



Israel's Path to Economic and Social Prosperity

Successes and
Remaining Obstacles

A STORY IN 25 CHARTS



KOHELET ECONOMIC FORUM

JUNE 2015 – SIVAN 5775

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Kohelet Economic Forum

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Successes

Facts and Trends in the Israeli Economy

- Israelis are much better off than they were a decade ago. (Chart 1)
- The Israeli labor market has performed extremely well over the past decade, in contrast to labor markets in most developed countries. Arab and Haredi (ultra-Orthodox) Israelis are participating in the workforce in rising numbers. (Charts 2-4)
- Inequality has been falling for five years in a row and the economic situation of low income Israelis is gradually improving, as many of them have recently joined the workforce. Worries about inequality in Israel don't take proper account of these trends and Israel's age structure. If Israel's age structure is taken into account, its levels of inequality are unexceptional. (Charts 5-7)
- Despite rising costs in isolated sectors such as food and housing, overall price growth has remained stable. (Chart 8)

Remaining Obstacles

Areas for Policy Attention

- Israel still has a long way to go for its per-capita income to match that of other developed countries. (Chart 9)
- Labor productivity in Israel is lower than in other advanced countries. Improving it is a primary challenge. Enhancing the skill and education levels of Arab and Haredi workers is a good place to start. (Charts 10-11)
- Education outcomes are poor. Teachers' salaries have risen in recent years, but more fundamental reforms are badly needed. (Charts 12-14)
- Arbitrary and complex regulation, bloated bureaucracy, and protection of incumbents keep Israel uncompetitive and inefficient. Bureaucracy, protection, and regulation need to be reduced, especially with respect to the food industry. (Charts 15-20)
- Israel's government spending is low relative to most western European countries, but higher than that of the United States and many fast-growing economies; its structural deficit is high; and its top marginal tax rate is fairly high among the advanced economies. (Charts 21-23)
- The rapid increase in home prices since 2008 can be attributed in large measure to the decline in interest rates and the increase in the capital-gains tax rate on financial investments. (Charts 24-25)

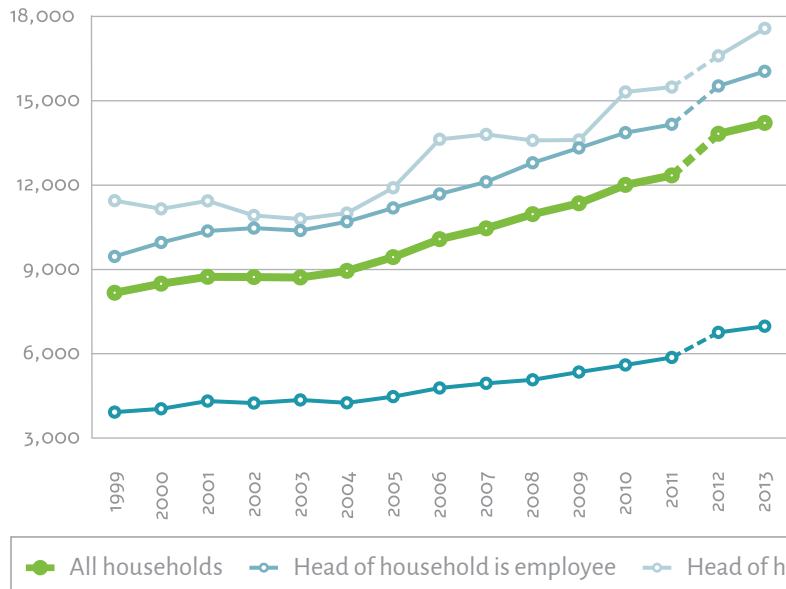
PART A

Successes

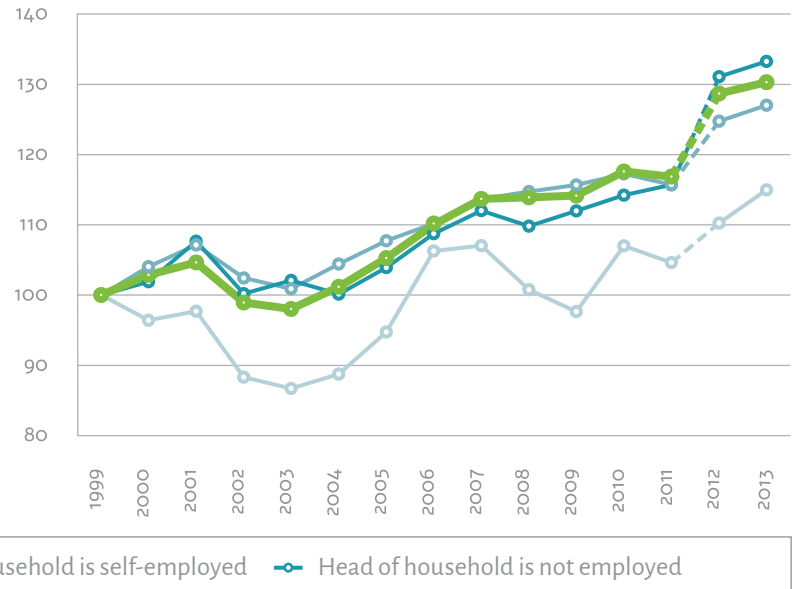
1. Israelis Are Better Off

Both nominal and real income grew rapidly in recent years among all types of households.

Net household income
Current prices (shekels/month)



Index of net income per standard person
Constant prices, CPI deflated (1999=100)



The dashed line between 2011 and 2012 reflects changes in survey methodology during this period

SOURCE: Kohelet Economic Forum processing of CBS data

2. More Israelis Are Working

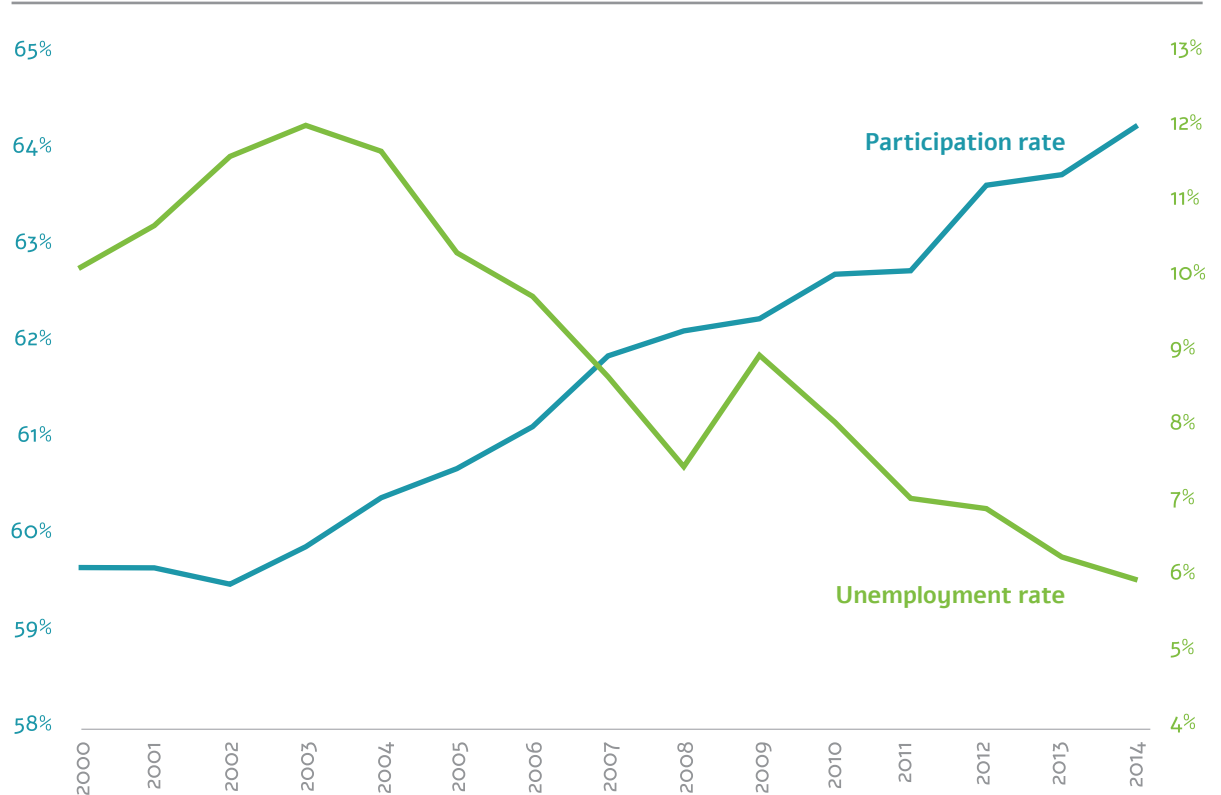
Many Israelis have joined the labor market and fewer are searching for work.

In recent years there has been a significant improvement in the Israeli labor market as the participation rate has increased and unemployment has fallen.

The increase in the labor force participation rate in Israel was one of the highest, and the rate of unemployment one of the lowest, among developed countries.

The increase in participation over the last decade stems in part from the August 2003 change in the transfer-payments regime, which increased incentives to work.

Unemployment and participation rates (ages 15+, chained data)



SOURCE: Kohelet Economic Forum processing of CBS data

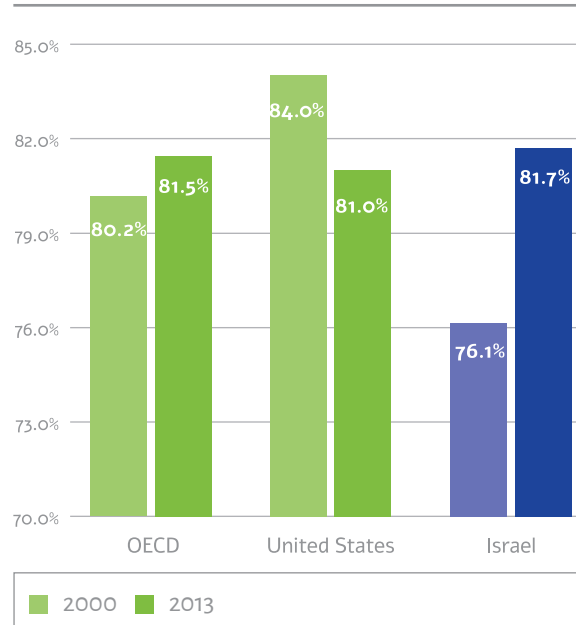
3.

One of the Strongest Labor Markets among Developed Countries

Israel's labor market now compares favorably to other OECD economies.

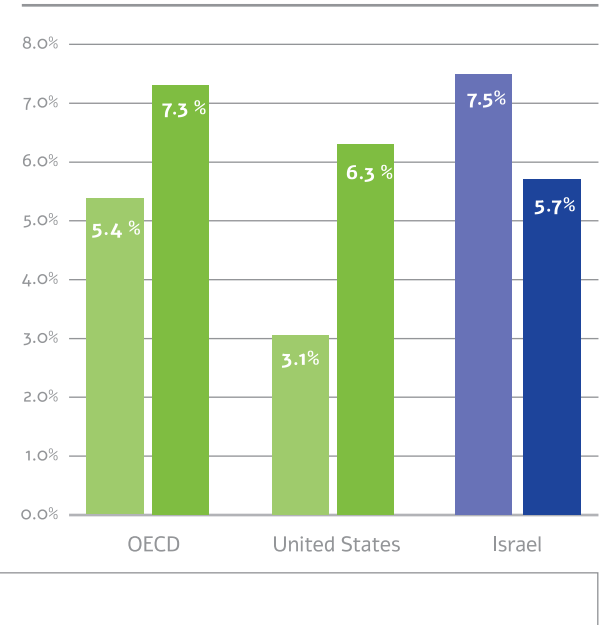
Since the 2003 change in the transfer-payments regime, Israel has gone from having an exceptionally low labor force participation rate and a rather high unemployment rate to having a labor market that is more robust than most developed countries'.

