



# **ANNUAL SURVEY 2004**

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## Forward

The present Annual Survey presents the wide range of activities of the National Insurance Institute of Israel (NII) in 2004 – payment of benefits and collection of insurance contributions, formulation of social policy and research.

The first chapter describes benefit payments in 2004, in view of the social policy of the government in the past three years, and describes overall welfare expenditure in Israel in an international perspective. It also surveys some social aspects of the public expenditure policy and its implications on cash benefits, health and education services as well as the income tax reform.

The second chapter presents the picture of poverty and income inequality in Israel in 2004, focusing this time on the trends that characterized Israel in the nineties in comparison to selected Western countries. Updated findings are presented on the scope of poverty according to the expenditure approach.

Special chapters are devoted to developments in the income support system to the working-age population (Chapter Three), in collection of national and health insurance contributions (Chapter Four), and in the main insurance branches (Chapter Five). Several chapters include boxes on topics in Israel's public agenda, or on the international experience in certain fields. The Survey also includes an English summary of the first chapter and of the chapter on trends in poverty and income distribution.

The Survey includes three Appendices: an Appendix of Publications – summaries of research reports and surveys published by the Research and Planning Administration in 2004 – an Insurance Branch Table Appendix and a Poverty and Inequality Table Appendix.

I extend my thanks to the employees of the Research and Planning Administration who assisted in the preparation of the Survey and bringing it to print, and particularly to Mia Orev-HaTal, who carried out the linguistic editing and to Sarah Gargi for translation of the Introduction to English.. Special thanks are due to Or-el Abutbul and Nira Amir, who bore the burden of the typing, for work carried out with willingness, initiative and devotion.

Leah Achdut

Deputy Director-General for Research and Planning

## **Preface**

### **By the Director General**

The first buds of economic recovery appeared in 2004; the standard of living – in terms of GDP per capita and wages – rose, employment expanded and there was even a slight decline in unemployment. However, not all population groups enjoyed the fruits of this growth. The 2002-2003 turnabout in the government's social policy continued to leave its mark on the national insurance (social security) system in 2004 as well. Child allowances continued to be slashed, the depth of the cut in the income support benefit was felt even more intensely, and the value of pensions to the elderly, widows and disabled remained frozen. Benefit payments continued to shrink both in real terms and as a share of the GDP: within a two-year period – 2002-2003 – they lost 1.4 GDP percentage points (1.2 without reserve service benefits), and relative to the GDP they withdrew to their 1997 value. In real terms, benefit payments are about 11% lower in 2004 than they were in 2001.

The data in the present Survey show once again that the welfare system in Israel is not exceptionally generous in an international perspective, not even in the 2001 peak year, and certainly not in 2004. The international comparison also reveals that Israel is one of the “leading” countries in the scope of poverty and disposable income gaps. Today's picture of poverty and inequality in income distribution, not yet fully reflecting the effects of the new social policy, is gloomy enough as it is. The rate of poor families soared to 18%, while the proportion of poor children shot up to about 31%. The NII benefits absorbed the deepest cuts, but the other social services, particularly the national health services, were struck as well, hurting mainly the weak sectors of Israeli society. At the same time, the income tax reform improved the situation of the well-off sectors. The reform did not provide an adequate solution to the economic distress of the low-wage earners; the increase of the tax burden by means of a reduction or cancellation of tax benefits (development towns) or by a

permanent freeze in the value of credit points, shall erode the disposable income of the families that already suffered from a deep cut in their benefit, particularly their child allowances.

Most agree that the economic growth in Israel — which we hope will continue — will not benefit the entire population. Many too share our doubt regarding the truth of the declaration that only work, and not benefits, is the sole solution to society's ills. True, work is of utmost importance, but it is not always sufficient to guarantee an adequate standard of living, particularly when one is working at low wages. Even if we agree that whoever goes out to work is extricated from poverty, it is still our obligation to assist those families at the threshold of poverty, as well as those who do not work due to unemployment, illness or old age.

The new legislation changed the face of the NII benefit system, and its effects will be felt even more strongly in the coming years. It was approved as a result of budgetary pressure during an economic recession, but as time passes it becomes ever more clear that to a large extent it reflects the perception of the policy makers regarding the character of the welfare state in Israel, and the role of the NII. The 2005 Economy Arrangements Law bears testimony to this: despite the growth of the economy, the role of the State in insuring its citizens against economic contingencies is being eroded (benefits to persons injured at work), while the independent status of the NII is being endangered. The government decision to lower (gradually, until 2009) the NII contributions paid by employers will tighten the Institute's dependence on the Treasury. Furthermore, it will lessen State receipts, and the budget deficit may lead to additional pressure to cut expenditure on benefits and other social services. When the process is over, the reduction will amount to about NIS 3.2 billion annually, in 2004 prices – in addition to the lowering of income tax by an amount that will reach about NIS 9 billion in 2006.

When I first took up my position as Director General of the National Insurance Institute, the picture described above led me to re-examine the main goals of the NII programs as well as the status of the NII relative both to the government and the insured public, and to formulate a plan of action in order to advance these goals. Parts of this plan of action are necessary to rehabilitate existing programs that do not adequately meet the needs of their target populations or to build new systems of assistance to solve problems that have arisen due to present labor market circumstances. Other parts of the plan are needed to help the NII work more efficiently and to improve its services, so that we may increase take-up of rights without allowing for exploitation of the system. I have therefore set up a number of committees comprised of both NII employees and outside experts in various fields. After several months of research and deliberations, these committees have submitted their recommendations. The preface to the NII Annual Survey of 2004 is a fitting opportunity to share with the public a brief summary of the results of the committees' work.

**The committee for examining the status of the NII** formulated a series of recommendations for action on the part of the NII both as an insurance system and as an independent corporation. The committee recommended determining socio-economic goals and a policy of social insurance to guarantee a security net to those in distress or economic crisis. Furthermore, it recommended classifying the benefits into two clusters, each cluster with its own rules of activity: an insurance cluster to include the core benefits of the NII, for which contributions are collected, and a social cluster, comprising the non-contributory benefits financed entirely by the State Treasury. In order to guarantee stability in the insurance cluster and to increase public confidence in it, it was recommended that the changes in this cluster be governed by long-range considerations and inter-generational principles in order to match receipts to expenditure, insofar as possible. The financing of the insurance cluster will be severed from short-range constraints of the State budget, and government participation will be

defined and limited. Changes in the insurance cluster will be carried out only after consultation with the NII Council — which includes government representatives — taking into consideration the actuarial reports conducted every few years, and in keeping with the social goals determined by the nation's leaders.

In the social cluster, conditions of entitlement and the level of benefit for minimum subsistence will be determined, and the benefits shall be re-examined in accordance with the social goals and the extent of their attainment. In order to strengthen the NII as an autonomous body, it was recommended to carry out changes in the NII Council and in the system of mutual relationships among the Minister of Social Affairs, the NII Executive Board, and the members of the Council.

In the government deliberations on the goals of the economic policy and in the size and composition of the State budget, a discussion of social goals and social aspects of the budget was notably missing. The picture presented to the policy makers when formulating the budget is therefore not a complete one. **The committee for examining the social aspects of the State budget** recommended presenting the government and the Knesset (Parliament) every year with an analysis of the implications of the state budget on the social situation, according to accepted measures, together with the presentation of the macro-economic forecast. The committee also recommended including in the national budget a chapter on its expected short-range social implications. The NII will be responsible for conducting and presenting a survey of social trends, as well as estimates of the implications of budgetary policy on income distribution and on poverty. For this purpose, the NII will build an “input-output model”, the social budget being the inputs and the social measures being the outputs. In the framework of the committee's work, the Research and Planning Administration prepared a preliminary model that included all the changes in the NII benefits, the direct tax reform and the health and education budgets.

Some of the research findings are presented in this Survey, and the NII intends to continue to work on and improve the model.

In view of the structural changes in the labor market, the globalization, the legislation harshening conditions of entitlement to unemployment benefits and the sweeping reduction in the income support benefit to all recipients, **the committee for examining the mutual relationship between the NII and the labor market** focused on low-wage earners and non-employed. The committee recommended introducing a program of refundable tax credits to low-wage earners (“negative income tax”), similar to that existing in several Western countries. The committee did not content itself with a recommendation alone; it proposed two alternatives to the program (at the same cost) and methods to implement it. The alternatives proposed and the set of considerations on which they were based may undoubtedly serve as a topic for future discussion, which we believe many will participate in. The committee recommended expanding unemployment coverage to include some of those to whom eligibility for unemployment benefits has been ruled out, and to re-examine payment of graded unemployment benefits in accordance with period of unemployment or level of unemployment in one’s area of residence. Regarding the income support system, it was recommended to improve the mechanisms of diagnosing employment potential and to provide a higher benefit to those whose capacity to work is limited due to poor health — physical or mental.

The committees that dealt with computerized information systems and the improvement of service to the citizen recommended integrating the benefit system with the insurance and collection system, so that the information on each client will be concentrated and uniform, and the systems would “speak” in one common language. They further recommended computerizing the medical boards and strengthening the system of monetary control. In order to implement these recommendations many resources are needed both in planning and in computer equipment — and naturally the

process will take several years, but it is essential in order to lighten the burden on the insured person of providing information to the NII, as well as to increase take-up of rights without exploitation of the system.

This is a welcome opportunity to note the professional work of all the committees and to thank all those who took part in their work. I am convinced that the efforts they initiated were not in vain. The research work and recommendations of two of the committees have already helped the NII prevent some cuts that the Treasury had planned to include in the 2005 Economy Arrangements Law, and to promote some important decisions made by the government during the debate on the 2005 budget: an increment to the old-age pension for needy elderly and the setting up of a committee to examine “negative income tax”. The NII also succeeded in getting the Treasury to agree to increase its 2005 administrative budget in order to begin planning the changes in the computerized systems and work processes. The tasks and challenges ahead of us are many, and entail much intense work and cooperation with the government and the Knesset. Our success in strengthening Israel as a welfare state depends not only on the support of the country’s leaders, but also on that of the public as a whole.

Dr. Yigal Ben Shalom  
Director General

## **Chapter 1**

# **Trends of Development in National Insurance**

**Leah Achdut**

## 1.1 Introduction

The turnabout in the government's social policy in 2002-2003 left its stamp in the social security system of Israel in 2004 as well. NII benefit payments as a percentage of the GDP fell to their 1997 level – only slightly higher than their average in 1993-1996. In three years benefits dwindled by about 1.4 GDP percentage points, down to about 7.9% of the GDP. In the survey year, benefit payments in cash and in kind decreased in real terms by about 4.5%, and the accumulated decrease since 2001 amounted to approximately 11.5%<sup>1</sup>. In terms of average per capita, benefits were eroded at an accumulated real rate of about 16%.

The decrease in benefit payments in 2004 encompassed all insurance branches (except benefits to elderly and the disabled, which rose slightly) as well as the income support program. Were it not for the growth in number of recipients, particularly in the central NII branches, there would have been a sharper decrease in payments reflecting the depth of the benefit cuts and the harshening of conditions of entitlement to benefits.

Payments of benefits to the working-age population – child allowances, unemployment benefits and income support – also declined in 2004. Child allowances were slashed again; the harshening of conditions of entitlement to unemployment benefits continued to be reflected in the low rate of unemployed persons who attained economic security; the cuts in the income support benefit, together with the changes in the employment test for this benefit, led to a decline both in the (average) benefit and in the scope of recipients. In three years, payments of child allowances plummeted by about 40%, of unemployment benefits – by about 43%, and of income support benefits – by about 20%.

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<sup>1</sup> The picture does not essentially change when payments of reserve service benefits are not taken into account; in this case, benefit payments were reduced by an accumulated rate of 10% and lost 1.2 GDP percentage points.

Both the substantial reductions in child allowances and the payment of an equal allowance for every child (by 2009) place Israel very low in the generosity scale of benefits for families with children, particularly large families, in comparison with many Western countries. At the same time, they strengthen her position as “leading” in the scale of poverty among children. Furthermore, the harshening conditions of entitlement to unemployment benefits place Israel at the bottom of the scale grading Western countries according to parameters of unemployment insurance coverage; in 2004 only 20% of unemployed persons in Israel were entitled to unemployment benefits. A follow-up of unemployment benefit recipients after the legislation shows that unemployment insurance grants economic security mainly to those who had relatively stable jobs prior to their unemployment. The legislation created a new reality, under which many workers who comprise the weak links of the labor market – the low-educated, low-wage employees and workers at temporary jobs – were not entitled to unemployment benefits after they lost their jobs.

In the income support scheme, which was – more than any other social security scheme – at the focus of public debate, the erosion in the minimum subsistence level guaranteed to the weak population groups continued, and will become even stronger with the entry of new recipients entitled to the reduced benefit at its low rate. Also, for the first time for many years, the number of recipients of income support benefit declined — from a peak of about 160,000 early 2003 to about 145,000 towards the end of 2004 (although stability characterizes the second half of 2004). This decline apparently reflects not only the ruling out of entitlement to about 5,000 (mainly single-parent) families when the legislation was implemented (June 2003), but also the faster pace of exits and the slowdown in the pace of entries to the system. The short period of time that has elapsed since the new legislation does not permit an analysis of the contribution of the various factors (changes in benefit level and in the income and employment tests as well as expansion of employment) that have led to in the decline in the number of recipients, nor does it allow us to forecast the long-range

implications of these changes. Nevertheless, the picture arising from the data is quite clear: the decline was concentrated in single-parent families and in couples with children, especially couples who had some earnings while in the income support system.

In 2004, for the second straight year, a considerable slowdown was noted in payments of disability pension and other benefits paid in the framework of Disability Insurance to the working-age population. This development was particularly notable after the sharp rise in these payments following the generous additions to disability benefits provided in 2000-2002 (in the framework of the agreements with the organizations of the disabled). Quite a large share of the growth in total NII benefit payments is attributed to the increase in disability payments. The influence of the Retirement Age Law in June 2004, which raised the age of entitlement to old-age pension for both men and women, already began to be felt in the Old-Age and Survivors' branch – but barely at all in the programs for the working-age population. The strong influence of this legislation on the system will be felt only in the coming years.

The developments in the social security system in 2002-2004 are compared to those that occurred in 2001, the year preceding the turnabout in the government's social policy and order of priorities. 2002 to 2004 were not only the years in which most of the amendments were actually implemented, but also years of deep recession. In 2001 the scope of the benefit payments was at a peak,<sup>2</sup> the sharp rise in the average wage in 1999-2000 was reflected in benefit levels in 2001, while the accumulated influence of the expansion of unemployment since mid-1997 was evident in programs such as unemployment and income support. The year 2001 also embodies the increments gradually provided to the disabled in 1999-2000 as well as those granted for children under the "Halpert Law." However, even in this peak year, Israel's welfare system in general and her system of cash benefits in particular were not exceptionally generous

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<sup>2</sup> In nominal terms, the scope of payments was at its highest in 2002.

in an international perspective – although in comparison to 1998,<sup>3</sup> the gap between Israel and the average for OECD countries had been reduced.

