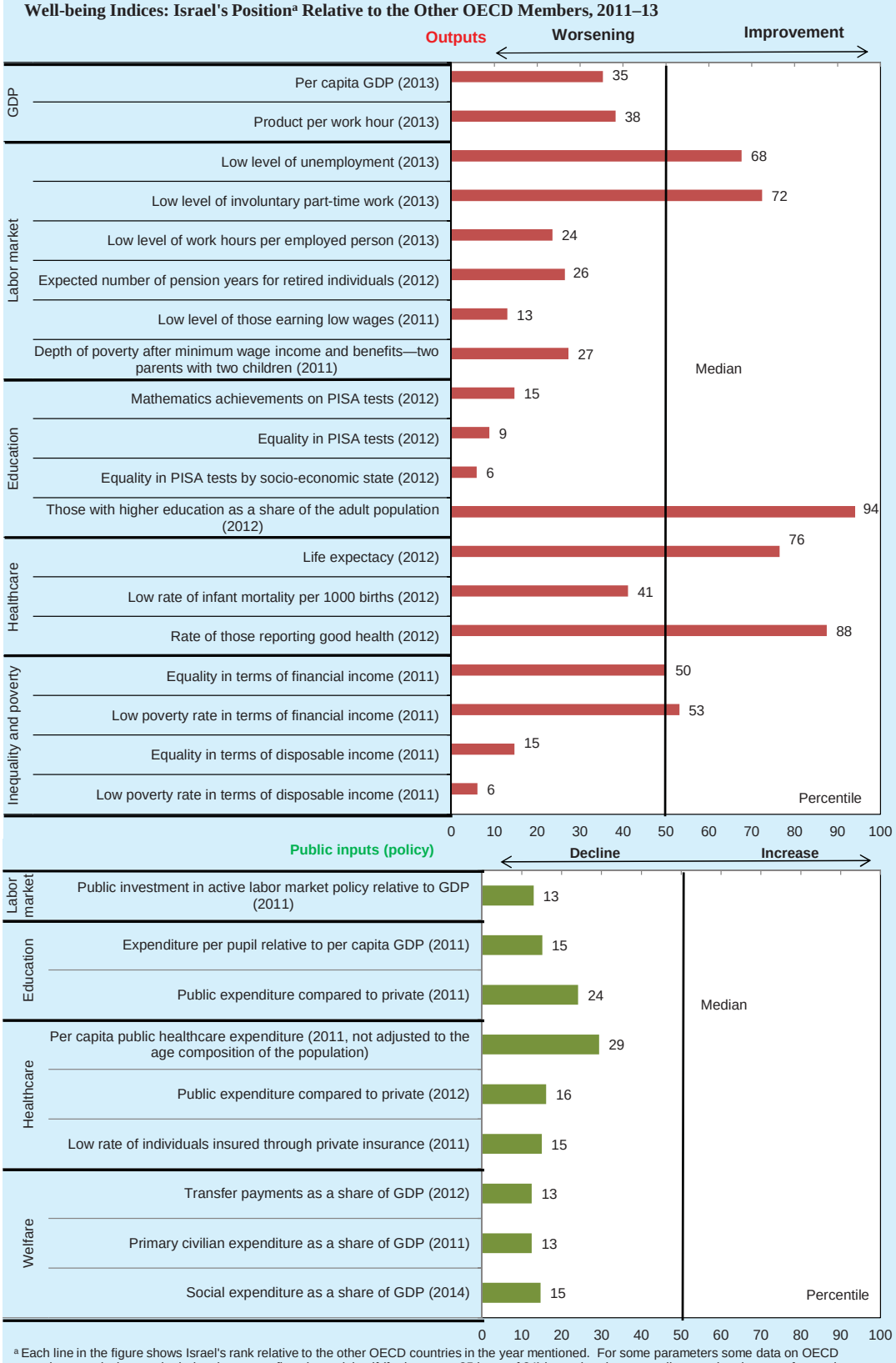
8 For example, there is a marked lack of core curriculum studies in the ultra-Orthodox population, and some of the Arab population lacks Hebrew knowledge.

9 A broader discussion of the low level of wages and of the minimum wage appears in Chapter 5.

10 Total household income before transfer payments and direct taxes.

11 Regardless whether it is the ratio between the 90th percentile and the 10th, between the 90th and the 50th, or between the 50th and the 10th.

Figure 8.1
Well-being Indices: Israel's Position[a] Relative to the Other OECD Members, 2011–13



[a] Each line in the figure shows Israel's rank relative to the other OECD countries in the year mentioned. For some parameters some data on OECD countries are missing, so the index does not reflect the rank itself (for instrance 25th out of 24) but rather the percentile, meaning the rate of countries ranked below Israel.

SOURCE: Based on OECD.

In order to find which factors may explain the rest of the variation, we used a multiyear model[12] to examine economic inequality according to the Gini index, and found that the coefficient of the employment rate is stable and ranges between -0.5 and -0.45. We can thereby conclude that the increase in the employment rate that has taken place in Israel since 2003 narrowed economic inequality by 3.2 points, which is the equivalent of the entire decline that has taken place in inequality of financial income.

Israel is anomalous in the inequality and poverty indices based on equivalized household disposable income.

Even though the poverty rate before government intervention is in the center of the distribution of poverty rates in the OECD, Israel is anomalous in the inequality and poverty indices based on equivalized household disposable income[13], due to the relatively low level of government intervention in the distribution of income by way of income tax and transfer payments.[14] In other words, policy that supported the employment rate was accompanied by the widening of measured social gaps, at least in the medium term.

The high values of the poverty and inequality indices led the previous Minister of Welfare to establish a public committee to examine the issue—the Committee to Fight Poverty (the Alaluf Committee). The committee submitted a report to the minister that was centered on the target of reducing poverty by ten percentage points within ten years (in order to reach the average poverty rate in the OECD) and reducing inequality. The committee's main recommendations include increasing benefits and indexing them to a fixed percentage of the poverty line (the committee Chairman and representatives of the Bank of Israel, the Prime Minister, and the Ministries of Finance and Economy expressed reservations about this recommendation); increasing the supply of public housing and of rental assistance; increasing the earning power of poor workers by expanding the earned income tax credit, expanding the scope of positions, and increasing the enforcement of labor laws; increasing the supply of daycare centers; expanding healthcare subsidies; and strengthening the differential budgeting in education (allocating resources according to socioeconomic background), particularly for pre-school. According to estimates, the cost of the recommendations will reach NIS 6–8 billion per year in the next five years. The government did not accept the recommendations.

[12] The variables included in the model: Per capita GDP, gross salary in the 90th percentile relative to gross salary in the 50th percentile (the most stable of the ratios), the labor force as a share of the population, the overall employment rate, and the rate of return on labor. The quality of the explanation of the regression reached 58 percent. We also examined the effects of the dependency ratio of the elderly population, student achievements on PISA tests, and the government's weight of GDP. However, the addition of these variables was not significant given the other variables.

[13] Equivalized household disposable income—Financial income plus transfer payments, minus direct taxes, after equivalization according to the OECD weights ladder.

[14] A detailed discussion on the issue appears in the Bank of Israel Annual Report for 2013, Chapter 8.

b. Social services

Compared to the other OECD members, there is little public expenditure on civilian needs in Israel.

Compared to the other OECD members, there is little public expenditure on civilian needs in Israel, and all expenditure indices are below the OECD median (Figure 8.1, lower portion). Excluding defense and interest expenditures, the government of Israel spends more than only three OECD countries: South Korea, Mexico and Chile. The following is a review of the situation in the main areas of social services.

Public expenditure per student relative to per capita GDP declined from 23 percent at the beginning of the century to 21.6 percent in 2011, but from then until 2014, it again increased, to 23 percent.

Education: National expenditure on education relative to GDP declined from the beginning of the century by one percentage point (the 2010–2012 average compared to the 2000–2002 average). Public expenditure per student relative to per capita GDP is lower than the OECD average. Although the most up-to-date international data—from 2011[15]—show that total public expenditure on education was similar to the OECD average (4.7 percent of GDP), the rate of children in the Israeli population is 50 percent higher. The low public investment per student is reflected in classrooms that are more crowded than average, low teachers' salaries[16], and low public financing of academic studies. According to Central Bureau of Statistics data and Bank of Israel calculations, public expenditure per student relative to per capita GDP declined from 23 percent at the beginning of the century to 21.6 percent in 2011. However, from then until 2014, it again increased, to 23 percent, with an accumulated increase in real terms of about 18 percent. This increase somewhat narrows the gap between Israel and the OECD average, assuming that the other members of the OECD did not change their ratios since 2011.