Participation rate (ages 25-54), 2000 and 2013



SOURCE: OECD

Unemployment rate (ages 25-54), 2000 and 2013



4.

All Israelis Are Getting to Work

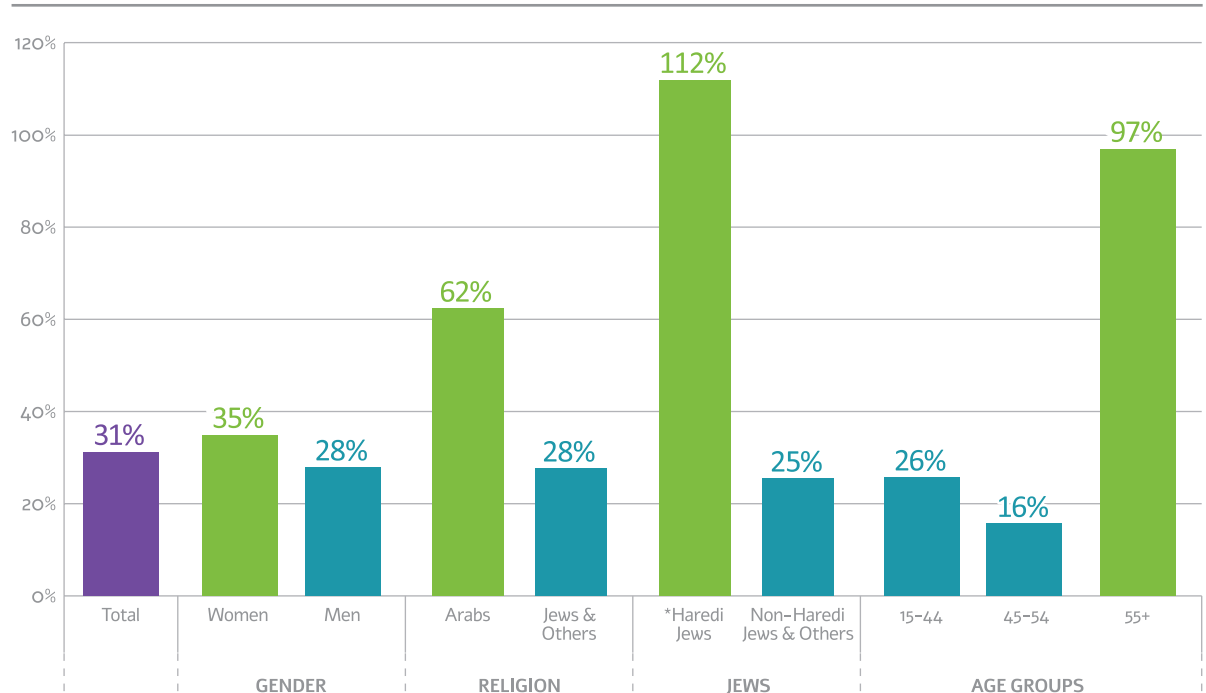
The expansion of the labor market has been driven, in part, by Haredi Jews and Arabs.

Haredi (ultra-Orthodox) Jews, Arabs, women, and older Israelis have joined the workforce in large numbers, expanding the number of employed Israelis by 31% from 2002-2011.

Groups that are new entrants to the labor force generally need to catch up in skills and occupational training. As these groups begin to earn in the marketplace, poverty and income inequality go down. Concurrently, this influx of low-skilled laborers has reduced the average employee wage, a statistic that seems much worse than the story it actually tells.

Percent change in salaried employment, 2002-2011

Selected groups



*Haredim: by most recent educational institution

SOURCE: Kohelet Economic Forum processing of CBS Income Surveys

5. Inequality Is Falling

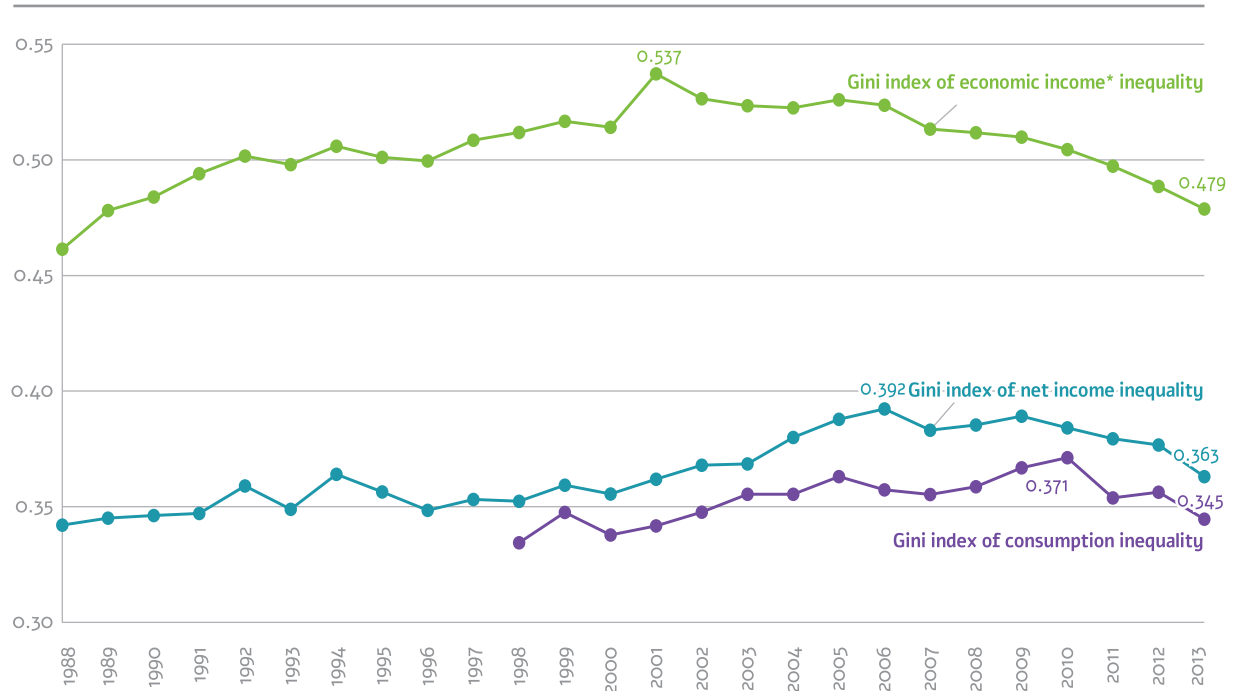
An expanding labor force has returned inequality to early-1990s levels.

The decline in inequality in recent years – largely due to the sharp improvement in the labor market – has brought Gini coefficients to a level last seen about 20 years ago.

Economic income inequality has declined since 2001 and net income inequality has declined since 2009. Both measures reached their peaks last decade.

Consumption inequality has also declined in recent years.

Gini indices of inequality



*Economic income: gross income derived from labor and capital

SOURCE: Gini Index of income inequality: chained National Insurance Institute data by Kohelet Economic Forum; Gini Index of consumption inequality: Kohelet Economic Forum processing of CBS data

6.

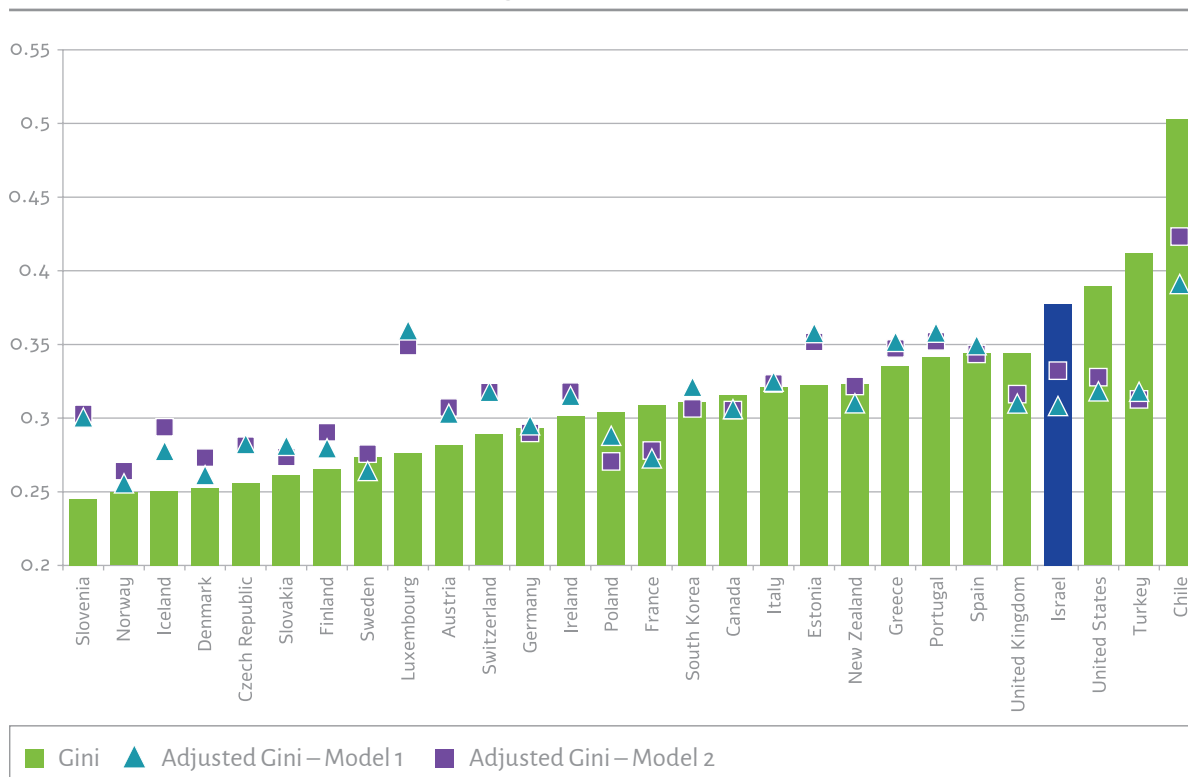
Israel Is Less Unequal than You Might Think

Given its age structure, Israel's income inequality is in the middle of the pack.

Countries with a younger population tend to have more income inequality. Israel is a remarkably young nation. Adjusting for population age structure and per capita income, Israel's income inequality rank declines from 4th place (among 28 OECD countries) to 15th place according to one model, and to the 7th place according to a second model.

The dependent variables in the regression analysis are $\log(\text{Gini})$ in the first model and Gini in the second model.