Israel is positioned in the 21<sup>st</sup> place in the scale grading the 29 OECD countries according to public expenditure on welfare relative to the GDP,<sup>4</sup> with the gap between this country and the OECD average measuring 2 GDP percentage points: 19.1% as compared to 21.2% in 2001. At the same time the gap between Israel and the EU average (24%) measured about 5 percentage points. Box 1A presents Israel's position – the 20<sup>th</sup> – in the index of cash benefits: In 2001, Israel improved its position on the scale of cash benefits to the working age population, as compared to previous years, but it should be noted that this improvement reflects not only the greater generosity of benefits, but also the considerable expansion of unemployment, placing Israel on a par with the countries suffering from the highest unemployment rates. Finally, the improvement in Israel's position on the scale of cash benefits was only a temporary one, since the considerable reduction in benefits to the working-age population since 2002 pushed the country back. Table 1 presents the structure of Israel's social expenditure in 1998-2004, clearly showing the deep cutback in NII cash benefits. Total public expenditure on welfare decreased in 2003-2004 by 1.6 GDP points, while the expenditure on cash benefits decreased by 1.3 GDP points, with most of the "loss" in GDP terms (1.15) coming from the NII cash benefits to the working-age population. Cash benefits to the elderly remained more or less without change – about 5.4 GDP points; the decrease by 0.2 GDP points in the old-age and survivors pensions and other cash benefits to the elderly was set off by the rise in pension payments to civil servants (who are actually part of the occupational pension system). A decrease of 0.4 GDP points took place between 2002 and 2004 in the scope of in-kind transfers, mainly comprised of health and long-term care.

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<sup>3</sup> See NII 2002-2003 Annual Survey.

<sup>4</sup> See diagrams at beginning of Survey.

Table 1: Public Expenditure on Welfare, 1998-2004 (percentages of GDP)\*

	1998	1999	2000	2001	2002	2003	2004
Total	17.73	17.55	17.53	19.05	19.32	18.87	17.68
Total cash benefits	10.46	10.41	10.46	11.57	11.55	11.16	10.33
Benefits to working-age population	5.60	5.55	5.55	6.14	6.13	5.61	4.98
NII	4.58	4.49	4.49	5.07	5.03	4.56	4.01
War and hostile actions	0.53	0.52	0.51	0.57	0.59	0.60	0.57
Other**	0.49	0.54	0.56	0.50	0.51	0.45	0.41
Benefits to the elderly	4.87	4.85	4.91	5.42	5.43	5.55	5.35
NII	2.86	2.83	2.83	3.14	3.09	3.06	2.96
Pension to civil servants	1.59	1.59	1.63	1.79	1.84	1.98	1.97
Other**	0.41	0.44	0.45	0.49	0.49	0.51	0.43
Total in-kind benefits	7.27	7.14	7.07	7.48	7.77	7.71	7.34
Health and long-term care	5.88	5.76	5.73	6.02	6.23	6.27	5.97
Other	1.39	1.38	1.35	1.46	1.54	1.44	1.37

\* Source: NII and CBS data, processed by the Research and Planning Administration according to OECD classification rules.

\*\* Includes benefits to demobilized soldiers, absorption basket and cash benefits as rental assistance.

\*\*\* Includes benefits to Nazi victims and cash benefits as rental assistance.

\*\*\*\* Includes in-kind benefits of NII, local authorities, national institutions, State non-profit bodies and Ministry of Labor and Social Affairs.

**BOX 1A****Generosity of Cash Benefit System in Israel and in OECD Countries, 2001**

The cash benefit system is the main pillar of public expenditure on welfare in all Western countries. The scope of these benefits is dependent not only on their level, but also on economic and labor market conditions, as well as on the demographic structure of the population. The cash benefit system in Israel – according to the OECD<sup>1</sup> classification and its most updated data (2001) – constitutes about 61% of total expenditure on welfare, slightly lower than the EU average (62.5%).

In the ratio of expenditure on cash benefits to the GDP, Israel is ranked in the 20<sup>th</sup> place – slightly lower than the OECD average: 11.6 as compared to 12.0 GDP percentage points, respectively – and an average of 15 GDP percentage points for the EU countries (EU – 15).

If the benefits to war and hostile action casualties, unique to Israel, and pensions paid to civil servants (in most countries, the latter are a part of the private occupational pensions, not the state pensions) – are not taken into account, Israel's expenditure on cash benefits falls to 9.1 GDP percentage points.

A distinction is generally made between cash benefits to the working-age population and those granted to the elderly, taking into account population size in each of these groups. In the scale of countries according to size of cash benefits per person of working age relative to GDP per capita, Israel is similar to the EU average and to the U.K., but higher than the OECD average. In this index, Israel is ranked in the 12<sup>th</sup> place (or in the 17<sup>th</sup> place, if benefits to war and hostile action casualties are not taken into account). Israel's position improved since 1998, reflecting the rise in cash benefits to

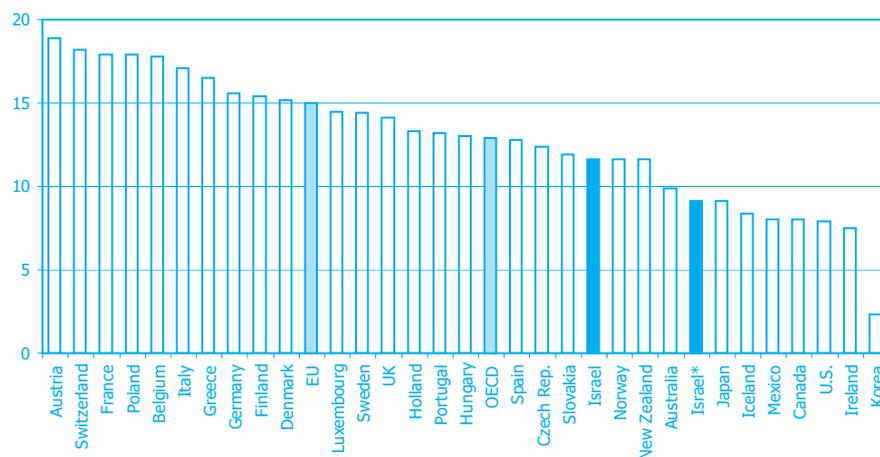
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<sup>1</sup> Government-financed expenditure on welfare, including financing of national institutions and non-profit institutions. A problem of inconsistency in the definitions of the various countries may arise in the classification of the financing of such institutions, particularly in view of the difficulty in separating between government and private financing.

the working-age population in 1999-2001, but worsened in 2004. In 1998, the cash benefits per working-age person relative to the GDP per capita was 6.2, and it rose to 6.8 in 2001 (when the OECD average remained 5.7), **but decreased to 5.5 in 2004**.

A different picture arises from a comparison of expenditure on cash benefits per elderly person as a percentage of the GDP per capita. Here Israel is close to the OECD average, but lower than the EU average. Excluding pensions to civil servants (1.8 GDP percentage points in 2001), Israel falls down to the bottom of the scale, to the 27<sup>th</sup> place. This low position reflects the structure of Israel's benefit system; it guarantees and finances a basic uniform benefit, at a relatively low level, without a supplementary, wage-related tier. In this case too, Israel in 2004 is at a lower position than previously. Expenditure on cash support per elderly person (without pensions to civil servants) relative to GDP per capita was 37.1 in 2001 (as compared to an average of 56.1 for OECD countries), decreasing to 34.7 in 2004.

**Cash Public Benefits as Percentage of GDP, OECD Countries and Israel, 2001**



\* Cash benefits excluding payments to war and hostile action casualties and pensions to civil servants.

Signs of economic recovery in 2004 were noted in the scope of contributions collected by the NII, but not in benefits, which continued to decline. One may surmise that the expansion of employment, accompanied by a moderate decrease in the unemployment rate, made a certain contribution to the trends noted in the number of benefit recipients in the Unemployment and Income Support schemes, and even in the Disability scheme. The relative stability in the average price level prevented further erosion in the purchasing power of benefits (those that were not cut, of course), but in view of the rise of real wages, the relative situation of benefit recipients got worse. The value of almost all benefits eroded in 2004 relative to the average wage. This would have occurred even if the policy of freezing the nominal value of benefits since December 2001, and canceling their linkage to the average wage, had not continued, since under previous legislation compensation for 2004 wage rises would be provided in 2005. Moreover, in light of the erosion in the average wage in 2002-2003, it is now apparent that the cancellation of linkage to the average wage has thus far had only a limited effect on benefit levels. The far-reaching implications of this policy on the standard of living of benefit recipients will be felt in the coming years, when real wages will continue to rise but benefits will be updated in accordance with price rises only.

The government officials pushing the present socio-economic policy believe in a “small” government, and in keeping with this perception they reduced public expenditure and cut taxes. Public expenditure was reduced by means of two constraints: the deficit target of the State budget, which was 4% in 2004, but is to be gradually lessened in the next years, and ensuring that public expenditure will not increase by more than 1% in real terms – an increase not even sufficient for the natural growth of the population.

The economic growth of 2004 led to an increase in State income from taxes, but in order to deflate pressure to raise public expenditure, the Treasury embarked time and again on the policy of lowering taxes; in addition to advancing the income tax reform,

the rates of V.A.T., sales tax and company tax all were lowered, and an agreement was signed with the Employers' Coordination Bureau on lowering national insurance contributions collected from employers. In most cases, the tax reductions will be carried out gradually, and will continue in 2006-2007 as well. However, in parallel to this policy, a number of measures were taken that actually increase the tax burden on certain population groups. For example, the benefits to persons living in development towns and to recipients of early pension were reduced, while the rate of national and health insurance contributions collected from the latter was raised. Also, the 2005 Economy Arrangements Law proposes to cancel the tax credit point for a non-working spouse. Furthermore, the value of the tax credit points will no longer be adjusted (as of 2005) according to inflation – a measure that will lead to constant erosion in the tax thresholds and, in the long run, to a greater tax burden, particularly on low and middle-wage earners, as well as on working women with children.

Both sides of the State budget – the expenditure side and the income side – affect the standard of living and welfare of the population, the scope of poverty and the economic gaps. Every year the government debates on the State budget open with a review of macro-economic developments in the country and a presentation of the forecast for the budgetary year in question as well as the coming years. The government uses this forecast when it determines or re-approves the targets of its economic policy, as well in its decisions on the size and composition of the budget as derived from these targets. However, notably missing from the government debate is a review of the implications of its recent policy on the social situation, or an analysis of the social aspects of the budget in question, according to measures accepted in Israel and in the world – despite the fact that an analysis on some of the social aspects is readily available, being carried out by the NII as well as other bodies. This is at least partially due to the fact that social targets are simply not set as part of government policy along with the economic targets.

The reduction of public expenditure is particularly detrimental to those population groups that are most in need of or in use of social services, while lowering the taxes on labor does not necessarily improve the distribution of net income. Moreover, there is no guarantee that economic growth will benefit the entire population, and even among those who do enjoy the fruits of this growth, not all enjoy them to the same extent. This is particularly true in a period of unbalanced growth, which improves the relative situation of highly educated workers and the high-tech sectors, and in this era of globalization, which further endangers the jobs and wages of the weak links of the labor force.

The findings presented below in this and other chapters of the Survey show a very gloomy picture of the social situation in Israel, and demand a plan of action in accordance with defined targets. Despite the differences in the various approaches as to what policy measures should be used to solve the social problems, it is possible to at least partially agree on a plan based on the common denominator of all these approaches. It is also possible to bridge some of the differences, leaving the more serious ones for another time. The efforts to convince Treasury officials to halt the cuts in the child allowances – even in keeping with the principle of an equal allowance for every child – did not succeed. Furthermore, the chances of increasing the income support benefit – even to those limited in their job capacity – seem very slim at the moment. The situation regarding easing conditions of entitlement to unemployment benefits is a similar one – although in our opinion, the Treasury did not intend to go so far in its policy, and is aware of the wide consensus among professionals and academics that unemployment insurance should be strengthened. The NII prepared proposals to expand the coverage of unemployment insurance, one of which – applying to daily workers – is presented in the chapter on Unemployment Insurance.

Assuming that today it will be difficult to improve the economic situation of non-working families of working age, the focus at this stage is on the elderly and on low-

wage workers. The discussions preceding the government decisions in the 2005 budget bore fruit, and the 2005 Economy Arrangements Law includes a proposal to raise the minimum income to those elderly entitled to income supplement. The government also decided to set up an inter-ministerial task force to examine the possibility of introducing refundable tax credits (negative income tax) to low-wage workers – in order to encourage them to join the labor market, or to guarantee more adequate wages to part-time or full-time workers. The experience of other countries shows that financial incentives to encourage non-employed to enter the labor market – combined with “welfare to work” programs – help achieve worthy goals at the level of the individual and the economy as a whole.

## 1.2 Social Aspects of Government Policy

This part of the chapter discusses the social aspects of government policy in recent years in three spheres: the evidence accumulated thus far on poverty trends in an international perspective; expenditure on health and education services financed by the government and their effects on the distribution of in kind transfers embodied in these services; and estimates of the effects of the income tax reform in 2003-2006. The findings presented are part of the work of a committee that recommended including social aspects in government debates on the State budget<sup>5</sup>. The committee’s research was based on a static short-run analysis; changes in the behavior patterns of individuals, families and firms following changes in policy were not taken into account. This is a drawback, particularly regarding the reactions of individuals to changes in the level of benefits and tax burden, as reflected in labor supply.

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<sup>5</sup> The committee was appointed by the NII Director General, Dr. Yigal Ben Shalom, and headed by Prof. Zvi Zusman and Mrs. Leah Achdut. The research work, carried out by the Research and Planning Administration of the NII, will shortly be published in full as a research paper.

### 1.2.1 Poverty and Income Distribution in Israel, in an International Perspective

In comparison to other social services – such as health and education – NII benefits absorbed the deepest cuts in the framework of the government policy to reduce public expenditure in 2002-2004. The findings thus far amassed clearly point to a rise in poverty rates in Israel, which were high even prior to the social policy of the past three years. It is true that the standard of living of the population at large was eroded due to the recession, but the cuts in the benefits – comprising an important element in the income of the weak population groups – led to an even deeper erosion in the standard of living of these groups. Diagram A shows the sharp fall in 2001-2003 in the standard of living of families in the bottom deciles – as expressed in the equivalent disposable income. Disposable adjusted income declined in the first and second deciles by about 17% and 10%, respectively, as compared to a 6% average decline in the population as a whole.<sup>6</sup> The rate of poor families soared to 19.3% in 2003, and the upward trend in the rate of poor children since the beginning of the recession continued —climbing up to 31%. Poverty intensity also deepened, and NII benefits contributed less than in the past to a reduction of poverty and income gaps. These trends are discussed in detail in the relevant chapters of the Survey.

