

ISRAEL:
|||
**A SOCIAL
REPORT**
|||
1998–2007



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INTRODUCTION

The first edition of **Israel: A Social Report** was published in 1998. To mark a decade of publication, this year's report covers a ten-year period, 1998-2007. The year 2007 is the last for which most data are available; where 2008 figures exist, even as estimates, we have included them as well.

Looking at the decade as a whole allows us to identify long-term socio-economic trends and examine the impacts of factors like social policy, armed conflicts, or immigration.

It is our hope that this report will be of use to persons who want to understand social development trends in Israel.



THE 1998-2007 DECADE

The years between 1998 and 2007 were characterized by a diminishing of equality and social justice in Israel.

The trend of increasing inequality began earlier. Since 1985, consecutive Israeli governments have gradually abandoned the earlier policy of encouraging broad social development and easing the integration of additional social groups into the social mainstream. Instead, they adopted policies that included stimulating economic growth by placing more and more collective resources at the disposal of the business sector and less and less at the disposal of public agencies. Time-honored goals like full employment, decent pay, social security, public education and public housing assistance were sidelined.

These trends became sharper during the last decade.

Between 2001 and 2003, the Israeli economy experienced a recession, at first as a result of the bursting of the global hi-tech bubble and later because of the second Intifada. The crisis was exacerbated by an increase in defense spending. The government responded by taking steps that reinforced the trends begun in 1985.

The business sector was energized by the transfer of pension savings from public to private hands, a reduction in corporate taxes and income taxes for the rich, and a downsize of national budgets designed to increase the amount of credit at its disposal.

At the same time, basic social arrangements were undermined, among them the social safety net, the pension system, the public school and higher education systems, the health care system and housing assistance programs.

The benefits bestowed on the business sector helped to stimulate economic activity: since 2003, the economy has experienced five consecutive years of growth. However, this economic growth was accompanied by an increase in inequality, as reflected in a sharp increase in the poverty rate, on the one hand, and by an unprecedented increase in the salaries of corporate executives, on the other. Moreover, the budget cuts had an adverse effect on the ability of the government to counter the increase in inequality by investing in public services like schools and universities.

At the time of writing, the whole world, including Israel, finds itself at the beginning of a serious economic crisis. Against this background, it seems a pity that we did not take advantage of the period of growth to improve the lot of the majority of Israelis.

Looking forward to the next decade, the present report points to a number of issues that should be at the top of the public agenda:

- In Israel, the fate of the economy depends not only on the ebbs and flows of the world economy but also on the degree of political stability in the region, particularly in the arena of Israeli-Palestinian relations. The report demonstrates that a fair political settlement with the Palestinians is not only in the political interests of Israel but also in its economic and social interests.
- In Israel, as in the rest of the world, economic growth in and by itself cannot lead to the development of a society based on the values of equality and social justice. This is especially true when economic growth is achieved mainly by transferring more and more collective resources to the business sector.
- Increasing equality and social justice require an active public policy of fair distribution of collective resources, of public control of long-term household savings, of full employment and living wages, of high-quality public education, of universal health services and of universal health services and of a reliable social safety net.

The Economy on a **ROLLER COASTER**

From the standpoint of the economy, the last decade resembles a roller coaster ride.

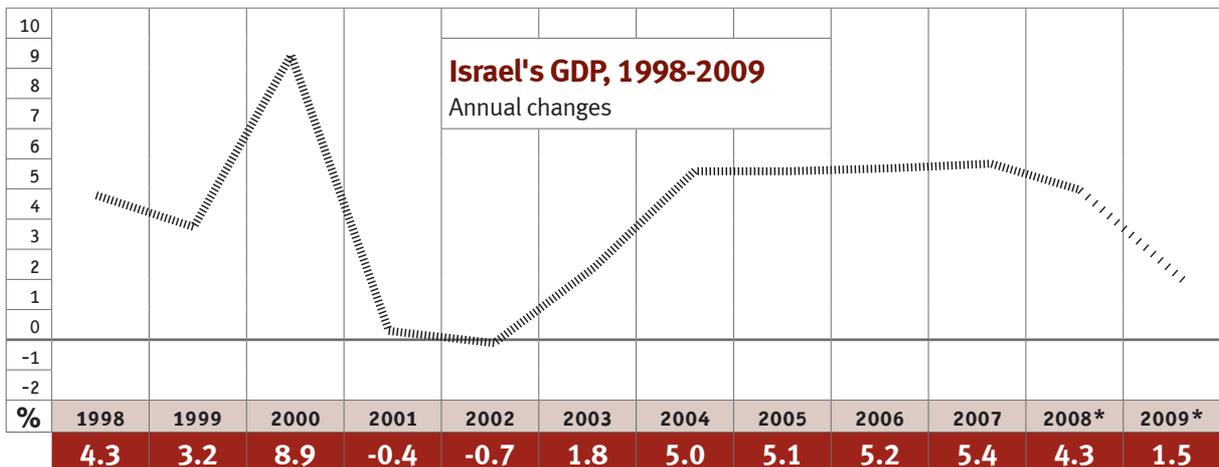
This can be seen by examining the annual change in GDP. At the beginning of the 1990s, Israel experienced six years of economic growth, during which the average annual growth was 6%, due to the population increase following the immigration of nearly one million persons from the former Soviet Union and Ethiopia. The end of the immigration wave was accompanied by a decline in economic growth. The 1990s were also marked by the growth of the hi-tech industries and related services. This process came to a head at the end of the 1990s, with the sell-off of many Israeli start-ups to multi-national corporations - resulting in an 8.9% increase in GDP in 2000. Another contributing factor to the high growth rate was the increase in tourism at the turn of the millennium and the optimistic atmosphere following the progress of political negotiations between Israel and the Palestinians.

The high rise in GDP ended in a steep decline, the result of the bursting of the global hi-tech bubble

and the outbreak of the second Intifada. During 2001 and 2002, Israel's economy contracted. While in other parts of the world the crisis set off by the bursting of the hi-tech bubble was short-lived, in Israel the Intifada led to a recession lasting more than two years.

Recovery was followed by five years of economic growth, beginning in the second half of 2003. That growth was stimulated by a number of factors: military suppression of the Intifada by reoccupation of the Palestinian territories, resulting in relative calm on the Israeli side of the Green Line but in an increase in poverty and distress on the Palestinian side; the growth of the world economy; and the cheapening of credit for business.

As this report goes to press (December 2008), the roller coaster is beginning another downward dive, this time due to an international financial crisis that is dragging the world economy along with it. While 2008 is expected to end with a reasonable growth rate of 4%, the prediction for 2009 is much lower - 1.5% according to the Bank of Israel.



* Estimate

Sources: Adva Center analysis of Central Bureau of Statistics (CBS) figures in *Statistical Abstract of Israel*, various years; Bank of Israel, Press Release, November 20, 2008.

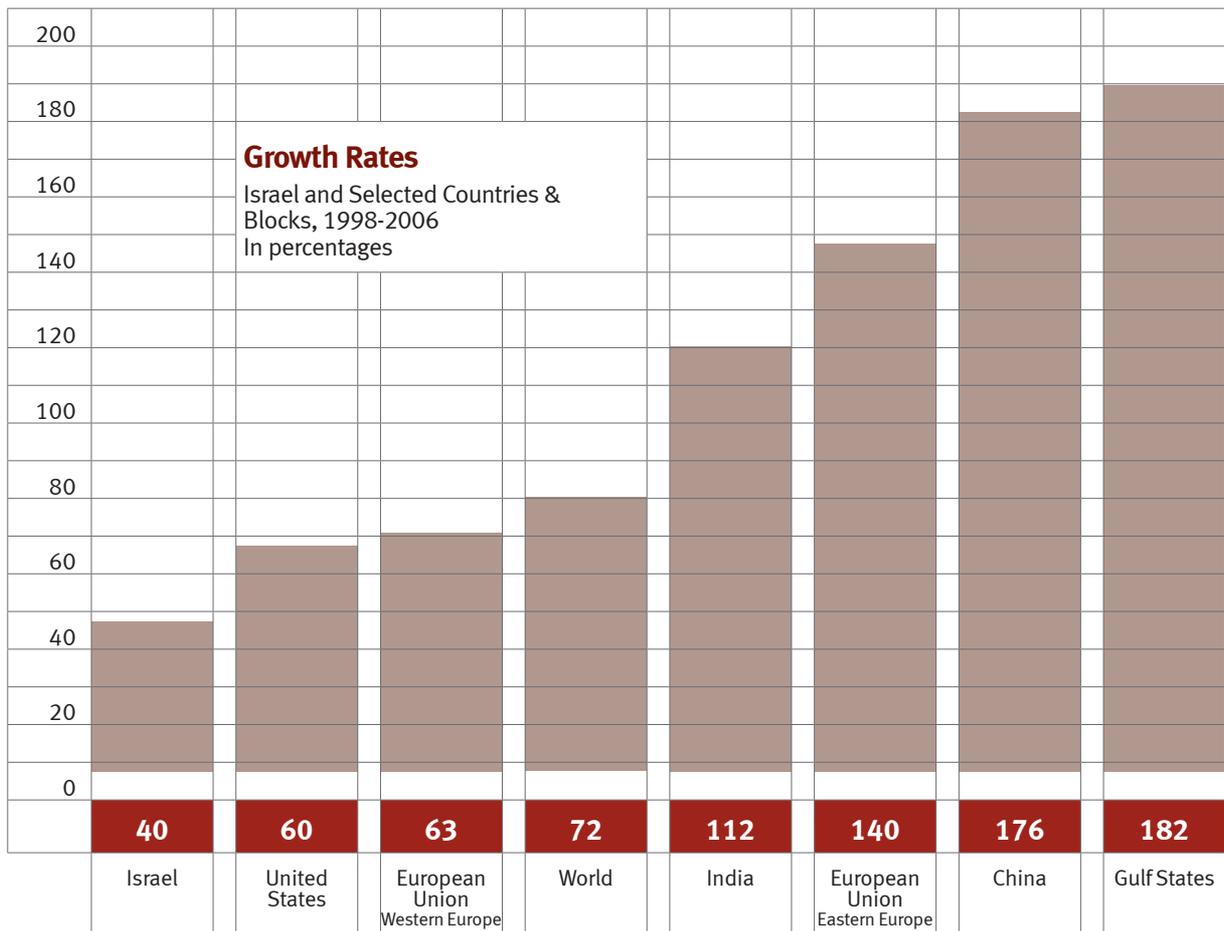
Israel's Economy **GREW LESS THAN OTHERS** Due to the Roller Coaster

The economic roller coaster left Israel's economic growth behind that of other countries, demonstrating the cost of the continuing conflict with the Palestinians.

Israeli politicians like to boast about the fact that in recent years Israel's GDP has been growing at an average annual rate of 5% - higher than that of Western economies. However, if we look around the world, we discover that between 1998 and 2006 (the last year for which international figures are available) Israel's GDP grew by a total of 40%, while the world economy grew by much more - 72%. The gap derives, among other things, from the contraction that occurred during the second Intifada.