Gini coefficient of income inequality, original and adjusted measures, 2011

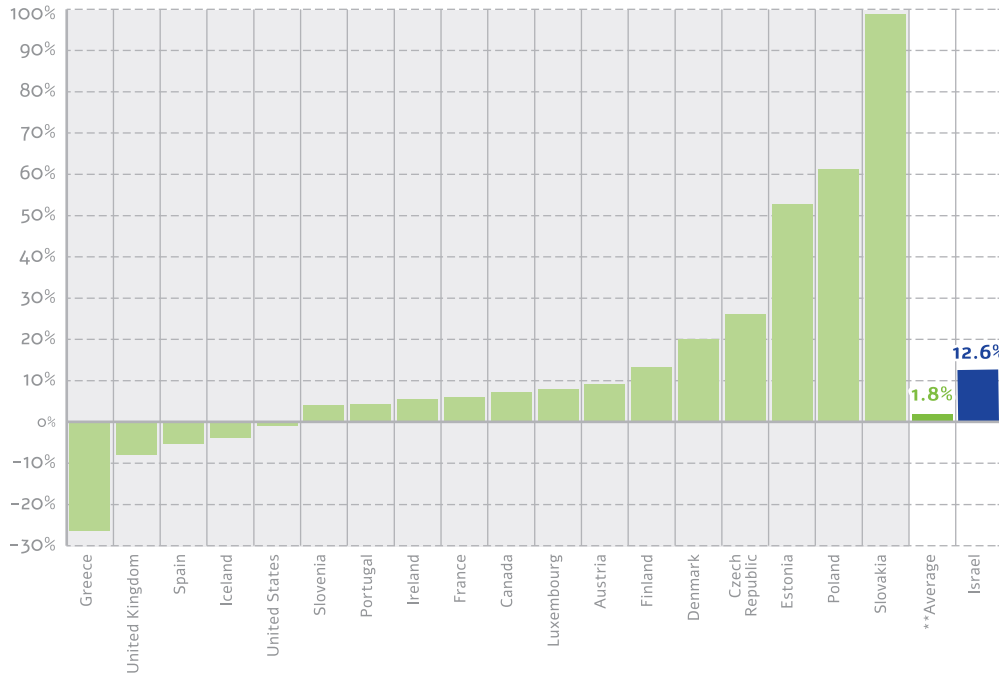


SOURCE: Kohelet Economic Forum processing of OECD data

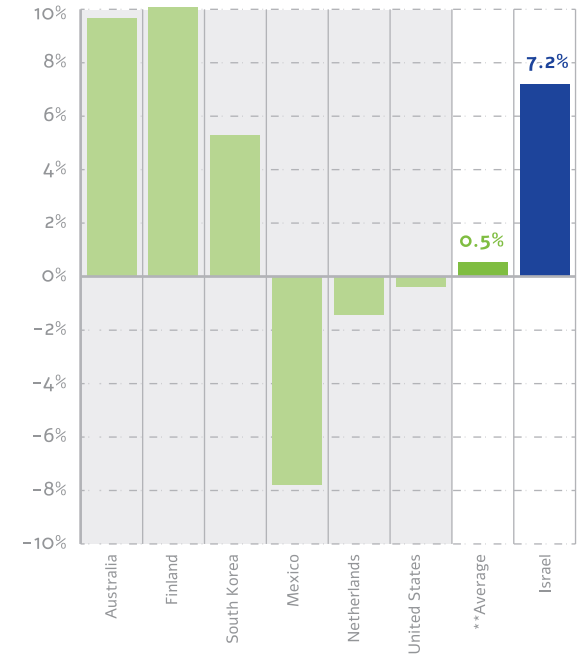
7. The Poor Are Better Off

The incomes of the Israeli poor have grown at a faster pace than incomes in Israel in general, and at a faster rate than the incomes of low-income individuals in other developed nations.

Change in median income of bottom quintile, 2005-2011



Change in median income of bottom quintile, 2008-2012



*The calculation was made for net income of P10, the individual located in the middle of the bottom quintile

**Weighted average across all countries examined, excluding Israel. The countries included are all those for which data were available in the years examined.

SOURCE: Kohelet Economic Forum processing of OECD data

8.

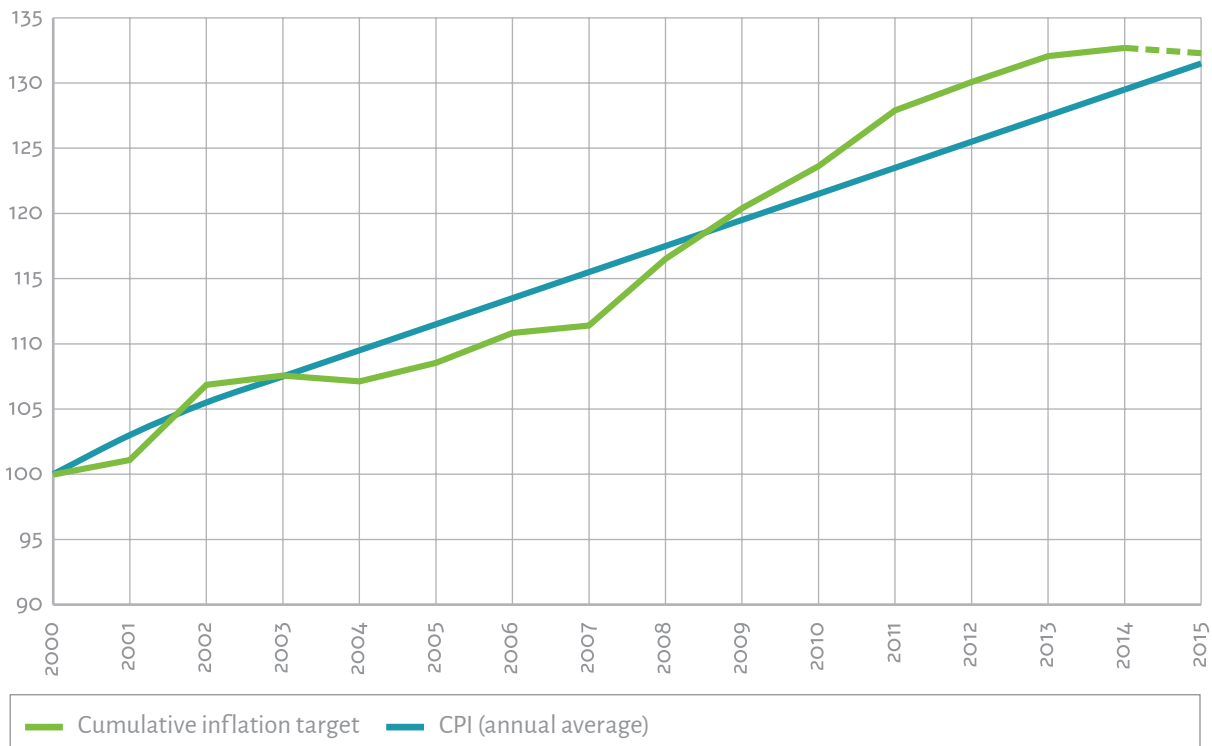
Price Growth Has Been Low and Stable

Despite suggestions for price controls, consumer price inflation in general has closely tracked the official inflation target over the last 15 years.

Low and stable inflation, in accordance with the target set by the government, has meant general stability and a high degree of certainty in recent years.

This has enabled households and firms to make long-term economic decisions with confidence.

The consumer price index and the inflation target (2000 = 100)



*Kohélet Economic Forum projection for 2015

SOURCE: CBS

PART B

Remaining Obstacles

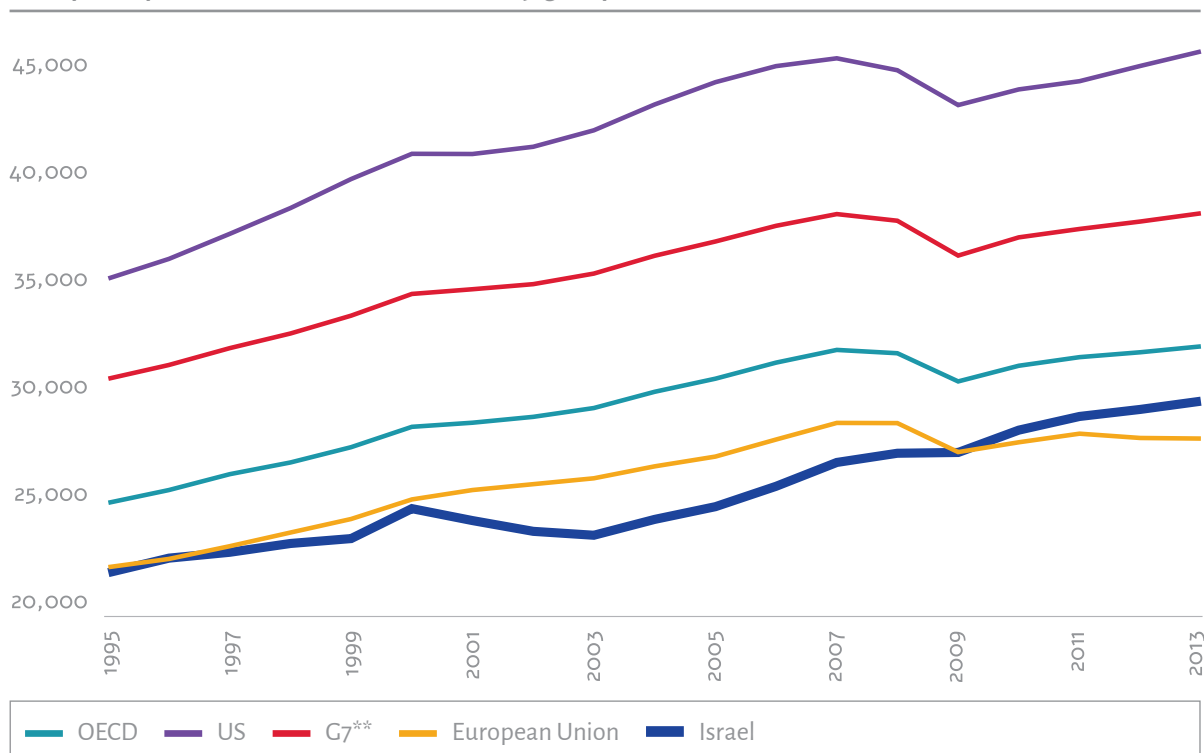
9. Israel Still Has a Long Way to Go

Despite significant growth in GDP per capita in the last two decades, income is still low compared to most developed countries.

The level of GDP per capita in Israel stood at 92% of the average level for the OECD in 2013, compared to 80% in 2005.

In recent years, GDP per capita in Israel overtook the average level in the European Union, while the gap relative to the US remained almost the same.

GDP per capita, Israel and selected country groups*



*2005 PPP-adjusted US dollars

**US, UK, Japan, Italy, Germany, France, and Canada

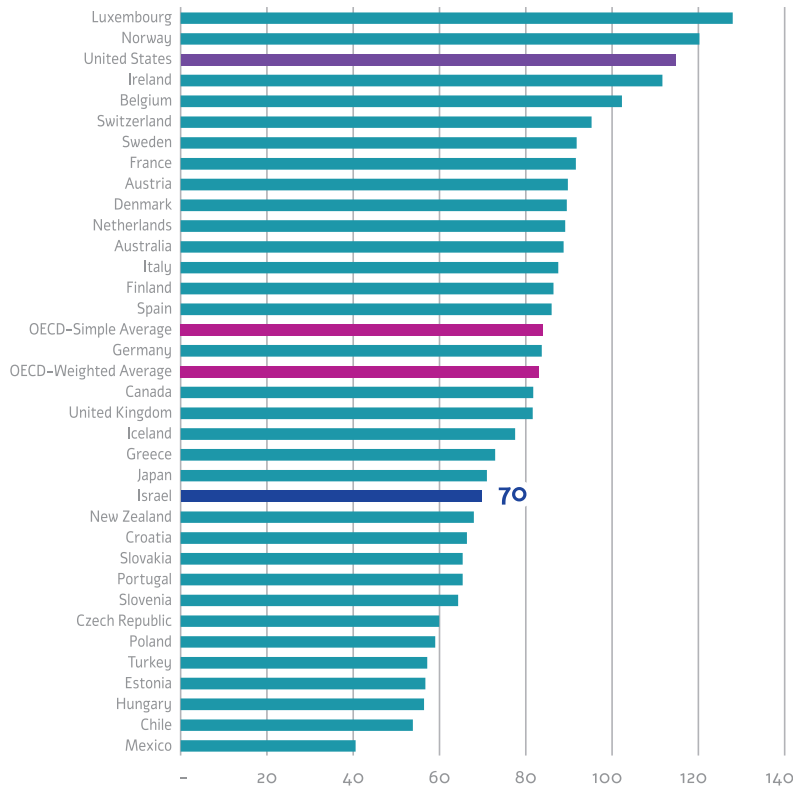
SOURCE: Kohelet Economic Forum processing of OECD data

10.