In an international perspective, the Israel of 2003 — and according to estimate, the Israel of 2004 as well — continued to “strengthen” her position as a front-runner in poverty rates. Diagrams B and C present poverty rates in several Western countries that participate in the Luxembourg Study, and concerning which data are available on trends in three prints of time: the beginning, middle and end of the ‘90’s. The

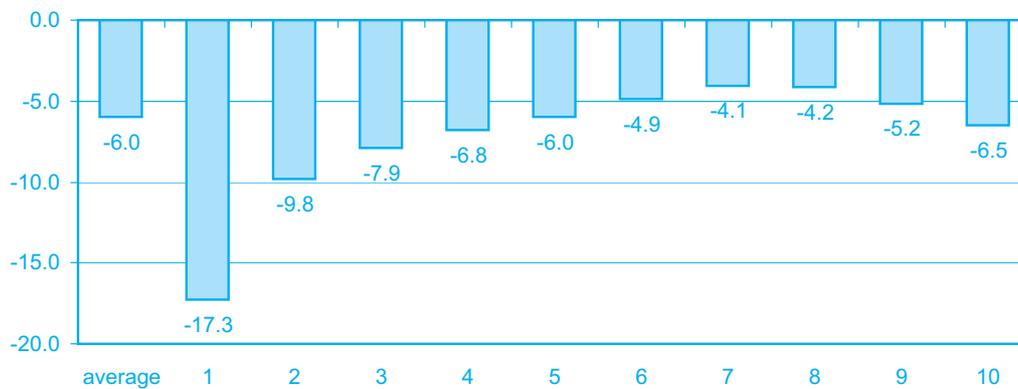
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<sup>6</sup> A similar picture — though not as sharp — was noted in the average income per family, without taking into account family size.

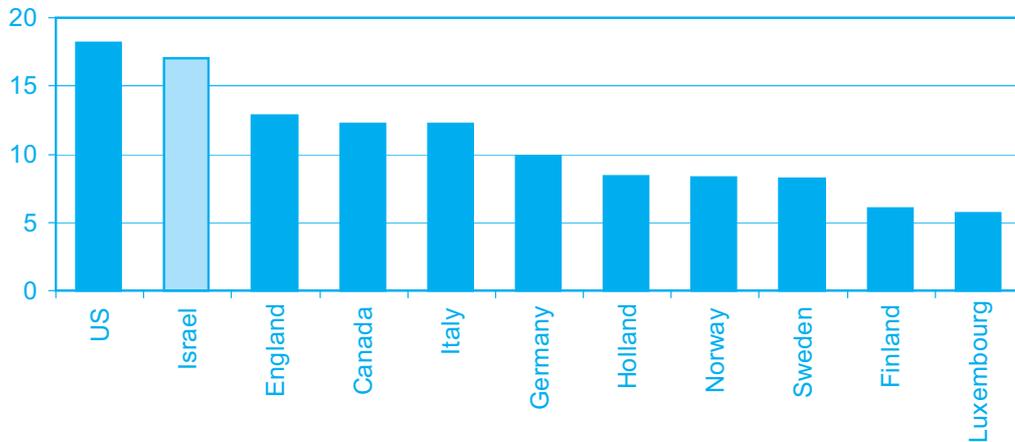
diagrams show that Israel leads not only in the level of poverty among families but also in the rate of growth of poverty in the course of the 90's.

The rate of poor families in Israel in the early nineties was about 5 percentage points lower than the parallel rate in the U.S. In the course of the 90's, however, Israel reduced the gap that had been in her favor, thereby distancing herself from countries like the U.K. and Canada — to which she had been similar in the early 90's. The United States, U.K. and Canada, characterized by high poverty rates, succeeded in keeping these rates stable (U.S.) or even reducing them (Canada and the U.K.) in the course of the 90's. These three countries were even able to reduce poverty among children, and other countries (like Norway and Sweden) managed to keep them stable, despite the economic crisis of the 90's.

**Diagram A: The Real Decrease in Adjusted Disposable Income, by Decile:  
2003 Compared to 2001 (percentages)**

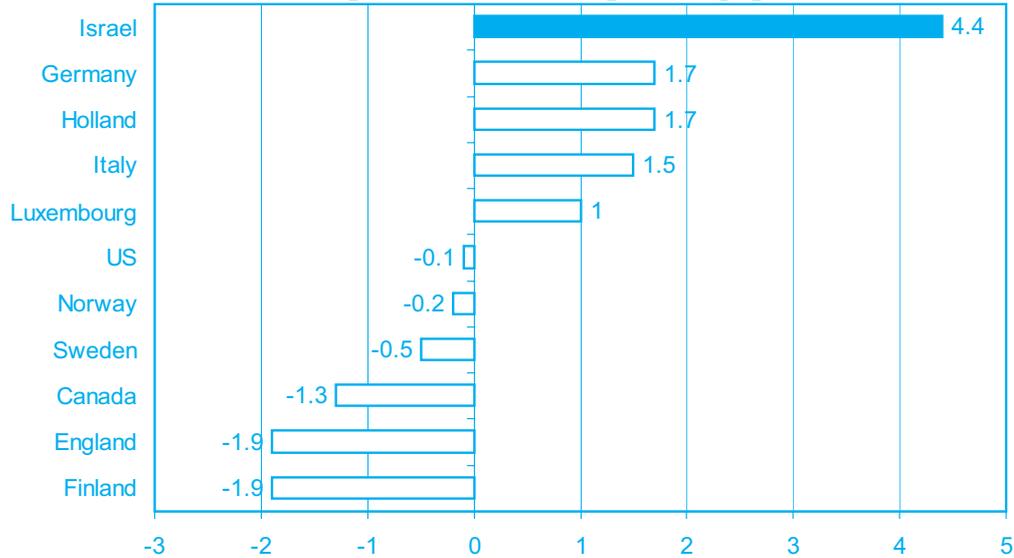


**Diagram B: Disposable Income Poverty Rate Among Families, in Selected Countries\*, 1999-2001**



\* In accordance with the Luxembourg equivalence scale. Use of the Israeli equivalence scale produces more or less the same results and the same ranking (see Tables 25-26 in the Poverty Table Appendix).

**Diagram C: The Change in Rate of Poor Families in Selected Countries, 1999-2000 Compared to 1990-1991 (percentage points)**



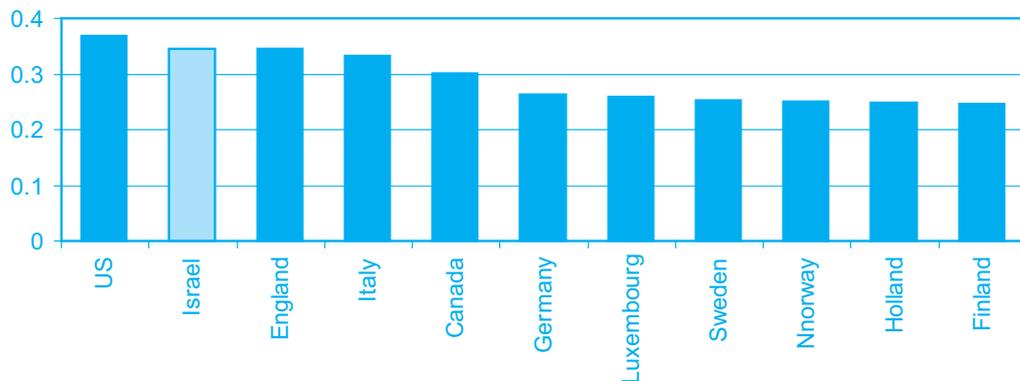
The United States experienced impressive economic growth in the 90's including a rise in the number of workplaces, which helped curb the growth in poverty. Together with these developments, the "welfare to work" programs helped poor mothers with children integrate into the labor market, and benefits for working families with children were strengthened (by means of tax credits). At the same time, those who remained poor became poorer due to cuts in their income support benefits. The U.K., more than any other country, serves as an example of the turnabout in social policy since the mid-90's, and embarked upon a wide range of policy measures – such as minimum wage legislation, support of both working and non-working families with children by means of refundable tax credit programs and "welfare to work" programs – all as additional supplementary strata to existing programs. The case of the U.K. is worthy of mention also because that country was a pioneer (following Ireland) in setting a policy goal of reducing poverty among children and following up on this goal. The government of the U.K. committed itself to reducing the rate of poor children by 50% by 2010 and to eliminating poverty by 2020. It determined that the follow-up would be carried out according to defined and transparent measures, the main ones being presented in Box 1B. According to the estimate of researchers, the target that was set for 2004-2005 will be achieved.

Following the U.K., the EU countries agreed (in a summit meeting of the EU in Nice, 2002) that every country must prove a substantial reduction in poverty rates by 2010, and must determine a list of indicators of social distress and exclusion for follow-up – in addition to the poverty measure according to the relative poverty line (60% of median income).

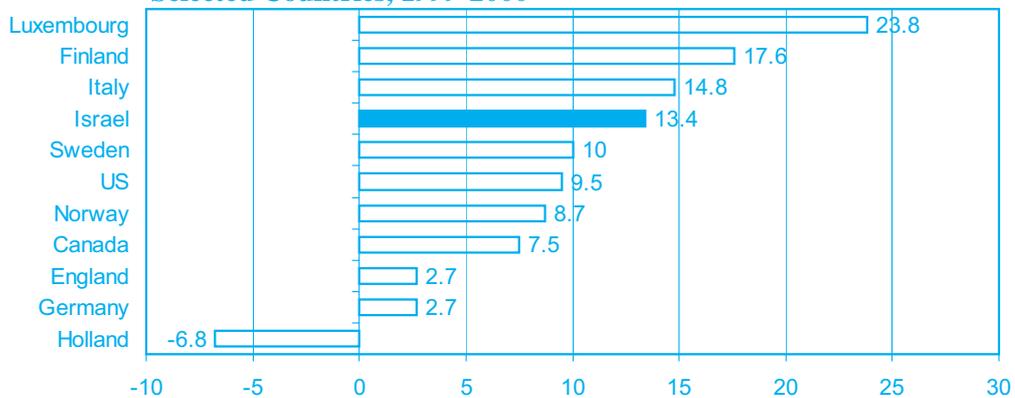
Diagram D presents the various countries graded according to the Gini index for the distribution of disposable income in the early 2000's. According to this index too, Israel is among the countries suffering most from high inequality. The ranking of the countries on this scale is exactly the same as their ranking by the rate of poor families.

The countries may be divided into two main, homogeneous groups, with Canada in the middle. In the first group, including the U.S., Israel, the U.K. and Italy, the index ranges between 0.368 and 0.333, and in the second group, including all the other countries, the index ranges between 0.247 and 0.264. The expansion of gaps in disposable income in the course of the 90's characterized all the countries except Holland, although the rate of growth in the value of the Gini index in Germany and the U.K. was very low.

**Diagram D: Gini Index of Distribution of Disposable Income in Selected Countries, in course of 90's**



**Diagram E: The Change in Gini Index of Distribution of Disposable Income in Selected Countries, 1999-2000**



**BOX 1B****Measures to Achieve the Target of Poverty Reduction — The Case of the U.K.**

The U.K. government committed itself to reduce the rate of poor children by 50% by 2010, and to eliminate poverty by 2020, following up on these targets by means of a combination of three measures:

- \* The rate of children living in families having an income under 60% of the median income – a relative poverty line, updated annually in accordance with income distribution data;
- \* The “backstop measure”: the rate of children living in families having an income under a “fixed” relative poverty line (the relative poverty line of 1998/9 is updated annually for inflation only).
- \* The measure of material deprivation, which records the proportion of families having an income under 70% of the median income who cannot afford to purchase a defined list of goods and services (such as quality housing, clothing, social activities for the children).

There is a general consensus that these measures are transparent, and not complicated to follow up on. The follow-up on the first two measures will be carried out annually, and on the third measure – once every few years. The UNICEF<sup>1</sup> report on poverty among children in developed countries recommends, more or less, adopting the British approach to choosing poverty measures and determining a timetable to achieve targets. The authors of the report state that one should be careful when using the “fixed” relative poverty measure. It represents a minimal test for governments, and the significance of failing to achieve a reduction of poverty according to this measure is that poor children do not participate in the fruits of economic progress, or that they are not protected in times of economic recession. However, the reduction of poverty according to this measure cannot be considered an achievement; rather, the recommendation to use it together with the relative measure obligates incoming governments to preserve past achievements, while setting goals for an additional reduction in poverty. Finally, the report’s authors believe that the target of lowering the poverty rate under 10% in the coming years is a realistic one for most OECD countries. Targets such as these require wide public consensus, so that the commitment to achieve them will be maintained even when governments change.

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<sup>1</sup> “Child Poverty in Rich Countries”, Report Card No. 6, UNICEF, Innocenti, Research Centre, 2005.

### 1.2.2 Government Expenditure on Health and Education and Income Distribution

Government expenditure on health (constituting almost 65% of total national expenditure on health) remained more or less unchanged in real terms, given that current expenditure is discounted by the civil public consumption index. Diagram E shows that it went up by only 0.2% between 2001 and 2004. The diagram also shows that the expenditure on health per capita adjusted to the capitation scale – which takes into account the size and composition of the population by age and thus reflecting the population's health needs – decreased by an accumulated rate of about 5.6%<sup>7</sup> between 2001 and 2004, with most of the decrease occurring in 2002. Under the 2005 budget proposal, the erosion in health expenditure per adjusted capita is expected to continue. On the other hand, government expenditure on education (constituting about 80% of national expenditure on education) grew in real terms by about 4.2%; discounted by the increase in the number of pupils in all school sections, it remained almost unchanged — an increase of 0.2%.<sup>8</sup> However, an analysis of expenditure per pupil by school sections shows that in 2002-2004, preference was given to pre-elementary schools and elementary schools, and even more so to higher education, at the expense of junior high school and high school. The 2005 budget proposal changes the picture, and the estimated expenditure on education will decline in real terms in all sections except for the pre-elementary schools.

The reduction in public expenditure on “in-kind transfers” as well – inherent in government-financed health and education services – hurts mostly families in the lower deciles, since the sums of “in-kind transfer” to these families are higher than to families in the upper deciles, and the size of the “in-kind transfer” constitutes a larger share of their cash income.

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<sup>7</sup> After discounting by the Consumer Price Index, the accumulated decrease amounts to almost 5.2%.

<sup>8</sup> After discounting by the Consumer Price Index, government-funded expenditure on health, as an average per pupil, went up by 0.7%.

