



**TAUB CENTER**  
for Social Policy Studies in Israel

**Proposal by the heads of the Taub Center**

# **A New Public Agenda for Israel**

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### *Preface*

The Taub Center for Social Policy Studies in Israel is an independent, non-partisan, socioeconomic research institute based in Jerusalem. It provides the country's leading policy makers and the general public with a “big picture” perspective and policy options in the economic and social spheres. The Center’s five interdisciplinary Policy Programs in education, labor, welfare, health, and economics include prominent academic researchers and leading experts from the policy realm who carry out cutting edge academic research on the nature, source, scope, and resolution of some of the most severe problems that Israel is facing, and bridge these together with the formulation of policy recommendations.

In this document, the Executive Director and the Chairs of the Taub Center Policy Programs – all researchers at Tel-Aviv University, the Hebrew University, and Ben-Gurion University – offer a comprehensive approach for dealing with the root causes of some of Israel’s core social and economic problems. This document’s uniqueness emanates from the level of consensus in the identification of Israel’s fundamental socioeconomic problems and the primary policies required for an in-depth treatment of them among authors from diverse backgrounds and with experience spanning a variety of fields and disciplines. The following recommendations are based on studies conducted both within and outside the Taub Center.\*

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\* All opinions expressed in this document, as in all Taub Center documents, reflect the authors’ views alone. They do not obligate the Taub Center, its Board of Directors, its Policy Program Fellows, its employees, other affiliated persons, or its supporters.

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Proposal by the heads of the Taub Center

## **A New Public Agenda for Israel**

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### ***Introduction***

A wave of protest calling for social and economic change has spread throughout Israel since mid-July 2011. So far, the protesters' demands have been diverse and at times unfocused. Shared by virtually all protesters, however, are the demands for social justice and the support for a welfare state like that found in Northern European countries. The leaders and supporters of the protest accuse the government of having abandoned its commitment to provide Israelis with economic and social security, and demand that it re-establish its authority and influence in these fundamental areas. They call for support in their struggle for fair and decent living conditions based on principles of solidarity and equality.

In light of the issues raised in this recent wave of protests, we, the heads of the Taub Center for Social Policy Studies in Israel, propose *A New Public Agenda for Israel* which reflects major, essential changes in Israel's national priorities. Rather than simply adopting the protesters' demands, we propose a concrete set of structural solutions to the major challenges facing Israeli society and economy – some have been raised by the protesters themselves and some have not – as they emerge from the Taub Center's work over the years.

## ***The Public Protest***

In the course of the protests, a number of issues have arisen. These primarily focus on the following:

- **Social justice and the reduction of inequality** – calls for a more equitable division of the national resources and also of the tax burden.
- **Welfare state** – calls for ensuring social services, healthcare services, education (from early childhood), and other social services by the government. There have been frequent references to ensuring accessibility to services through adequate subsidies or even through complete government funding.
- **Halting privatization** in a variety of areas.
- **Structural change in the tax structure** – demands that the value added tax (VAT) be cut by 5 percent and the current plan for lowering direct taxes should be frozen.
- **Affordable housing** – government policies to reduce housing prices and rents; calls have been made to increase the supply of public housing and to institute rent control and regulate rental conditions.
- **Free education** for children from the age of three months, reduction of average class size and longer school days in the public, or State – as it is referred to in Israel – school system.
- **Ending sectoral privileges** such as preferential support of the ultra-Orthodox population and for Jewish settlements, as well as other preferential treatment for certain sectors of the population in housing and education.

- **Health services** – calls for improvement in doctors' pay, for supporting public healthcare and narrowing inequalities between the country's geographic center and the periphery.
- **The labor market** – wage reform that takes into account, amongst other issues, price increases, safeguarding workers' rights, raising the minimum wage, and elimination of employment through the use of manpower agencies in the public sector.
- **Reducing market concentration.**

The new set of priorities proposed below addresses these and other issues emanating from Taub Center research.

## *A New Public Agenda*

The recent wave of protests increased awareness of Israel's deep social and economic problems and created a historic opportunity, facilitating public discussion on a scale that could finally lead to a change in Israel's national priorities. This document is based on a comprehensive, systemic, perspective that should serve as a guiding light for the country's policymakers – focusing on the general good rather than on the demands of special interest groups with large political clout.

The deterioration in Israel's human capital and physical capital infrastructures has substantially eroded its capabilities and provides an important starting point for this document. Core treatment of Israel's primary long-term problems requires a sharp turnaround in the rehabilitation, upgrading and reconstruction of these infrastructures. Substantial – and intelligent – investments are crucial for dealing with the multi-decade neglect of these infrastructures. This is the principal key to reducing poverty and inequality while substantially increasing the rate of growth in the standards of living.