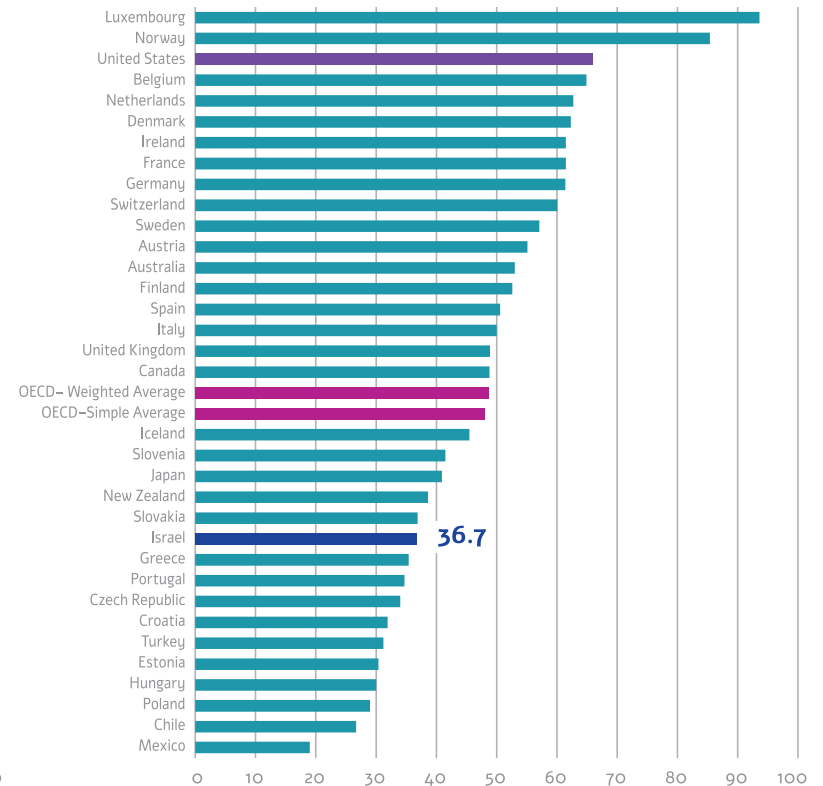
Israel Has a Productivity Problem

Labor productivity in Israel is lower than the OECD average and significantly lower than in the United States. Increasing labor productivity should be a top priority for Israel's economic policy makers.

GDP per worker, PPP-adjusted thousands USD, 2013



GDP per hour worked, PPP-adjusted USD, 2013



SOURCE: OECD and Kohelet Economic Forum processing

11.

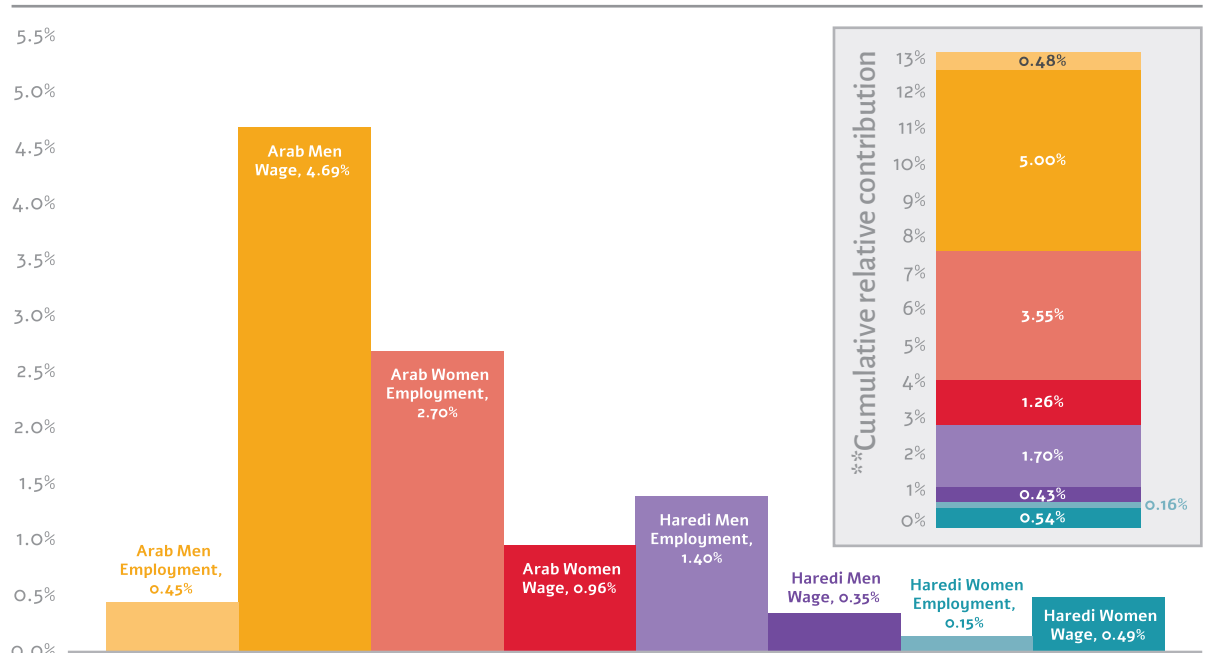
The Low-Hanging Fruit of Israel's Economy

If Arab and Haredi workers had the workplace productivity and employment rate of the average non-Haredi, Jewish Israeli worker, labor income would increase by 13%.

The simulation shown in the figure indicates the potential for growth if the employment rates and the earnings of Arabs and Haredi Jews were to catch up with those of non-Haredi Jews.

It is especially important that Arabs and Haredi Jews catch up given their increasing share in the population. If Israel fails to integrate these growing populations into the broader workforce, the general standard of living would be seriously held back.

Impact on total labor earnings from matching employment rate and wages of Ultra-Orthodox*** and Arabs to those of non-Haredi Jews (Percent, based on 2013 data)****



*Total income – calculated based on the income of individuals aged 15 years and over, assuming wage is equal to productivity

**Relative contribution – the contribution of each component considering the total impact resulting from multiplying the employment rate times the wage (proportional)

***Haredi: by most recent educational institution

****Separate benchmark rates were used for men and women

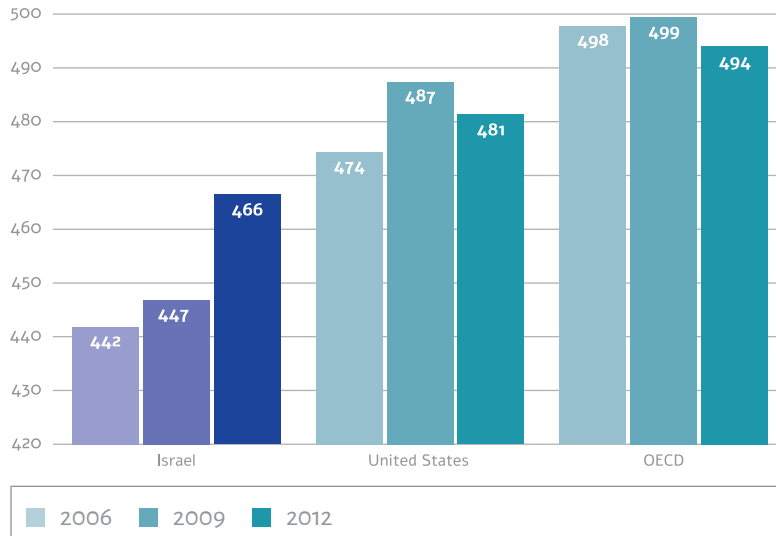
SOURCE: Kohelet Economic Forum's analysis of CBS income surveys

12.

Education Results Are Still Substandard

There has been a slight increase in Israel's ranking in the PISA exams, but its international ranking remains low, despite Haredi schools not participating in the exams.

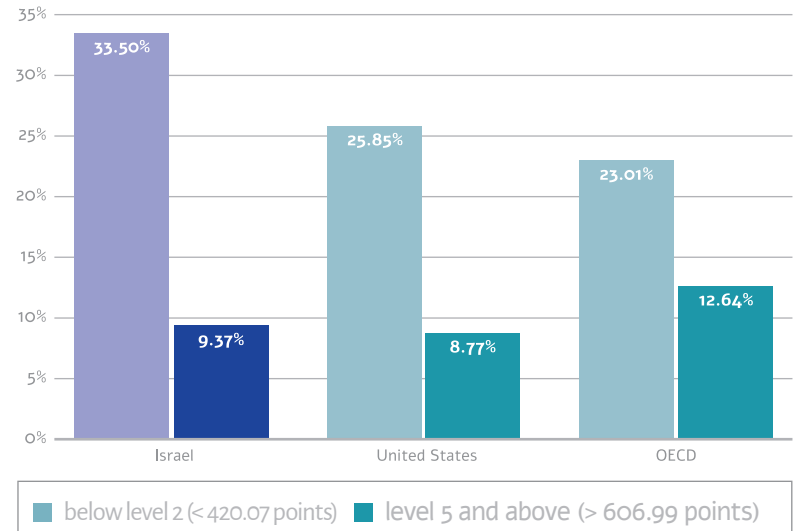
Scores in mathematics in three most recent waves of PISA exams



*Does not include Haredi schools

SOURCE: OECD

Percentage of students at high and low ends of test results, 2012



13.

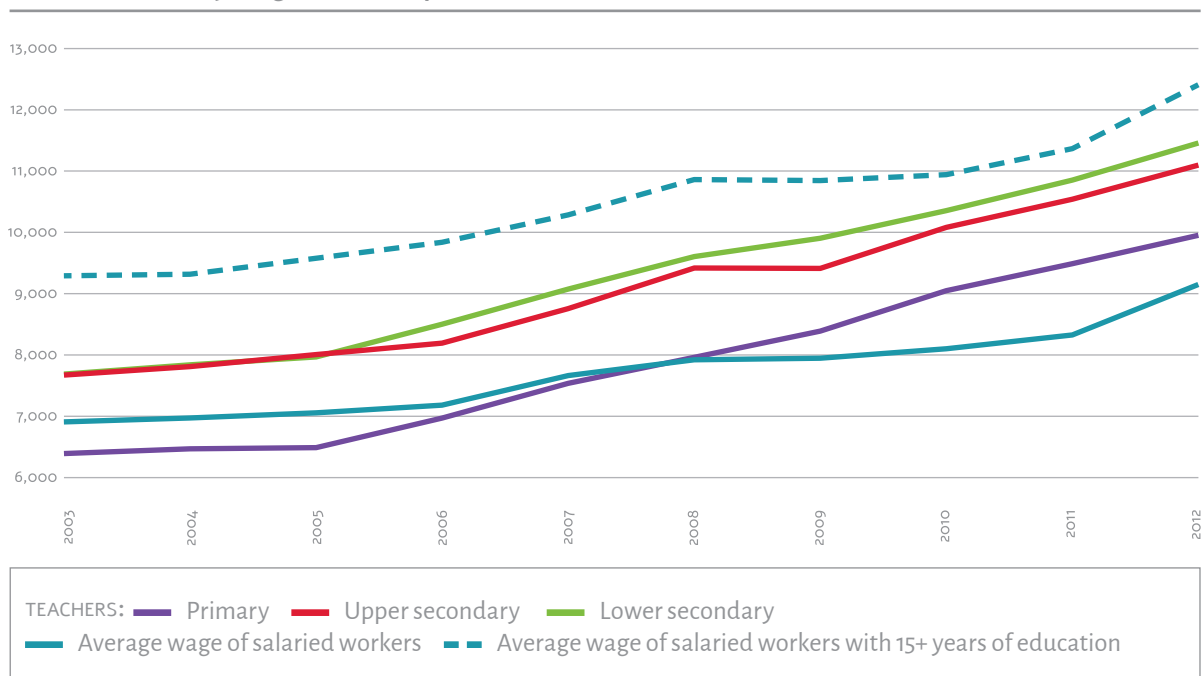
More Money for Teachers is Not Enough

Teachers' salaries have risen significantly in recent years, but more fundamental education reforms are badly needed.