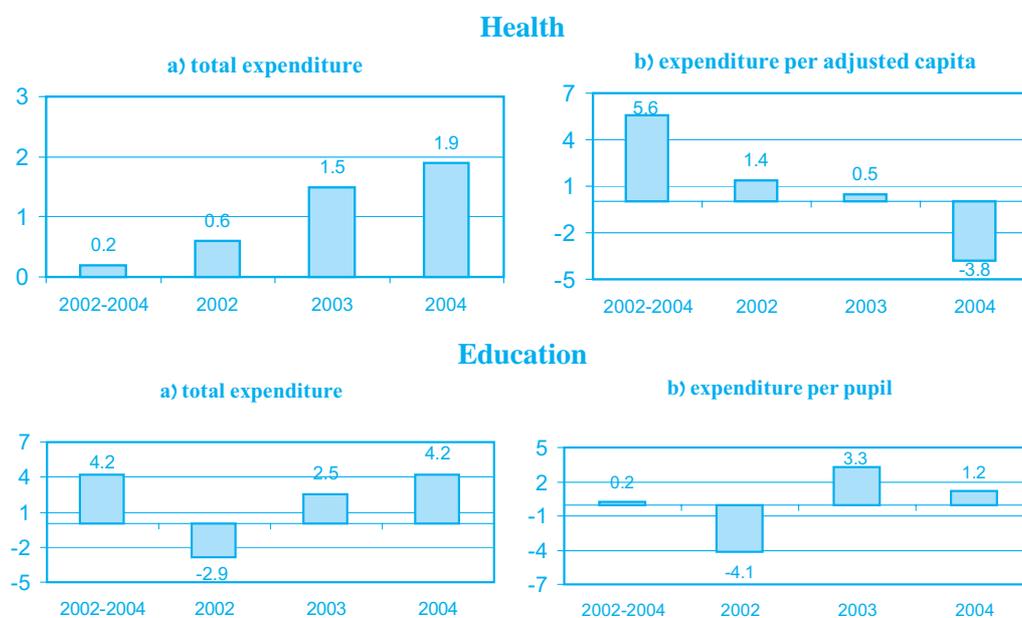
**Table 2: Government Expenditure on Health and Education, 2001-2004,  
at current prices (NIS million)**

Expenditure	2001	2002	2003	2004
Education*	31,614	31,664	33,190	35,074
Health**	27,009	28,043	28,488	28,825

\* The most recent data published by the CBS refer to 2001, and expenditure for 2002-2004 was inflated to the budgetary changes in the Ministry of Education and in the higher education.

\*\* The expenditure data published by the CBS for 2003 were inflated to 2004 according to the budgetary changes in the Ministry of Health, national and health insurance receipts and health expenditure of the NII.

**Diagram F: Rate of Real Change\* in Government Expenditure on Health and Education, 2002-2004**



\* Deducting civil public expenditure index.

### 1.2.3 The Income Tax Reform

The income tax reform began to be implemented in 2003 on the basis of the recommendations of the Rabinovitz Committee. The committee recommended gradually reducing marginal tax rates on income from personal labor in 2003-2008, while imposing a tax of 10% to 25% on income from capital. Since the reform was approved by the Knesset, the government decided – in a series of decisions – not only to advance the reform and complete it by 2006, but even to carry out a greater tax reduction, mainly to low-wage and medium-wage earners. At the same time, under the economic policy of 2002-2004, additional changes were introduced in the income tax system, which resulted in a heavier tax burden on certain groups. Changes were also introduced in the collection of both national and health insurance contributions; these will be described below in the chapter on collection by means of the NII. The present part of the chapter will present estimates on the effects of the changes in income tax on the distribution of the tax burden as well as on the distribution of disposable income. Due to the lack of adequate data on income from capital, the analysis does not relate to taxation on capital, and it is therefore necessarily a partial one.

However, even the very partial data that are presently available on income from capital show that the inequality in the distribution of this income is greater than the inequality in income from work, and therefore a considerable share of the burden of taxation on capital falls on families in the upper part of income distribution. It is therefore reasonable to assume that the influence of the reform, in all its components, will be less regressive than that of the reduction of taxes on work alone. At the same time, it should be remembered that the tax reform is a deficit one, and that the expected receipts from taxation on capital are meant to cover only a small share of the amount of reductions of the income tax.

The estimates presented below are related to changes in the tax brackets and in the marginal rates for 2003-2006, to a reduction in tax benefits for residence in certain areas and to the non-adjustment of the tax credit point (as of 2005). The estimates also relate to the lowering of the burden of national insurance contributions paid by low-wage employees (lowering the reduced rate while raising the regular rate with a zero budget), but not to changes in contributions paid by recipients of early pensions and by members of the permanent army<sup>9</sup> – nor to the episode of the cancellation of the ceiling in the first half of 2003.

A simulation of the 2003-2006 changes in the income tax was carried out, on the basis of the wage, employment and demographic data of the 2003 integrated income survey. The 2002 tax system served as the starting point for the evaluation of the changes in the tax burden and in net income, thus enabling an estimate of the exclusive influence of the reform – although one may claim (as mentioned above) that the reform in itself can influence employment or wages.

The tax reduction inherent in the legislative changes examined – making the tax burden both lighter and heavier – will amount to about NIS 9 billion in 2006, in 2003 terms<sup>10</sup> (about NIS 5.7 billion in 2003-2004 and another approximate NIS 3.3 billion in 2005-2006). The average amount of income tax per family will decrease by about 24%, and the income tax rate out of economic income will decline from 17.2% prior to the legislative changes, to 13.1% in 2006.

The data presented in Table 3 shows that families in the first three deciles (of the total population) do not benefit whatsoever from the income tax reduction, while families

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<sup>9</sup> Due to a lack of data for the simulation of these changes in the Income Survey.

<sup>10</sup> In view of the fact that the volume of income from work in the Income Survey is biased downwards by approximately 15%, the amount of the reduction of tax on work will be higher. Due to the progressive structure of the taxation, the amount of the tax reduction will be higher than 15%, even if we assume uniform under-reporting in all income levels.

in the three top deciles will benefit from about 82% of the total amount of the reduction by 2006. Families in the top decile alone will benefit from 54% of the tax reduction in 2006. That is, the reform will increase the disposable income of the top decile by a sum of close to NIS 5 billion in 2006 (in 2003 terms).

The extent of the progressivity/regressivity of the tax reform is examined, *inter alia*, by its influence on the distribution of disposable income. The average tax rate did decline more in the middle deciles than in the higher deciles, but the greater part of the tax reduction serves to increase the disposable income of the higher deciles. Two findings show the regressive influence of the reform on the distribution of disposable income: firstly, the income of the top deciles rises by higher rates, and secondly, as a consequence, their share in total net income also rises. Diagram F shows the effects of the tax reform on the disposable income of families in the various deciles (again, it should be stressed that the estimates are based on a given set of wage, employment and demographic data). The average income per family will increase by 4.7% from 2002 (without the reform) to 2006, and while the income of the third decile will grow by about 1%, that of the top decile will grow by 8%. In parallel, the share of the two top deciles in total income will rise from 42.2% before the reform to 43.2% in 2006. The rise is notable in the top decile, whose share in total income will rise by about one percentage point, while the share of the seven low deciles will decline.

This development will be reflected in a rise in the Gini index for the distribution of disposable income<sup>11</sup> at an accumulated rate of 2.4% – from 0.3675 in 2002 without a reform to 0.3764 in 2006.

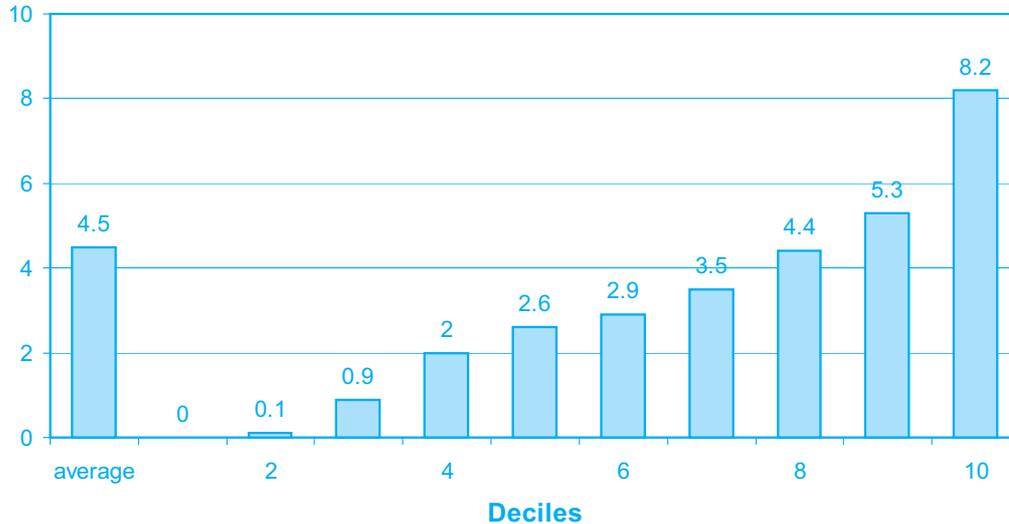
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<sup>11</sup> In the calculation of the Gini index for 2006, the families were classified according to “new” disposable income.

Table 3: Indicators of the Influence of Changes in Income Tax, by Decile, 2003-2006

	1	2	3	4	5	6	7	8	9	10	Average
<b>2002</b>											
Distribution of economic income	0.0	0.7	2.5	4.1	5.9	7.9	10.5	13.4	18.1	36.8	100.0
Average tax rate*	0.0	33.0	10.9	11.9	13.7	15.3	17.0	21.0	25.0	36.5	25.8
Average income tax rate*	0.0	0.6	1.1	3.3	5.5	7.5	9.4	13.0	16.9	28.1	17.2
Income tax distribution	0.0	0.0	0.2	0.8	1.9	3.4	5.7	10.1	17.8	60.1	100.0
Distribution of NII and health contributions	2.3	2.5	2.9	4.2	5.7	7.3	9.4	12.5	17.3	36.0	100.0
Disposable income distribution	3.1	5.0	4.5	5.8	7.2	8.9	10.8	12.6	15.8	26.4	100.0
<b>2006</b>											
Average tax rate*	0.0	32.1	9.3	9.4	10.8	12.3	13.7	17.2	20.8	31.1	21.6
Average income tax rate*	0.0	0.3	0.3	1.3	3.0	4.8	6.3	9.3	12.6	22.4	13.1
Income tax distribution	0.0	0.0	0.0	0.4	1.3	2.9	5.0	9.5	17.5	63.2	100.0
Distribution of NII and health contributions	2.3	2.5	2.7	3.9	5.4	7.0	9.2	12.3	17.4	37.3	100.0
Disposable income distribution	2.9	4.8	4.3	5.7	7.1	8.9	10.7	12.6	15.9	27.3	100.0
*	The average tax rate from the family's economic income.										
**	The change was carried out in 2006 and remained in 2004-2006.										

**Diagram G: The Accumulated Change in Disposable Income Following the Income Tax Reform, 2006 as Compared to 2002**



It should be noted that the 2003 amendment regarding NII contribution rates – lowering the reduced rate while raising the regular rate – eased the contribution burden mainly for low and middle-wage earners. This measure too did not contribute to a rise in the disposable income of families in both low deciles, but it decreased the share of the 3<sup>rd</sup> to 7<sup>th</sup> deciles in total contributions, at the expense of an increase in the share of the two top deciles. Thus, the measure served to reduce the regressivity of the changes in the income tax system.

### 1.3 Benefit Payments

In 2004, total NII benefit payments, in cash and in kind – both contributory and non-contributory – amounted to about NIS 42.8 billion, as compared to 44.9 billion in 2003 and NIS 47.3 billion in 2002. These sums also include other payments carried out by the NII – mostly for government ministries – the costs of developing services in

the community and the administrative and operative expenses of the national insurance system.<sup>12</sup>

The trend of decrease in NII benefit payments, in real terms, continued in 2004, when they decreased by about 4.5%; the accumulated decrease of the past three years amounted to about 11.5%. Even if payments of reserve service benefits – which fell in 2003–2004 (after having risen sharply in 2001–2002) – are not taken into account, the accumulated decrease in benefit payments is still notable: 10%. NII benefit payments declined to 7.9% of the GDP, as compared to 9.36% in 2001–2002. Were it not for the growth in the number of benefit recipients – mainly in the central NII branches – we would have noted a steeper decline, reflecting the benefit cuts and the harshening of conditions of entitlement to benefits.

The real decrease in benefit payments in 2004 characterized all NII branches and programs, except for benefits for the elderly and disabled. This decrease was particularly notable in benefits for the working-age population – child allowances, unemployment benefits and income support.

The cuts in the child allowances continued in 2004, as part of the gradual process of equalizing the allowance for all children under the Economy Recovery Law (2003) and the special temporary order for 2004–2005. In 2004 alone payments of child allowances decreased by about 21%. The harshening of conditions of entitlement to unemployment benefits continued to affect payments in 2004, when they declined by another 13% in real terms. The cuts in the income support benefit, along with changes in the employment test for this benefit, were fully reflected in 2004, when they caused a further decrease of about 9.5% in income support payments.

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<sup>12</sup> Administrative and operative expenses for 2004 are estimated at NIS 1.2 billion.

In other branches granting benefits to the working-age population – work injury and maternity – there was a slight decrease (of about half a percent, in real terms) in benefit payments. In the Work Injury branch, there was a notable real decrease (about 2%) in expenditure on hostile action casualties, after an over twofold rise (2.3) in 2001-2003.

The relative stability in benefit payments of the Maternity branch is the result of two opposing trends in the payments of this branch: payments for maternity grant dropped sharply (30%) due to legislative changes in August 2003, as did alimony payments (by 3%) after a 13% decrease in 2003. At the same time, the other payments of this branch rose moderately (maternity allowance by 4% and hospitalization grant by 1.5%).

There was a 1.8% rise in payments of the Old-Age and Survivors branch – even lower than the growth in number of recipients. The payments of old-age and survivors' pensions under the NII Law increased by 3% in real terms, while payments of pensions to new immigrants continued to decrease, for the fourth consecutive year – by 2.4% in 2004. Payments of the Long-Term Care branch rose by 0.8%: benefits by 0.5% and other expenditure by 42%.

In the Disability branch, which had expanded considerably in 1999-2002 as a result of the favorable legislation enacted after the strike of the disabled population, the notable slowdown in the growth of benefit payments continued for the second year (1.3% in 2004). This slowdown reflected not only a more moderate increase in the number of recipients, but also the limitation of retroactive payments to 12 months only. This limitation applied to all NII benefits, but its influence was greatest in the Disability branch.