How could the transfer payments, taxes and social services also contribute towards meeting these objectives? We agree with all Israeli governments that the most effective way to ensure a person's economic security is for those who are able to work for a living to actually do so. Current policies, however, channel many individuals on poverty's edge towards low wage employment – perpetuating poverty rather than reducing it. It is imperative that the government shed its penchant for absolving itself from overall accountability, including fragmentation of benefits programs. The government must embrace the fair and just principle of progressive taxation (he who earns more, pays more) as a



basis for the construction of a broad social and political consensus in Israel, as exists in Northern European countries.

The following is a list of primary changes that need to be made in the national public agenda.

## **Government Expenditure**

**Background.** According to OECD data, the ratio of total public expenditure to GDP in Israel was 45.5 percent in 2010. While reasonable, this ratio is lower than in previous years (52.6 percent in 2000-2005) and below the social welfare countries of Northern Europe, where it ranges from 46 percent (Norway) to 58 percent (Denmark). Since defense spending accounts for a larger share of government expenditures in Israel than in other countries, the remaining civilian expenditures in Israel are even lower. The country's infrastructure investments are particularly low (more on this later).

**Policy Proposals.** The national priorities determining the overall size and distribution of Israel's national budget need to be revisited and existing budgets can no longer be treated as sacred. The problem is not simply the size of the budget and how it is allocated, but also its management and the extent to which public institutions utilize – or do not utilize – the resources at their disposal. The recommendations made here do not increase the deficit limit and are consistent with the current policy of reducing the debt-GDP ratio. The objective here is to focus on the overall picture rather than on specific budget lines. The issue is not only one of total education, welfare, and health expenditures – for example – but also on the internal apportionment and management of each of these budgets. Therefore:

- Public funds must be distributed on the basis of national rather than sectoral perspectives.
- The social welfare principle needs to be strengthened, with the government ensuring the availability of its services to all citizens in the areas of health, education, childcare, old age, care for the disabled and elderly, etc.
- Israel's human capital and physical capital infrastructures must be substantially upgraded to reduce poverty and increase the rate of growth in the country's living standard.
- The government bureaucracy needs to become more efficient. It is currently considered one of the chief impediments to the determination and implementation of long-term policies.

At a time when the world economy may well enter another deep recession and the financial crises in some Western nations might spread to additional countries, it is important to seriously consider the advisability of implementing any increase in government expenditures. Instead, the focus should be on the reapportionment of Israel's existing budget. If a decision is made to increase public expenditures nonetheless, including government investments, this should be contingent upon an equivalent increase in tax revenues. In this regard, two alternatives are proposed. The first is to increase the budget by NIS 20 billion (approximately 2.5 percent of GDP)<sup>1</sup>, in order to deal with the most pressing needs and as a partial response to some of the demands made by the protesters. The second alternative is to increase the budget by NIS 40 billion (approximately five percent of GDP), returning Israel's debt ratio to its 2005 levels and closer to the current ratio of debt to GDP in

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<sup>1</sup> This brings the ratio of public expenditure to GDP up to the Northern European average for 2000-2007, before the onset of the recent global economic crisis.

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Northern European countries. This alternative would allow more extensive rehabilitation of Israel's human and physical infrastructures.

## Sources of Funding

**Background.** Israel's tax system is afflicted by a number of serious problems: 51 percent of Israelis (54 percent of salaried employees) are below the tax threshold<sup>2</sup> and pay no income tax. The corporate tax burden has decreased by six percent of GDP since 1986. In current prices, this equals about NIS 48 billion. The indirect tax burden is particularly high, accounting for 51 percent of the country's entire tax revenues in 2010. The magnitude of the "shadow economy" in Israel (23 percent of the GDP, or NIS 190 billion, according to very rough estimates<sup>3</sup>) further reduces tax revenues – probably by a considerable extent. The tax mix is not designed in a strategic manner, and planned tax cuts are inconsistent with other government objectives such as government deficit and national debt targets. The current tax distribution – with the top decile paying approximately two-thirds of all taxes (including national insurance and health insurance taxes) and three-fourths of all income taxes – further constrains the maneuvering space for tax reform.

**Policy Proposals.** To fund the proposed increases in government expenditure, while preventing an increase in the deficit, the government must:

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<sup>2</sup> All tax data in this document are based on the State Revenue Division Report for 2011, Israel Ministry of Finance.

<sup>3</sup> Dan Ben-David (2011), "Israel's Shadow Economy." *State of the Nation Report: Society, Economy and Policy 2010*, Taub Center for Social Policy Studies in Israel.