The reforms implemented in the education system in recent years – *Ofek Hadash* in 2008 and *Oz Le'tmura* in 2011 – increased teachers' salaries considerably.

The increase in teachers' salaries may have a positive effect on student achievements, but it is insufficient. Further reforms are necessary to increase the managerial independence of schools and to allow performance related compensation of teachers.

Teacher* monthly wages (current prices, shekels)



*Including educational supervisors

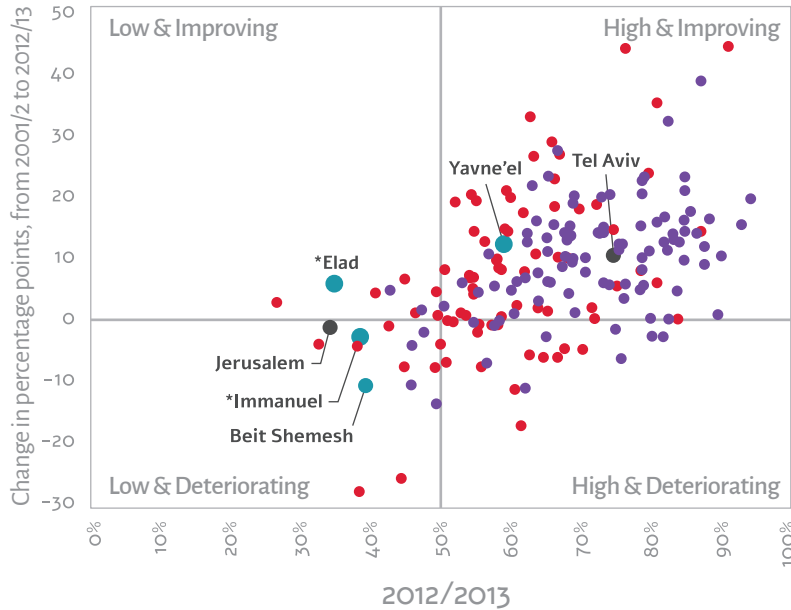
SOURCE: CBS and Kohelet Economic Forum processing

14.

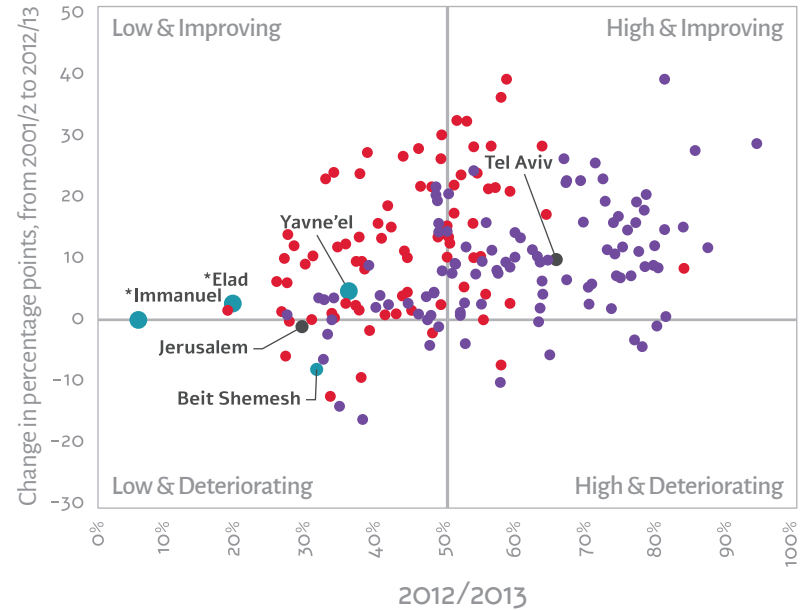
Arab and Haredi Students Are Falling Behind

Non-Haredi Jews increasingly pass their basic and college-entry exams, Arabs are still far behind in terms of passing college-entry exams, and Haredi Jews continue to rank toward the bottom in both.

Share completing basic matriculation exams



Share completing college-entry matriculation exams



● Haredi municipalities ● Non-Haredi Jewish municipalities ● Arab municipalities

*The data for Elad is for the years 2009/10 and 2012/13 and for Immanuel for the years 2009/10 and 2011/12

**Haredi localities: Elad and Immanuel – according to the National Economic Council list of Haredi municipalities; Close to half the residents of Yavne'el and Beit Shemesh are Haredi

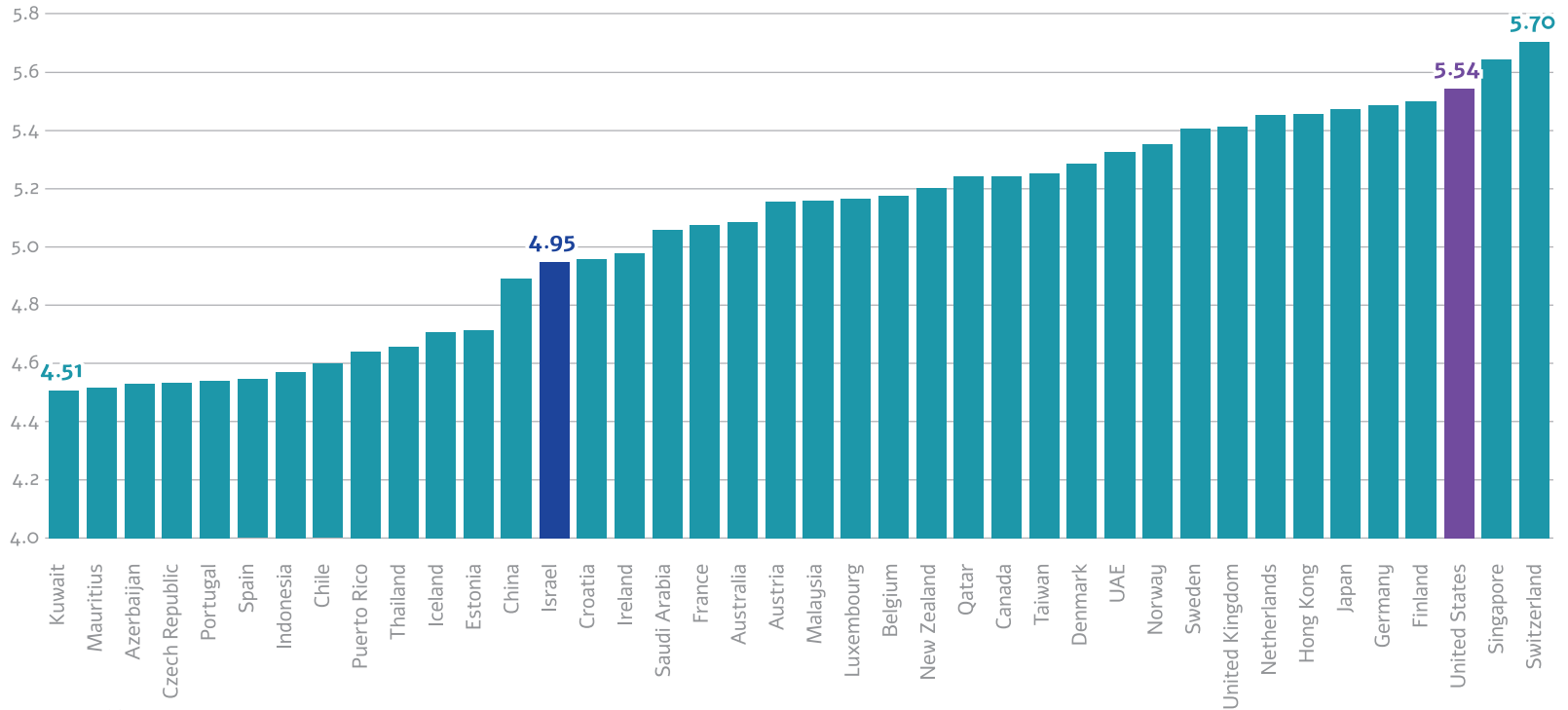
SOURCE: Kohelet Economic Forum processing of CBS data

15.

Israel's Institutions and Policies are Uncompetitive

Israel ranks 27th in the “World Competitiveness Report,” significantly behind most advanced economies.

2014 World Competitiveness, 40 leading countries (1 – lowest, 7 – highest)



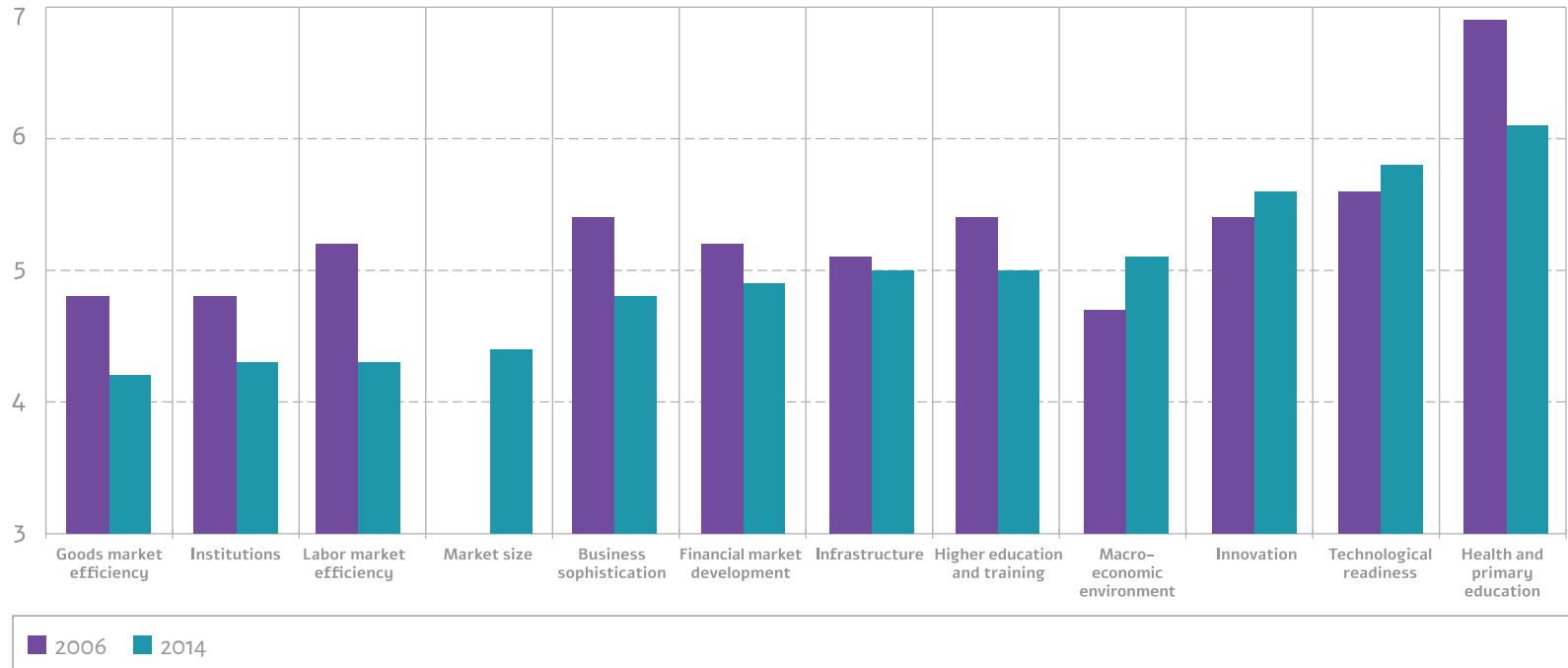
source: World Economic Forum, Competitiveness Report

16.