Payments of contributory benefits under the National Insurance Law decreased by about 3.2% in real terms in 2004, while payments of non-contributory benefits under other state laws or agreements with – and completely financed by – the Treasury (such

as income support, mobility, alimony, old-age and survivors to new immigrants and reserve service) decreased in real terms by a higher rate: 8.8%. The sum of non-contributory payments amounted to about NIS 8.4 billion in 2004, constituting some 20% of total benefit payments (as compared to 22.4 in 2002).

**Table 4: Benefit Payments and Collection from the Public (percentages relative to the Gross Domestic Product), 1980-2004**

Year	Benefit Payments		Collection from the Public	
	Total	Contributory Benefits	Total*	National Insurance Contributions**
1980	6.09	4.98	6.77	5.15
1985	7.14	5.51	6.57	4.45
1990	8.36	7.04	7.21	5.28
1995	7.69	6.02	8.02	4.49
2000	8.31	6.62	6.52	4.43
2001	9.34	7.34	6.87	4.65
2002	9.38	7.28	6.89	4.68
2003	8.74	6.91	6.71	4.54
2004	7.93	6.35	6.51	4.38

\* Including collection for the sick funds.

\*\* Including *Treasury indemnification* for the reduction of national insurance contributions of employers.

Table 5, presenting the distribution of benefit payments by branch, shows that the decrease in the share of the Children, Unemployment, Income Support and Reserve Service Branches in total payments continued in 2004. At the same time, the share of the other branches, especially that of the two largest branches – Old-Age and Survivors and Disability – increased. 54.6% of total benefit payments were concentrated in these two branches in 2004. The Disability branch, the third largest branch until 2001, replaced the Children branch, and became the second largest branch. The share of the Disability branch rose to 17.2% in 2004, as compared to 10.5% in the mid 90's, while benefit payments of the children branch plummeted down to about 11% of the total, as compared to about 20% in the mid-90's.

Table 5: National Insurance Benefit Payments (including administrative costs), 1995-2004

Year	Total Payments*	Old-Age & Survivors**	General Disability	Work Injury, Hostile and Border Actions	Maternity	Children	Unemployment	Military Reserve Service*	Income Support***	Long-Term Care & Other
NIS million (current prices)										
1995	21,188	7,675	2,254	1,487	1,206	4,287	1,280	1,053	1,149	798
2000	39,706	13,670	5,128	2,569	2,423	7,000	3,023	1,039	2,957	1,897
2001	45,481	15,403	6,092	2,884	2,675	7,644	3,591	1,351	3,581	2,258
2002	47,289	15,684	7,009	3,128	2,809	6,798	3,624	1,779	3,796	2,662
2003	44,920	15,795	7,278	3,183	2,754	6,169	2,522	1,164	3,344	2,711
2004	42,769	16,008	7,344	3,158	2,731	4,869	2,184	720	3,018	2,736
real annual growth (percentages)										
1995	10.1	8.6	16.1	14.6	20.8	4.5	16.2	2.9	13.7	13.5
2000	8.1	8.4	14.8	11.4	10.8	1.5	-0.9	-7.4	18.1	18.2
2001	13.3	11.5	17.5	11.0	9.2	8.0	17.5	28.7	19.8	17.7
2002	-1.6	-3.7	8.8	2.6	-0.7	-15.9	-4.5	24.6	0.3	11.5
2003	-5.7	0.0	3.1	1.1	-2.6	-9.9	-30.9	-35.0	-12.5	1.1
2004	-4.4	1.8	1.3	-0.4	-0.4	-20.8	-13.0	-37.9	-9.4	1.3
distribution by branch (percentages)										
1995	100.0	36.2	10.6	7.0	5.7	20.2	6.0	5.0	5.4	3.8
2000	100.0	34.4	12.9	6.5	6.1	17.6	7.6	2.6	7.4	4.8
2001	100.0	33.9	13.4	6.3	5.9	16.8	7.9	3.0	7.9	5.0
2002	100.0	33.2	14.8	6.6	5.9	14.4	7.7	3.8	8.0	5.6
2003	100.0	35.2	16.2	7.1	6.1	13.7	5.6	2.6	7.4	6.0
2004	100.0	37.4	17.2	7.4	6.4	11.4	5.1	1.7	7.1	6.4

\* Payments for 1995 do not include the amounts transferred to the Ministry of Defence as reimbursement of the debt for savings in reserve service duty days.

\*\* Including payments for income support.

\*\*\* For the working-age population.

## 1.4 Benefit Level

The policy of freezing the level of benefits that until January 2002 were linked to the average wage continued in 2004. The Economy Recovery Law (June 2003) determined that all benefits paid by the NII, except for old-age and survivors' pensions, would not be updated until the end of 2005, and that as of January 2006 benefit recipients would be compensated by rice rises only. The old-age and survivors pensions were meant to be updated by the **rise** in the price index in January 2004, but prices went down by (0.4%) in 2003; these pensions will be updated in January 2005 by 0.9%. In view of the real erosion in the average wage in 2002-2003, it is now clear that the policy of freezing the basic benefits at their nominal value had only a moderate effect on benefit levels. The accumulated loss from the non-adjustment of benefits according to changes in the average wage in 2002-2003 amounted to 2.1% (1.2% in 2002 and 0.9% in 2003), but were it not for the policy of freezing benefits, their value would have decreased by 2.7% in January 2004. The rise in real wages in 2004 changed this picture, and in January 2005 the benefits were meant to be updated by about 0.6% – even lower than the rate by which the old-age and survivors' pensions were updated, in keeping with price rises (0.9%). The influence of the cancellation of linkage to the average wage, and its replacement by adjustment according to price rises, will be felt in 2006 and even more in the following years.

The real level of benefits in 2004 was influenced not only by the policy of freezing benefits and by the decline in the average price level in that year, (relative to 2003) but also by the fact that in 2004, the effects of benefits cuts implemented in mid-2003 and the continued cuts in the child allowances, were felt in full.

The level of the basic old-age and survivors' pensions remained relatively stable in 2004 (rose by about 0.4% due to the decline in the price index by this rate). To sum up the years 2002-2004, the basic old-age pension lost about 9.5% of its purchasing

power while the pensions paid to the elderly entitled to income supplement, as well as the survivors' pensions (not reduced by 4% in 2002) were eroded by a much lower rate in real terms: about 5.6%.

**Table 6: The Old-Age and Survivors' Pension and the Minimum Income Guaranteed to Pension Recipients (constant prices and percentage of average wage\*), Monthly Average, 1975-2004**

Year	Basic old-age & survivors' pension				Guaranteed minimum income (including child allowances)			
	Single elder		Widow/er with 2 children		Single elder		Widow/er with 2 children	
	2003 prices (NIS)	% of average wage	2003 prices (NIS)	% of average wage	2003 prices (NIS)	% of average wage	2003 prices (NIS)	% of average wage
1975	616.0	14.9	1,023.2	24.8	1,057.6	25.5	1,989.2	48.1
1980	677.2	13.5	1,312.5	26.3	1,178.6	23.8	2,411.1	48.2
1985	765.0	15.2	1,481.7	29.5	1,528.9	30.5	3,058.4	61.2
1990	963.2	15.9	1,863.0	30.7	1,511.7	25.0	3,065.4	50.5
1995	975.0	15.5	1,889.9	30.1	1,631.7	26.0	3,383.7	53.9
2000	1,089.0	14.9	2,108.4	28.8	1,819.3	24.9	4,002.7	54.7
2001	1,180.6	15.8	2,286.9	30.5	1,974.3	26.3	4,326.9	57.7
2002	1,097.4	15.6	2,169.1	30.8	1,872.4	26.6	3,980.5	56.4
2003	1,109.5	16.2	2,149.4	31.4	1,855.5	27.1	4,015.2	58.7
2004	1,114.0	15.8	2,158.0	30.7	1,863.0	26.5	3,985.0	56.7

\* As measured by the Central Bureau of Statistics.

Developments in the value of benefits relative to the average wage show a different picture: Due to the real erosion in wages by about 10% in 2002-2003, there was no change in the level of the basic old-age pension relative to the average wage, and the minimum guaranteed income to the elderly and survivors even rose in real terms. On

the other hand, the rise in real wages in 2004 led to an erosion in the relative value of the pensions in that year: for example, the basic old-age and survivors' pension as a percentage of the average wage decreased from 16.2% in 2003 to 15.8% in 2004.

Similar trends were noted in the basic benefits of the Disability branch. In previous years, there was a sharp rise in average benefits (following the implementation of the agreements with the disabled organizations), but this rise was halted in 2004, when the average level of benefits increased by rates of 0.5% to 1.8% only, in real terms, due mainly to slight changes in the composition of the population entitled to the various types of disability benefits.

The cutbacks in the child allowances continued in 2004, when allowances were slashed twice: in February, by NIS 24 for every child (from NIS 144 to NIS 120), and again in July, when the second stage of equalizing the allowance for all children was implemented, and the February reduction was lessened by NIS 4 for the fourth and subsequent children. Furthermore, an allowance of only NIS 120 was paid for "new children" born in 2004. The allowance paid to a family with two children decreased by about 16% in real terms in 2004 as compared to the previous year (continuing the decrease of about 6% in 2003), while the allowance paid to a family with 5 children (without "new" children) decreased by about 23% (continuing the decrease of about 14% in 2003).

The average long-term care benefit provided to the elderly (the benefit is translated into care hours) remained the same in real terms in 2004 (after an erosion of about 5% in the previous two years). This stability was noted despite the sharp increase in the rate of beneficiaries entitled to the high rate of the benefit, and resulted mainly from the 7% reduction in the low rate of the benefit in July 2003.

**Table 7: Minimum Guaranteed Income to Working-age Population (at set prices and as percentages of average wage), monthly averages, 1985-2004**

Year	Single				Single parent with 2 children* (incl. child allowances)		Couple with 2 children (including child allowances)			
	Regular rate		Increased rate		2004 prices (NIS)	% of average wage	Regular rate		Increased rate	
	2004 prices (NIS)	% of average wage	2004 prices (NIS)	% of average wage			2004 prices (NIS)	% of average wage	2004 prices (NIS)	% of average wage
1985	1,223	24.5	1,526	30.5	3,057	61.2	2,753	55.1	3,210	64.3
1990	1,210	20.0	1,513	24.9	3,065	50.5	2,790	46.0	3,244	53.5
1995	1,222	19.4	1,526	24.3	3,378	53.9	2,924	46.6	3,381	53.8
2000	1,360	18.6	1,700	23.2	3,744	51.2	3,223	44.0	3,732	51.0
2001	1,476	19.7	1,845	24.6	4,056	54.1	3,462	46.2	4,015	53.6
2002	1,372	19.6	1,715	24.5	3,738	53.4	3,186	45.5	3,732	53.4
2003**	1,332	19.5	1,567	22.9	3,192	42.5	2,756	40.3	3,177	46.6
2003***	1,664	24.4	1,664	24.4	3,621	53.0	3,585	52.4	3,585	52.4
2004**	1,337	19.0	1,504	21.4	2,851	40.5	2,484	35.3	2,851	40.5
2004***	1,671	23.8	1,671	23.8	3,590	51.0	3,553	50.5	3,553	50.5

\* 1985 and 1990 data refer to widow with two children who was entitled to income support.

\*\* The eldest of the family is not yet 55.

\*\*\* At least one member of the family is over 55.

The June 2003 cut in the income support benefit was fully reflected in 2004, and the real erosion in the maximum sums of this benefit continued in that year as well. For example, the benefit to a single person (under age 55) entitled to the increased rate of benefit was eroded by 4% (continuing the erosion of about 9% in 2003), the benefit to a single parent with two children plus child allowance was eroded by about 11% (continuing the erosion of about 14.5% in 2003), and the benefit to a couple with two children was eroded by about 10% (continuing the 15% erosion of 2003). The average benefit per family declined by about 8% in real terms in 2004, continuing the decline of about 20% in 2003.

In the branches paying wage-replacing benefits, slight changes were noted in the level of the benefits, except for the maternity grant, and these can be attributed to developments in wages and in the composition of benefit recipients in 2004. The average daily unemployment benefit remained without change in real terms, despite the wage rises, due to a moderate increase in the share of the unemployed with low wages prior to their unemployment.

The average daily unemployment benefit decreased from 52% of the average daily wages in 2003 to 50.6% in 2004. A similar development was noted regarding the average daily maternity allowance: its real level remained the same due to a moderate increase in the share of mothers with low wages prior to their giving birth. On the other hand, the average maternity grant dropped by 32.5% in real terms in 2004, continuing the decline of about 30% in 2003. This drop in the maternity grant is a result of the legislation implemented in August 2003 (and in January 2004), according to which the grant paid to the 2<sup>nd</sup> child was reduced to 9% of the average wage and the grant to the 3<sup>rd</sup> and subsequent children – to 6% of the average wage (as compared to 20% of the average wage for the 2<sup>nd</sup> to 4<sup>th</sup> children and 40% to the 5<sup>th</sup> and subsequent children prior to the legislation).

**Table 8: Child-Allowance Point and Child Allowances\* (constant prices and percentage of the average wage\*\*), Monthly Average, 1975-2004**

Year	Value of child-allowance point		Allowance for 2 children**		Allowance for 4 children		Allowance for 5 children	
	2004 prices (NIS)	% of average wage	2004 prices (NIS)	% of average wage	2004 prices (NIS)	% of average wage	2004 prices (NIS)	% of average wage
1975	181	4.4	364	8.8	1,135	27.4	1,544	37.3
1980	141	2.8	283	5.6	883	17.7	1,200	24.0
1985	160	3.1	181	3.6	1,239	24.7	1,760	35.1
1990	185	2.9	89	1.5	1,435	23.4	2,036	33.2
1995	180	2.8	360	5.8	1,446	23.4	2,057	33.4
2000	183	2.5	367	5.0	1,476	20.2	2,101	28.7
2001	182	2.4	364	4.8	1,462	19.5	2,369	31.6
2002	172	2.5	306	4.3	1,224	17.3	1,984	28.1
2003	170	2.4	289	4.2	1,067	15.6	1,704	24.9
2004	171	2.4	244	3.5	833	11.8	1,313	18.7

\* Including Special Allowance for Veterans.

\*\* As measured by the Central Bureau of Statistics.

\*\*\* The allowance level in 1985-1993 relates to a family (up to 3 children) not eligible for the first child allowance, and since October 1990 – for the second child allowance as well. In March 1993 the payment of child allowance on a universal basis was renewed.

Similarly to unemployment benefits and maternity allowance, the injury allowance paid in the Work Injury branch remained more or less without change in real terms. The average injury allowance paid to employees decreased in real terms by about half a percent, while that paid to the self-employed increased by about 4%. The level of the work disability pension and the dependents' pension also remained almost the same – a real increase of about half a percent.