The highest growth rate was boasted by China, India and the Gulf States; somewhat lower rates were registered by the countries of Eastern Europe that joined the European Union. But even the industrialized countries of the West grew more than Israel: the European Union states (without the new members from Eastern Europe) grew by 63% and the United States grew by 60%.

The fact that between 2004 and 2006 Israel's growth rate was much higher than that of the Western states does not cancel out the losses suffered by Israel in 2001 and 2002 and the low growth registered in 2003.



UNEQUAL ECONOMIC GROWTH

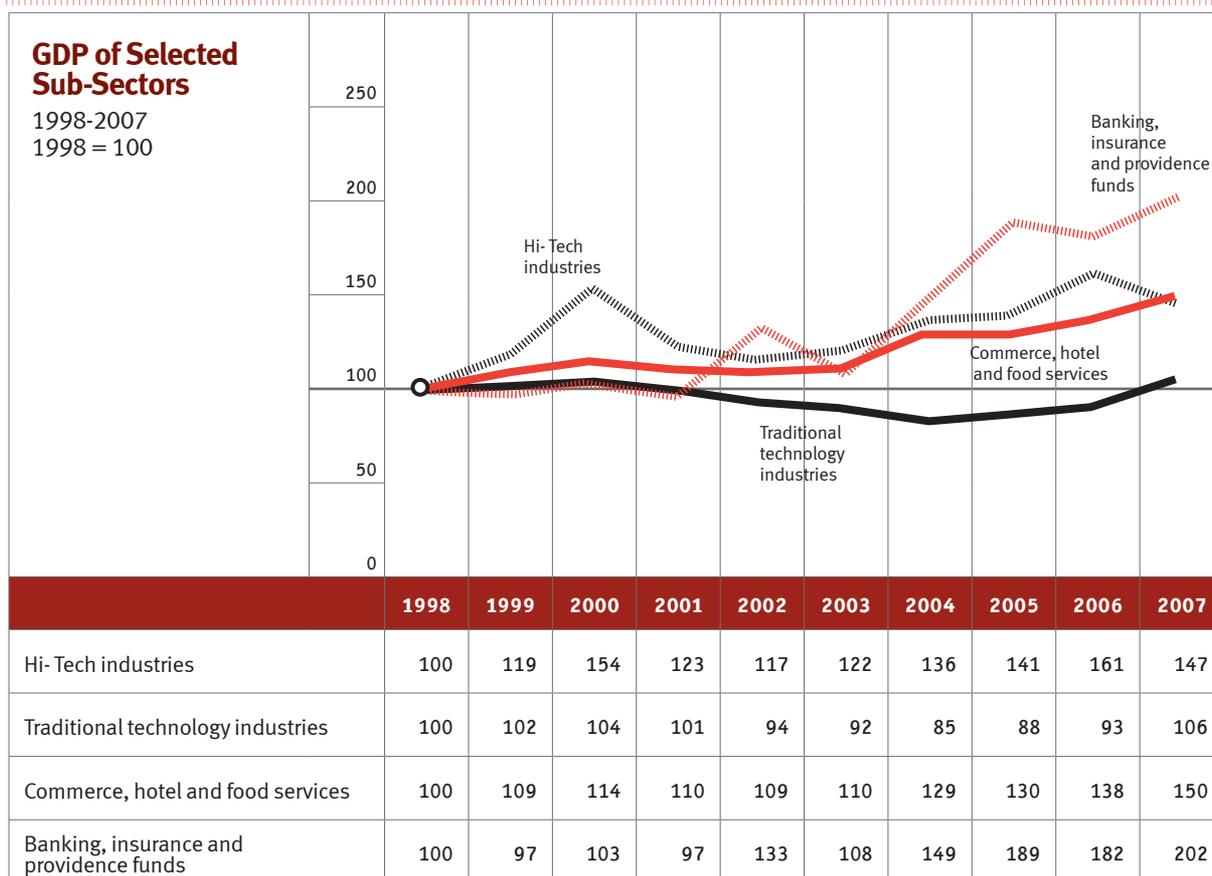
Not only was the history of Israel's economic growth between 1998 and 2007 like a roller coaster ride, but the growth itself was also unequally distributed. Different sectors of the economy grew at different rates; thus economic growth had a different impact on each region of the country and each social group.

The highest rates of growth were experienced by the banking, insurance and providence fund sectors. These sectors were adversely affected for a short time during the Intifada period, but they registered exceptionally high growth rates in the period following it. These sectors were the standard bearers of the global financial bubble that burst in 2008.

Hi-tech industries also registered significant growth: they, too, were adversely affected during the Intifada; their growth rates after the end of the Intifada were lower than those of the financial services. These two sectors - financial services and hi-tech - employ less than 10% of the Israeli labor force.

Commerce, hotel and food services grew at a lower rate up to the outbreak of the Intifada; afterwards they caught up with the hi-tech sector.

The lowest growth rates were registered by the traditional technology sectors. In fact, between 2002 and 2006, their growth was negative, reversing only after the Intifada ended.



Source: Adva Center analysis of figures received courtesy the National Accounts Department of the Central Bureau of Statistics.

Investments Centered IN FEW SECTORS of the Economy

Economic growth was unequally distributed, among other things, because investments generally went to the sectors considered most profitable. In the absence of a public policy encouraging investments - whether local or foreign - in a variety of sectors of the economy and in different parts of the country - investments were centered in limited sectors of the economy located in the center.

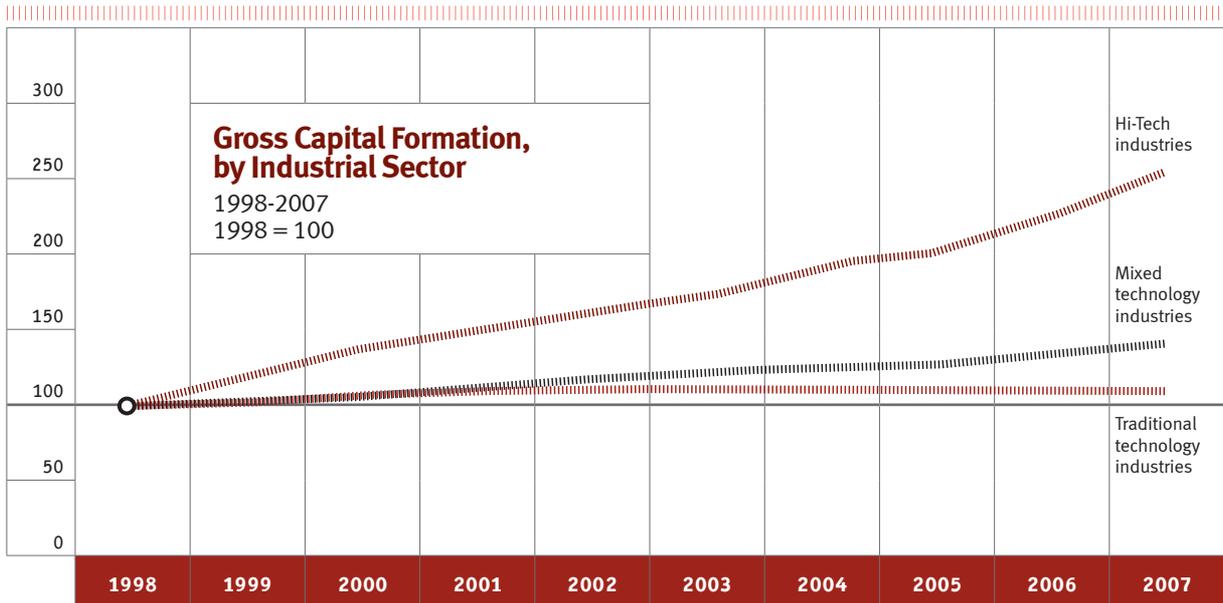
Tangible evidence of this phenomenon can be found in investment figures for different industrial sectors of the economy. Between 1998 and 2007, the hi-tech industries attracted the most investments: Investments in these industries grew by 11% a year on

average, including the Intifada years. In 2007, gross capital investment in this sector was 2.5 times larger than in 1998.

In other sectors, investments were far lower. In the mixed technology industries, investments grew by an annual average of 4%: In 2007, gross capital investment was 1.4 times larger than in 1998.

In the traditional industries, growth was much more sluggish. The average annual growth rate was 2%: Between 1998 and 2007, gross capital investment grew by 11%.

The graph below presents investment figures, showing the percentage change in gross capital investment in each sector.



Notes:

1. Gross capital formation = total expenditures of plants, government and non-profit agencies on fixed assets for civilian use, construction works in progress, machines, equipment and vehicles.
2. Mixed technology industries include chemicals and oil, mining and quarrying, plastics and rubber, machines and equipment, transport vehicles, jewelry and decorative art.

Source: Adva Center analysis of figures received courtesy The Bank of Israel.

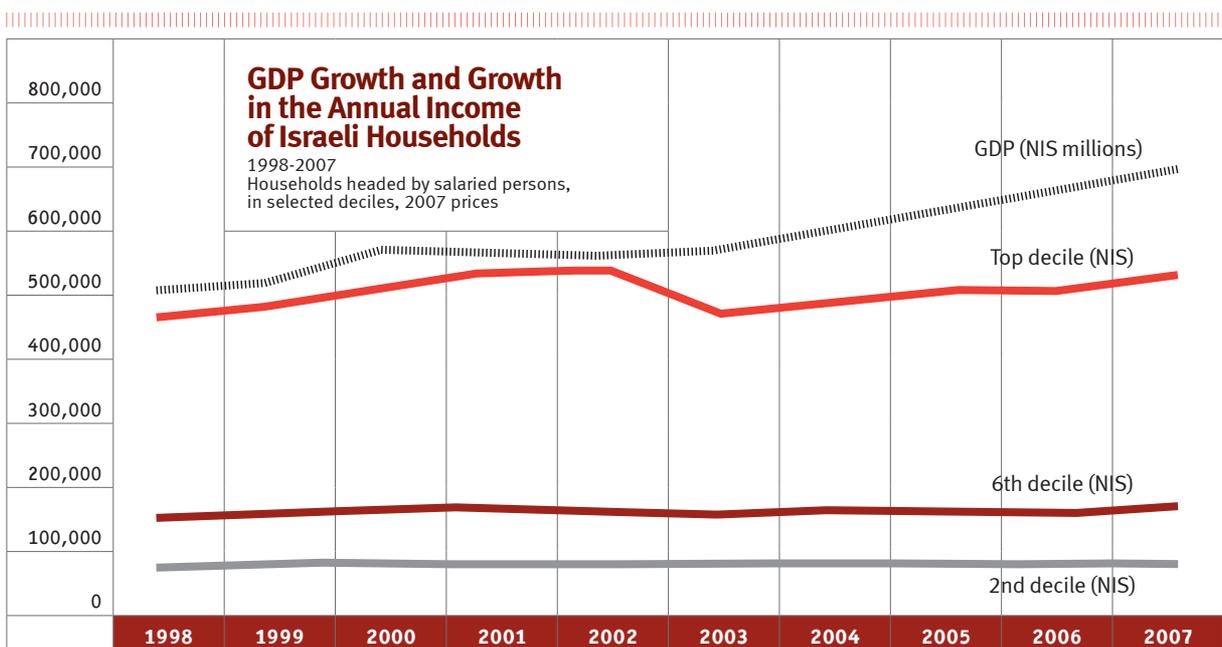
The Fruits of Growth TRICKLED UP more than DOWN

Political and economic leaders justify their efforts to stimulate the economy by placing as many collective resources as possible at the disposal of business, by contending that this is the best way to promote social goals: The more the economy grows, they say, the more fruits it produces, and the more they trickle down to all social strata.