- Close loopholes that enable high wage earners to evade fair taxation and prevent them from using the law to set up fictitious companies in order to enjoy lower corporate taxes and avoid individual taxes.
- Cancel tax benefits – both current and planned – amounting to NIS 20 billion (out of the current benefits totaling NIS 38 billion) with special emphasis on tax exemptions in the financial market.
- Distribute the financing of infrastructure projects over several generations, by funding infrastructure projects partly by taxation on current generations and partly by loans to be paid back by future generations.
- Substantially strengthen the police force, tax enforcement agencies and the courts in order to reduce shadow markets, boost tax revenues and increase equity in the shouldering of the tax burden.
- Institute mandatory filing of income tax returns and substantially increase the resources for enforcement of this law.

In the event that they are needed, and after the above steps are implemented, the government may also:

- Cancel the planned cuts in direct taxes.
- Raise employer social security payments (which decreased from approximately 16 to 5.5 percent over the years) by some NIS 5 billion. Cancel planned corporate tax cuts and raise corporate taxes in order to add an additional NIS 5 billion in revenues (which would be a return to the level of revenues in 2005).
- Over time, and to the extent possible, reduce value added taxes (VAT) and increase the ratio of direct-to-indirect taxes in order to make the overall tax system less regressive. Lowering the VAT to 10

percent would shrink tax revenues by some 20 billion NIS (approximately 2.5 percent of the GDP).

- Serious consideration should be given to the possibility of significantly lowering Israel's defense expenditures – for example, by NIS 5 billion – in particular by reducing military salaries and pensions. In keeping with the Brodet Commission guidelines<sup>4</sup>, the government should move up implementation of the recommendations of the McKinsey Report<sup>5</sup> and consider shortening the length of compulsory military service in Israel.

## Housing

**Background.** The widespread feeling that buying a home has become increasingly difficult is supported by the data. Excess demand has caused housing prices to rise by almost 40 percent (in real terms) since December 2006.<sup>6</sup> At that time, it took 7.5 years of work at an average wage to buy an average home. In April 2011, it took 11.2 years of work – a 50 percent increase in only three and a half years. The current figure

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<sup>4</sup> In May 2007, the Brodet Commission submitted a comprehensive and detailed report on the administration of the defense budget.

<sup>5</sup> Report written by the McKinsey & Company consultant group that received a multi-year contract to examine the the Israel Defense Forces. The initial report was submitted in November 2009 and included recommendations for improving the military efficiency and reducing the budget by about NIS 1.3-1.6 billion annually. The first issue examined was procurement. The group will also be examining manpower issues.

<sup>6</sup> Polina Dovman, Yossi Yachin, Sigal Ribon, "Israel's Housing Market 2008-2010: Is There a Housing Bubble?" Bank of Israel, Discussion Paper, June 2011.

comes close to the peak figure of 12.1 years registered in May 1996 (in the wake of the large immigration wave of the early 1990s). Buying a home requires 15 percent more work today than it did in January 1973 (9.7 years) and 21 percent more than the 1973-2011 average (9.3 years).

**Policy Proposals.** The government, which owns most of the land in Israel and manages it via the Israel Land Administration, needs to increase the amount available for housing. The building approval process needs to be speeded up and more construction is needed. On the basis of professional cost-benefit analyses, substantial investment is required in transportation infrastructures, including trains, buses, and roads to reduce gaps between the large cities and the periphery. This must be done in conjunction with improvement in education and health services in periphery communities to make them more attractive to current residents of Israel's larger and more expensive cities.

Real estate acquisitions must be taxed differentially to distinguish between real estate acquired for investment purposes and for personal residential purposes. Home purchases by foreign citizens and non-residents of Israel should be taxed differently than purchases by Israeli residents. Urban planning must undergo significant improvement, and new construction technologies should be promoted.

Until such time as market reforms are complete, subsidies on the basis of an income means test for home purchases and rentals should be considered. Finally, the Israel Land Administration must undergo fundamental reform.

## The Labor Market

**Background.** The Israeli labor market suffers from a number of significant problems. Rates of employment among Israeli men are low relative to Western countries. Employment rates among prime working age men (ages 35-54) are 80.5 percent, compared with 85.8 percent for the OECD on average. Amongst women, the rate of employment among Arab women is particularly low.<sup>7</sup> One expression of Israel's problematic employment picture is lost GDP. Had Israel's rate of employment equaled the OECD average, an additional NIS 29 billion in GDP would have been produced in 2009 alone.<sup>8</sup> Widespread employment of foreign workers – one of eight workers in Israel's business sector is non-Israeli – drives down the pay and worsens the employment conditions of unskilled local workers, perpetuates outdated production techniques that rely on cheap labor, and imposes an additional burden on welfare services. The use of manpower agencies to hire temporary workers has become ubiquitous: many such workers are exploited, their chances of accumulating human capital are diminished and their pay is kept low to maximize manpower agency profits. These developments have all contributed to increasing income inequality in Israel.