## 1.5 Benefit Recipients

A continued slowdown was noted in 2004 in the growth in benefit recipients in the two largest national insurance branches – Old-Age and Survivors and General Disability. This trend also characterized the long-term care branch, as well as the recipients of disability pension and dependants' pension in the Work Injury branch. However, the numbers of recipients of income support benefit, alimony, and unemployment benefits decreased, while the number of children for whom child allowance was received remained stable.

The number of benefit recipients in the Old-Age and Survivors' branch rose by only 1.8% in 2004, as compared to an average rise of 2.3% in 2002-2003, and of 3% in 2001. In 2004, the NII paid pensions to about 722,300 elderly persons and survivors. The slowdown in the growth of the number of old-age and survivors beneficiaries, noted since the mid 90's, may be partially explained by the decrease in immigration to the country and the ensuing reduction in the number of elderly immigrants. A further explanation may be found in the July 2004 implementation of the Retirement Age Law, which raised the conditional age of entitlement to old-age pension for both men and women, as well as the absolute age of entitlement to pension for women. This change too slowed down the growth in the number of pension recipients.

In the first half of 2004, the number of new recipients of old-age pensions under law was about 4,000 as a monthly average. This number has decreased steadily since July 2004, and particularly in the months of July and August, during which there were only 500 new pension recipients, as a monthly average. Were it not for the raising of the entitlement age, the number of new pension recipients in 2004 would have reached an estimated 47,700 men and women, while the actual number was about 28,700.

As a result of the above changes, the number of recipients of old-age pension under NI Law rose in 2004 by 3.2%, as compared to about 4% in each of the previous three years. The number of recipients of the special old-age benefit (not under NI law) decreased in 2004 for the third year since the wave of immigration of the early 90's and at a higher rate: by 3.8%, as compared to 3% in 2003 and 1.5% in 2002. The number of persons receiving survivors' pension only remained more or less stable, similarly to previous years, at about 104,500 widows and widowers. (Those who receive old-age pension plus half of their survivor's pension are counted among the recipients of old-age pension).

The recent significant slowdown in the growth of benefit recipients in the Long-Term Care branch – granting in-kind benefits (care hours) to elderly limited in their daily functioning – continued from a rate of 10% in 2001 (similar to the previous five years), to 6.5% in 2002 and to about half a percent in each of the years 2003-2004. An analysis of the entry and exit flows of the long-term care system over the past two years shows that the slight growth in benefit recipients in 2003 resulted from a decrease in the number of entrants into the system, due, in turn, to a decline (of 10%) in the number of claims submitted as well as a moderate decline in the rate of claims approved. The rise in the number of entries in 2004 was due to an increase (of 10%) in claims (although the rate of approved claims went down in that year as well), while the parallel rise in the number of exits resulted from re-examinations of claims at the initiative of the NII.

The continued slowdown in the growth of recipients of benefits from the Disability branch encompassed all types of benefits: recipients of general disability pension increased by 3.2% in 2004, as compared to 4.5% in 2003 and about 5.7% as in annual average for 2000-2002. Moreover, a real slowdown was noted in the number of recipients of attendance allowance and mobility allowance, after a sharp rise in these numbers due to the legislation expanding the rights of the disabled population

(following agreements with the organizations of persons with disabilities in 1999-2000). It should be stressed that the influence of the postponement of the retirement age on the number of recipients of benefits for the working-age population – particularly general disability pensions, long-term care benefits and income support – was hardly felt in 2004, but will be reflected in the coming years.

In the Children branch, there was a slowdown in 2002-2003 in the growth in the number of families receiving child allowances – from 2.3% to 0.4%. This trend was halted in 2004, but the rate of growth remained low. In this year, the number of families who received child allowances rose by 0.7%. At the same time, the number of children for whom allowances were received rose by 1%, similarly to 2001-2003. Child allowances were paid in 2004 for about 2.23 million children living in some 942,000 families.

Regarding wage-replacing benefits, it was found that the steep decline in the number of recipients of unemployment benefits continued in 2004, and this number fell to about 58,300, as a monthly average, as opposed to about 105,000 in 2001. In 2004 only about 21% of the non-employed received unemployment benefits, down from about 45% in 2001. The unemployment rate decreased from about 11% in 2003 to about 10.4% in 2004, but the number of non-employed remained the same (about 279,000). The influence of the 2002 legislation, making conditions of entitlement to unemployment benefits stricter, was strong enough to cause a drop in the rate of recipients of unemployment benefits over a relatively long period.

The downward trend in the number of recipients of injury allowance, noted since 1997, was halted in 2004, when this number rose by about 7% and reached approximately 66,000. The rate of recipients of injury allowance out of total employed, 4.3% in 1996 (before the frequent amendments to the work injury

Table 9: Number of Benefit Recipients in Main Insurance Branches, Monthly Average, 1985-2004

Year	Old-age and Survivors	General Disability			Work Injury		Maternity		Children Families Receiving Child Allowances **	Unemployment ***	Income Support to Working-age Population	Long-term Care
		Disability Pension	Attendance Allowance	Benefit for Disabled Child	Mobility Allowance	Injury Allowance *	Permanent Disability Pension	Maternity Grant				
1985	390.2	62.1	4.6	4.0	10.6	56.9	9.9	101.3	42.7	19.6	20.4	-
1990	442.6	73.4	6.5	5.8	11.4	56.7	11.8	103.6	43.7	50.6	30.8	25.0
1995	553.9	94.0	10.2	10.3	13.2	84.9	14.6	113.1	55.2	61.5	74.8	59.0
2000	657.1	135.3	16.6	15.3	16.8	76.2	19.8	131.8	70.6	92.6	128.4	95.7
2001	677.0	142.4	18.9	16.4	19.3	69.1	20.8	127.1	71.2	104.7	142.0	105.4
2002	692.9	150.5	20.6	17.5	20.9	70.0	21.8	128.5	71.4	97.1	151.6	112.2
2003	709.3	157.3	21.7	18.4	22.3	61.5	23.0	136.4	73.9	70.5	155.5	113.0
2004	722.3	162.4	22.7	19.5	23.5	65.8	24.0	141.2	77.5	57.8	145.5	113.4
Annual Growth (percentages)												
1986-1990	2.6	3.4	7.2	7.7	1.5	-0.1	3.6	0.5	0.5	20.9	8.6	17.4
1991-1995	4.6	5.0	9.4	12.2	3.0	8.4	4.4	1.8	4.8	4.0	19.4	18.7
1996-2000	3.5	7.6	10.2	8.2	4.9	-2.1	6.3	3.1	5.0	8.5	11.4	10.2
2000	3.4	6.4	16.9	8.5	17.5	3.1	4.8	4.9	7.3	-3.6	12.6	8.8
2001	3.0	5.2	13.9	7.2	14.9	-9.3	5.1	-3.6	0.8	13.1	10.6	10.1
2002	2.3	5.7	9.0	6.7	8.3	1.3	4.8	1.1	0.3	-7.3	6.5	6.5
2003	2.4	4.5	5.3	5.1	6.7	-12.1	5.5	6.1	3.5	-27.4	2.6	0.7
2004	1.8	3.2	4.6	6.0	5.4	7.0	4.3	3.5	4.9	-18.0	-6.9	0.4

\* The number of different recipients throughout the year.

\*\* The figures for 1985 and 1990 include families to whom the allowance for the first and second child were reimbursed through the employers.

\*\*\* The figure for 1985 refers to the average number of payments. The figures for 1990 onward refer to the number of recipients.

program), decreased to 2.6% in 2003 and remained at that level in 2004. It may be concluded that the rise in the number of injury allowance recipients resulted from the expansion of employment in 2004. It should be noted, too, that the replacement of foreign workers by Israeli workers in 2003-2004, particularly in the construction industry, could have been expected to have increased the number of recipients of injury allowance, since the rate of take-up of rights in the Work Injury branch among foreign workers is a very low one.

In contrast to the rise in the number of recipients of injury allowance, the average number of days of work capacity remained stable in 2004 (34 days), as compared to an accumulated decrease of about 28% in 2002-2003. The number of recipients of (permanent) disability pension in the Work Injury branch increased by about 4.3% in 2004 (as compared to an annual average increase of about 5% in three preceding years), reaching some 23,500.

The rise in the number of women who received maternity allowance can be explained by an expansion in employment in 2003-2004: in both years 2001 and 2003 their number rose by only 1%, while in each of the years 2003-2004, it rose by 3.5% and about 5% respectively.

Finally, the new legislation on income support for the working-age population implemented in the second half of 2003 was fully reflected only in 2004. The changes were not only in the structure of the benefit, but also in the rules of the unemployment test, required of almost all claimants, except for parents of children under the age of two and other exceptional groups. Even before the amendments to the Income Support Law were implemented, a moderation was noted in the rate of growth of the number of income support recipients – this rate gradually decreased from 13% in 1998-2000 to 6.5% in 2002.

The amendments implemented in 2003 ruled out benefit to about 4,500 families who had previously received benefit, and made the entrance of new recipients more difficult. A follow-up of developments in 2003 and 2004 shows that the number of recipients decreased gradually and steadily from about 160,000 in the first quarter of 2003 to about 150,500 in the last quarter of that year. This decrease continued in 2004, although at a slower pace and not steadily. The number of benefit recipients rose from about 151,600 as a monthly average in 2002 to about 155,000 in 2003 (a 2.6% rise), but it decreased to about 145,500 in 2004 (a decrease of about 6.5%). The 2004 decrease in the number of recipients characterized mostly single-parent families and couples with children. On the other hand, there was a rise in the number of single people who received benefit in 2004.

### **1.6 Collection of Contributions from the Public and Sources of Financing**

The NII benefit payments are financed from four sources: collection of national insurance contributions (direct collection from the public as well as Treasury indemnification against the reduction in employer and self-employed contribution rates); government participation in the financing of contributory benefits; and receipts from interest in investments of surpluses in government bonds. In addition to collection of national insurance contributions, the NII collects health insurance contributions and transfers them to the sick funds.

Similarly to previous years, collection from the public in 2004 was influenced not only by economic developments, but also by the frequent changes in government policy regarding the financing of the national insurance and health systems. The restoration of the ceiling of income liable for insurance contributions in July 2003 (after it was cancelled in July 2002) was fully reflected in 2004 collection. This policy lightened the burden of insurance contributions on those employees, employers and the self-

employed who were in the top percentiles of the income distribution. In contrast to this policy, a number of legislative changes led to a greater burden of contributions for certain population groups, and these changes too were fully reflected in 2004. The main changes are: (1) the health contribution rates imposed on members of the permanent army were equalized to the rate deducted from worker's wages (the 2003 Economy Arrangements Law), and (2) early pensions were made entirely liable for national and health insurance contributions at the rates imposed on workers – except for national insurance contributions to the unemployment branch (the 2004 Economy Arrangements Law).

The additional collection arising from these two amendments was estimated at about NIS 300 million annually, with the share of the health system in this addition being the higher one – about 70%. The greater contribution burden entailed by these two changes did not affect the low-income population groups. The wages of the permanent army members are rather high, and the change regarding early pensions actually benefited those with a relatively low pension: those with pension below the average wage will pay lower national and health insurance contributions, while the remainder of the population will pay higher contributions – sometimes considerably higher (see Box 4A in Chapter 4 on collection of contributions by means of the NII).

Government policy on the adjustment of NII benefits was applied also to the collection parameters. In 2002-2004, the average wage under NI Law was not updated, and thus nor were the NII the contribution brackets. The average wage will continue to remain frozen until the end of 2005, and as of 2006, the ceiling will be updated by the rise in the price index only. However, the income brackets for the reduces rate and the minimum income for contributions continue to be adjusted in accordance with changes in the average wage, even after 2006. The change in the method of updating the ceiling will eventually lessen the burden on very high wage-earners, while those who pay minimum contributions (such as students and the

unemployed) will be discriminated against. On the other hand, the continued linkage of the income brackets for the reduced rate to the average wage will prevent a heavier contribution burden being entailed on low wage-earners.

### 1.6.1 Collection of Contributions from the Public

The forecast of 2003 NII collection from the public was confirmed, when total NII receipts from national and health insurance contributions from the public amounted to NIS 32.9 billion: NIS 21.7 billion to the national insurance branches and NIS 11.2 billion to the health system. Another NIS 1.4 billion –Treasury indemnification – should be added to the sum of collection from the public.

Collection from the public grew in 2004 by about 2.5% in real terms: national insurance contributions by 6.8% and health contributions by 3.8%. Were it not for the amendments introduced in mid-2003 and early 2004, collection from the public – as well as each of its components – would have risen by an estimated 4.3% in real terms.

The direct collection of contributions from employees and employers in 2004 was influenced by the positive developments the labor force: a rise in real wages and a higher (than previous years) growth rate in the number of employed persons – by 2.1% in real terms. However, the economic recovery of 2004 was not yet felt in collection from non-employees, which decreased by 2.2% in real terms. Collection from the self-employed (constituting about 82% of total collection from non-employees) decreased by 5.4% in real terms. Collection from the self-employed in 2004 was based mainly on 2002 tax assessments, so that we can expect that the acceleration in economic activity will be reflected in collection for 2005-2006. On the other hand, collection from other non-employees rose by a sharp rate – 30% – mainly due to the NII policy of expanding the category of special types of insured persons and increasing the scope of collection from them.

Table 10: Collection for National Insurance Institute &amp; Health System 1999-2004

	1999	2000	2001	2002	2003	2004
In Current Prices (NIS Million)						
Total receipts from contributions	27,412	30,511	32,814	33,995	33,660	34,301
Total collection from public	24,771	27,655	29,724	31,378	32,275	32,941
For NII branches	16,045	17,893	19,147	20,495	21,424	21,722
For health system	8,726	9,762	10,577	10,883	10,851	11,219
Total Treasury indemnification	2,641	2,856	3,090	2,617	1,385	1,360
Indicators of development of collection from the public						
A. Percentage of real change						
Total collection from public	4.4	10.4	6.3	-0.1	2.2	2.5
For NII branches	4.1	10.3	5.8	1.3	3.8	1.8
For health system	4.9	10.7	7.2	-2.7	-1.0	3.8
B. As percentage of GDP						
Total collection from public	5.8	5.9	6.3	6.4	6.4	6.3
For NII branches	3.7	3.8	4.0	4.2	4.3	4.1
For health system	2.0	2.1	2.2	2.2	2.2	2.1
C. As percentage of direct taxes to individuals						
Total collection from public	35.8	35.1	35.8	37.8	38.9	39.7
For NII branches	23.2	22.7	23.0	24.7	25.8	26.1
For health system	12.6	12.4	12.7	13.1	13.1	13.5
D. As percentage of direct taxes						
Total collection from public	29.1	27.0	28.3	30.8	32.5	32.0
For NII branches	18.9	17.5	18.2	20.1	21.6	21.1
For health system	10.3	9.5	10.1	10.7	10.9	10.9

The data show that in 2004, the trend of increase in the scope of collection from the public by means of the NII, in relative to the GDP, was halted, and there was even a slight decrease – from 6.4% in 2003 to 6.3% in 2004. On the other hand, the share of collection from the public out of total direct taxes from individuals continued to rise for the fifth consecutive year, reaching 39.7% in 2004. The share of health contributions out of total collection from the public rose from 33.6% in 2003 to 34.1% in 2004, due to the differences in the influence of the legislation on national insurance and on health insurance contributions.