Between 1998 and 2007, the fruits of growth did, indeed, reach all social strata, but they trickled mostly up rather than down.

If we examine the annual income of Israeli households, we find that the income of those in the top income bracket (decile) rose parallel to GDP growth. During the second Intifada - which had an adverse effect on the whole society - the income of households at the top also declined. However, they regained their losses the moment the economy began to revive.

In contrast, the annual income of households in the sixth and second deciles grew at a slower pace.



Source: Adva Center analysis of CBS, *Statistical Abstract of Israel*, various years; CBS, *Income Survey*, various years; the figure for 2007 is courtesy the Central Bureau of Statistics.

AFFLUENT HOUSEHOLDS Saw the Largest Increase in Income

The last decade can be divided into three sub-periods: 1998-2001 - the years of economic growth that preceded the Intifada; 2001-2003 - the Intifada/recession period; and 2003-2007 - the years of economic growth after the Intifada.

Looking at household income figures by income bracket, we come up with some interesting findings:

To begin with, in the two sub-periods of economic growth - that preceding the Intifada and that following it - the greatest percentage increase occurred in the top two income brackets. Between 1998 and 2001, the average income of households in the top income bracket increased by 16% and that of the second to the top, by 14%. The average incomes of households in other income brackets grew by 12% to 13%.

In the growth period beginning in the second half of 2003, households in

the top two income brackets again saw their incomes grow the most - by 12% - while the incomes of households in other income brackets rose by between 6% and 9%.

During the Intifada years, households in the two highest income brackets registered the greatest declines in income: 11% for the top income bracket and 10% for the second highest. Despite this setback, households in the two highest income brackets enjoyed the largest jump in income over the course of the whole decade: 15%. Households in the third highest income bracket also saw their incomes increase by an average of 15%. In contrast, the incomes of households in all the other income brackets increased by between 10% and 13%.

Although the difference in percentage points is not great, their significance increases by accumulation over the years. As this phenomenon repeats

itself decade after decade, the income gaps grow.

It is also interesting to examine the actual amount of money added to the income of households in each income bracket. Between 1998 and 2007, the monthly income of households in the second lowest income bracket increased by NIS 507, that of the sixth income bracket by NIS 1,486, and that of the top income bracket by NIS 5,522.

The increment is just as important as the percentage: the monthly increment for households in the top income bracket is large enough to cover half the university tuition fees for a year; the increment for households in the sixth income bracket suffices for the purchase of a few articles of clothing; and the increment for households in the second from the bottom income bracket is enough to buy a little more food.

Gross Monthly Income of Households Headed by Salaried Persons

1998-2007, NIS, 2007 prices

Income bracket (netile)											Percentage change			1998-2007	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2003-2007	2001-2003	1998-2001	%	Nis
1	3,147	3,301	3,484	3,554	3,242	3,307	3,252	3,366	3,400	3,549	7%	-7%	13%	13%	402
2	5,086	5,298	5,604	5,681	5,398	5,258	5,257	5,299	5,350	5,593	6%	-7%	12%	10%	507
3	6,535	6,798	7,200	7,333	6,965	6,766	6,811	6,817	6,871	7,211	7%	-8%	12%	10%	676
4	7,980	8,344	8,795	8,991	8,455	8,296	8,479	8,450	8,560	8,862	7%	-8%	13%	11%	882
5	9,528	10,023	10,504	10,760	10,186	9,969	10,268	10,245	10,368	10,686	7%	-7%	13%	12%	1,158
6	11,420	11,952	12,502	12,860	12,120	11,943	12,256	12,288	12,455	12,906	8%	-7%	13%	13%	1,486
7	13,698	14,405	15,095	15,340	14,560	14,278	14,760	14,783	14,995	15,507	9%	-7%	12%	13%	1,809
8	16,707	17,719	18,679	18,933	17,969	17,325	17,974	18,291	18,381	19,284	11%	-8%	13%	15%	2,577
9	21,714	23,043	24,264	24,730	23,265	22,255	23,171	23,643	23,921	24,912	12%	-10%	14%	15%	3,198
10	37,250	38,828	41,313	43,118	43,638	38,166	39,378	40,729	41,105	42,772	12%	-11%	16%	15%	5,522

Source: Adva Center analysis of CBS, *Income Survey*, various years.

Households in the TOP INCOME BRACKETS Increased Their Slices of the Total Income Pie

We have seen that the incomes of Israeli households in the top income brackets increased in the course of the last decade by a somewhat higher percentage than those of other households. This phenomenon is reflected in the distribution of the total income pie: Households in the top income brackets increased their share at the expense of households in the middle and low income brackets.

- The share of households in the top income bracket grew from 28% in 1998 to 28.3% in 2007.
- The share of households in the second highest income bracket grew from 16.3% to 16.5%.
- In contrast, the share of households in each one of the sixth lowest income brackets *decreased* by 0.1%.

Income Distribution by Income Bracket

1998-2007

Calculated by gross monthly income of households headed by salaried persons, in percentages

Income bracket (decile)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
1	2.4%	2.4%	2.4%	2.3%	2.2%	2.4%	2.3%	2.3%	2.3%	2.3%
2	3.8%	3.8%	3.8%	3.8%	3.7%	3.8%	3.7%	3.7%	3.7%	3.7%
3	4.9%	4.9%	4.9%	4.8%	4.8%	4.9%	4.8%	4.7%	4.7%	4.8%
4	6.0%	6.0%	6.0%	5.9%	5.8%	6.0%	6.0%	5.9%	5.9%	5.9%
5	7.2%	7.2%	7.1%	7.1%	7.0%	7.2%	7.3%	7.1%	7.1%	7.1%
6	8.6%	8.6%	8.5%	8.5%	8.3%	8.7%	8.7%	8.5%	8.6%	8.5%
7	10.3%	10.3%	10.2%	10.1%	10.0%	10.4%	10.4%	10.3%	10.3%	10.3%
8	12.6%	12.7%	12.7%	12.5%	12.3%	12.6%	12.7%	12.7%	12.6%	12.7%
9	16.3%	16.5%	16.5%	16.3%	16.0%	16.2%	16.4%	16.4%	16.5%	16.5%
10	28.0%	27.8%	28.0%	28.5%	29.9%	27.7%	27.8%	28.3%	28.3%	28.3%
Income brackets (deciles) 1-8	55.7	55.7	55.5	55.2	54.1	56.1	55.8	55.3	55.3	55.3
Income brackets (deciles) 9-10	44.3	44.3	44.5	44.8	45.9	43.9	44.2	44.7	44.7	44.7
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Adva Center analysis of CBS, *Income Survey*, various years.

PROPORTION OF PERSONS Earning Less than the MINIMUM WAGE INCREASED

PROPORTION OF PERSONS Earning More than the AVERAGE WAGE DECREASED

In the previous pages, we examined the income gaps among households. This page looks at wage gaps among individuals - which contribute, of course, to wage gaps among households.

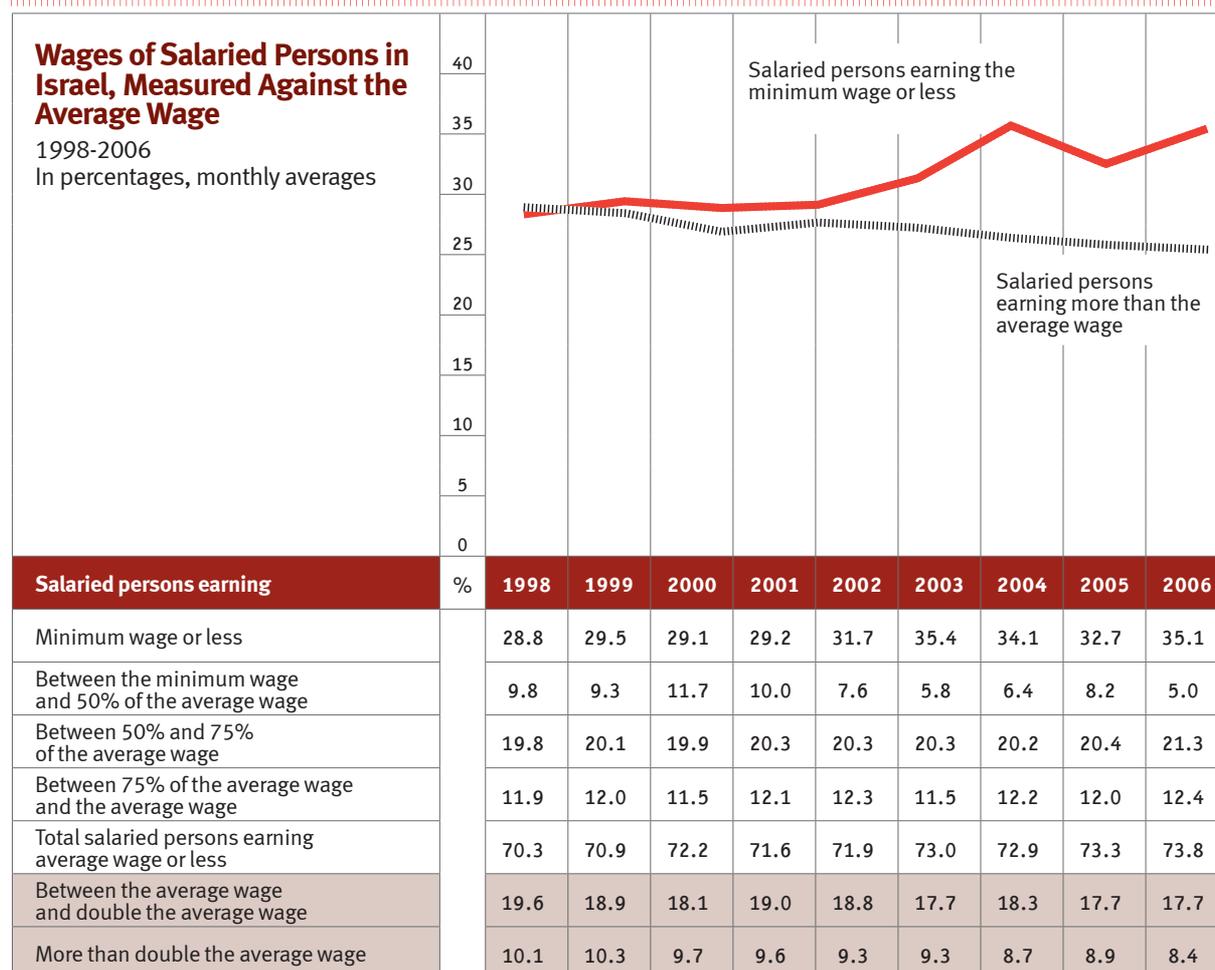
The National Insurance Institute publishes figures on the proportion of salaried persons earning the minimum wage or less, the proportion of salaried persons earning the average wage or less, and the proportion of persons earning more than the average wage.