What Holds Israel Back

Factors like innovation, technological readiness, and education help keep Israel competitive, while poor institutions and inefficient goods and labor markets hinder growth.

Israel's score in the 12 main categories of the World Competitiveness Report



SOURCE: World Economic Forum, Competitiveness Report

17.

A “Start-Up Nation” Despite Itself

Israel's barriers to entrepreneurship are high by international standards.

Of OECD members, only Mexico has more regulatory protection of incumbent firms than Israel.

Israel performs particularly poorly in measures of friendliness to entrepreneurship. Regulatory procedures are exceptionally complex and difficult to comply with, in comparison to most advanced countries.

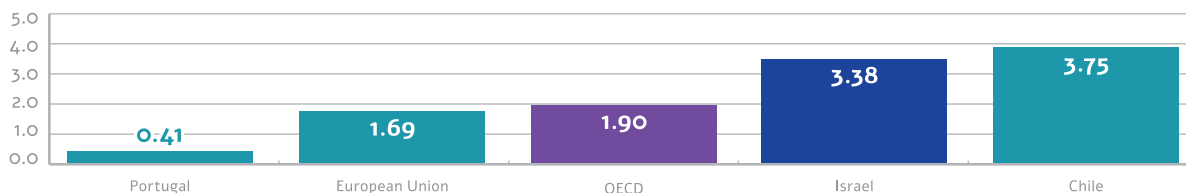
Likewise, Israel imposes more administrative burdens on start-ups than most OECD nations.

Given these rankings, it's bewildering that Israel has the “start-up” reputation it has. Israeli entrepreneurs are so burdened by regulation that we do not yet know what they are capable of.

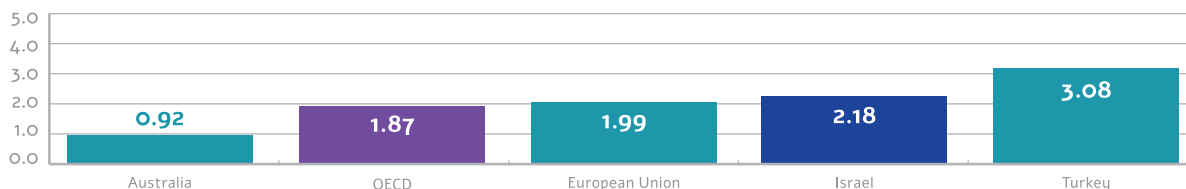
Index scale of 0-6 from least to most restrictive

Israel, OECD, and EU averages, and OECD lowest and highest

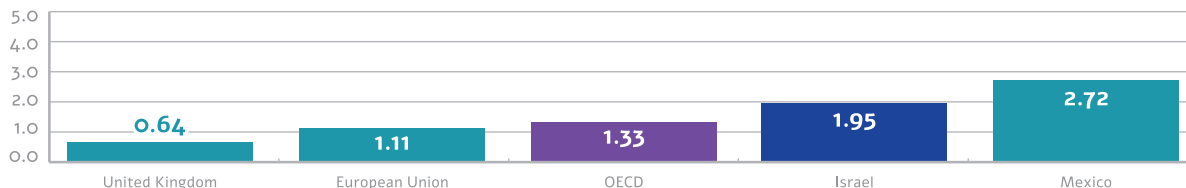
Complexity of regulatory procedures



Administrative burdens on startups



Regulatory protection of incumbents



SOURCE: OECD, Going for Growth, 2015

18.

A Growth-Suffocating Government

Israel scores poorly in measures of market restrictions and state control.

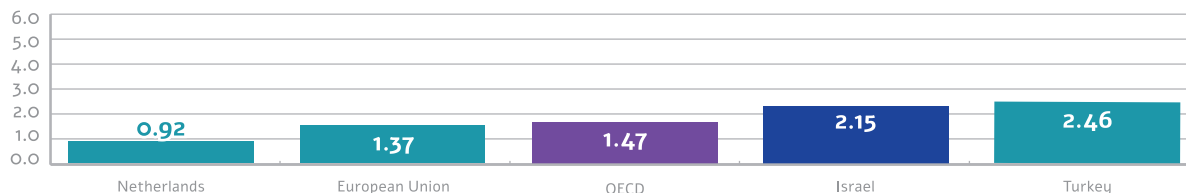
Israel's government is among the most intrusive among developed economies. Only Turkey has more restrictive regulations on its product market.

Likewise, Israel ranks highly in measures of state control, with public ownership levels above average and state involvement in business operations comparable to Greece.

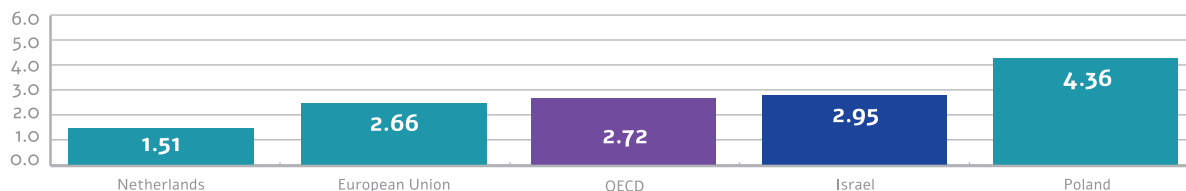
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Israel, OECD, and EU averages, and OECD lowest and highest

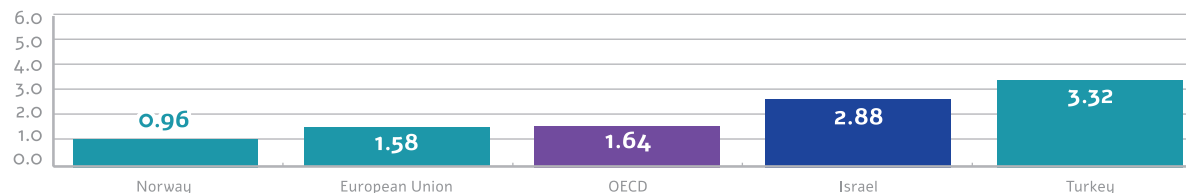
Restrictiveness of economy-wide product market regulation



State control: public ownership



State control: involvement in business operation



SOURCE: OECD, Going for Growth, 2015

19.

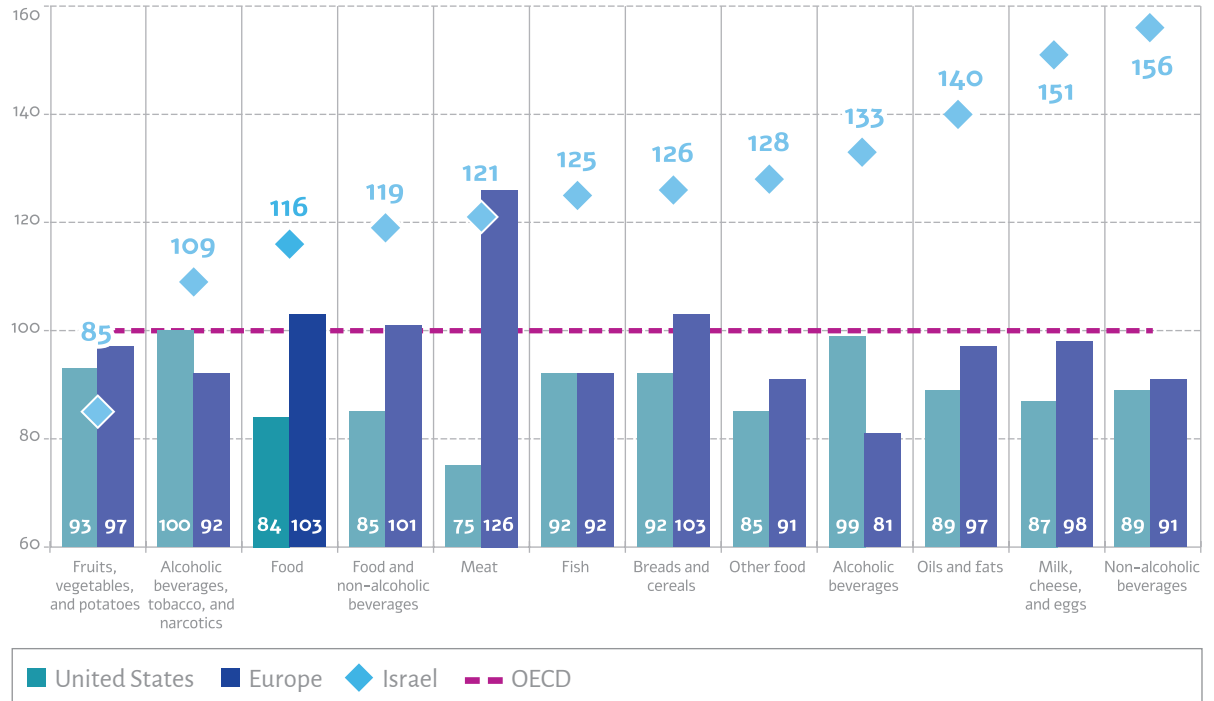
Regulations Inflate the Price of Food

Restrictions on the marketplace are severely felt at the grocery store.

In 2011, the last year prices were compared, Israel's food prices were off the charts compared to those of the OECD, United States, and Europe.

Prices of all food categories except fruits and vegetables are higher in Israel than in other developed countries. The Kedmi Committee stressed that the high prices are due to several factors, among them restrictions on imports, lack of competition in production and marketing, and an inefficient standardization system.