### 1.6.2 Sources of Financing

Total NII receipts for financing its branches amounted in 2004 to about NIS 47.6 billion in real prices. This was the third consecutive year in which there was a real decrease in the total sources of financing. Receipts from national insurance contributions (collection from the public and Treasury indemnification) grew in real terms by 1.6%, while government participation in financing insurance branches (under article 32 of the NI Law) increased by a higher rate in real terms – by 2.2%. The reason for this is that in 2004, the government began financing the increase in the benefits to disabled persons in accordance with the 1999-2000 agreements with the organizations of persons with disabilities. On the other hand, government financing of non-contributory benefits decreased by about 8.8% in real terms, continuing the 11.4% decrease of 2003. This decrease stems mainly from the decline in payments of income support benefits (both to the working-age population and to the elderly), alimony, and benefits to radiation-affected persons paid by the NII, as well as from the sharp decrease in payments of reserve service benefits.

NII receipts from interest on its investments amounted to about NIS 4.6 billion, and in 2004 they rose by 2.6% in real terms as compared to 2003.

Table 11: Sources of Financing National Insurance Branches, 1995-2004

Year	Total receipts	Collection of national insurance contributions*	Government participation	Government financing of benefits	Receipts from interest
3NIS (current prices)					
1995	23,581	12,171	4,222	4,650	2,507
2000	41,209	20,749	8,336	8,148	3,907
2001	46,110	22,237	9,952	9,756	4,075
2002	48,659	23,112	10,520	10,594	4,266
2003	47,972	22,809	10,802	9,453	4,500
2004	47,591	23,082	10,996	8,587	4,600
Real annual growth (percentages)					
2000	7.6	9.8	1.6	10.8	3.6
2001	10.7	6.0	18.1	18.4	3.2
2002	-0.2	-1.7	0.0	2.7	-1.0
2003	-2.1	-2.0	2.0	-11.4	4.8
2004	-0.4	1.6	2.2	-8.8	2.6
Distribution (percentages)					
1995	100.0	51.6	17.9	19.7	10.6
2000	100.0	50.4	20.2	19.8	9.5
2001	100.0	48.2	21.6	21.2	8.8
2002	100.0	47.5	21.6	21.8	8.8
2003	100.0	47.5	22.5	19.7	9.4
2004	100.0	48.5	23.1	18.0	9.7

\* Including Treasury indemnification.

The share of government financing of non-contributory benefits continued to fall in 2004, down to 18.0% of total financing sources, whereas government participation in financing the insurance branches went up to 23.1%. Receipts from independent sources – insurance contributions and maximum income – increased from 56.9% in 2003 to 58.2% in 2004.

### 1.6.3 Surpluses/Deficits and Financial Reserves

Government policy in 2002-2004 was reflected in the gradual shrinking of the current deficit in NII activities in 2002-2003, and even in slight surplus in 2004. If income from interest on NII investments is not taken into account, the deficit was reduced since 2001 by over NIS 3.6 billion and in 2004 there was even a surplus of about NIS 230 million. In 2004 alone the deficit was reduced by more than NIS 1.7 billion.

**Table 12: Surpluses/Deficit in National Insurance Branches, 2001-2004**

Insurance Branch	Surplus/Deficit Without Interest on Investments			Surplus/Deficit Including Interest on Investments		
	2001	2003	2004	2001	2003	2004
NIS million (current prices)						
Total	-3,420	-1,526	230	657	2,974	4,830
Old-age & survivors	-633	-930	-1,156	1,019	1,010	804
General disability	-1,762	-2,962	-2,634	-912	-2,202	-2,014
Work injury	-1,193	-897	-833	-821	-587	-563
Maternity	-852	-940	-941	-674	-830	-876
Children	5,338	7,737	9,031	5,890	8,717	10,401
Unemployment	-3,090	-2,076	-1,739	-3,090	-2,076	-1,739
Long-term care	-1,410	-1,522	-1,553	-1,049	-1,262	-1,364
Other	182	64	55	294	204	181

This trend is expected to continue in the coming years. The reduction of the current deficit over the past three years was particularly notable in the Work Injury and Unemployment branches, and in parallel, the current surplus in the Children branch increased, reaching about NIS 9 billion in 2004. Even in branches in which the current deficit continued to grow, this growth was much more moderate in the past year. Moreover, the sharp growth in the deficit that had characterized the General Disability branch in recent years was reduced by about NIS 300 million in 2004.

The improvement in the NII's financial situation is also noted when taking income from interest on past surpluses into consideration: total surpluses, including interest, increased from about NIS 660 million in 2001 to NIS 2.97 billion in 2003 and to about NIS 4.83 billion in 2004. Deficits remained in all the branches with the exception of Children and Old-Age and Survivors. The assets of the Unemployment branch ran out in 1999, and since then the branch has been financed entirely from the Children branch. The elimination of the current deficit from the NII budget is naturally expressed in a reduction of the deficit in the State budget.

Diagram H: The National Insurance Institute - Resources and Uses

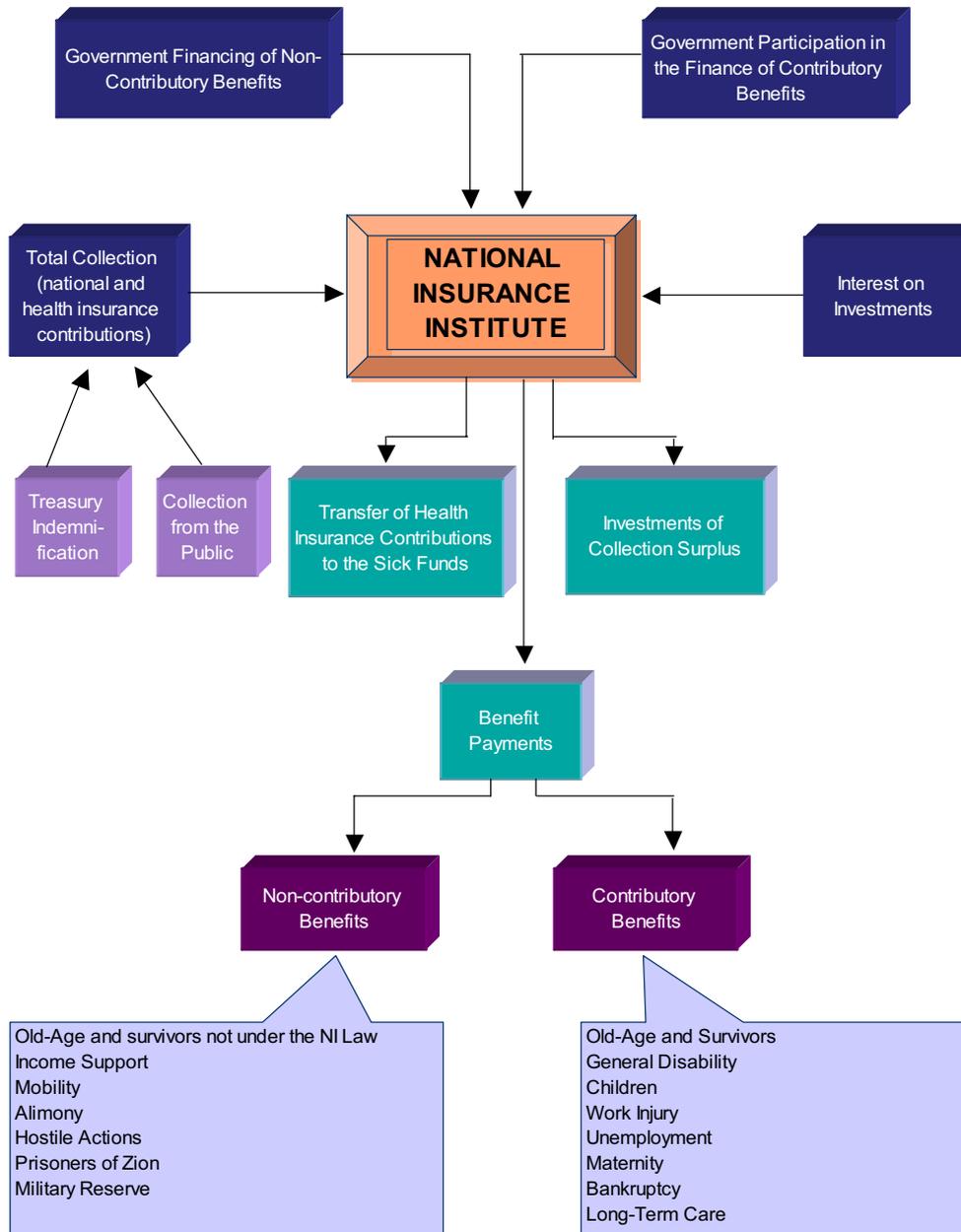
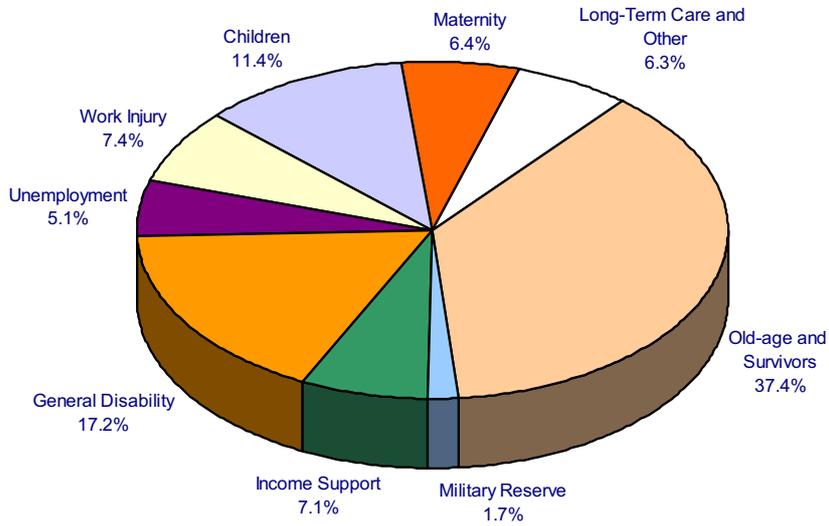
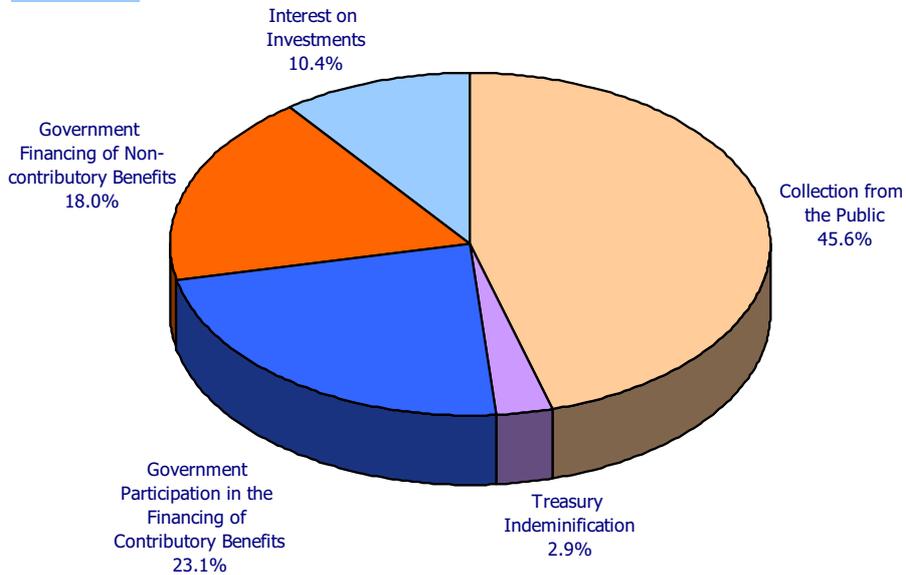


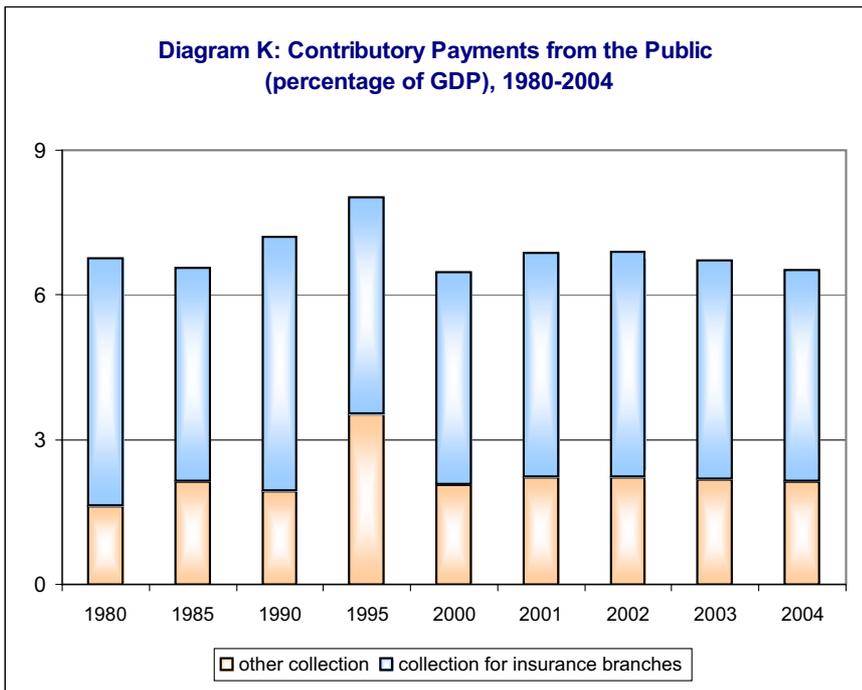
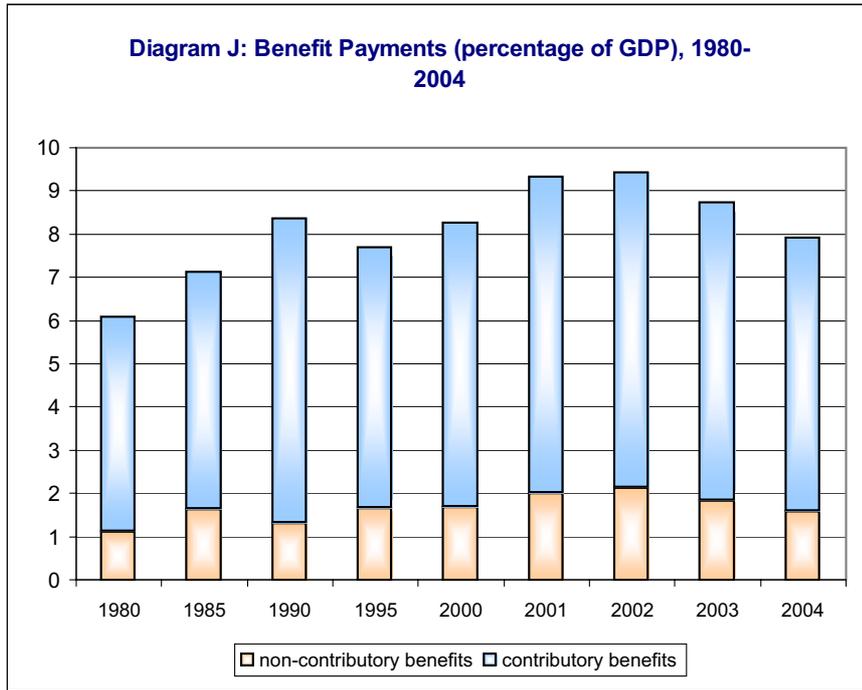
Diagram I: The Distribution of NII Benefit Payments and Receipts - 2004