During the last decade, the proportion of persons receiving more

than the average wage decreased, while the proportion of persons receiving the minimum wage or less increased.

In 1998, 28.8% of salaried persons received the minimum wage or less, compared to 35.1% in 2006.

In contrast, in 1998, 29.7% of salaried persons received more than the average wage, compared to 26.1% in 2006. At the same time, the proportion of persons earning the average wage or less rose from 70.3% in 1998 to 73.8% in 2006.



Note: In 2006 the average wage of salaried persons was NIS 7,607.

Sources: Adva Center analysis of National Insurance Institute, *Average Wages by Selected Economic Variables*, Jacques Bendalak, various years; the figure for 2006 courtesy of the Research Department of the National Insurance Institute.

Wage Gaps between **WOMEN AND MEN** Remained Stable

Wage gaps between women and men have remained stable through thick and thin, that is, in periods of economic crisis as well as in periods of economic growth.

During the 1998-2007 period - which saw both ups and downs - the wage gaps between women and men changed very little. Women's monthly pay was approximately 60% of men's monthly pay, and women's hourly wage was approximately 80% of men's.



Wage Inequalities among Jewish Ethnic Groups **NARROWED**

Wage Inequalities between Jews and Arabs **REMAINED THE SAME**

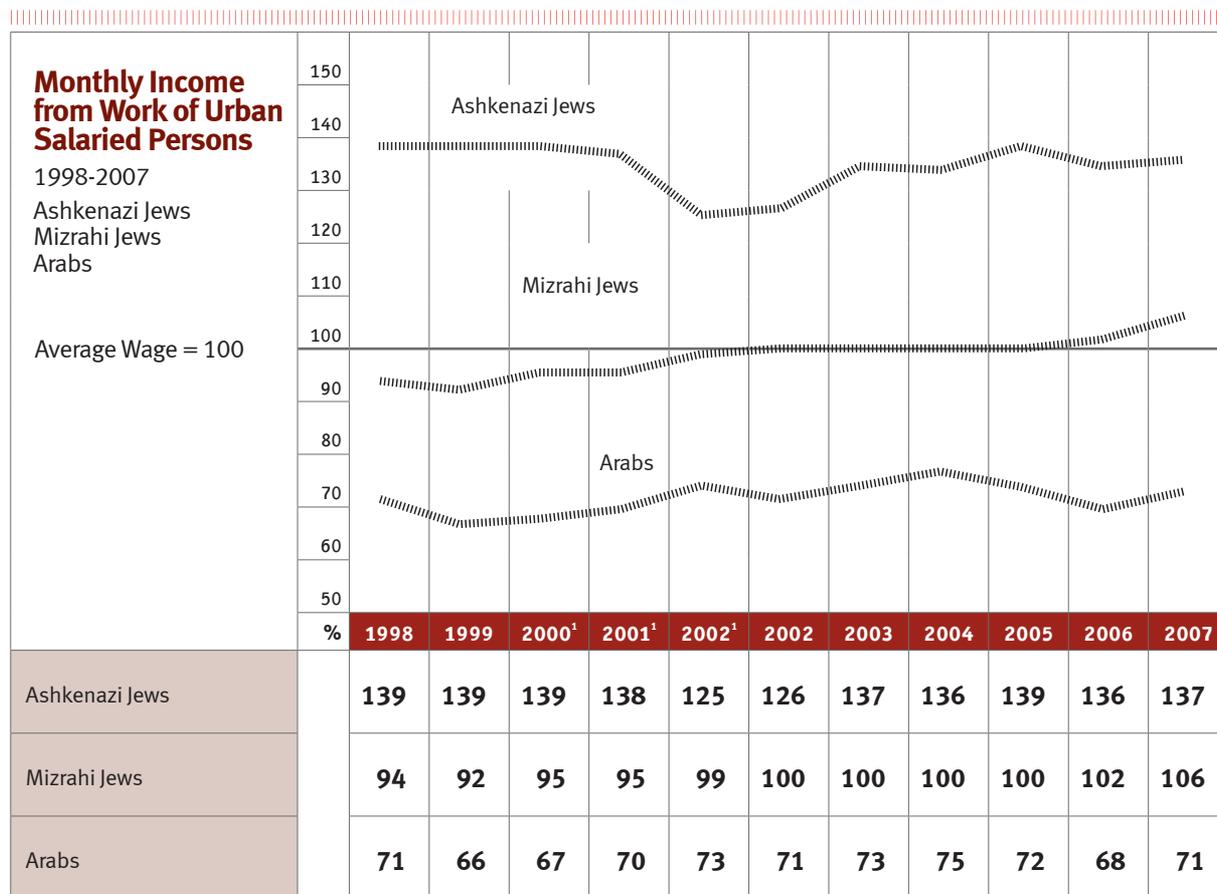
Between 1998 and 2007, the wage gaps between urban salaried persons from different ethnic groups did not change much.

Israeli Jews whose parents came to Israel from Europe or the Americas (Ashkenazi Jews) earned between 36% and 39% more than the average wage. In 2002, the height of the Intifada, their wages decreased somewhat in relation to the average, but immediately returned to their previous level when the hostilities ceased.

Arab salaried persons receive the lowest wages: about 30% less

than the average wage. Moreover, the relative level of their wages remained stable, with only slight variations.

In the middle are Israeli Jews whose parents came to Israel from countries in the Middle East or North Africa (Mizrahi Jews). Between 1998 and 2002, their wages increased somewhat, relative to the average wage, and the same kind of improvement occurred in 2006 and 2007. While at the beginning of the last decade their wages were slightly below average, since 2005 they have been slightly above average.



Notes:

1. The figures do not include Palestinian residents of East Jerusalem.

2. Salaried person = person who had some income from paid work in the three months prior to the CBS income survey.

Sources: Adva Center analysis of CBS, *Income Survey*, various years; the figure for 2007 is courtesy the Consumption Department of the Central Bureau of Statistics.

THE MIDDLE CLASS

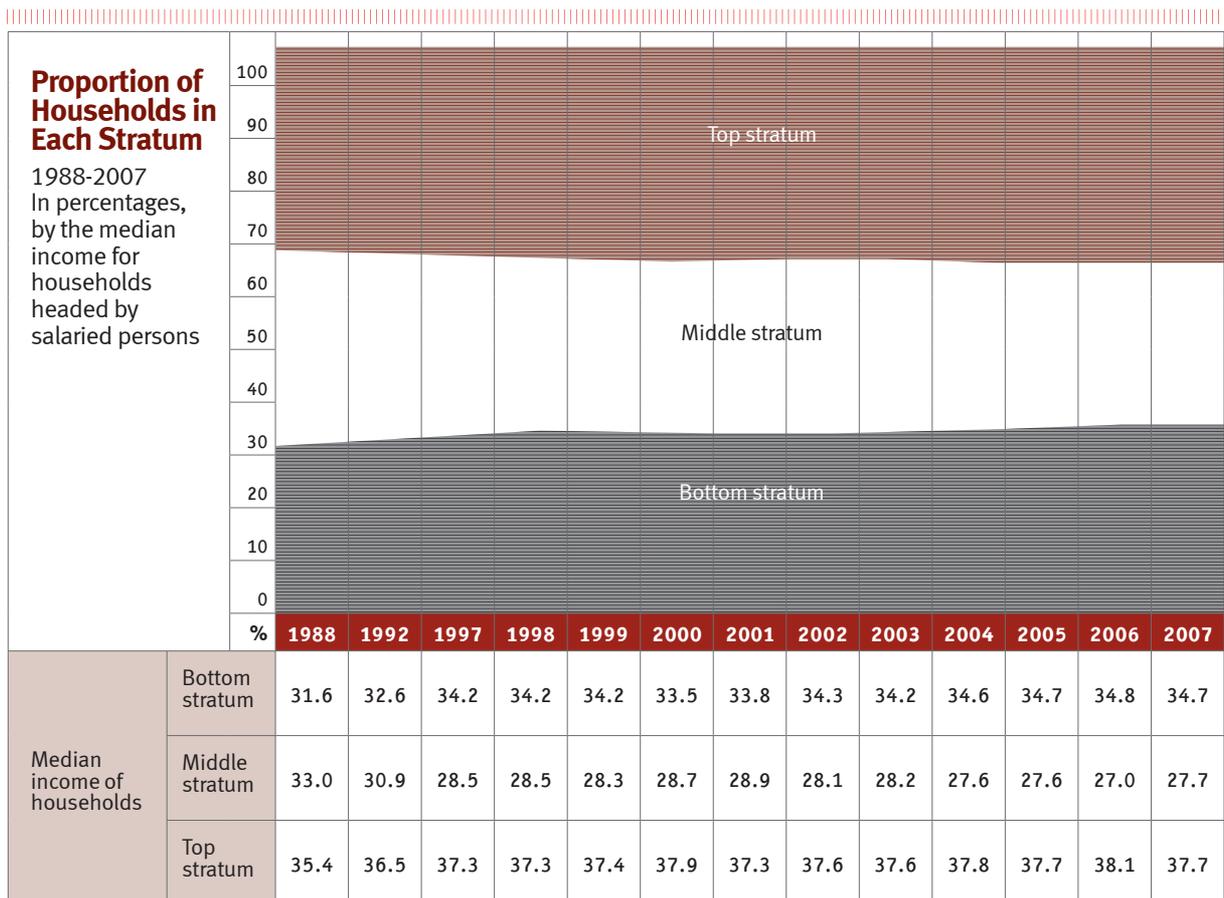
Continued to Contract

One of the most significant expressions of increasing wage and income inequality in the area of wages and income is the shrinking of the middle class.

Just as the increase in inequality did not begin in the decade under discussion, the shrinking of the middle class also began earlier. The figures on this page and the following are from 1988 - two decades ago. We divided households headed by salaried persons into three strata: the middle stratum, consisting of households whose salaried income is between 75% and 125% of the median

household income; the top stratum, consisting of households whose income is higher than 125% of the median household income; and the bottom stratum, consisting of households whose income is lower than 75% of the median household income.

The figures reveal a clear trend of the contraction of Israel's middle class. In the two decades since 1988, the size of the middle class declined by 16%, from 33% to 27.7% of total households. Of the households that left the middle class, 57% fell to the bottom stratum and 42.6% rose to the top stratum.