Price levels for grocery expenditures relative to average OECD prices, 2011 (OECD=100)



*Not including meals away from home

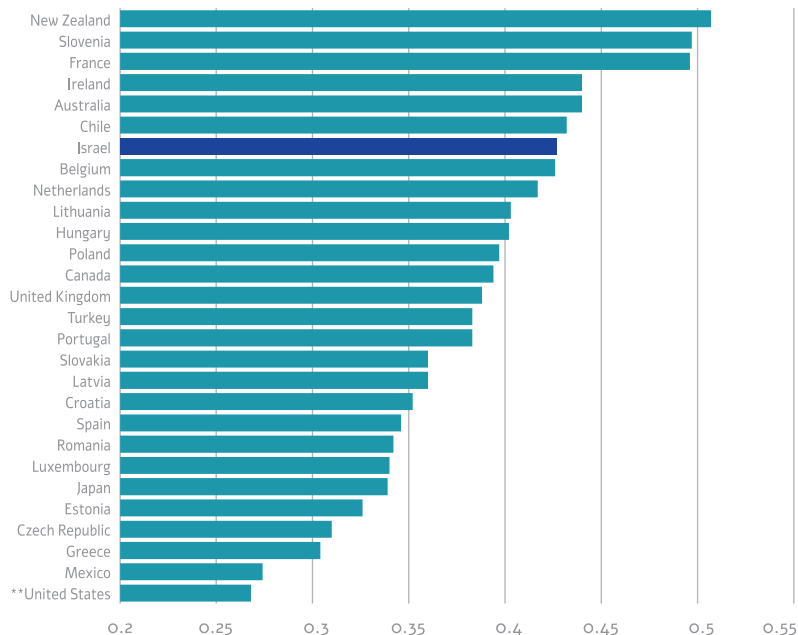
SOURCE: OECD

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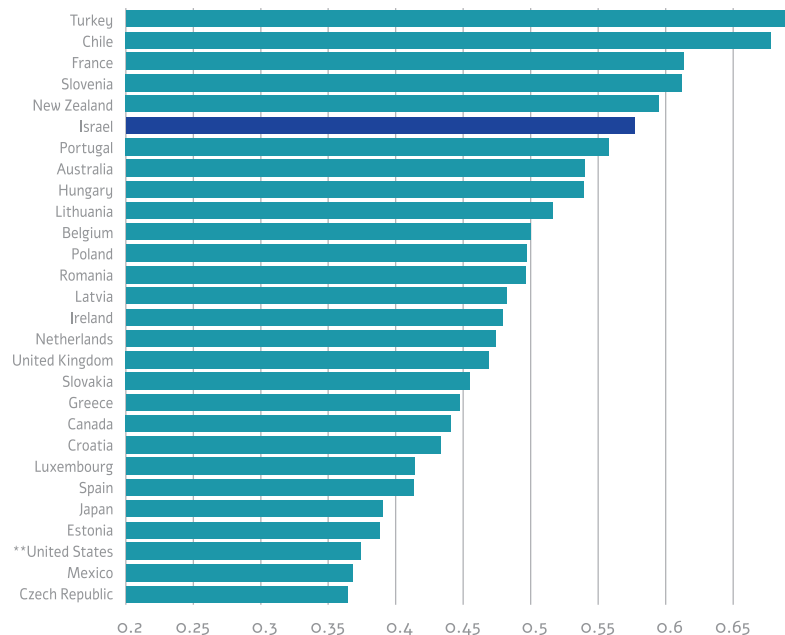
A Minimum-Wage Hike Is Not a Great Idea

The minimum wage – a classic constraint on hiring and growth – is quite high relative to other advanced economies and is slated to rise even further.*

Minimum wage relative to average earnings of full-time workers (2013)



Minimum wage relative to median wages of full-time workers (2013)



*The minimum wage in Israel will gradually increase, from 4300 shekels in early 2015 to 5300 shekels in December 2017

Many workers in Israel, mainly in the public sector, are defined as “minimum wage workers,” while they actually earn much higher salaries – in some cases significantly above the average salary

**The data for United States refer to the federal minimum wage; some of the states impose higher minimum wages

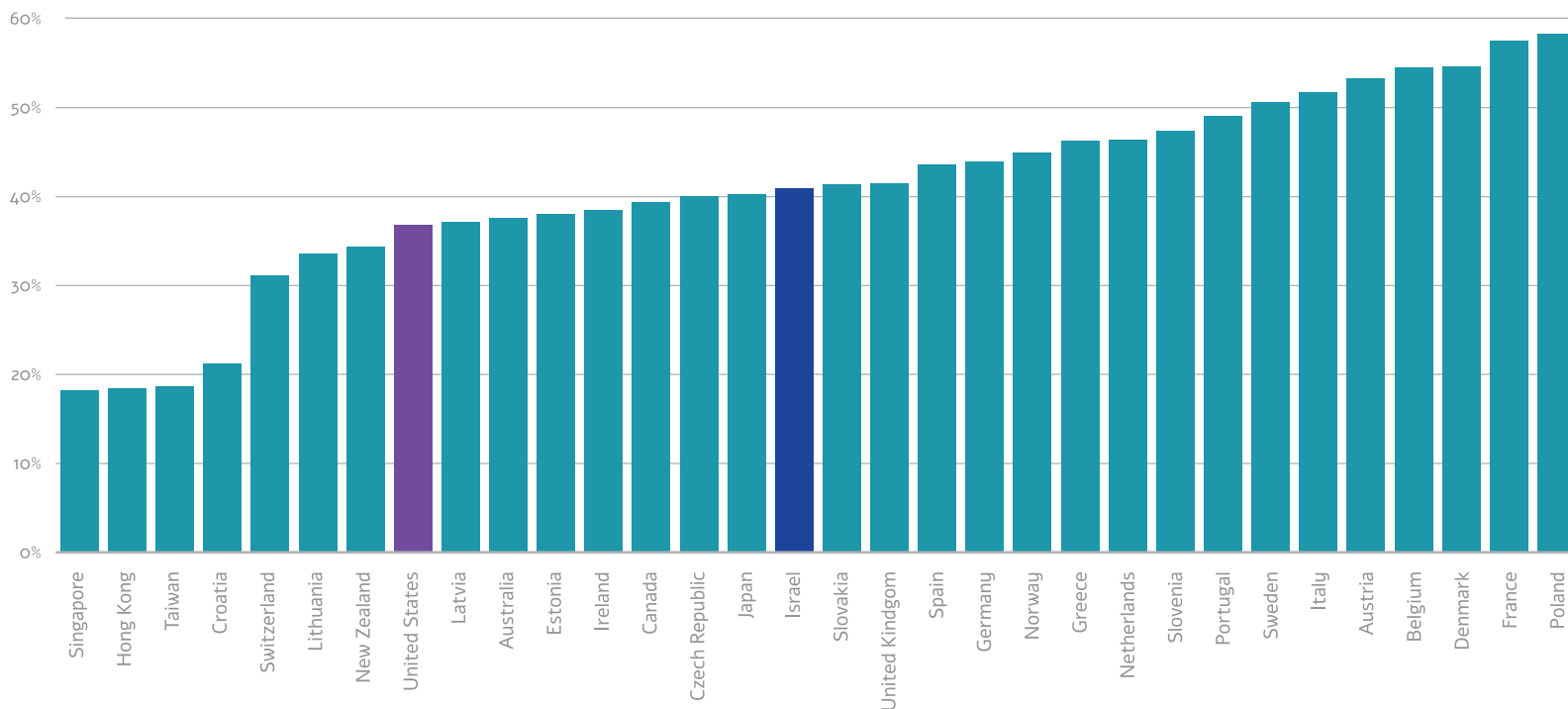
SOURCE: OECD

21.

Substantial Government Expenditures

Israel's public expenditures are low relative to most western European countries, but much greater than those of the United States and many fast-growing economies.

General government expenditure as a percent of GDP, 2014



*Including only advanced economies with more than 1 million citizens

SOURCE: IMF, World Economic Outlook, 2015

22.

Poor Fiscal Performance

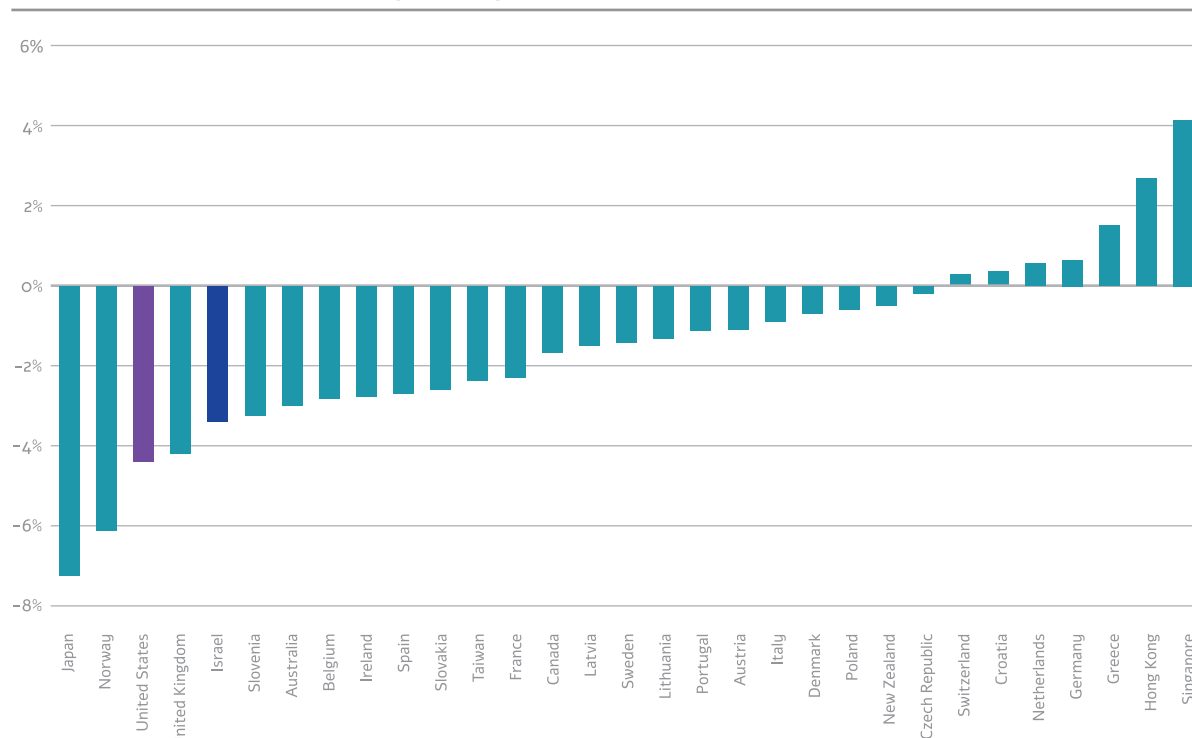
Israel's structural budget deficit is high compared to nearly all other advanced economies.

Successive Israeli governments did not take sufficient advantage of the high growth of the last decade to reduce the budget deficit.

Despite setting multi-year deficit targets, the government often revised the targets instead of making the cost-cutting reforms necessary to meet them.

As a result, the structural budget deficit remained high both in absolute terms as well as relative to other nations. To the extent that the Israeli economy experiences negative shocks, its fiscal room to maneuver will be extremely limited.

Structural fiscal balance of the general government as a percent of potential GDP, 2014



*Including only advanced economies with more than 1 million citizens

SOURCE: IMF, World Economic Outlook, 2015

23.