PISA tests show that there are many weak students in Israel and few strong ones.

Israel is among the leading countries in the OECD in terms of years of education of those aged 35–44, and is at the center of the distribution in terms of university quality.[17] However, achievement is not high. Average scores are not high, and there is a high level of variance among students that originates in socioeconomic background, including variance between Jews and Arabs. PISA tests show that there are many weak students in Israel and few strong ones, while the scores in the other OECD member countries are distributed more or less symmetrically (Figure 8.2). Since achievement levels are particularly low among Arabs and population groups with weak socioeconomic backgrounds[18], the Ministry of Education proposed in 2014 to allocate budgets for study hours along a slightly more progressive method than what

[15] OECD (2014), Education at a Glance.

[16] PISA data show that in 2012, teachers' salary in Israel was 89 percent of per capita GDP, while the average among the other OECD countries was 123 percent.

[17] The index of university quality is set by weighting (1) university quality—the average overall score of the universities for 2013, according to the Times Higher Education World University Rankings; (2) the average size of the universities relative to the country's population; and (3) the number of universities relative to the population.

[18] In Israel, there is a particularly low rate of students who come from weak socioeconomic backgrounds and obtain high scores on PISA tests. For instance, Israel comes in 5th place among the 34 OECD member countries in terms of the ratio between the chances of a student from a weak socioeconomic background to score achievements that are not low and the chances of a student from a strong background to score such achievements.

has been customary until now. However, the implementation of the proposal was delayed due to the dissolution of the government.

Healthcare: Compared to the other OECD countries, Israel is prominent in a number of main healthcare indicators. Infant mortality per thousand births is relatively low, life expectancy is high, there is a low mortality rate among those aged 0–69 (the age range for preventable death), and there is a high rate of individuals who report that they are in good health.[19] In contrast, public investment in public hospital infrastructure is lower than in the other OECD countries, and in real terms it did not increase between 1995 and 2010. As a result, there is little physical capital in public hospitals.[20] The underinvestment is reflected in the fact that Israel lags behind the OECD average in a number of indices of the quality of healthcare services. By way of illustration, the number of hospital beds per thousand people is two-thirds of the OECD average, and the occupancy rate of those beds is about 25 percent higher. In Israel there are 2.5 MRI machines and 9 CT machines per million residents, while there are an average of 13 MRI machines and 24 CT machines per million residents in the OECD. In addition, there are low numbers of young nurses and physicians[21] in

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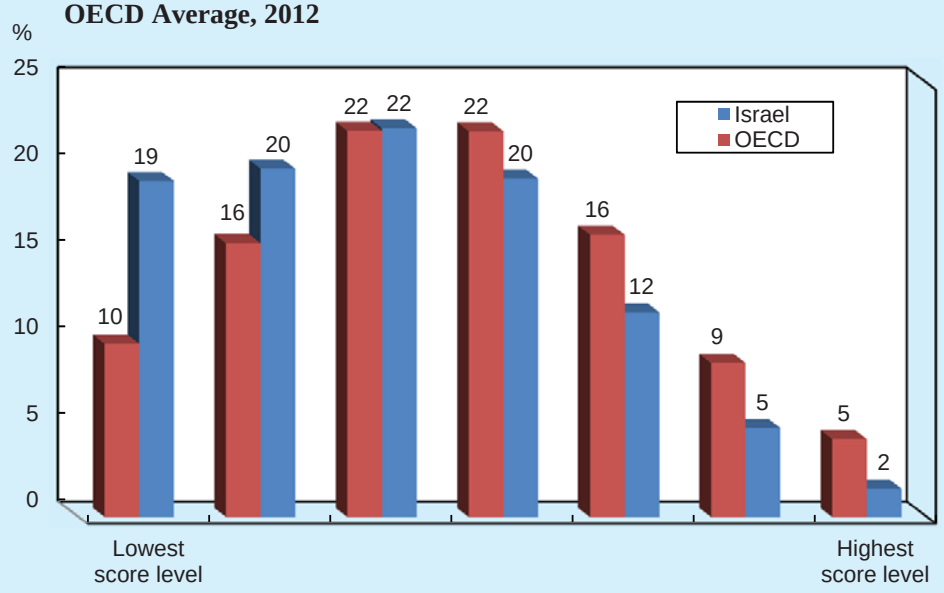
Figure 8.2
Distribution of PISA Test Scores in Mathematics, Israel and the OECD Average, 2012



SOURCE: OECD.

[19] In addition to the healthcare system, there are other factors that affect these indices, including drinking, smoking and exercise habits, the climate, and heredity.

[20] More on investment in the physical capital of the public healthcare system appears in Bank of Israel (2015), Recent Economic Developments, 138.

[21] The focus on young people is intended to highlight the state of medicine in the future, and shows the pace of training physicians in Israel.

Israel, and subjective satisfaction with the healthcare system in the residential area is ranked 28th out of the 34 OECD members.

The lower public expenditure on education and healthcare contributes to the fact that in these areas, the ratio between private and public expenditure is high by international comparison (Figure 8.1, lower portion). This applies particularly to the healthcare field, since private financing as a share of national healthcare expenditure has increased in recent years. The financial hardships of the public healthcare system[22] have led the government to establish a public committee—the Advisory Committee for Strengthening the Public Health System (the German Committee). However, the implementation of the committee's recommendations—to strengthen public medicine by adding NIS 1 billion a year to the budget—was delayed due to the dissolution of the government.

Households themselves did not increase total private expenditure on healthcare and education services as a share of disposable income. Relative to the previous decade, they slightly increased healthcare expenditure[23], but per child expenditure on education declined by a more marked rate, and increased with income (Table 8.1). Since achievements in education are relatively low, it is possible that households are not internalizing the full positive effects of education. It seems that liquidity limitations do not explain the decline in private national investment in education as a share of GDP, since investment as a share of disposable income decline in all but the lowest quintile.

Low expenditure on civilian needs worsens inequality, and may also have a negative impact on economic efficiency.

Infrastructure: Box 2.2 deals with investment in roads and railways—investment that for the most part is made with public financing—and shows that Israel lags in this area both in terms of the stock of infrastructure capital, and in terms of investment.

In addition to the fact that the low public expenditure in Israel worsens inequality, it also may have a negative impact on economic efficiency in general. There are four possible channels for this: 1. Public products have positive externalities[24], which the market does not take into account; 2. Competitive market allocation in the healthcare field leads to inefficiency, requiring government intervention. For instance, market allocation may lead to a better physician treating a simpler medical condition among those with higher income, while a less competent physician would treat a more serious problem among those with lower incomes. Another example is in the area of health insurance, where there is a problem of asymmetry of information; 3. When the quality of public services falls below a minimal level, it may push more well-to-do population groups to increase their consumption of private services, which may further erode

[22] More on the state of the public healthcare system appears in Bank of Israel (2014, 2015), Recent Economic Developments, 137 and 138.

[23] Some of the growth is derived from the fact that products were added to the "public services" category due to classification changes in the Household Expenditure Survey.

[24] Externalities—the effects of factors that are not involved in a certain action. By way of illustration, paving a road has externalities on the standard of living of residents in the surrounding areas, including improved access (positive effect) and air pollution (negative effect).

Table 8.1
Education and healthcare expenditures[a] as a share of disposable income, by household income quintiles, 1999–2001 compared with 2010–2012

Households	Years	Healthcare	Education[b]
Average among all households	1999–2001	5.4	7.4
	2010–2012	5.7	6.7
	Difference	**0.28**	**-0.70**
Lowest quintile	1999–2001	9.5	5.7
	2010–2012	9.9	6.0
	Difference	**0.36**	**0.33**
Second quintile	1999–2001	6.8	7.5
	2010–2012	7.5	7.4
	Difference	**0.63**	**-0.07**
Third quintile	1999–2001	5.7	9.2
	2010–2012	6.2	8.0
	Difference	**0.50**	**-1.28**
Fourth quintile	1999–2001	5.3	9.5
	2010–2012	5.4	8.6
	Difference	**0.16**	**-0.88**
Fifth quintile	1999–2001	4.4	8.3
	2010–2012	4.5	6.9
	Difference	**0.16**	**-1.31**

[a] Among households with expenditures significantly higher than zero.
[b] Average expenditure per child, in families with children under age 18.
SOURCE: Based on expenditure surveys.

them[25]; 4. In most households, equivalized disposable income increases as the head of household grows older, both because labor income increases and because the children grow older and leave the home. Therefore, most advanced economies provide assistance to households to smooth consumption—meaning to distribute it in a more balanced fashion among the various stages of the life cycle—through tax benefits and support payments for young parents. The support of young parents in Israel is particularly low in comparison to the other OECD members countries.[26]

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[25] By way of illustration, the low number of teaching assistants in public kindergartens for those aged 3–4 has led many parents to refuse to send their children to those kindergartens, even though tuition there is lower than alternatives in the private sector.