Source: Adva Center analysis of CBS, *Income Survey Data*, various years.

During the same period, the share of the middle class in the income pie declined by about 25%, from 27.9% to 21%. That part of the share of the middle class that was lost went to the upper class.

The greatest decline occurred between 1988 and 1998; during that decade, the middle stratum contracted from 33% of households to 28.5% of households. Those were the years of the large wave of immigration from the former Soviet Union and from Ethiopia. A good many of the new immigrants found themselves in the bottom stratum, at least during their first years in Israel.

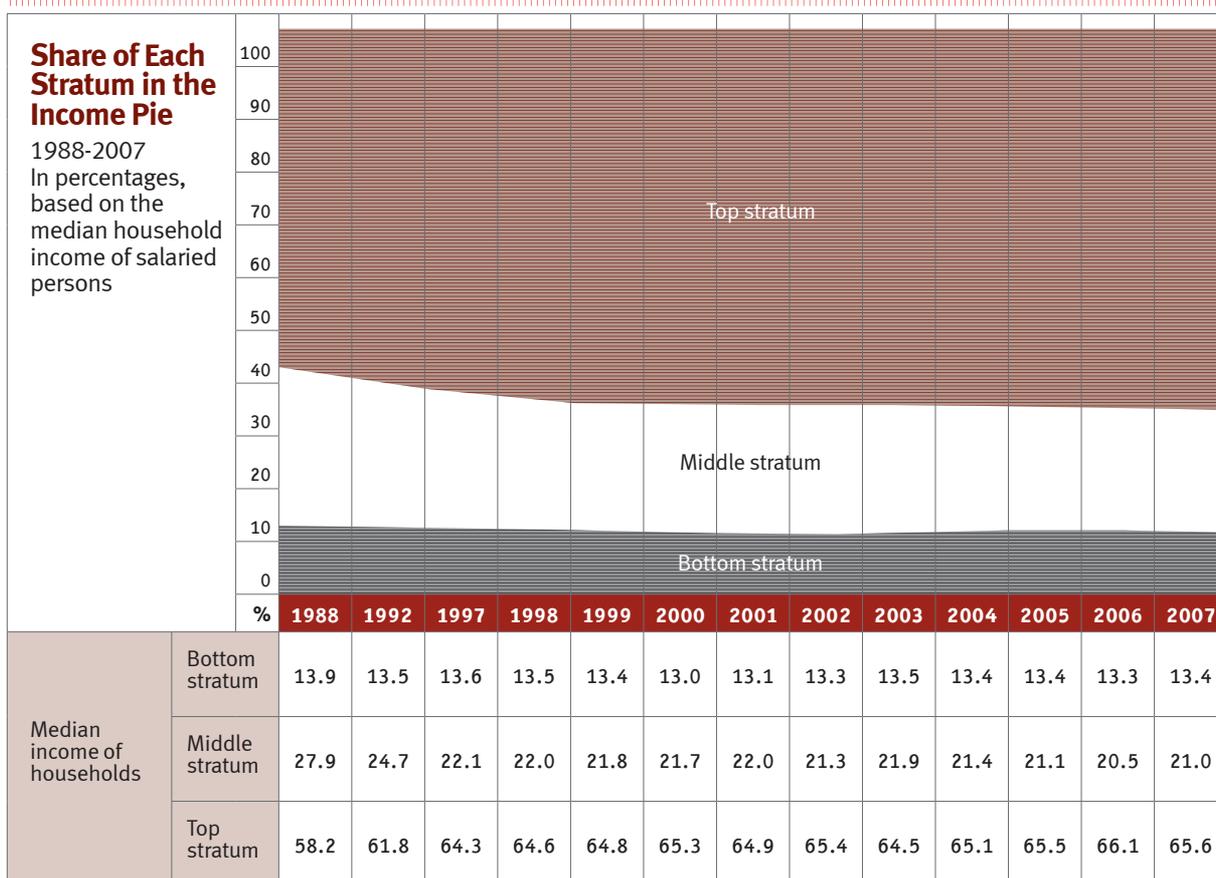
The contraction of the middle class continued during the Intifada years, albeit at a lower rate.

With the lowering of the level of hostilities and the resumption of economic growth, one might have expected the middle class to grow, but that is not what happened. Rather, it continued to contract.

The same thing happened with regard to the middle class's share of the income pie: between 1988 and 1998, its share decreased from 27.9% to 22%. Thereafter it continued to contract, but at a slower pace. In 2007, the share

of the middle stratum in the total income pie was 21%.

Note: Following an international convention, we defined the middle class as households whose income was between 75% and 125% of the median household income. The top stratum includes about four income deciles: the 10th, 9th, 8th and part of the 7th. For most of the topics covered previously, the top stratum or upper class referred to the top two income deciles (top quintile).



Salaries of Corporate Managers SOARED

The most dramatic change that occurred between 1998 and 2007 was in the salaries of corporate managers.

In 2007, the average annual salary bill of senior corporate executives in companies included in the "Tel Aviv 25" list (the 25 largest corporations on the Tel Aviv stock exchange) was NIS 8.43 million, or NIS 703,000 per month (16 times the average income of households in the top income decile).

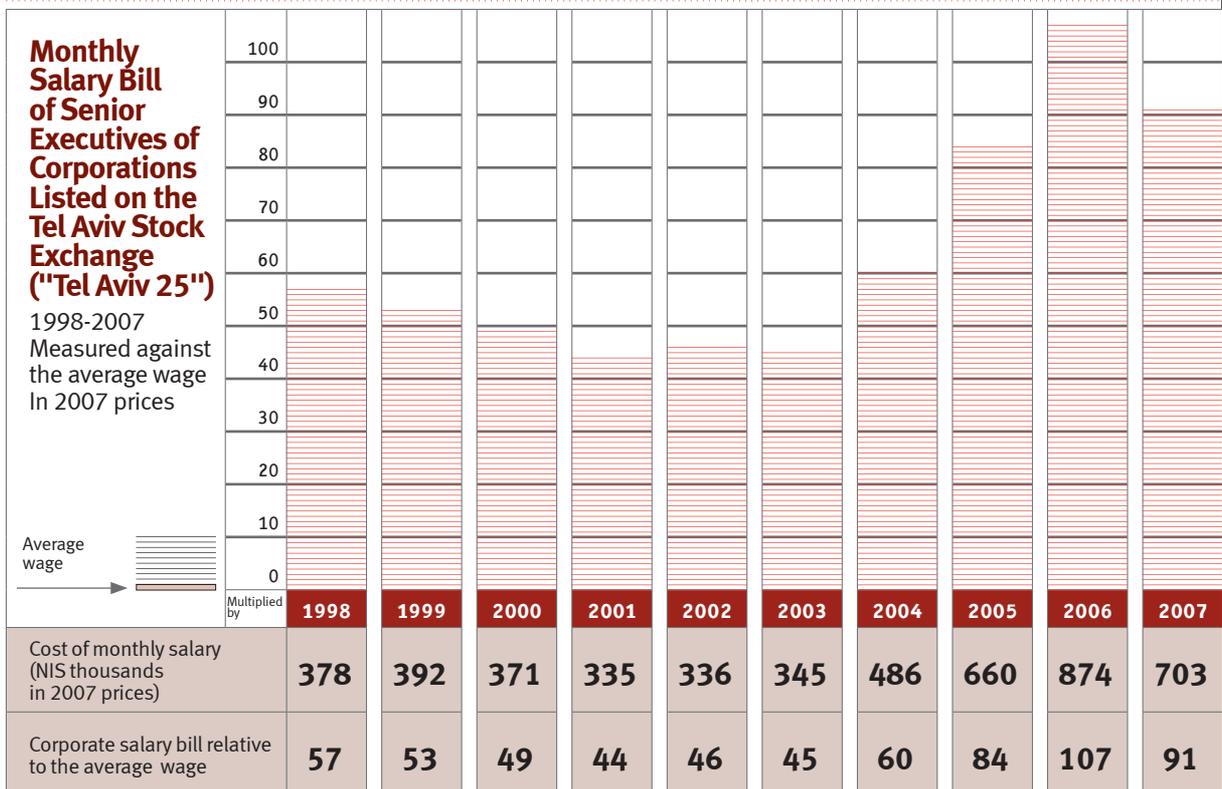
The same year, the annual average salary bill of a manager in one of the "Tel Aviv 100" corporations (the 100 largest corporations on the Tel Aviv stock exchange) was NIS 5.22 million, or NIS 435,000 per month (10 times the average monthly income of households in the top income decile).

Between 1998 and 2007, the annual salary bill of senior executives of corporations in the "Tel Aviv 25" increased by a factor of 1.8: from NIS 4.5 million in 1998 to NIS 8.43 million in 2007.

Although the salary bills of these corporate managers declined during the Intifada years, afterwards they rose to unprecedented heights.

In addition to salaries, many corporate executives also receive additional benefits, like stock options.

Relative to the average wage, the cost of executive pay soared in the course of the last decade, as can be seen in the following table.



The Government Also Contributed to GROWING INCOME INEQUALITIES

Inequalities were exacerbated not only by market forces but also by government actions.

In 2002, at the height of the economic crisis brought on by the second Intifada, the Israeli government decided to institute a plan for reducing corporate and individual income taxes. A year later it decided to speed up implementation of those tax cuts.

The tax cuts were implemented at the same time as unprecedented budget cuts, the latter of which had a negative effect on all of Israel's social services. Once taxes were reduced, it was not easy to reinstate

services hurt by budget cuts when economic growth resumed.

Tax cuts for individuals increased the net income of employed persons earning NIS 40,000-50,000 a month by NIS 2,000 and more per month.

As result of the tax cuts, between 2002 and 2007 the state treasury lost a total of NIS 14.4 billion in revenues, and the prediction is that by 2010 the loss will amount to NIS 21.7 billion - an amount that is not much less than the annual budget of the Ministry of Education - the civilian ministry with the highest annual budget.

Tax Reductions and Tax Increases

2002-2010
Accumulated effect compared with 2001, in NIS millions

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total Tax Reductions	0.0	-3.6	-11.7	-17.2	-24.5	-29.3	-33.0	-35.9	-38.9
1. Taxes	0.0	-3.6	-10.9	-16.0	-22.5	-26.4	-29.6	-31.8	-34.8
a. Individual income tax	0.0	-3.6	-7.7	-11.5	-13.7	-14.7	-16.9	-18.5	-21.0
b. Corporate tax	0.0	0.0	-0.4	-0.8	-2.2	-3.1	-4.0	-4.4	-4.9
2. Social security	0.0	0.0	-0.8	-1.2	-2.0	-2.9	-3.4	-4.1	-4.1
Total Tax Increases	3.6	8.4	11.8	12.8	14.3	14.9	15.7	16.6	17.3
1. Taxes	2.2	5.6	9.0	10.0	11.5	12.1	12.9	13.8	14.5
Net Effect	3.6	4.8	0.1	-4.5	-10.2	-14.4	-17.4	-19.3	-21.7
1. Total taxes	2.2	2.0	-1.9	-6.0	-11.0	-14.3	-16.7	-18.0	-20.3
2. Social security	1.4	2.8	2.0	1.6	0.8	-0.1	-0.6	-1.3	-1.3

The Income of AFFLUENT Israelis Grew POVERTY Also Grew

We have already seen that between 1998 and 2007 incomes increased for persons at the top of the income ladder.