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<sup>7</sup> Eran Yashiv (2011), "A Macro Economic Perspective," *State of the Nation Report: Society, Economy and Policy 2010*, Taub Center for Social Policy Studies in Israel.

<sup>8</sup> The 2009 average employment rate in the population above age 15 was 56.5 percent in the OECD, 52.6 percent in Israel. The loss of GDP was calculated on the basis of these different employment rates, given Israel's 2009 GDP of 768.3 billion NIS and a 0.68 elasticity between output and labor, with each additional worker assumed to be able to produce only 0.75 of the amount produced by those already employed.

Israel's labor market can be characterized as a dual market. The primary market comprises skilled workers with employment stability and relatively high compensation, while the secondary market comprises unskilled, poorly compensated workers with low job security, often earning less than minimum wage and facing significant obstacles in the transition to the primary market. The secondary market is largely comprised of Arabs, foreign workers, Jewish-Ethiopian immigrants, and others. These groups are weak in many respects, for example in terms of unionization.

It is highly likely that at least some of those reported as not employed do actually work, but do not report this to the tax authorities. Tax enforcement is insufficient and almost non-existent in the case of small-scale tax evasions.

**Policy Proposals.** An extensive reform is needed, replacing non-work incentives with incentives to work. Low income earners should receive a negative income tax allowance at rates which are sufficient to act as a real incentive to work. In place of the current negative income tax rate of nine percent (given under very restrictive conditions which further diminishes its effectiveness as a work incentive), Israel should adopt the 40 percent rate currently being paid in the United States which has been proven to be a significant incentive to work. In addition, negative income tax benefits in the United States are provided up to much higher income levels than the average in Israel. These steps must be accompanied by an extensive campaign to raise awareness of the negative income tax program.

Supplementing the financial incentives of negative income taxes, new employment and job placement centers are needed while the system matching workers and jobs in Israel needs to undergo substantial reform. Employment and placement centers should be set up on a regional basis



and specialize in particular areas which reflect the special skills and needs of each region's local population and employers. For each job seeker, the centers should find, offer, and recommend several alternatives: continuing education, professional training, and/or immediate job search. The centers should guide and accompany job seekers along their chosen path until they find a job and for an additional period to be determined. Placement centers must be rewarded on the basis of their placement success rates and the amount of time their clients are employed at their new jobs.

The above measures should be backed by a significantly improved urban and inter-city transportation infrastructure, longer school days, and support and enrichment programs such as daycare centers and organized youth activities in socioeconomically disadvantaged neighborhoods and communities.

The number of foreign workers in general and illegal foreign workers in particular should be reduced significantly, primarily by making their employment considerably more expensive through a special tax and increased and effective enforcement including heavy fines for employers and manpower agencies who are non-compliant. Manpower and temporary work agencies should be strictly regulated; workers employed by such agencies should be allowed to unionize; and there should be a system to find and punish employers violating fair employment conditions.

The public sector should move towards salaries paid in one simple gross amount, incorporating the entire array of compensation elements currently in place. A simplified compensation system that is transparent and reflects workers' actual pay would facilitate clear and fair salary discussions, with workers fully aware of their exact monthly and annual compensation. In addition, old-age benefits to the needy (currently much

lower than common in the developed world), which constitute the first layer of the pension system, should be increased.

Specific steps need to be taken to promote employment among large groups characterized by low rates of labor market participation. Ultra-Orthodox Jewish men and Arab women are the two major groups in this regard, although the problem also exists among ultra-Orthodox Jewish women and Arab men. Such steps may include subsidies in order to increase demand for such workers, assistance in the creation of new workplaces suitable for these groups, improved transportation to and from Arab villages, efforts to close the lower education and higher education gaps – particularly between Arabs and Jews – and anti-discrimination legislation. In order to greatly decrease future employment problems amongst these populations, the level of education must be significantly upgraded in core subjects through the 12<sup>th</sup> grade level. This is particularly relevant for the ultra-Orthodox population where core studies are minimal and currently end at 8<sup>th</sup> grade – at most – for boys.