[26] Brender, A. and M. Strawczynski (2014), "Government support for young families in Israel", Discussion Papers Series 2014.02, Bank of Israel Research Department (in Hebrew).

In order to achieve sustainable improvement in healthcare, education and infrastructure, civilian expenditure as a share of GDP must be increased significantly.

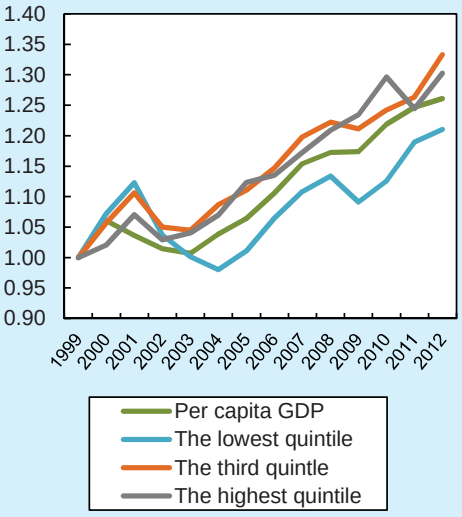
In summing up the well-being processes that have taken place in recent decades, we find that the sharp decline in direct transfers that are not conditional on employment, alongside the reduction in income tax rates, contributed to increased employment but also contributed to widening social gaps. In order to achieve sustainable improvement in the areas in which Israel is weaker than the other OECD members—education, healthcare and infrastructure—civilian expenditure as a share of GDP must be increased significantly. However, such an increase without lowering defense expenditure as a share of GDP will require the cancellation of tax exemptions and the widening of the tax base, or an increase in tax rates, and may reduce incentives to work and to hire. (It should, however, be noted that the tax burden in Israel is not high compared to the other OECD countries.) One of the main ways to improve the tradeoff between these objectives is to streamline public social expenditure: If more effective and focused policy measures are formulated, the burden required to achieve them will be lower.

2. RECENT TRENDS IN THE DEVELOPMENT OF HOUSEHOLD INCOME

This section reviews the development of household income between 1999 and 2013, against the background of the business cycles and the policies adopted over the course of this period. It also assesses how these developments were reflected in a number of well-being indices.

Households' disposable monetary income is equal to financial income (income from work and capital) plus transfer payments, minus direct taxes. Disposable income is therefore comprised of net financial income and income from transfer payments. At the beginning of this section, we assess how it has developed over the reviewed period in the various income quintiles. We then discuss the changes that have taken place in its composition during that time.

Figure 8.3
Per Capita GDP and Equivalized Net Income Per Household in Real Terms, 1999–2012 (Index: 1999 = 1)



SOURCE: Based on Expenditure surveys, and National Accounts data.

a. Households' disposable income

Equivalized disposable income—both average and median—increased during the reviewed period at a similar pace to growth in per capita GDP. In the three upper quintiles, it increased by 2.1 percent per year, and in the lowest quintile it increased by 1.5 percent per year (Figure 8.3 and table 8.2).

Table 8.2
Increase in per capita GDP, and in equivalized household income, selected years

	Years	1999–2001	2002–2004	2005–2012	**1999–2012**
	Per capita GDP	1.8	1.2	2.5	**1.8**
Equivalized disposable income	Average	4.5	1.6	2.3	**2.1**
	Lowest quintile	6.0	-2.8	2.6	**1.5**
	Third quintile	5.2	1.8	2.6	**2.2**
	Highest quintile	3.4	1.9	2.1	**2.1**

SOURCE: Based on expenditure surveys and National Accounts data.

Between 1999 and 2001, income in the lowest quintile increased rapidly due to the increase in benefits (which were indexed to the average wage, which was particularly high in 2001[27]), and due to the Families With Many Children Law (the Halpert Law).[28] In 2003 and 2004, it declined sharply, mainly due to the sharp cut in transfer payments, particularly child allowances[29], but also due to a decline in wages, since the benefits were still indexed to the average wage. During this period, the income of the lowest quintile eroded significantly relative to income in the other quintiles.

From 2005 to 2012, the equivalized disposable income of most of the population increased at a similar pace—about 2.5 percent per year—although the income of the highest quintile increased at a slightly slower pace.

From 2005 to 2012, the equivalized disposable income of most of the population increased at a similar pace, although the income of the highest quintile increased at a slightly slower pace.

In the two highest quintiles most of the increase derived from a reduction of direct taxes, while in the two lowest quintiles, it derived from an increase in the number of breadwinners per household. In the middle quintile, it was affected by both an increase in financial income and a decline in direct taxes (Table 8.3).

The cut in transfer payments made at the beginning of the century had a significant and immediate impact on the disposable income of the lowest quintile, because a significant proportion of that income was derived from the transfer payments. In contrast, joining the labor force was a much more gradual process. The cumulative increase in real income among the lowest decile in recent years has not completely compensated for the relative erosion at the beginning of the century, and the gaps in disposable income have widened compared to the beginning of the period.

The incidence of poverty has been stable since 2005 (the green curve in Figure 8.4). The poverty line itself rises with the pace of growth of per capita GDP (the blue curve), and the depth of poverty—how far the average disposable income of

[27] More on the development of wages appears in Bank of Israel (2015), Recent Economic Developments, 138.

[28] The law was passed by the Knesset in November 2000, leading to a marked increase in child allowances from the fifth child, and to an increase in childbirth grants for those children. In June 2003, the law was repealed and child allowances declined to a level even lower than what had been in place before November 2000.

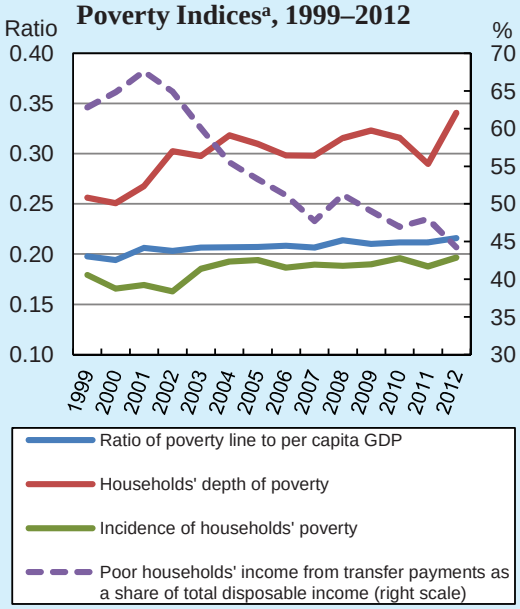
[29] The average income from transfer payments among households in the lowest quintile declined by about 14 percent between 2001 and 2003.