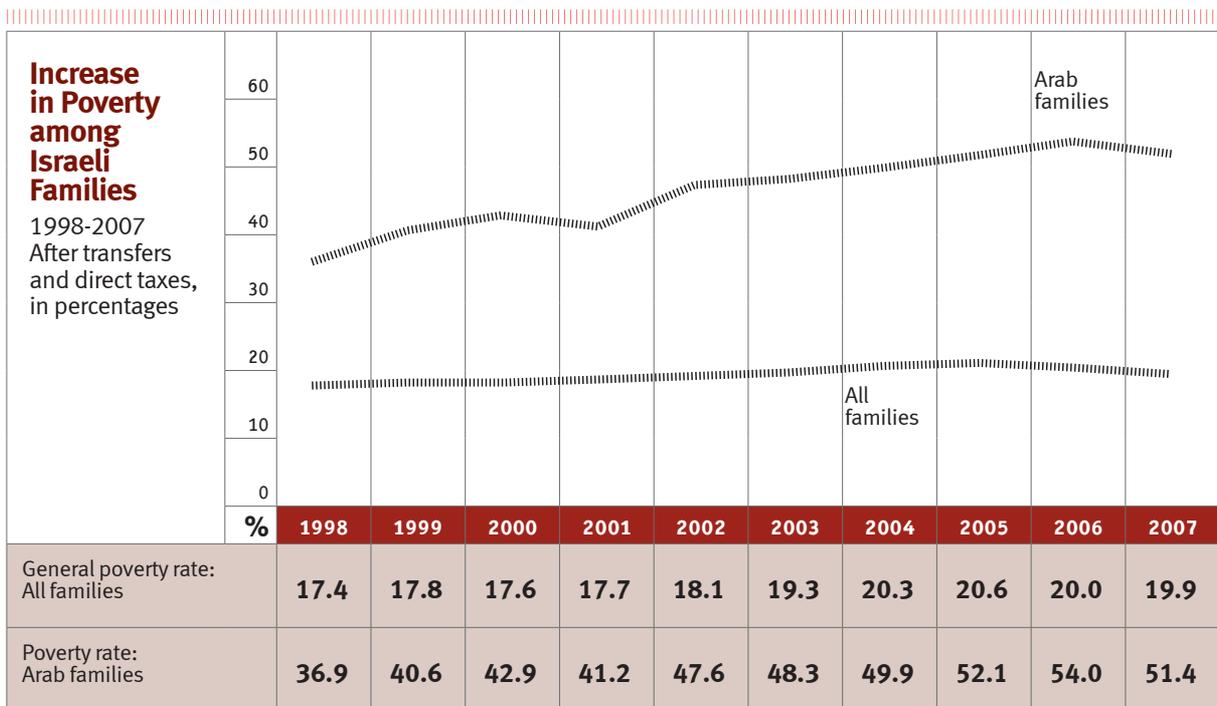
In contrast, at the lower end of the income ladder, the past decade brought with it an increase in poverty. The causes were multiple: the absence of capital investment in Arab localities in Israel, the low workplace participation of ultra-orthodox men, the large percentage of new jobs that were part-time rather than full-time, and the growth of indirect hiring - through temp agencies and similar organizations.

In the last decade, the poverty rate reached unprecedented proportions: in 2005, 20.6% of all families in Israel were below the poverty line.

Since then, that proportion has decreased slightly.

Poverty increased especially during the period of economic growth following the ebbing of the Intifada. This was the outcome, among others, of cuts in social assistance.

An especially sharp increase in the rate of poverty occurred among Arab families: from 36.9% in 1998 to 51.4% in 2007.



Social Safety Net Now Provides LESS ASSISTANCE RATHER THAN MORE

As inequality and poverty grew, more and more Israelis needed assistance from the social safety net. However, the social safety net itself was damaged, lowering its capacity to help the needy.

Between 2001 and 2004, a period covering the height of the economic crisis brought on by the second Intifada, budget cuts were made amounting to approximately NIS 65 billion. The biggest cut was

in the payments of the National Insurance Institute. Child allowances were cut by 45%, unemployment compensation by 47% and income maintenance by 25%.

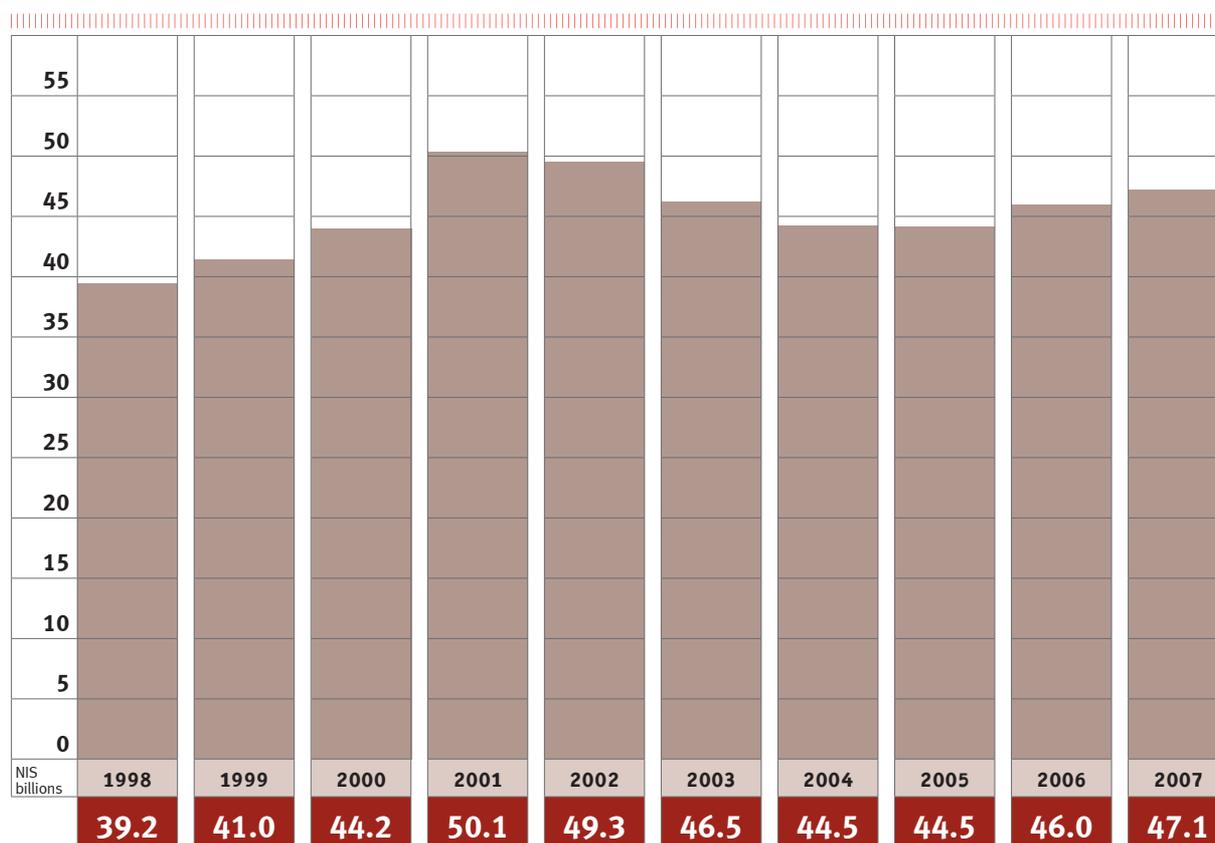
Moreover, in 2003 a decision was made to link social security payments to the cost of living index rather than to the average wage, a move that will result in the erosion of all benefits over time.

The outcome of the above changes is that in the face of a growing population, growing poverty, increased unemployment (during the Intifada) - social security payments decreased, from NIS 50.1 billion in 2001 to NIS 44.5 billion in 2004. Afterwards, they increased somewhat. They still have not returned to their 2001 and 2002 levels.

National Insurance Payments

1998-2007

In NIS billions, 2007 prices



Sources: Adva Center analysis of National Insurance Institute, *Annual Report*, various years; National Insurance Institute, State Revenues Authority, *Operating Budget*, various years.

SOCIAL Expenditure FAILED TO COUNTERACT Increasing Income Disparities

As we have seen, between 1998 and 2007, income disparities grew steadily. We have also seen that the government itself contributed to the increase in inequality, by making tax cuts that benefitted high-income persons.

The government also provides social services that contribute directly to the general welfare: public schools and universities, health services, social security and personal welfare services. Properly budgeted, these services can partly compensate for income inequality. Thus it is relevant to ask whether or not the government increased its expenditures on social services during the last decade.

The figures show that at the beginning of the decade there were

significant increases in the budgets of the social services, from NIS 10,304 per capita in 1998 to NIS 11,290 per capita in 2001. Then the second Intifada broke out, the economy entered a recession, and defense outlays increased. Against this background, a decision was made to roll back expenditures on social services.

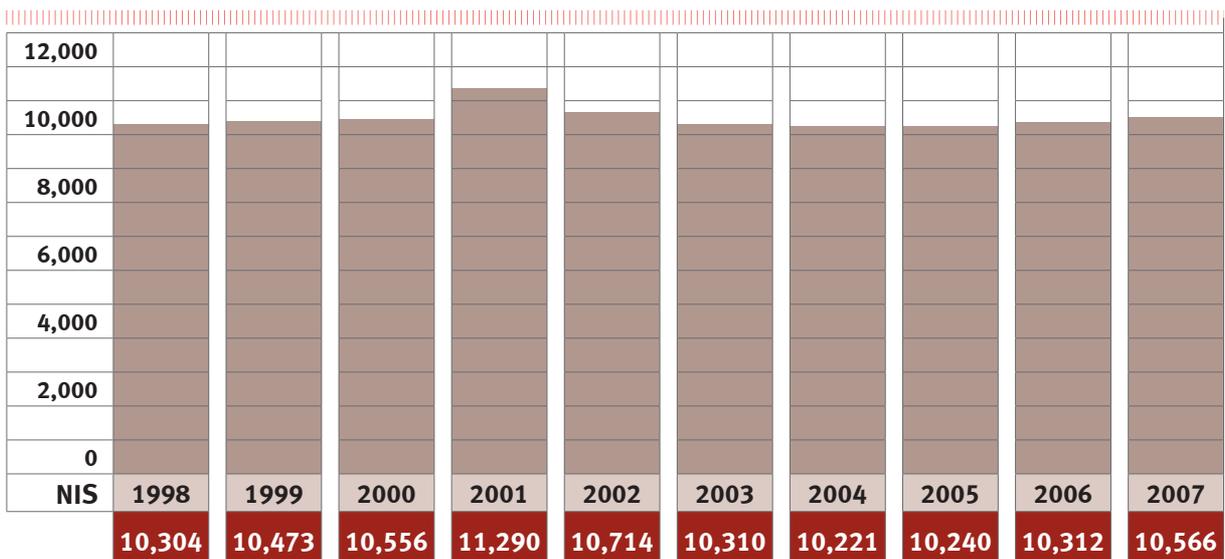
Even when economic growth resumed, social outlays did not return to their former level. It was only in 2007 that they equaled the expenditure in 1998.