## **Education and Higher Education**

**Background.** Israel's education system suffers from a multitude of problems. The average achievement level in core curriculum subjects is lower in Israel than in 25 developed OECD countries. Achievement gaps between pupils are greater in Israel than in all OECD countries.<sup>9</sup> An increasing number of pupils do not study core subjects. Excessively large classes, especially in the Arab and in the non-religious Jewish schools,

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<sup>9</sup> Dan Ben-David (2011), "Israel's Education System: An Updated International Perspective," *State of the Nation Report: Society, Economy and Policy 2010*, Taub Center for Social Policy Studies in Israel.

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make both teaching and learning more difficult.<sup>10</sup> Teachers are dissatisfied with their salaries, while admission standards to the teaching profession are very low. Growing inequality between schools in terms of both resources and achievements is a source of social tension.

The main problems affecting higher education are the rising average age of faculty; the dearth of positions; serious "brain drain"; inadequate research budgets; and incompetent management in many of the institutions. This plethora of problems has lowered academic quality, harming both research and teaching. A number of steps have been taken in recent years to raise faculty salaries, increase the number of positions and to expand research budgets.

**Policy Proposals.** Teacher compensation should be raised to Western levels (relative to per capita GDP); at the same time, there should be an improvement in the quality of teaching manpower and other professional standards. An apolitical and professional national education authority needs to be established and given the authority for determining the education system's core curriculum. The core curriculum should be of a high standard, mandatory and uniform throughout the education system; only schools teaching it in full should be eligible for government certification and funding. Individual schools or school networks should not be prevented, however, from offering special curricula beyond the core studies. School certification and funding should be conditional upon

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<sup>10</sup> Average class size in elementary schools is 23-26 in the State-religious (Jewish) schools; 26-30 in Jewish State schools; and approximately 31 in Arab schools. These differences reflect injustice in the allocation of public resources. Expenditure per pupil is inversely related to class size. It follows that expenditure per pupil is higher in Jewish State-religious schools than in their Arab and Jewish State school counterparts. This inequality must be remedied.

non-discriminatory admission and registration policies with respect to pupils of different ethnic and social groups.

Schools should be funded on the basis of transparent and uniform budgetary criteria, taking into account the socioeconomic level of the pupil population at each school. This requires a transition from budgeting by class to budgeting per individual pupil (“differential standard” budgeting) at all school levels. Because of the significance of preschool education – especially for children, but also for parents who are thus freed to join the labor force – education budgets should be large enough to allow free compulsory education from preschool through the twelfth grade. The entire education system should transition to a longer school day and from six to five days a week. Education budgets should enable each school to offer both the core curriculum and additional elective curricula. School principals (who should undergo professional management training) should prepare their own work plans and determine the allocation of their resources. They will be responsible for implementing the work plans, achieving the goals, adhering to the budget, and for recruiting and dismissing teachers (subject to labor agreements).

Average class size should be equal across Israel’s different education sectors. To achieve this goal, average class size in Arab and non-religious Jewish public schools should be reduced to no larger than the current average class size in State-religious schools.<sup>11</sup>

In higher education, the government has recently decided to fund “excellence centers” with budgets for hiring new faculty members. This important step is designed to recruit outstanding academics; it is limited,

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<sup>11</sup> We are aware that part of this distortion in class sizes is due to the fact that the number of religious families is small in a number of communities and is unable to fill large classes. But this is only a partial explanation for the large gap in class sizes across sectors.

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however, only to certain fields. To fill the dwindling ranks of outstanding university faculty in all fields, higher education funding and faculty positions must be restored to their 1970s levels, before the number of faculty positions per capita in the general population was reduced by about half. Finally, higher education should be made more accessible through student loans covering full tuition, repayment of which should be conditional upon students' earnings after graduation (similar to student loan programs in Australia and the UK).

## Health

**Background.** Israel's recent governments have failed to implement many structural health reforms, despite the recommendations of various public commissions.<sup>12</sup> The share of public funding in Israel's total health expenditures has dropped from 70 percent in 1996 to 60 percent in 2010 – the lowest since records have been kept in Israel (1963), and the lowest among developed countries with universal health insurance.<sup>13</sup> Public funding has been replaced in part by co-payments and voluntary health insurance plans – in particular “supplementary” plans funding private medical treatment, which are held by 80 percent of Israeli households. These insurance plans cover treatments at private medical facilities.

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<sup>12</sup> The State of Israel (1990), Report of the National Investigation Committee on the Functioning and Efficiency of Israel's Health Care System (“the Netanyahu Commission”); The State of Israel (2002), Report of the Commission on Public Healthcare and Physician Status in the Public System (“the Amora Commission”).

<sup>13</sup> Dov Chernichovsky (2011). “The Healthcare Services System,” *State of the Nation Report: Society, Economy and Policy 2010*, Taub Center for Social Policy Studies in Israel.