Table 8.3
The development of disposable income, its components and labor input, by quintile, since the beginning of the century[a]

	Years	Disposable income	Transfer payments	Income from work	Income from work after direct taxes	Number of breadwinners	Monthly work hours per household	Income from work after taxes
Average among all households	1999–2001	11,587	1,876	11,511	7,985	1.19	186	43
	2010–2012	13,791	1,787	12,745	9,993	1.33	198	50
	Percent change	**19.0**	**-4.7**	**10.7**	**25.1**	**11.2**	**6.8**	**17.2**
Lowest quintile	1999–2001	4,144	2,581	1,716	1,327	0.46	61	22
	2010–2012	4,732	2,164	2,607	2,280	0.65	85	27
	Percent change	**14.2**	**-16.2**	**51.9**	**71.8**	**42.1**	**38.9**	**23.7**
Second quintile	1999–2001	7,073	2,348	5,084	4,096	0.96	142	29
	2010–2012	8,034	2,101	5,872	5,193	1.11	154	34
	Percent change	**13.6**	**-10.5**	**15.5**	**26.8**	**15.5**	**8.5**	**16.8**
Third quintile	1999–2001	9,954	1,820	8,778	6,974	1.32	206	34
	2010–2012	12,044	1,613	10,604	9,176	1.53	229	40
	Percent change	**21.0**	**-11.3**	**19.4**	**31.6**	**16.0**	**11.5**	**18.0**
Fourth quintile	1999–2001	13,821	1,411	14,344	10,516	1.57	251	42
	2010–2012	16,599	1,513	15,927	13,080	1.69	267	49
	Percent change	**20.1**	**7.2**	**11.0**	**24.4**	**7.5**	**6.6**	**16.7**
Highest quintile	1999–2001	22,873	1,228	27,444	16,950	1.64	269	63
	2010–2012	27,393	1,552	28,544	20,105	1.64	255	79
	Percent change	**19.8**	**26.3**	**4.0**	**18.6**	**-0.4**	**-5.1**	**24.9**

[a] Income is in fixed prices, base year - 2013.
SOURCE: Based on expenditure surveys.

Figure 8.4
Poverty Indices[a], 1999–2012



[a] To calculate the depth of poverty, the average income of poor households is divided by the poverty line, and the numerator is subtracted from one.

SOURCE: Based on expenditure surveys.

poor families is from the poverty line—is more or less stable (the red curve). In other words, while the incidence of poverty in Israel is high, the disposable income of poor households has increased together with growth.[30]

While the incidence of poverty in Israel is high, the disposable income of poor households has increased together with growth in per capita GDP.

The poverty line increased with per capita GDP before 2003 as well, and in certain periods it even increased more rapidly. However, the income of the poor was based mainly on benefits, as reflected in the increase of benefits as a share of GDP. In contrast, in recent years, the disposable income of poor households increased as a result of their increased labor supply. At the beginning of the century, transfer payments accounted for about 70 percent of the disposable income of poor households, while in recent years, they account for slightly more than 40 percent (Figure 8.4).[31]

At the beginning of the century, transfer payments accounted for about 70 percent of the disposable income of poor households, while in recent years, they account for slightly more than 40 percent.

Table 8.3 examines the change in disposable income and its components by quintile and taking into account the number of breadwinners and the number of work hours, and sums up how the processes that took place in the economy since the beginning of the century have been reflected.

Since the beginning of the century, inequality by disposable income has increased, because the disposable income of the two lowest quintiles increased less than among the three highest quintiles. However, the inequality in terms of income from labor narrowed, because the households with the lowest income expanded their labor supply, inter alia due to the cut in benefits. In contrast, households in the highest quintile lowered their labor supply, and the increase in their disposable income was mostly the result of reduced direct taxes.

[30] Box 8.1 in the Bank of Israel Annual Report for 2013 examines how the standard of living of poor people in Israel has developed relative to 1997. The box shows that the poor have also improved their standard of living in line with growth.

[31] By way of comparison, among 21 OECD member countries, the average share of transfer payments in 2010 was 62 percent of disposable income of the lowest quintile. Source: Based on Luxembourg Income Survey.

It is therefore interesting to see that the increase in labor supply decreases with the increase in household income, which shows that the effect of income[32] was more dominant at the two extremes of the income distribution. Those with high income experienced a positive shock (lower taxes) and reduced their work hours, while those with low income experienced a negative shock (lower benefits) and increased their labor supply.

Table 8.3 also shows that the reverse ratio between growth in labor input and wages per hour led to changes in the composition of labor inputs in the economy, and employees with relatively low labor productivity currently have more work hours. (Between the two periods, their share of the lowest quintile increased from 6.6 percent to 8.6 percent of total work hours, and in the two highest quintiles, it declined from 56.0 percent to 52.8 percent.) Even though households in the lowest quintile significantly increased their labor inputs, they can increase them more. If they increase them to the level of a household in the second quintile (meaning an increase of about 80 percent), then without a change in their hourly wage, they will add about NIS 2000 a month to their disposable income, and the economy's Gini index will decline by about 3.2 points.

Going to work and increasing the scope of the position involve a loss of leisure, and among parents of young children they also incur financial costs.

However, it is important to remember that going to work or increasing the scope of the position do not only involve a loss of leisure, but also incur financial costs, mainly in the case of mothers of young children. The most prominent of such expenses include transportation, childcare, and professional training. In this context, attention should be drawn to two important indicators: 1. The rate of households privately paying for daycare and afternoon care has been in a constant significant upward trend since the beginning of the century. This is particularly prominent in the lowest quintiles—those that have most significantly expanded their labor supply. Households that privately pay for daycare and afternoon care doubled in proportion, and the segment of their disposable income occupied by these services increased by about 1 percentage point, to 14 percent. Expenditures on these services increased among the two lowest quintiles by more than 25 percent in real terms, and in 2012, a household in the lowest quintile spent an average of NIS 700 per month on daycare and afternoon care, while a household in the second quintile spent NIS 1200 on these expenses.[33] 2. There is low financing for professional training in Israel, although it has positive external effects.

[32] The economic literature breaks down the effect of increase hourly wages to two different effects: the income effect and the alternative effect, assuming that leisure is a product, demand for which increases with income (a normal product). The income effect means that increased income will expand leisure consumption, meaning a reduction of labor. The alternative effect means that increased income will lower leisure consumption and expand labor, since leisure itself is now more expensive (the alternative cost of leisure consumption increases). The two effects obviously act in opposite directions, and it is unclear which of them is stronger. It is therefore unclear how an increase in hourly wage affects labor supply. In the case of a cut in benefits, growth in the labor supply was observed, since in this case, only the income effect is supposed to operate.

[33] These were true until 2012. In 2013, in accordance with the recommendations of the Committee for Economic and Social Change (the Trajtenberg Committee), the government expanded public support for daycare.

In view of the decline in leisure and the increase in peripheral expenses, it therefore seems that the changes in policy made in the past decade have led to reduced labor input with an increase in leisure and in disposable income among those with high incomes, and to an increase in labor input, less leisure and an increase in disposable income among those with low incomes.

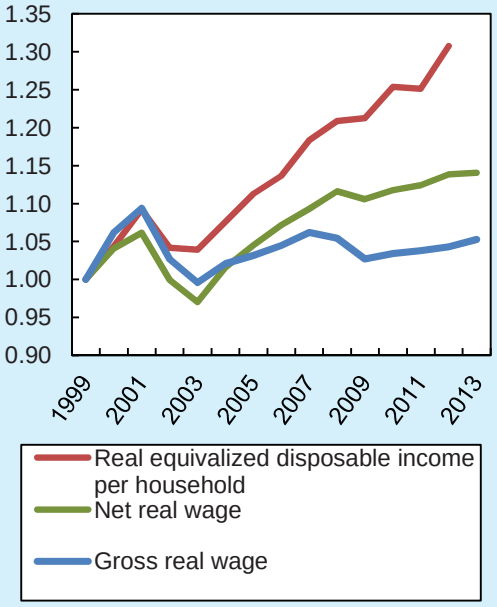
The changes in policy made in the past decade have generated greater benefit for households with higher incomes.

b. Workers' disposable income

The disposable income of households serves as a standard of living index. About 80 percent of it is derived from income from work, which, for its part, is comprised of the number of the household's work hours and the average wage per hour of work. While the disposable income of most households has increased similar to per capita GDP since 1999, the average income of workers has eroded in recent years, and their purchasing power has not increased. The average real wage has more or less maintained its level since the beginning of the century[34] (Figure 8.5).

While the development of direct taxes caused net employee wages to increase more than gross wages, net wages also increased by a lower rate than the growth rate or than net household income—variables that were also affected by the increase in labor inputs. Therefore, it can be said that standard of living increased thanks to an increase in labor inputs.

Figure 8.5
Gross and Net Real Wages Compared to Average Equivalized Disposable Income, 1999–2013 (Index: 1999 = 1)



SOURCE: Based on expenditure surveys and National Insurance Institute data on employee wages.

[34] It should be noted that real wages increased very rapidly between 1995 and 2001. More on the development of real wages since 1990 appears in Bank of Israel (2015), Recent Economic Developments, 138.