Thus, in the course of the last decade, and certainly since the second Intifada, the national budget did not operate as a counterweight to the trend of increasing income inequality in Israel.

Social Expenditure per Capita

1998-2007

In NIS, 2007 prices



Note: Social expenditures include the budgets of the following ministries: Education; Science, Sports and Culture; Health; Higher Education; National Insurance payments covered by the Treasury; and Social Welfare.

Sources: Adva Center analysis of Ministry of Finance, State Comptroller, Financial Report, various years; CBS, Statistical Yearbook of Israel 2008, # 59.

ONLY A FOURTH of 17 Year Olds Go on to College

The best way to guarantee a reasonable standard of living is to get a college degree.

This way is not open to 74% of Israeli youth, due to the fact that the school and higher education systems resemble pyramids with a wide base and a narrow tip.

Among persons who were 17 years old in 1999, no more than 79.9% were still in enrolled in school in tracks leading to matriculation.

Among these, only about a half succeeded in passing their matriculation exams: these young

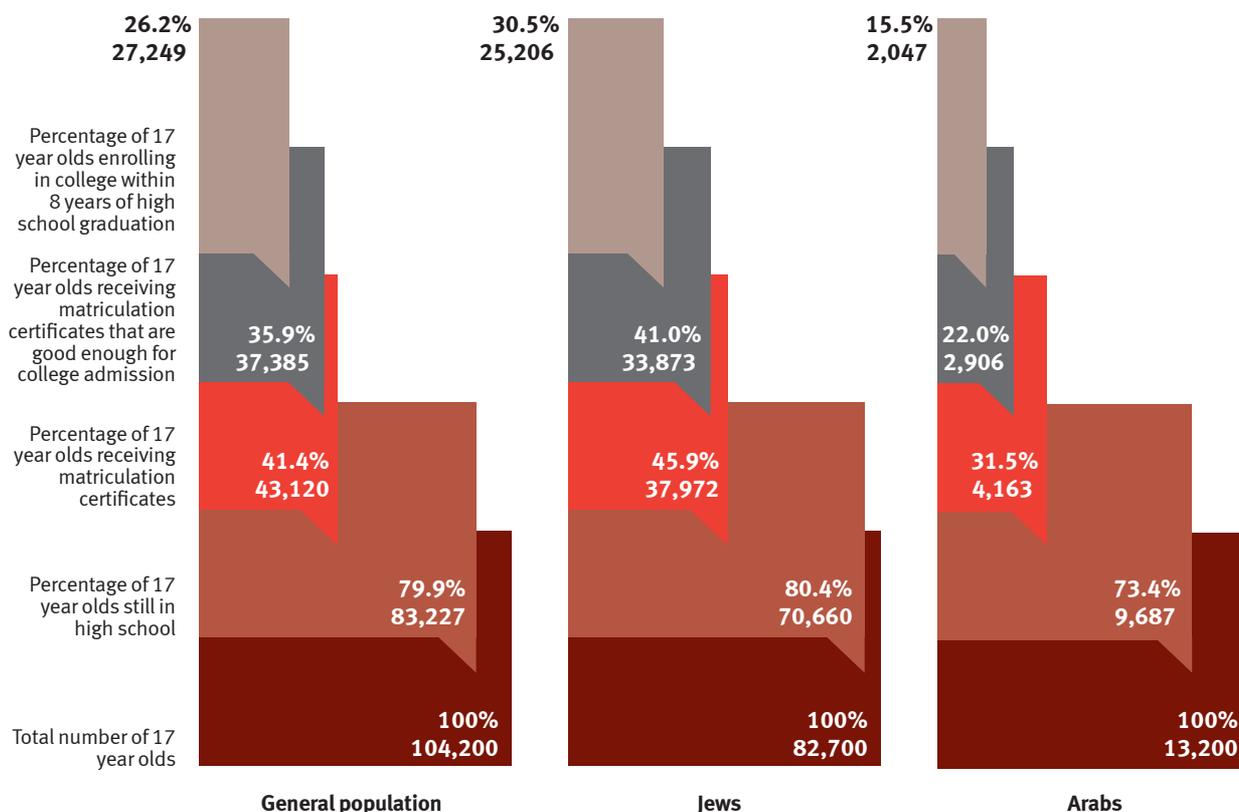
people constituted 41.4% of the age group.

Among young people succeeding in their matriculation exams, some received certificates that did not qualify them for college entrance. The result: the percentage of students eligible for college admission was not more than 35.9% of the age group.

The percentage of young people who enrolled in institutions of higher learning within eight years of graduating high school was in 2007 no more than 26.2% of the age group; that is, about one out of four.

Jewish youngsters entered college at twice the rate of Arab youngsters.

Percentage of 17 Year Olds Attending College



Notes:

1. Matriculation figures are for spring examinations.
2. Arabs: includes Moslem and Christian students; does not include Druze and Bedouins living in the Negev.
3. Higher Education: includes universities (excluding the Open University) and private and public academic colleges.

Sources: Adva Center analysis of Ministry of Education and Culture, Pedagogical Authority, Exams Department, *Bagrut Figures*, various years; CBS, *Statistical Abstract*, various years; Adva Center, *Students Succeeding in the Matriculation Exam, by Locality*, various years; figures received courtesy the Department of Higher Education at the CBS.

Unequal Advance: SUCCESS IN THE MATRICULATION EXAMS

Between 1998 and 2007, there was an increase in the success rates of 17 year olds in the matriculation exams from 38.5% in 1998 to 46.3% in 2007.

Examining the figures for different social groups, one finds that the most significant and steady improvement was for young people from affluent localities - from 54.9% in 1998 to 69% in 2007.

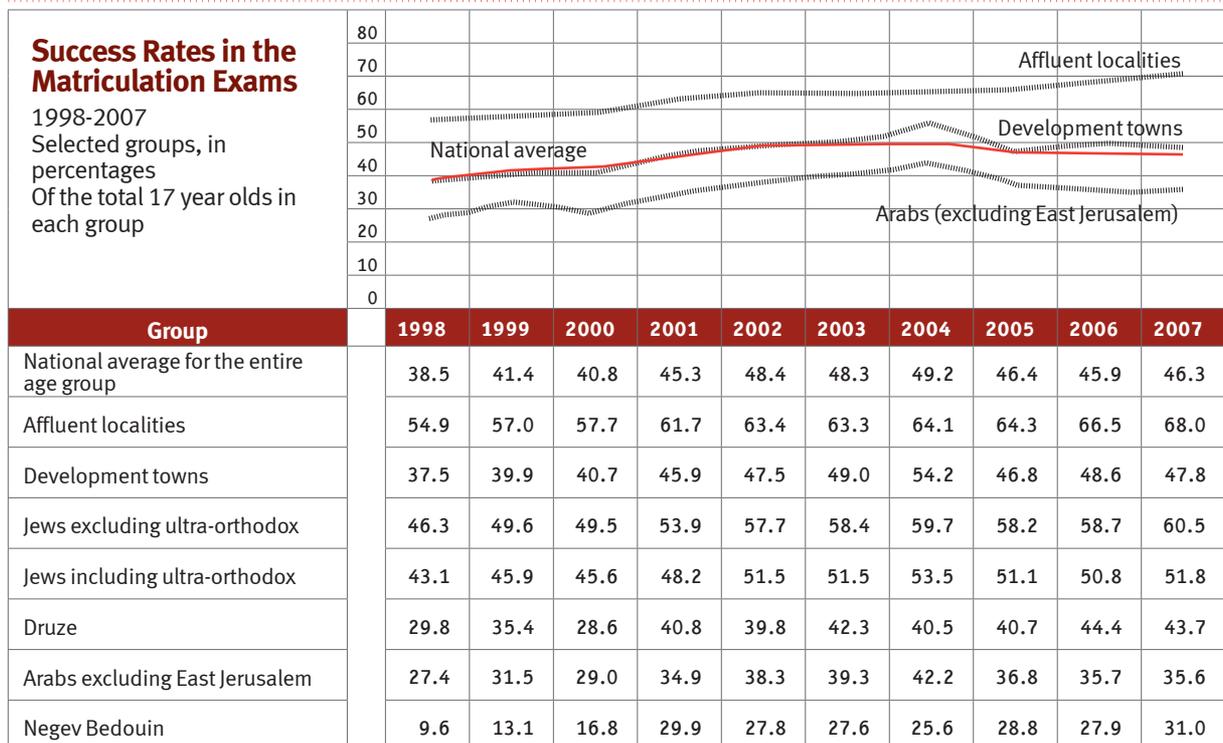
In contrast, in Jewish development towns and among Arabs, Druze and Negev Bedouin, one sees ups and downs and less improvement. Among Arab 17 year olds, for example, the success rate rose from 27.4% in 1998 to 35.6% in 2007 (half the success rate in affluent localities, all of which are Jewish). This represents a decrease from

the success rate in 2004 - 42.2%. In Jewish development towns, the success rate was 54.2% in 2004, but it decreased to 47.8% in 2007.

The biggest improvement registered was for Negev Bedouin, from 9.6% in 1998 to 31% in 2007. Still, there is a long way to go.

The slow improvement registered in the matriculation exam success rates was achieved, in large part, by greater leniency in the rules.

It appears that this phenomenon led to increased inequalities in the quality of matriculation certificates: some were good enough to allow admittance to the best universities, while others were good enough to allow admittance to regional colleges and the Open University.



Note: The entire age group includes both ultra-orthodox students and students in East Jerusalem.

Sources: Adva Center analysis of Ministry of Education, Sports and Culture, Pedagogical Administration, Exams Department, *Bagrut Exam Figures*, various years; Adva Center, *Success Rates in the Matriculation Exams by Locality*, various years.