The higher share of private expenditure on medical services has had adverse effects on households. Many families, especially in the lower income brackets, have had to forgo other goods and services in order to pay for medical care; approximately 2,000 households have been reduced to poverty; and relative accessibility to medical care for low-income groups has been limited.<sup>14</sup> The elimination of co-payments at family care clinics and the introduction of publicly funded dental care for children have had somewhat of a mitigating effect.

The public healthcare system has lost many of the resources and much of the organizational ability it needs in order to meet the public's health needs. Patients, especially those who can afford private insurance, are regularly referred from public to private care. The private system is encumbered with expensive and, in many cases, redundant infrastructure and technologies. Medical specialists often "vanish" to do private work during their shifts at public facilities.<sup>15</sup> As a result, doctors who remain in the public system – interns and specialists alike – have to cope with heavier workloads, while the income discrepancy between public health employees and those in the private sector increases.

The public system has proven unable to cope with these changes. The changes in funding, in particular, have resulted in economic inefficiency, inequality, and poverty, further exacerbating the socioeconomic gaps between Israel's geographic center and the periphery.

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<sup>14</sup> Guy Navon and Dov Chernichovsky (2011), "The Effect of Private Healthcare Expenditures on Income Distribution and Poverty in Israel," Bank of Israel and Ben-Gurion University in the Negev (in preparation).

<sup>15</sup> There are no precise data on this phenomenon. As early as 2000-2001, one-half of all specialists reported doing at least some private work. See Nurit Nirel, Arie Shirom, and Shuruk Ismail (2004), "Employment Characteristics of Advising Physicians in Israel's Secondary Healthcare System," *Ha-Refuah* 143(7): 482-488.

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**Policy Proposals.** In order to expand public health insurance benefits, expand the healthcare workforce, invest in the public healthcare system, and introduce certain structural reforms, public healthcare expenditure should be returned to its previous level of 70 percent of the total national expenditure on healthcare. The required structural reforms include in the near term the universalization of “supplemental” health services, i.e., their extension to the entire publicly insured population. Such extension should be funded by making the “supplemental” premiums mandatory or, the preferred method would be by using part of the healthcare tax, which is progressive, and can be made more progressive by raising its “ceiling.”<sup>16</sup> Elderly and chronic patients should be exempt from payments.<sup>17</sup> Israel’s periphery regions must be allotted their fair share of public healthcare funding.<sup>18</sup>

Healthcare benefits must be expanded in the areas of dental and nursing care. The right to choose a physician, currently available only to private patients, should be extended to public hospital patients. The training and certification of medical personnel, particularly physicians, must be reexamined, among other reasons in order to recruit medical personnel from abroad and to offer individual contracts and generous pay raises to interns and specialists working in the public system and as part of the

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<sup>16</sup> If there will be a mandatory payment, the State will pay the NIS 0.8 billion to funding premiums for eligible individuals (recipients of guaranteed basic income from income assurance, etc.). This addition to the already existing amount in the system will add approximately NIS 4 billion to the public healthcare system.

<sup>17</sup> These co-payments cover only a fragment of patients’ healthcare expenditures, nevertheless, they can be a substantial burden for low-income and chronic patients.

<sup>18</sup> The State of Israel (1990, 2002), see note 8 above. Dov Chernichovsky (2011), “Changes in Sick Fund Allocation to Close Gaps between Israel’s Center and Periphery - Is It Possible?” Taub Center for Social Policy Studies in Israel.

physician-choice network. Rules and regulations concerning the employment of physicians in the public health system must be enforced.

Several additional structural reforms must be introduced to the healthcare system. Medical activity must be re-channeled from the private to the public healthcare system. Maternity, childcare, and mental health services should be integrated in the general healthcare system.<sup>19</sup> Nursing care and insurance must undergo reform.<sup>20</sup> General hospitalization facilities owned by the government and sick funds (HMOs) should either be turned over to a national hospital authority or become corporations that operate according to real hospitalization costs.<sup>21</sup> The Ministry of Health should limit its activity to policymaking, regulation and enforcement, rather than to service provision as an interested party. Finally, expanded investments in the public system must prioritize Israel's outlying periphery, with the possibility of decentralized management of health service budgets across Israel.

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<sup>19</sup> The State of Israel (1990, 2002), see note 8 above. Hava Palti, "Preventive Medicine for Pregnant Women and Children," Taub Center for Social Policy Studies in Israel. Avner Elizur, Yehuda Baruch, Mordechai Shani (2004), "Mental Health Reform in Israel," Taub Center for Social Policy Studies in Israel.