3. FACTORS OF INEQUALITY: ISRAEL AND THE OTHER OECD MEMBERS

According to the Gini index, inequality in Israel declined between 2009 and 2012 by 1.2 points, but inequality measured by equivalized disposable income is still higher than in the other OECD countries. Inequality measured by financial income is not exceptional.[35] In this section, we will see that the inequality gap according to disposable income in general, and particularly according to equivalized disposable income, derives from, among other things, the fact that direct government intervention in the distribution of income in Israel is relatively low, and from the fact that the poor households in Israel include more individuals. The international comparisons are based on microeconomic data from 22 OECD member countries.[36] The base year for the comparison is 2010.

a. Direct government intervention in the distribution of income

Table 8.4 shows the ratio between household income in the various quintiles and income in the middle quintile, and compares Israel to the OECD average. The table focuses on three types of income: household financial income (Panel A); household disposable income (Panel B); and equivalized household disposable income (Panel C).

Table 8.4
The ratio between household income in the various quintiles and household income in the third quintile, Israel and the OECD average[a]

	A			B			C		
	Financial income per household			Disposable income per household			Equivalized disposable income per household		
	Israel	OECD average	Difference between Israel and OECD	Israel	OECD average	Difference between Israel and OECD	Israel	OECD average	Difference between Israel and OECD
Lowest quintile	0.23	0.29	-0.05	0.39	0.46	-0.07	0.35	0.47	-0.13
Second quintile	0.52	0.56	-0.04	0.64	0.73	-0.08	0.65	0.76	-0.11
Third quintile	1.00	1.00		1.00	1.00		1.00	1.00	
Fourth quintile	1.57	1.56	0.01	1.41	1.30	0.10	1.42	1.32	0.10
Highest quintile	3.12	2.87	0.25	2.40	2.07	0.33	2.82	2.22	0.59
Highest decile	4.06	3.59	0.47	2.98	2.51	0.47	3.67	2.74	0.93

[a] According to the most up-to-date data on each country, mostly from 2010.
SOURCE: Based on Luxembourg Income Survey (LIS).

[35] More appears in the Bank of Israel Annual Report for 2013, Chapter 8.

[36] Luxembourg Income Survey. The countries used in the comparison are: Australia, Canada, Germany, France, Estonia, Finland, Denmark, Greece, Iceland, Italy, Ireland, Luxembourg, Netherlands, Norway, Poland, Slovakia, Slovenia, Spain, UK, US, Sweden, Austria and Switzerland. The data for most countries show the situation in 2010, except for the data on Sweden (2005) and Austria and Switzerland (2004).

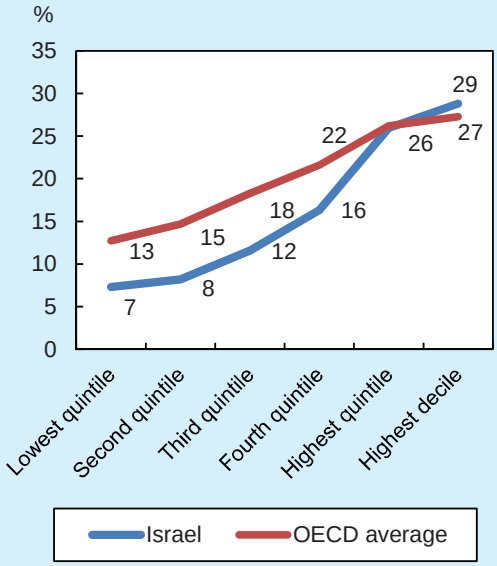
Panel A shows that in terms of financial income, the ratio between the highest quintile and the third—and particularly the ratio between the highest decile and the third quintile—is higher in Israel than the average ratio in the OECD. However, even so it is not exceptional (6th place out of 22).

Panel B shows the role of the direct taxes and direct transfers policy (direct intervention). Compared to the other OECD countries, the relative state of the two highest (fourth and fifth) quintiles in Israel has improved as a result of the policy, and the state of the two lowest (first and second) quintiles has worsened. In other words, direct government involvement in the distribution of income is less progressive in general than in the other OECD countries.

In terms of financial income, the ratio between the highest quintile and the third—and particularly the ratio between the highest decile and the third quintile—is high in Israel, but not exceptional.

Direct government involvement in the distribution of income is less progressive in general than in the other OECD countries.

Figure 8.6
Direct Taxes as a Share of Gross Household Income, by Quintiles and the Highest Decile, Israel and the OECD Average[a], 2010



[a] According to the most up-to-date data on each country, mostly from 2010.
SOURCE: Based on Luxembourg Income Survey (LIS).

However, in terms of only direct taxes, the tax system is very progressive because it relies mainly on households from the highest quintile—those that are responsible for about 60 percent of revenue derived from direct taxes. However, the burden of direct taxes among these population segments is not exceptional by international comparison (Figure 8.6). The direct tax burden on the other households is much lower than in the other OECD countries. In other words, Israel is not exceptional compared to other countries because it has a high direct tax burden on the highest quintile, but because it has a low direct tax burden on the other quintiles.[37]

The direct tax burden on the highest quintile is high but not exceptional, while the direct tax burden on the other quintiles is exceptionally low.

Direct and progressive tax levels in Israel have declined sharply[38] compared to the beginning of the century, while

[37] The maximum marginal income tax rate in Israel was 48 percent in 2012—7th out of 34 countries in the OECD—and rose to 50 percent in 2013.

[38] The rate of progressive taxes declined mainly through sharp reductions in income tax brackets. Therefore, income tax payments as a share of GDP declined from 6.3 percent in 2002 to 3.5 percent in 2013. Among households that paid income tax at a rate higher than zero, the average payment in current prices was 35 percent lower than the payment at the end of the 1990s. More on the subject appears in the Bank of Israel Annual Report for 2013, Chapter 6.

indirect and regressive tax levels remained unchanged overall. Therefore, the tax system as a whole has become far less progressive.[39]

b. The demographic aspect: household size

The average number of individuals in households in the OECD countries does not vary from one quintile to another. However, in Israel there is a negative correlation between disposable income and the number of individuals in the household, which increases inequality even more.

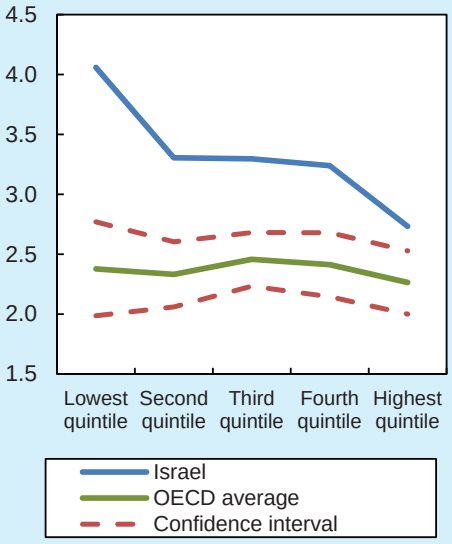
Panel C shows the role of household size in explaining the increase in equivalized inequality. Low-income households in Israel have more children: While the average number of individuals in households in the OECD countries ranges around 2.5 in all income quintiles[40], there is a clear opposite ratio in Israel, with more than 4 individuals per household in the lowest quintile and about 2.73 individuals per household in the highest quintile (Figure 8.7).

The negative correlation between disposable income and the number of individuals in the household in Israel increase inequality even more, relative to the other OECD members. Therefore, the relative state of the lowest two quintiles grows worse, and the state of the two highest quintiles improves.

Figure 8.8 separately shows the contribution of policy and the contribution of demography to the differences in inequality between Israel and the OECD average. The Figure focuses on the ratio between equivalized disposable income in a household in the lowest quintile to the parallel income in a household in the highest quintile. It shows that in breaking down the sources for the gap in this ratio between Israel and the OECD average, we find that 22 percent of the gap derives from financial income, 25 percent is the result of policy, and 54 percent is the result of demography. Similar to Figure 8.7, this figure also shows confidence intervals, which show that in terms of equivalized disposable income, Israel is a particular exception in the ratio between the highest quintile and the lowest.

These findings create a dilemma for policy makers: Transfer payments that are not dependent on earning power

Figure 8.7
Average Number of Individuals per Household, by Quintile, Israel and the OECD Average[a], 2010



[a] According to the most up-to-date data on each country, mostly from 2010.

SOURCE: Based on Luxembourg Income Survey (LIS).