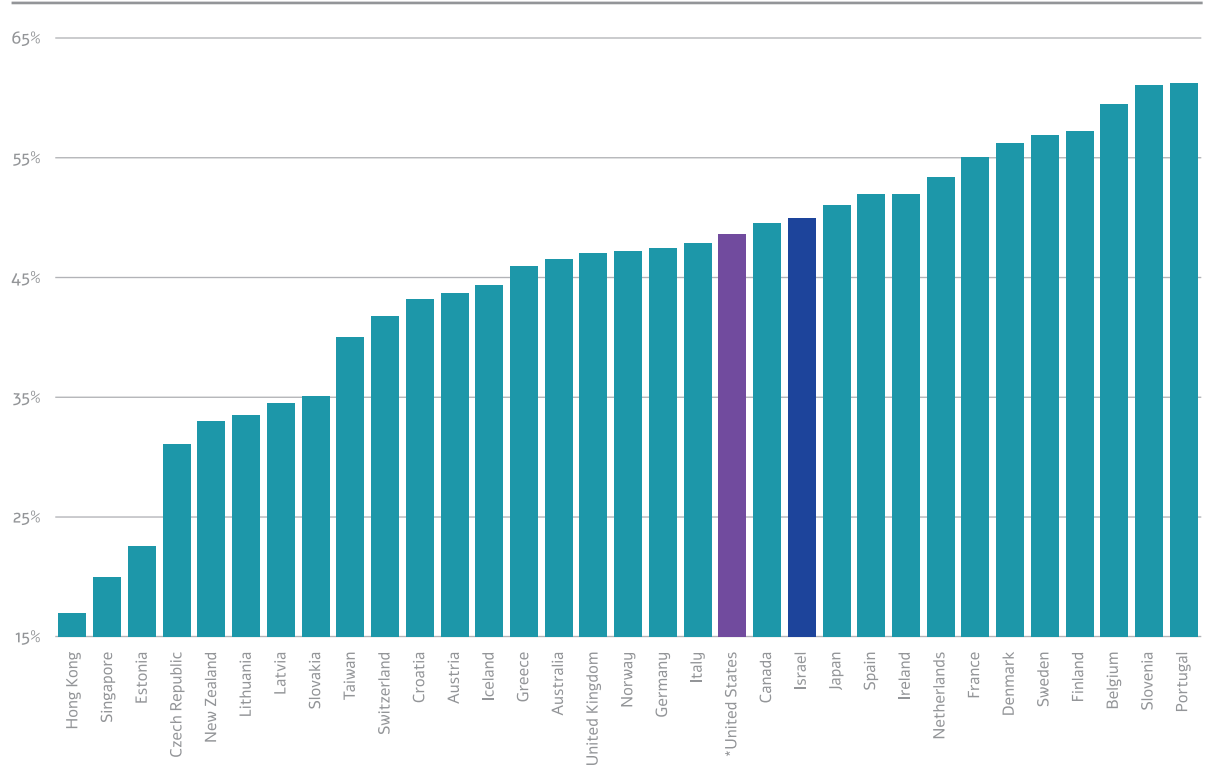
A Tax Code Unfriendly to Growth

Israel's top marginal income tax rates are higher than most advanced countries*.

The tax burden in Israel – including average income tax rates – is lower than it was 10-15 years ago.

Nevertheless, the top marginal tax rate remains high by international standards. Israel taxes its most productive citizens – workers who are most likely to move to another jurisdiction – at rates much greater than those of the world's fastest-growing economies.

Top rate of personal income tax and employee social security contributions, 2014



*The tax rate for the United States is calculated using Detroit, Michigan as typifying United States tax rate

SOURCE: OECD, governments' data, and KPMG

24.

Israel Faces Rising Home Prices

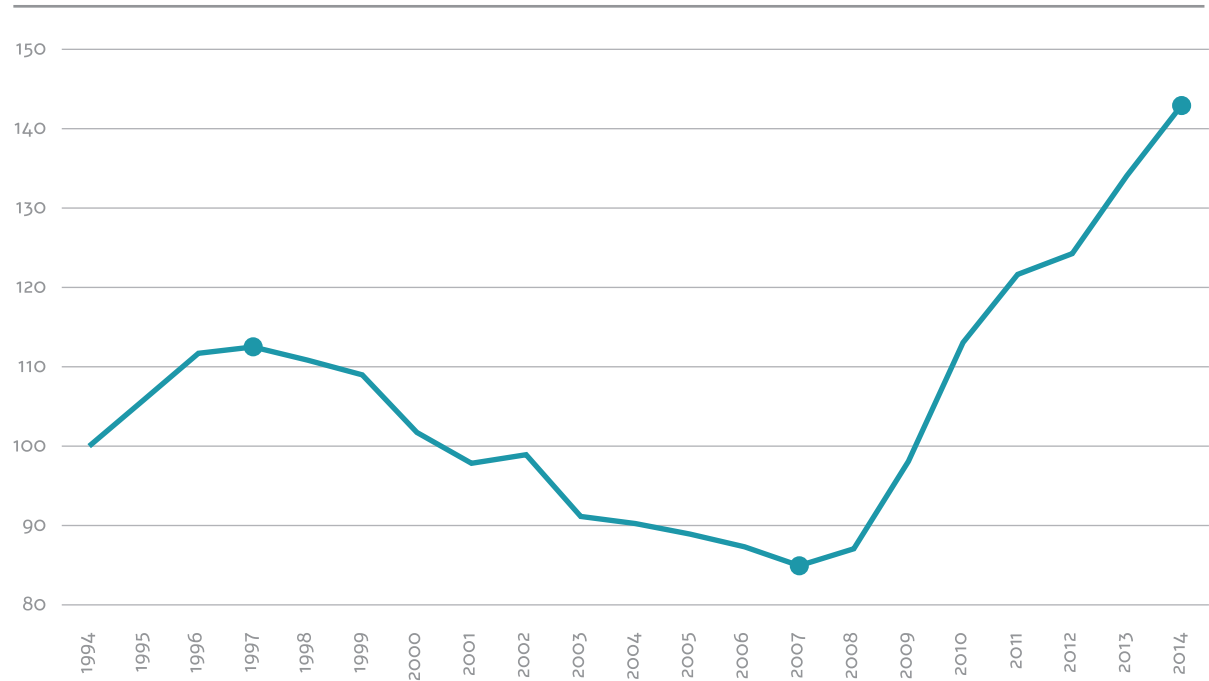
Starting in 2008, home prices rose dramatically.

Between 2007 and 2014, after a decade of overall declines, real home prices rose at an average annual rate of 8%.

The result of this sharp rise was that in 2014 prices were 68% higher than in 2007 and 27% higher than at the previous peak in 1997.

Real home price index, relative to CPI excluding housing

Index: 1994=100



SOURCE: CBS

25.

What Caused the Surge in Home Prices?

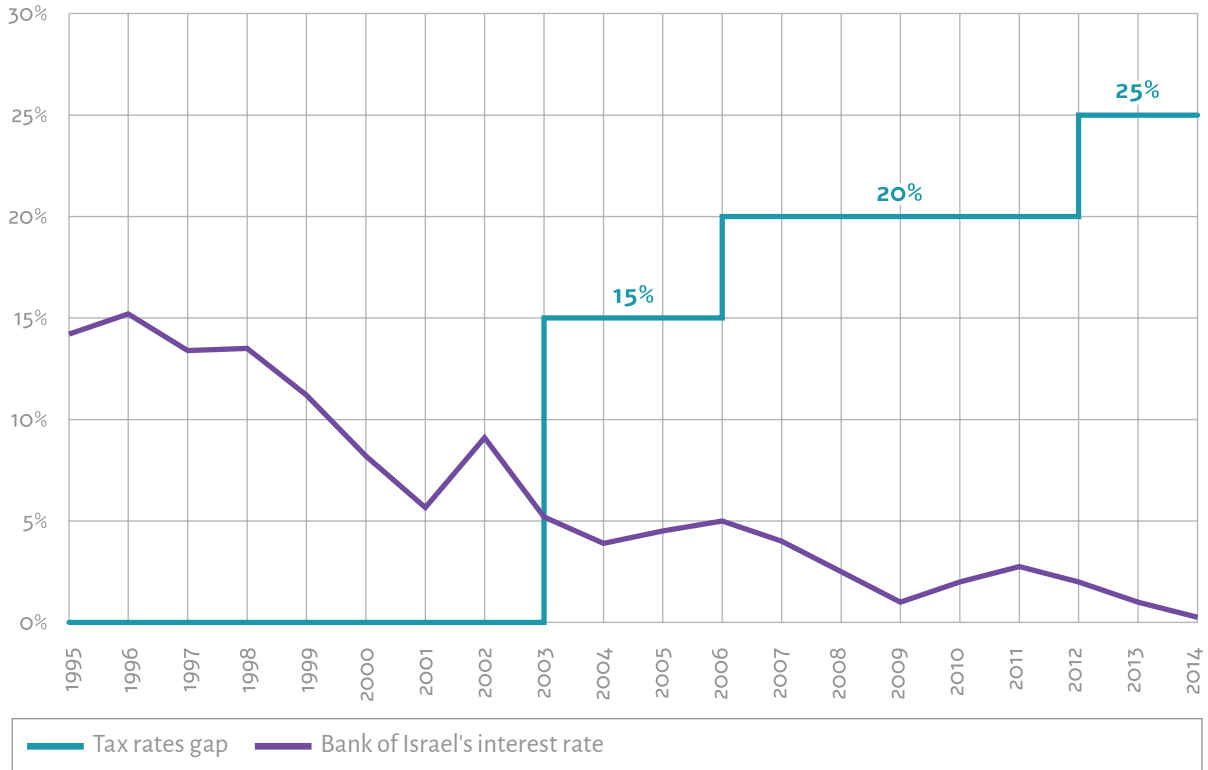
Low interest rates and the increase in the capital-gains tax rate on financial investments have fueled demand.

The sharp increase in home prices was caused, in part, by government policies that fueled the demand for real estate.

The sharp decline in interest rates was one important factor in the increased demand for home purchases.

A second factor is a bias in the tax code. In 2003, the government began to differentiate how it taxed capital-gains on financial investments and capital-gains on real-estate investments (especially in the case of owners of only one home). The discount on real-estate capital-gains taxes has expanded twice since then, as home prices have skyrocketed.

Bank of Israel's interest rate and the gap between the capital-gains tax rate and the tax rate on capital-gains from first home



SOURCE: BOI, Ministry of Finance

PART C

Data Sources and Methodological Remarks

Data Sources and Methodological Remarks

- **Data sources:** The main sources of data are the Central Bureau of Statistics (CBS) and the OECD database. Additionally, some of the data were taken from the following sources: the Bank of Israel (BOI), World Bank (WB), International Monetary Fund (IMF), United Nations (UN), International Labour Organization (ILO), European Commission (Eurostat), World Economic Forum (WEF) and government ministries mentioned.
- **Data processing:** The figures portrayed include data published by the above sources and also data processed by the Kohelet Economic Forum (KEF). In both cases the source is indicated.
- **The selected years:** In time series, the choice of year follows the following principles:
 - The last year in the series is the latest for which data is available
 - The first year is 2000, the earliest for which data is available, or, in some cases, the year before a change in trends
 - When isolated years are presented, the selection was made according to these same criteria
- **Countries of reference:** International comparison was made according to the following criteria:
 - In most cases, Israel was compared to the OECD average, the United States, and in some cases, the European Union or the Euro area because they are powerful demographic and economic entities
 - In some cases, the OECD countries were clustered by geographic region, but only if the variance within each area was relatively low
 - For when it was relevant, an OECD weighted average was calculated and presented in addition to the simple average – if not otherwise mentioned, the OECD average is a simple average
 - When the data source was not the OECD, the countries included were all the countries in the database, the OECD members included in the database, or best in the category
 - When there was a change in the composition of the reference group over the time presented in the chart (e.g., new members of the OECD), the entire chart is based on the composition that obtained at the beginning of the time period, in order to maintain a consistent comparison
- **The population groups:** Data presented are divided by age groups or by sex when the division is relevant to the trend observed. When groups are divided by other features, a comment is added about the way each group (e.g. Haredi Jews) are identified.



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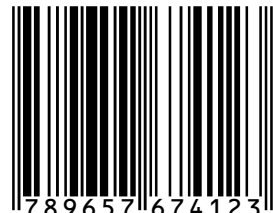
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