<sup>20</sup> Dov Chernichovsky and Michal Koreh (2009), "Funding and Organizing Long-Term Care in Israel: Issues and Reform Suggestions," *Gerontology*, 36(1): 117-140.

<sup>21</sup> The State of Israel (1990, 2002), see note 8 above. The State of Israel (2004), Report by the Committee on the Operation, Management, Budgeting and Ownership of Government-Run Hospitals ("the Leon Commission"). Arie Shirom et al (1997), "The Incorporation of Public Hospitals in Israel: Assessment of Development and Policy Alternatives," Taub Center for Social Policy Studies in Israel. It is worth noting that contrary to public perceptions, the actions listed in Section 6 are not instances of privatization.



## Infrastructure

**Background.** Israel lags behind much of the developed world in terms of infrastructure (especially physical infrastructure), in areas such as transportation, electricity, water supply, sewage, rescue and firefighting services and pollution control. Israel's national budget for 2011 has allocated NIS 12.5 billion to investment in infrastructure, out of a total budget of NIS 271 billion (debt payments excluded). In other words, only 4.6 percent of the national budget and 1.5 percent of the GDP (compared with 3-4 percent in most developed countries) are allocated to infrastructure development.

**Policy Proposals.** Expanding investment in essential infrastructure is crucial in addressing existing lags. Priority should be given to railroad services (although the cost-effectiveness of different approaches to railroad investment requires serious consideration), roads, bus services, electricity generation and delivery, and water and sewage systems. In the long term, expenditures on infrastructure should meet Western and Northern European standards, although a transition period to build such infrastructure would require more significant expenditures. To meet the considerable costs, some infrastructure development should be financed via BOT (Build, Operate, Transfer) and PFI (Private Finance Initiative), adjusting each method to the requirements of the particular project. Some projects, however, would require direct government investment in which case funding would be in part through long-term loans, sharing the costs with the future generations who stand to enjoy the new infrastructure.

## **Welfare**

**Background.** In recent years a great deal of welfare activity has been “outsourced” by the government to private individuals and to non-profit agencies. This has resulted in greater inequality, a weaker publicly funded social safety net protecting low-income individuals and families, and less housing support for young families. These phenomena have provided a major impetus for the current protest wave, as discrepancies between the social rights extended to different groups in the population grew, and services to the disabled and the economically disadvantaged were cut. At the same time, changes in the way certain services are provided have substantially reduced compensation and worsened work conditions for the employees providing these services.

Reforms in benefits and services must be based on the understanding that each citizen and each family is exposed to various risks which may result in loss of income, including layoffs, acts of war and terror, accidents, disease, old age, disabilities whether from birth or acquired, and so forth. Principles of collective responsibility and mutual assistance dictate changes in current practices.

**Policy Proposals.** Current trends in the Israeli social welfare system – reduced government responsibility, increased selectivity and the partitioning of programs – must be changed. There is a need to strengthen the universal benefits system based on social security payments made jointly by employees, employers, and the government (in other words, employers’ contributions should be made mandatory again). Elderly should be paid a universal, reasonable benefit, replacing the currently disjointed system of “income supplements” given only to the especially needy even though it currently fails to bring them above the poverty line.

The large gap between tens of thousands of low-paid workers lacking even basic benefits and work conditions, on the one hand, and members of the upper deciles, on the other, requires, among other things, strict enforcement of minimum wage laws and other basic labor rights. The Israeli government must lead the way in how it treats its own employees and provides its services. In addition to providing citizens with higher quality services, the government as employer should offer its own employees decent wages and social benefits. The government should increase the quantity and accessibility of public sector jobs, at wages high enough not only to cover the everyday needs of the employees and their families but also to enable them to contribute, via taxation, to the funding of the social services and transfer allowances that the government provides to them and to other citizens.

Such steps would mark a substantial change from Israel's recent economic policies, which have cut back on public services, only to outsource them to private companies whose ostensibly low costs are based on low wages and the systemic infringement of basic labor rights. The proposed changes respond to the public need for better services, including not only health and education but also for such services as public daycare centers to ease the burden on working parents and nursing care for seniors, chronic patients, children and adults with disabilities, and many others. The role of private entrepreneurs and non-profit agencies in providing welfare, education and health services must be minimized. These services and others must be provided by the government as an obligation to the public, not as charity or philanthropy.