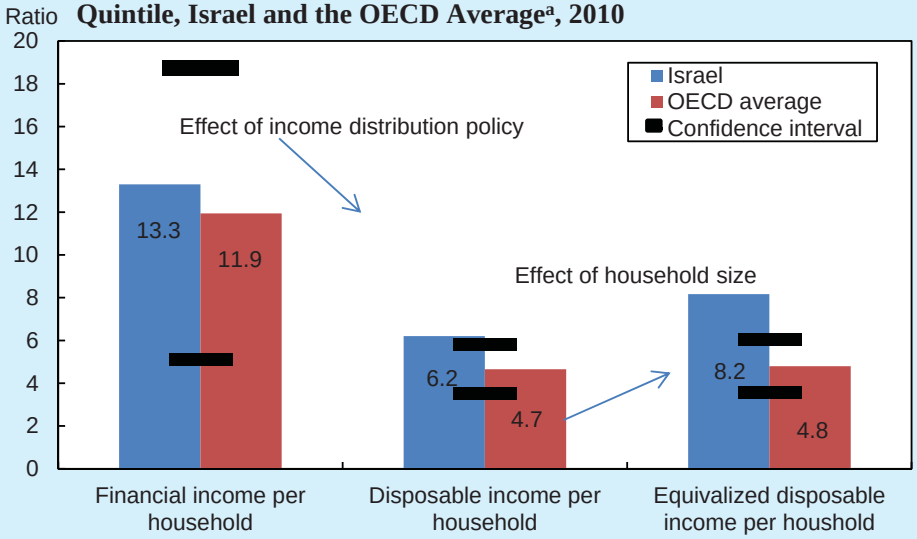
[39] As shown by Strawczynski, M. and Y. Kedar (2014), "Development of the Progressive Nature of the Statutory Tax Rate in Israel," Working Paper, Van Leer Jerusalem Institute.

[40] The finding is valid regarding most of the countries examined, and not just regarding their average.

may encourage increased family size and underemployment, particularly among poor families, thereby entrenching poverty among them, while an increase in transfer payments makes it possible to raise the standard of living among people with less ability to integrate in the labor force. One of the ways to balance these considerations is to increase transfer payments only for working families—for instance through the earned income tax credit (negative income tax)—but this brings into sharper relief the need to exclude individuals with particularly low earning power from the group.

Increasing transfer payments that are not dependent on earning power for the working-age population may encourage increased family size and underemployment, while an increase in transfer payments to people with less ability to integrate in the labor force makes it possible to raise their standard of living as well.

Figure 8.8
Ratio of Income in the Highest Quintile to Income in the Lowest Quintile, Israel and the OECD Average[a], 2010



[a] According to the most up-to-date data on each country, mostly from 2010.
SOURCE: Based on Luxembourg Income Survey (LIS).

Box 8.1

Public Housing in Israel

The steep rise in home prices brought the importance of housing assistance to the forefront of the nation's agenda and again raised the discussion of public-housing policy. In the past, the government made broad use of such policy in order to increase housing affordability among population groups whose economic means do not allow them to purchase a home and who spend a large share of their income on rent. This box focuses on public housing and describes its development over the years as well as the characteristics of the dwellings and the residents. It then offers an international comparison of housing assistance. Finally, it examines the advantages and disadvantages of public housing and offers suggestions for the appropriate policy to adopt in this area.

Housing assistance—past and present

Currently, the government provides housing assistance primarily in three ways, listed in increasing order of recipients' needs: (1) Mortgage subsidies; (2) Rental subsidies in the free market, and (3) Allocating accommodations in public housing (and for senior citizens, in assisted living) at subsidized rents. The assistance policy is the responsibility of the Ministry of Construction, and there are housing companies that are responsible for the stock of public-housing homes and their maintenance.[1]

Over the years, government housing assistance has decreased in all of its channels. The government cancelled the grants for purchasing a home (except for immigrants from Ethiopia); reduced the size of subsidized mortgages and their inherent benefit (Agmon, 2014)—among other ways due to the reductions in the interest rate; cut assistance for rentals in the free market, and allowed their real value to erode.[2,3] These steps were taken despite the high poverty rate and despite the real increase that occurred in recent years in housing prices. As a result, and to some extent also due to reduced immigration to Israel, government expenditure on housing assistance declined from NIS 4.6 billion in 2000 (in 2014 prices) to around NIS 2.0 billion in 2014. This contraction, in turn, reduced the share of households that do not own a dwelling and whom receive housing assistance through one of two primary channels—public housing and rental assistance. In 1987, before the mass immigration from the former Soviet Union, about half of households that did not own a dwelling received assistance through such channels, and in 2014 only slightly more than one-quarter did, while the share of home ownership declined slightly over those years.

[1] The stock of homes in public housing is primarily managed by the Amidar and Amigour companies. In addition, there are the following municipal companies: Heled—Government-Municipal Company for Housing Renewal and Development Ltd. in Petah Tikva; Halamish—Government-Municipal Company for Housing Renewal Ltd. (Tel Aviv); Prazot—Government-Municipal Company for Housing Ltd. (Jerusalem); Shikmona—Government-Municipal Company for Housing Renewal in Haifa Ltd, as well as "Housing and Development" (primarily in Qatzrin and in Judea and Samaria).

[2] Due to the social protest in the summer of 2011, the government increased somewhat the amount of rental assistance.

[3] The expenditure on housing assistance does not include the value of the rental subsidy in public housing, the cost of purchasing homes for stock (net of revenue from selling the homes), and housing loans. Agmon (2014) and Achdut and Gordon (2004) describe the legislative changes that were enacted since the beginning of the previous decade and that reduced the housing assistance.

At the end of 2014, there were about 61,000 homes in public housing[4,5], and based on administrative data, the tenants paid an average of NIS 340 per month in rent.[6] The rent level was set in accordance with family characteristics and the location of the dwelling. Those eligible for a dwelling in public housing include families that have not owned a home since 1971, have exhausted their earning capacity[7], have low income, and who have three or more children unless they are new immigrants.[8] In 2014, more than 2,000 eligible families were waiting for a dwelling in public housing (excluding families waiting to exchange their dwelling), and the average waiting time for a home in the center of the country has reached 5–10 years. It should be noted that those waiting are eligible for an increased rent subsidy.

Public housing has an interesting history. The State of Israel provided, from the day of its founding, rapid and extensive housing solutions in order to absorb the waves of immigration and to develop and settle remote areas. In the State's first decades, many public-housing dwellings were built through public construction, mainly in peripheral areas. The total reached around 200,000 at the end of 1960s (Weinstein, 2014), and they housed more than a quarter of households in Israel. Most of their residents were new immigrants and had few economic means. Beginning in the 1970s, the government changed this policy. First it switched from public construction to homebuyer (and contractor) assistance, and later on to assistance with rents in the free market. In parallel with expanding the use of rental assistance, the government reduced the use of the public housing mechanism—it decreased the stock of homes in public housing by sales initiatives and fewer purchases, and as of the end of 2014 the stock of homes as noted was about 61,000.

The sale to residents of homes in public housing has existed for many years, in order to ensure dwellers the ownership of a home that can be bequeathed as well as for other reasons that will be listed below, and the homes were sold at marked discounts. The first sales initiative (the Great Opportunity) began in the middle of the 1980s and ended in 1994—the discount in that program reached 60 percent at the most, and through that program about 5,000–7,000 homes were sold each year (Weinstein, 2014).

In 1998, the Public Housing (Purchasing Rights) Law, 5758–1998, was enacted, and this enabled residents to purchase the homes at a maximum discount of 85 percent (the rate of the discount increases with the tenure in public housing). The law's enactment was delayed several times, and sales initiatives were conducted instead—"My House" (1999–2000), "Buy your Home" (2000–04), "My Home is Here" (2005–09), and "A Home of My Own" (2008–10). Altogether, about 33,000 dwellings were sold in these recent initiatives, while the number of homes bought for stock during the same period was only about 1,600. Less than half the receipts from the sales were guided to housing projects, and only about 7 percent were guided to the purchase of new homes, even though the funds were originally designated for purchasing new homes

[4] As of 2011, about 2,300 homes were rented to public entities (State Comptroller, 2013). Likewise, about 500 homes are currently not inhabited.

[5] In addition to the stock of homes in public housing, there are 24,000 assisted living housing units, at low rent, and these homes are occupied by senior citizens (primarily immigrants).

[6] At the end of 2014, there were 144,000 families receiving free market rental assistance, at an average amount of NIS 880 per month.