**Benefit Payments**



**Receipts**





## **Chapter 2**

# **Trends of Development in Poverty and Income Inequality (Summary)**

**Leah Achdut  
Refaela Cohen  
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## 2.1 Introduction

As part of research carried out in Israel on poverty and income distribution, a relative approach to measuring poverty was formulated in the early 1970s, in line with that accepted by the majority of researchers and social policymakers in the Western world. According to this approach, poverty is an expression of relative distress that should be evaluated relative to the standard of living typical of a given society: a family is considered poor not only when it is unable to purchase a basic basket of products necessary for its subsistence, but also when its living conditions are significantly inferior to those of society as a whole. The relative approach further recognizes that distress is not only reflected in low income, but may also be expressed in level of assets, housing conditions, education and public services available. Nevertheless, since there is no agreed index that takes into account all the constituent aspects of distress, and since the National Insurance Institute possesses data (from Central Bureau of Statistics Income Surveys) only for the current income of households in Israel, poverty is measured solely as a function of the latter. The relative approach offers several operative methods for measuring poverty based on the level of income which rely, as a common denominator, on a comparison of the level of income of families on the lowest scale of income with the level of income of all other families. Each method is predicated on a “poverty line” set as a percentage of the income which is “representative” of society. A family whose income is below the poverty line will be considered poor, without this necessarily implying that the family suffers from want in the form of hunger, malnutrition, threadbare clothing or dilapidated housing, but only that its income is significantly lower than the representative income.

In Israel, the method for measuring poverty is based on the following three principles:

- a. The first principle views the family’s net income as the relevant income for assessing poverty. Net income is defined as the family’s market income (from work as well as from ownership of physical production means and financial assets)

plus transfer payments (received not in return for economic efforts, such as national insurance benefits or support from institutions and individuals in Israel and abroad), less direct taxes (income tax, national insurance contributions and health insurance contributions).

- b. The second principle regards the median net income of the population as the society's representative income. Median income is defined as the level of income which 50% of families have at least that income, while the remaining 50% have a higher level of income. The poverty line is defined as the level of income equivalent to 50% of the median net income. A family whose net income is lower than one half of the median net income is thus regarded as poor.<sup>1</sup> Economic growth leading to an increase in the median net income also results in the raising of the poverty line. A non-poor family whose net income has increased by less than the rate of increase of the poverty line may thus become a poor family.
- c. The third principle adjusts the poverty line to the family size. This principle is based on the assumption that family size involves economics of scale, whereby the growth of a family by an additional person increases its needs not by an equivalent, but rather by a lesser, proportion. In other words, the additional income required by a family in order to maintain a fixed standard of living decreases with the increase in the number of family members. To enable a comparison between the standard of living of families of different sizes, an "equivalence scale" was developed by which the needs of each such family can be measured against the needs of a family of a given basic size. More specifically, the equivalence scale translates the number of persons in a family into the number of "standard" persons (or the number of "standard adults") in that family (Table 1). The scale is based on a two-member family which is assigned a value of two standard persons.

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<sup>1</sup> The median income is preferable to the average income, as representing the typical standard of living, since the latter is affected by extreme values in income distribution (i.e. by very high or very low incomes).

According to this scale, a family with one member has a value of 1.25 standard persons. In other words, the needs of a one-member family are not assessed as equivalent to one half the needs of a two-member family, but as greater. Similarly, the needs of a four-member family (which has a value of 3.2 standard persons) are not set at double the needs of a two-member family (which has a value of 2 standard persons), but at less than double (only 1.6 times greater).

In keeping with these principles, the poverty line per standard person in Israel was set at 50% of the median net income per standard person. A family in Israel is classified as poor if its net income, divided by the number of standard persons in the family, is lower than the poverty line per standard person. The poverty line per family can be calculated in a similar manner – by multiplying the poverty line per standard person by the number of standard persons in the family.

**Table 1: Number of Standard Persons and the Poverty Line per Family, by Number of Family Members, 2003**

Number of family members	Number of standard persons	Poverty line per family	
		percentage of the average wage	NIS per month
1	1.25	25.3	1,736
2	2.00	40.6	2,777
3	2.65	53.7	3,680
4	3.20	64.9	4,443
5	3.75	76.0	5,207
6	4.25	86.2	5,901
7	4.75	96.3	6,595
8	5.20	105.5	7,220
9	5.60	113.6	7,776

As already indicated, the Annual Income Surveys conducted by the Central Bureau of Statistics (CBS) serve as the basis for calculating the dimensions of poverty and income inequality in Israel. Up until 1997 (inclusive), the survey population included households whose head was an employee or non-working person, in urban localities with 2,000 or more inhabitants (excluding East Jerusalem)<sup>2</sup>. In 1998 the Central Bureau of Statistics decided to produce a combined Income Survey, based on both the current Income Survey and the Family Expenditures Survey. The combined Income Survey is based on a larger sample (1.8 times the previous sample) and encompasses 95% of all households in Israel in most forms of settlement. In addition to the employee and non-working populations in urban localities, the combined Income Survey also covers the self-employed population, the population in the moshavim and in rural and community localities, and the inhabitants of East Jerusalem.<sup>3</sup> However, in 2000-2001 the inhabitants of East Jerusalem were not included in the survey, due to difficulties in data collection. For comparison purposes, the 2003 data were reproduced with East Jerusalem.

The present summary surveys the dimensions of poverty and income inequality in Israel in 2002-2003 on the basis of the combined Income Survey, and presents the main findings regarding the impact of transfer payments and direct taxes in reducing their scope. The dimensions of poverty are expressed by means of the two most widely used aggregate poverty indices in empirical studies, both in Israel and abroad: the poverty incidence and the poverty gap. The poverty incidence index indicates the scope of poverty in terms of the percentage of poor families in the total population. The poverty gap index reflects the depth of poverty: the poverty gap of a poor family is defined as the difference between the poverty line (corresponding to the family's

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<sup>2</sup> Up until 1994 (inclusive), the Income Surveys included non-Jewish localities with 10,000 or more inhabitants (excluding East Jerusalem). Since 1995, the Income Surveys have been expanded to include non-Jewish localities numbering 2,000–10,000 inhabitants.

<sup>3</sup> The populations not yet included are mainly the kibbutzim and the Beduin inhabitants who do not reside in permanent localities.

size) and the family's actual income, while the poverty gap of the population as a whole is defined as the sum of the poverty gaps of the total number of poor families in the population. The poverty gap index can be standardized and defined as the ratio between the average poverty gap per poor family and the poverty line (hereafter, the "poverty gap ratio"). Income inequality among the entire population is measured by the GINI index.

## 2.2 Poverty in 2003 as Compared to 2002

In 2003 the scope of poverty in Israel expanded. The rate of families whose net income fell under the poverty line rose from 18.1% in 2002 to 19.3% in 2003. This development is in contrast to the stability that characterized the poverty rate since 1997<sup>4</sup>.

The rise in the rate of poor families according to net income in 2003 is also in contrast to the stability characterizing this year in the rate of poor families according to economic income (before transfer payments and taxes). Similarly to 2002, in 2003 33.9% of all families had an economic income lower than the poverty line. This stability can be at least partially explained by the expansion in employment that characterized even the traditional branches, as well as by the stability noted for the second year in the real level of the minimum wage – in contrast to the erosion of actual wages.

The expansion of the poverty rate by net income was also noted among persons and children; the rate of poor persons out of total persons in the population rose from 21.1% to 22.4%, while the rate of poor children out of total children in the population rose from 29.6% to 30.8%. The increase in the rate of poor children in 2003 continued

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<sup>4</sup> For the population that does not include the residents of East Jerusalem the trends are similar, although the gap in poverty rate between the two populations has diminished.

the gradual upward trend that occurred in the years 1999-2002. The poverty rate of children in 1998 was 22.8%.

The rise in the poverty rate by net income characterized all population groups, although it was not statistically significant (at a level of up to 5%<sup>5</sup>) in all these groups. The poverty rate among families headed by an elderly person rose from 19% in 2002 to 22.3% in 2003, and among families with children – from 21.7% to 23%. Among single-parent families, the rate of poverty increased from 25.3% to 27.6%. The rise was a more moderate one among large families and non-Jewish families. The erosion in the child allowances to large families will be reflected only in data of the 2004 Survey.

The increase in the poverty rate did not skip over working families. For example, the rate of single-earner families with a net income below the poverty line grew from 17.6% to 18.6%.

Similarly to 2002, poor families became poorer in 2003, and their average income drew further away from the poverty line. The average poverty gap per family continued to rise in 2003, reaching 30.5% of the poverty line, as compared to 29.7% in 2002.

The increase in the poverty gap characterized all population groups, except for working families, and was especially prominent in non-working families of working age. The decline in the poverty gap of working families can be attributed to the increase in the income of the working poor, due to the addition of more workers to the poverty ranks or/and due to the stability in the minimum wage. On the other hand, the rise in the poverty gap among non-working families stems from the erosion in the level of benefits paid to the working-age population.

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<sup>5</sup> All changes are significant at a level of 10%.

**Table 2: Poverty in Total Population, by Selected Poverty Measures  
2002 and 2003**

Poverty measure	Before transfer payments and direct taxes	After transfer payments and direct taxes	Percentage of decrease stemming from transfer payments and taxes
<b>2002</b>			
Poor population			
Families	634,000	339,000	
Persons	2,079,000	1,321,500	
Children	828,200	617,600	
Incidence of poverty (%)			
Families	33.9	18.1	46.6
Persons	33.2	21.1	36.4
Children	39.7	29.6	25.4
Poverty gap ratio (%)*	66.6	29.7	55.4
<b>2003</b>			
Poor population	645,300	366,300	
Families	2,156,200	1,426,800	
Persons	862,200	652,400	
Children			
Incidence of poverty (%)			
Families	33.9	19.3	43.1
Persons	33.8	22.4	33.7
Children	40.7	30.8	24.3
Poverty gap ratio (%)*	64.8	30.5	52.9

\* The weight given to each family in calculating the measure is equivalent to the number of persons in the family.

In 2003, the contribution of the transfer payments to the reduction of poverty declined; the rate of poor families after transfer payments and taxes was about 43% lower than

the rate of poor according to economic income – compared to a parallel rate of about 47% in 2002. The poor non-working population (elderly and working age), as well as workers whose income is below the tax threshold, suffered from erosion in their benefits<sup>6</sup>, but naturally, did not benefit at all from tax reductions; thus their situation deteriorated in relation to that of the working population. Furthermore, the erosion of benefits more than set off the slight improvement in the economic income of the poor and the positive effect of the lowering of taxes, particularly of national insurance contributions.

### 2.3 Inequality in Income Distribution in 2003 as Compared to 2002

The picture of income gaps that arises from the data of the 2003 Income Survey indicates two contrasting developments: while the gaps in the distribution of economic income grew smaller, those in the distribution of net income grew slightly wider. The Gini index of economic income distribution declined by about 2%, but the index of net income distribution rose slightly – by half a percent.

The significance of these findings is that in 2003, the contribution of the benefits and direct taxes to the reduction of gaps in net income decreased, and that the decline in inequality in economic income was not translated into a parallel decline in inequality in net income. Taken together, in 2003 the transfer payments and taxes reduced the Gini index of the distribution of economic income by 30%, as compared to 31.5% in 2002.

A more detailed analysis shows that the economic income per standard person (on average in a family) declined in real terms by about 3%, while the decline in the two

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<sup>6</sup> Details of the cuts in National Insurance benefits in the framework of the government economic policy in 2002-2003 are described in the Annual Survey of the NII for 2002-2003.

upper deciles was higher – by 4.5% and 6%, respectively<sup>7</sup>. On the other hand, the net income per standard person decreased by about 1.5% in real terms, the rate of decrease being higher in the five lower deciles – between 3.9% in the lowest decile to 2% in the fifth decile<sup>8</sup>. The net income per standard person remained the same in the 3<sup>rd</sup> to 9<sup>th</sup> deciles, but decreased by about 2% in the top decile.

**Table 3: Gini Index of Inequality in Income Distribution, 1999-2003**

	Before transfer payments and direct taxes	After transfer payments and taxes	Percentage of decrease stemming from transfer payments and taxes
<b>Total population</b>			
2003	0.5265	0.3685	30.0
2002	0.5372	0.3679	31.5
1999	0.5167	0.3593	30.5
<b>Change in Gini Index (%)</b>			
2003 compared to 2002	-2.0	0.2	
2003 compared to 1999	1.9	2.6	

<sup>7</sup> The sharp decline in economic income of the top decile in 2003 as compared to 2002 was influenced by a small number of exceptional cases (of a very high income) in the 2002 sample. A sensitivity test of the real change in the income of the top decile and of the Gini index of the distribution of the general income shows that omission of these cases moderates the changes to a great extent.

<sup>8</sup> The weight given to each family in the calculation of income per standard person is equal to the number of persons in the family. When each family is weighted, the economic income per standard person decreases by 2% and the net income per standard person remains the same in real terms. However, even in this case the patterns of income change according to decile remain.

The decrease in economic income reflects the wage erosion, more notable in the upper deciles, while the slight decrease in net income reflects the erosion in benefit levels, since the reduction of income tax increased net income. The share of each of the five low deciles as well as of the top decile in total net income declined, while the share of the 6<sup>th</sup> to 9<sup>th</sup> deciles rose. The ratio between the income of the top quintile and that of the bottom quintile rose slightly: from 7.0% to 7.1%.

An appendix of bilingual tables and graphs appears at the end of the second chapter.