## Market Concentration

**Background.** Market concentration in Israel has been the subject of much media attention but relatively little research. Kosenko's (2008) study, based on a unique panel dataset and covering some 650 public companies traded on the Tel-Aviv Stock Exchange between 1995 and 2005, found Israel's economy to be characterized by a high degree of market concentration.<sup>22</sup> In the period under study, 20 or so business groups, most of them family-owned, controlled about 160 publicly traded companies and nearly half of the Israeli market. The market share of the ten largest groups is among the largest in the West, controlling about 30 percent of the market. The control structure of Israel's business groups has been found to be distinctly pyramidal, with approximately 80 percent of companies affiliated with business groups held under this structure. Israel's business groups are also characterized by high diversification with a particularly strong foothold in the financial sector: approximately one-half of Israel's financial firms are affiliated to business groups.

Concentration at these levels hinders competition, causes inefficient resource allocation, limits transparency regarding company management, and includes widespread control of large portions of the economy, which may lead to macroeconomic difficulties in times of crisis. Concentration distorts incentives for investment, leading to excessive risk taking in financial markets. In addition, concentration exacerbates the nexus between big money and government and may impede the country's political and social functioning.

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<sup>22</sup> Konstantin Kosenko (2008), "The Emergence of Business Groups in Israel and Their Effects on Companies and on the Israeli Economy," Bank of Israel, Discussion Paper, February 2008.

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**Policy Proposals.** The primary ways to deal with concentration are through taxation and regulation. In the United States, concentrated control structures were successfully dismantled by tax reforms in the 1930s, a major component of which was the double taxation of inter-company dividend payments (taxing both the paying and the recipient company). In Britain, the London Stock Exchange regulations enacted in the 1960s stipulated that holders of controlling interest in a publicly traded company could not hold more than 30 percent of stock capital. It is unclear whether the same measures are suitable for Israel. The government's handling of this important issue has so far been rather limited. A government commission on economic concentration is currently headed by Eyal Gabbay and Haim Shani, two government Directors-General on the verge of retirement. The issue must be addressed in more depth, including proposals for new, significant taxation and regulation measures. Effective measures would help lower prices, increase transparency, lead to a more efficient use of economic resources, and reduce risks in the financial market.

## Epilogue

### *The Meaning of Social Justice in a Well-Functioning Welfare State*

The leaders of the current wave of protest should be commended for their focus on government involvement in areas well beyond those that would benefit their own socioeconomic group. Their demands are broader in character: they are calling for a more open and civil market economy – one that is ensured by a more active government. Their activity is driven

by the desire to instill values of solidarity, equality, and social justice which have received a reduced role in the dominant economic doctrines of the recent decades. Adoption of a more self-interested agenda – one devoted to reviving the advantages of the middle class and solely motivated by the disappointment of middle-class young adults unable to attain their parents' standard of living – would have violated these same values.

Mortgages do not provide a housing solution for the genuinely poor; and regulating the Tel-Aviv apartment rental market would offer no help to residents of Israel's more peripheral regions. Helping social workers and other low paid public employees win compensation closer to that of their more fortunate private sector counterparts is a commendable goal. No less important, however, is the plight of the egregiously low paid security guards, foreign workers, sanitation employees, nursing workers, and others who make up Israel's vast population of workers employed at or below minimum wage. To improve their lot, it is incumbent to reach out to non-middle-class groups outside of the ethnic and cultural mainstream of Israeli society (some even lack Israeli citizenship). This requires a common agenda pressing for the legislation and enforcement of new labor and social laws designed to empower workers by helping them find alternatives to the low wages offered to them in the labor market including in the public sector; and such legislation must be enforced.

In the long run, gaps between those with few opportunities and those belonging (actually or potentially) to the middle class have two main sources: some individuals lack access to high quality education and thus fail to acquire skills that are in demand, while others acquire those skills but lack access to employers willing to pay decent wages in return. Both problems have a particularly detrimental effect on Israel's Arab citizens, who face discrimination by both private employers and the government

(through its social and economic policies, including its land and construction policies).

Other forms of inequality also continue to persist, however. One, of which many Israelis are aware, is geographical: Israel's periphery is seriously disadvantaged relative to the center of the country. Another, of which fewer are aware, is purely socioeconomic. To offer children from lower income families more equal access to the acquisition of sought after job skills, public funding of schools must provide additional resources to schools with pupils of low socioeconomic backgrounds; and promote the integration of children from low-income families in schools with a more affluent pupil population.

A similar problem affects the areas of government benefits and other welfare areas. Powerful pressure groups manage to divert large portions of government budgets to their narrow interests, skewing in their favor the allocation of national resources which are supposed to serve the entire public. Social policy based on equity, solidarity, and justice must be impartial, blind to the particular identities of beneficiaries, sensitive only to such questions as family size, age, disability, income level, etc.

In other words, it is important to remember that social justice requires not only support for those without resources and advantages, but also, at times, the reduction of privileges enjoyed by more affluent groups.

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