[7] A high degree of disability or receiving an income support allowance or income supplement for at least two years. Among new immigrants there is a group that is not obligated to exhaust its earning capacity: disabled people, the elderly, and mothers/fathers in single-parent families. Details appear in the report of the Committee to Fight Poverty in Israel (2014).

[8] As an illustration, the following couple is eligible—under certain circumstances—for a home in public housing: veteran in Israel, has three or more children, exhausted its earning capacity, and their income in 2015 was less than NIS 6,033 per month.

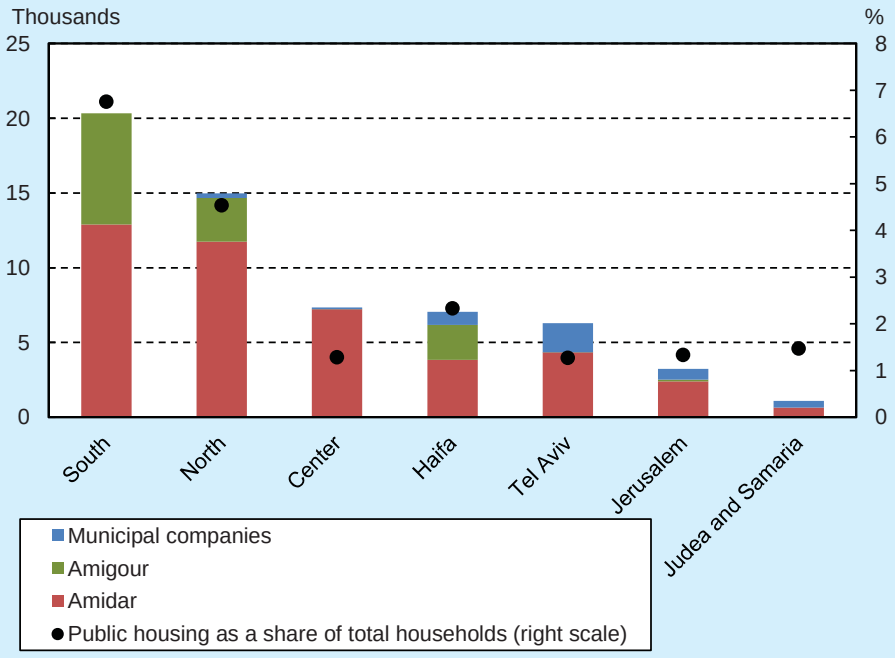
for stock (Fidelman, 2011). In any case, since the homes were sold at a marked discount, only a relatively small number of homes could be purchased with the receipts.

In July 2013, the government decided to permit residents to purchase the homes at terms that were set in the Public Housing Law, for five years or until the sale of 15,000 homes from stock. The government has implemented the decision since January 2014, and by the beginning of 2015 residents had submitted 5,500 purchase requests, and about 2,300 homes were purchased. The revenue from the sale of the homes is designated for increasing the stock of public-housing homes, for renovating the homes, and for rental assistance. The Ministry of Construction plans to allocate NIS 1 billion in 2015–16 for the purchase of 1,000 homes, primarily in the center of the country. The Ministry will purchase the dwellings through the housing companies, and to date has transferred NIS 400 million to Amidar for such purposes.

Characteristics of dwellings and residents in public housing

Public housing has served as a tool for dispersing the population and therefore many dwellings are located in peripheral areas, as noted, and in particular in the Southern district, where they make up about 7 percent of total dwellings (Figure 1). In Be'er Sheva, their number reaches about 5,000 (about 7 percent of homes in the city), and in Bet She'an, Dimona, Yeroham and Mizpe Ramon they make up more than 20 percent of the homes (Figure 2). A considerable majority of such homes is located in neighborhoods with a weak-medium

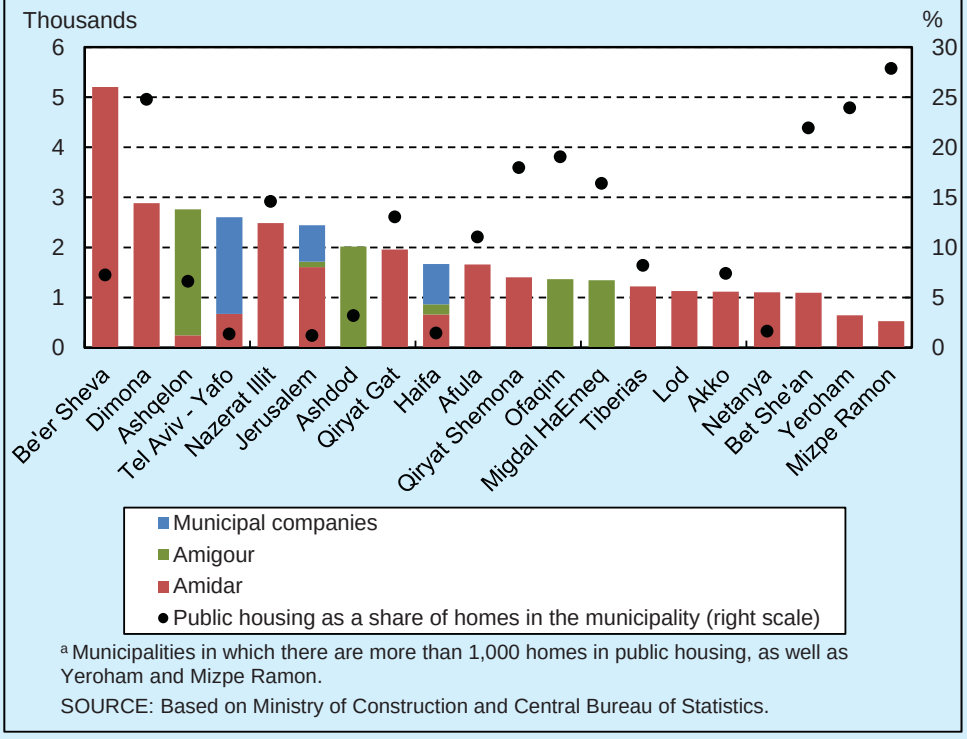
Figure 1
Stock of homes in public housing and their share of total households, by district[a], 2013



[a] Districts according to Ministry of Interior classification.

SOURCE: Based on Ministry of Construction and Central Bureau of Statistics.

Figure 2
Stock of homes in public housing and their share of all homes in the municipality, selected municipalities[a], 2013



[a] Municipalities in which there are more than 1,000 homes in public housing, as well as Yeroham and Mizpe Ramon.

SOURCE: Based on Ministry of Construction and Central Bureau of Statistics.

socioeconomic ranking[9] (in many cases rehabilitation neighborhoods). The location of the homes—in the geographic and socioeconomic periphery and far from employment opportunities—reduces working-aged residents' opportunities to escape poverty.

The dwellings in public housing are very old—their median age is 45 years—and nonetheless the budget for their maintenance is very low. Housing density in those homes is only 0.9 persons per room, mainly because they are frequently occupied by senior citizen households. In many cases there is no alignment between the size of the dwelling and the number of people living in it—an individual or a couple may live in a large dwelling, while families with children may live in small dwellings (see the report of the Committee to Fight Poverty in Israel, 2014).

We examined the demographic and socioeconomic characteristics of residents in public housing compared with the main target population—poor households[10], who rent a dwelling in the free market and who do not own a home (Table 1). About half of the residents are new immigrants (a considerable

[9] In Arab municipalities, there are hardly any public housing homes. In ultra-Orthodox neighborhoods there is a tiny amount.

[10] The comparison group does not include Arabs. The group also does not include a home headed by someone younger than 35, since their share in public housing is extremely small.

Table 1
Demographic and socioeconomic characteristics of poor households living in rented[a] housing and of households living public housing[b,c], 2012

	Poor households living in rented housing	Households living in public housing
Age (median, years)	53	55
Number of household members	2.9	2.2
New immigrants[d] (percentage)	50	51
Married (percentage)	47	23
Number of years of education	13.4	11.5
Employed (percentage)	44	42
Employed, aged 35–54 (percentage)	73	55
Monthly income (NIS):		
Total, gross	4,230	5,064
From labor	1,772	1,796
From pension	46	187
From allowances and support	2,412	3,062
Total, net	3,997	4,804
Total, net—equivalized	1,641	2,512
Receiving disability allowance (percentage)	12	28
Receiving income support (percentage)	14	25
Housing density (persons per room)	1.1	0.9
Monthly expenditure on rent (NIS)	1,942	387

[a] Jewish (and other) households headed b—e and transfer payments) refer to the head of the household.
[c] The five upper percentiles, by labor income, of both renting households and public housing households, were not included.
[d] Immigrated after 1989, or immigrated from Africa (mainly Ethiopia) from 1980 and onward.
SOURCE: Based on Central Bureau of Statistics (Household Expenditure Survey, 2012).

majority from Former Soviet Union countries, and about 10 percent from Ethiopia[11]); about two-thirds of the remaining residents were born in Asia or Africa. A high percentage of residents are elderly, single-parent households and receive subsistence allowances. This finding is in line with the fact that the eligibility for public housing is focused on those with low earning capacity: the share of employed persons among the working-aged residents is low relative to the comparison group, and their education level is lower. Net family income per month is around NIS 5,100, and three-fifths of that derives from allowances and

[11] About 9 percent of Ethiopian-immigrant households live in public housing.

support payments (mainly disability allowances, old-age allowances, and income support). More than half of households in public housing are living below the poverty line.

International comparison

Western countries also provide housing assistance, through a variety of channels, and there is some heterogeneity in the share of people receiving such assistance in the population and in the amount of public expenditure (European Parliament, 2013). In 2009, dwellings in public housing made up about 8 percent, on average, of total dwellings in the European Union, compared with about 4 percent in Israel (including assisted living), while home ownership in those countries was similar to the level in Israel. However, in Europe as well a prolonged decline can be seen over the years in the number of homes and in their share of total dwellings.

Public housing stock in Israel is small. However, the alternative—rental assistance—is not large, as Israel is in the middle of the OECD ranking in terms of share of those receiving rental assistance (Andrews et al., 2011), but EU countries spent about 0.28 percent of GDP, on average, on assistance at the end of the previous decade, while Israel spent only about 0.16 percent of GDP. In addition to Israel providing relatively low housing assistance, its home prices, relative to per capita GDP, are higher than prices in other advanced economies[12], especially in recent years.[13] Based on the EU's (and others') definition, households that spend more than 40 percent of their disposable income on housing suffer from housing cost overburden. The share of households renting a home in the free market and suffering from housing cost overburden in Israel is about 37 percent, of which one-third are poor[14], and the burden is greater than that in most EU countries (Figure 3). Since the incidence of poverty in Israel is greater than that in other countries, and home prices are relatively high, it may indicate that there is a considerable need in Israel to reduce the burden.

In most Western countries, housing assistance focuses on the weakest population groups, and the share of elderly, poor, and single-parent households among overall public housing residents is greater than their share in the general population.[15] European countries have been working in recent years to improve the physical condition of public housing dwellings and to broaden residents' socioeconomic range and location, in order to yield some added value from the possible interaction between population groups. Another widespread trend in those countries is to provide housing assistance not only to people earning the least, but also to working families with low incomes, for example by subsidizing rent and encouraging construction of affordable housing.

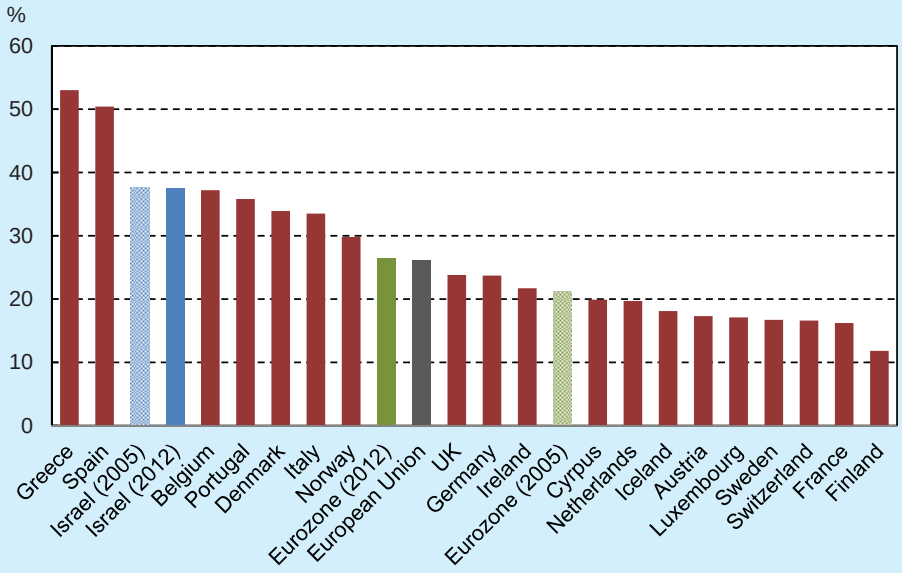
[12] Based on the following sources: International Monetary Fund, Bank for International Settlements, Central Bureau of Statistics, Israel Tax Authority (real estate prices register). Data are available for the following countries: France, the Netherlands, Norway, Spain, UK and US. Only in the UK are home prices, relative to per capita GDP, similar in recent year to prices in Israel.

[13] There are no parallel available data for rent. However, when conducting an international comparison of rent relative to net salary for various professions (ranked across the scale of salaries in the economy), and focusing on Tel Aviv and major cities in other OECD countries, it is found that in every case Tel Aviv is above the reference median, and in most cases it is in the top third (UBS 2012). With that, it is likely that among countries there are differences in the gap between the ratio of rent to net salary in major cities and the ratio for the country as a whole.

[14] The burden in Israel is more common among low income, elderly, and young (especially students) households.

[15] This discussion is based on the European Parliament (2013) and Scanlon, et al. (2014).

Figure 3
Share of households renting a home in the open market whose housing expenditures exceed 40 percent of their disposable income[a]
(Israel and selected EU countries[b], 2012)



[a] Housing expenditures: utilities (electricity, water, gas and heating), current maintenance expenses, home insurance, municipal tax and building committee payments. Household disposable income (adjusted to the Eurostat definition): net household monetary income plus imputed income from employer's vehicle minus current transfers to other households (in Israel and abroad). The definitions appear in Eurostat (2013).
[b] The Eurozone countries include those who were members of the EU since its establishment plus Estonia, Malta, Slovenia, Slovakia and Cyrpus (total of 17 countries).

SOURCE: Data on Israel—Based on Central Bureau of Statistics (Household Expenditure Surveys for 2005 and 2012); EU countries—Eurostat (2014), Table 3.7, http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&pcode=tessi164&language=en.

Conclusion and policy recommendations

As the poverty rate in Israel is high, housing assistance has eroded over the years, the burden of housing is high in international comparison (and over time), and the share of housing assistance is relatively low compared with accepted levels in Western countries, there is room for Israel to expand the system of housing assistance and to update the criteria for receiving such assistance. In order to formulate more detailed recommendations on the proper public housing policy to adopt, its advantages and disadvantages need to be examined.

Public housing ensures a stable protection against the necessity of changing a home due to soaring rent in the free market and/or due to a deterioration in the economic situation of the household—a common occurrence among the needy, as many of them lack occupational stability. In contrast, public housing in its current composition has many shortcomings: (1) It creates a poverty trap—earning above a low threshold is liable to immediately negate eligibility for a dwelling in public housing, because the State does not offset the amount of the assistance proportionately to the increase in labor income. This situation is liable to deter residents from increasing their labor income.[16] (2) The stock of homes is often distant from employment

[16] In actuality, very few income tests are conducted for people living in public housing.

opportunities. (3) The physical characteristics of the homes (such as size and accessibility) are not in line with the needs of many households (such as the number of people and any disabilities). (4) Large housing clusters are in poor neighborhoods, which is liable to negatively impact the social integration of the residents and perhaps even to strengthen the spatial neglect deriving from the homes not being owned by the people living in them. (5) The homes are old, and since adequate upkeep involves heavy costs, the homes and surrounding areas are frequently in states of neglect.

Nonetheless, it appears that public housing provides a proper solution to households with low earning capacity, including households of disabled people. Therefore, such population groups should be provided with an adequate stock of public housing homes, and at the same time the homes' physical condition should be improved. Likewise, their geographical distribution should be aligned with that of the residents—in particular those of working age—and specifically the share of homes outside the geographic and socioeconomic periphery should be increased. As for households with earning capacity, it is suggested to consider broadening other housing assistance alternatives for them, including rental assistance, as such alternatives prevent a poverty trap and allow them to live in areas where they will be able to integrate more easily into the labor market.

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