The State Failed to INCREASE Investment in Education

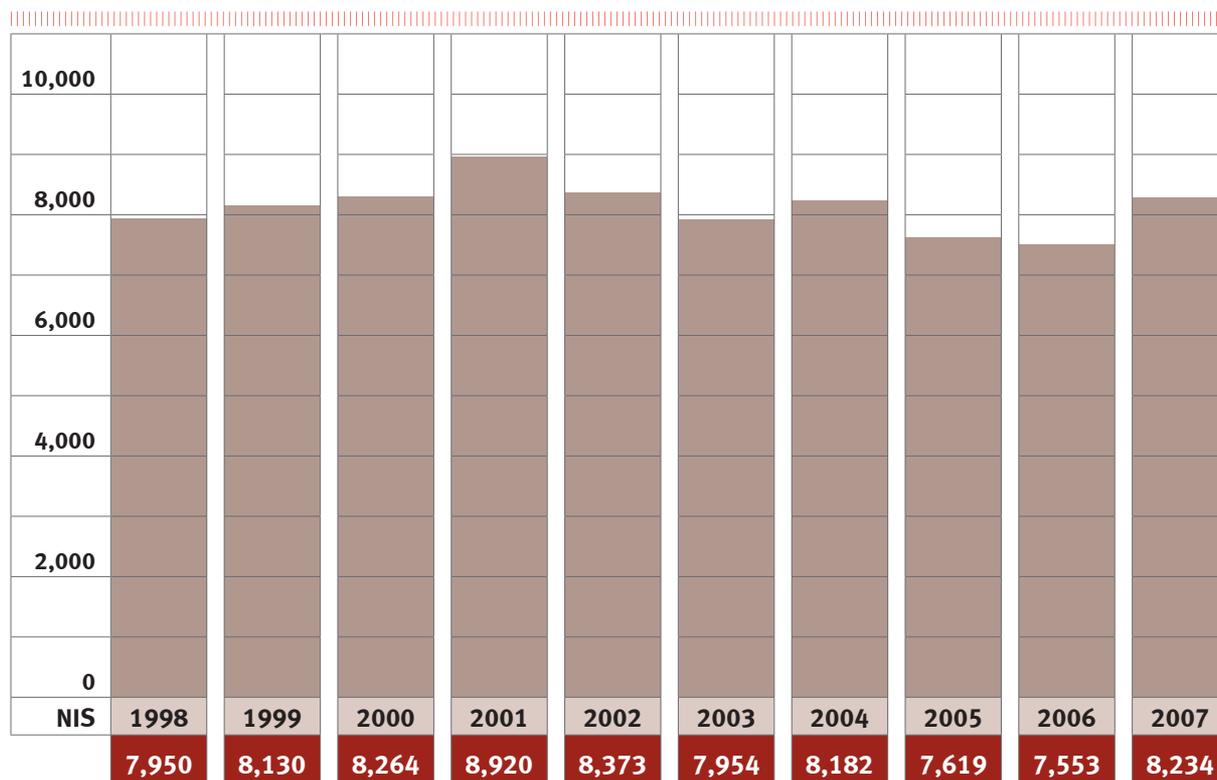
The state did not simply fail to increase its investment in education. It actually decreased its investment in the school system. The education budget underwent erosion during the period of budget cuts following the second Intifada. The clearest reflection of budget erosion is the

decline in the allocation for teaching hours - the main budget line for elementary and high schools. On a per student basis, this allocation decreased from NIS 8,920 in 2001 to NIS 7,553 in 2006. The budget increased somewhat in 2007, returning to its 2000 level.

Teaching Hours per Student

1998-2007

In NIS, 2007 prices



Note: The student population includes persons aged 6-17.

Sources: Adva Center analysis of Ministry of Finance, Comptroller's Office, *Financial Report*, various years; CBS, *Statistical Abstract of Israel*, various years.

GAPS IN HIGHER EDUCATION REMAIN STABLE

Only about a fourth of the relevant age group goes on to college.

The proportion of young people from affluent localities who went to college is much higher than the proportion from Jewish development towns and Arab localities.

In affluent localities, the proportion of persons aged 20-29 who went to college was slightly above 10% during most of the last decade, while the proportion in development towns was close to 6% and in Arab localities, lower still.

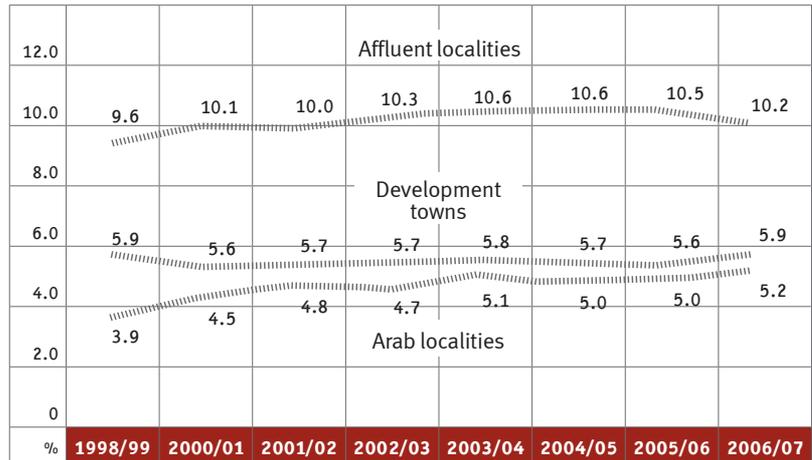
Throughout the decade the gaps between young people from affluent localities and those from development towns remained stable. In contrast, in Arab localities, there was a gradual increase in the proportion going on to college, from 3.9% in 1998 to 5.2% in 2007.

These gaps are true not only for enrollment in universities but also for enrollment in public colleges. Figures for public colleges are available only from the 2002/2003 academic year. They show an increase in enrollment of persons from all three types of localities. They also show that in public colleges as well as in universities, young people from affluent localities are over-represented. Moreover, while at universities the representation of young people from development towns is similar to that of young people from Arab locales, in public colleges the representation of young people from development towns is twice as high as that of young people from Arab localities.

Students Studying for a Bachelor's Degree

In Universities

1998-2007, by type of locality, percentages of 20-29 year olds



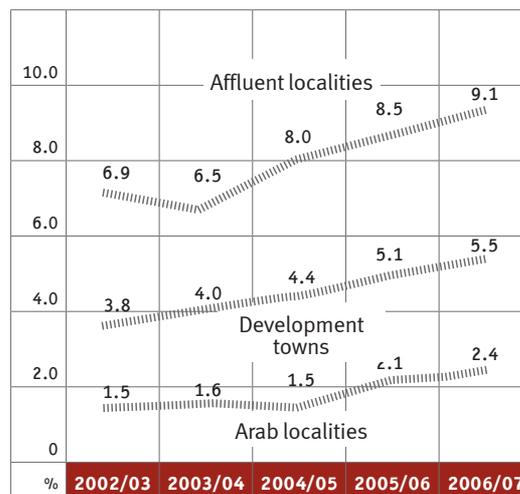
Notes:

1. The figures do not include the Open University.
2. The figures include localities in which there are at least 50 students.

Sources: Adva Center analysis of CBS, *Local Authorities in Israel*, various years; CBS, *Demographic Characteristics of Applicants for Studies, Students and Degree Recipients in Universities*, various years; CBS, *Academic Colleges in Israel*, 2004/2005, January 2006; CBS, *Students in Institutes of Higher Education*, 2006/2007, October 2008.

In Public Colleges

2002-2007, by type of locality, percentages of 20-29 year-olds



Note: Figures include localities with at least 50 students.

Sources: Adva Center analysis of CBS, *Local Authorities in Israel*, various years; CBS, *Demographic Characteristics of Applicants for Studies, Students and Degree Recipients in Universities*, various years; CBS, *Academic Colleges in Israel*, 2004/2005, January 2006; CBS, *Students in Institutes of Higher Education*, 2006/2007, October 2008.

Higher EDUCATION BUDGET Decreases rather THAN INCREASES

In order to deal with inequality in access to higher education, among other things, the higher education system needs to be expanded. Expansion requires a larger budget. However, in the period under study, public investment in higher education decreased rather than increased.

In the framework of budget cuts made during the second Intifada, the budget for higher education was also reduced. A tangible expression of this is to be found in the decline of the allocation per student, from NIS 44,721 in 2000 to NIS 36,135 in 2002 to NIS 35,710 in 2006.

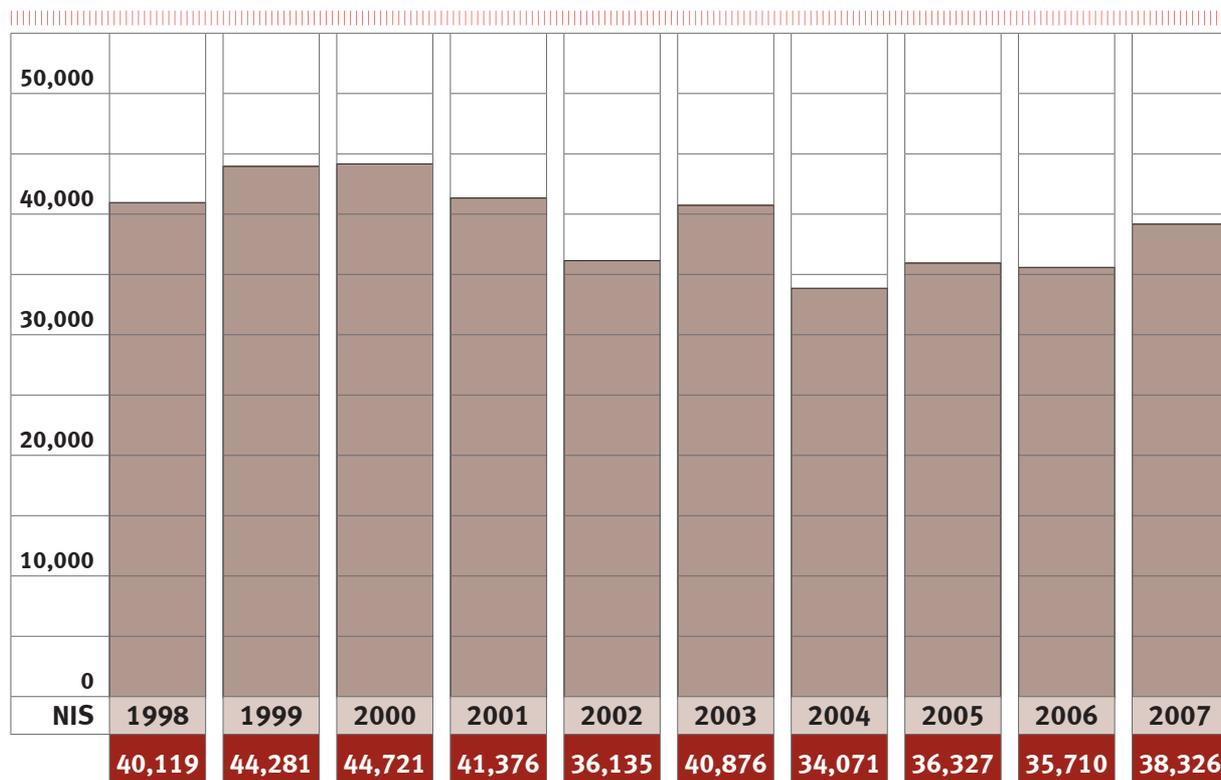
In 2007, the per student allocation increased somewhat.

Higher Education Budget, Per Student

1998-2007

For students in universities and public colleges

In NIS, 2007 prices



EROSION of Public Funding of Health Services Sick People PAY MORE

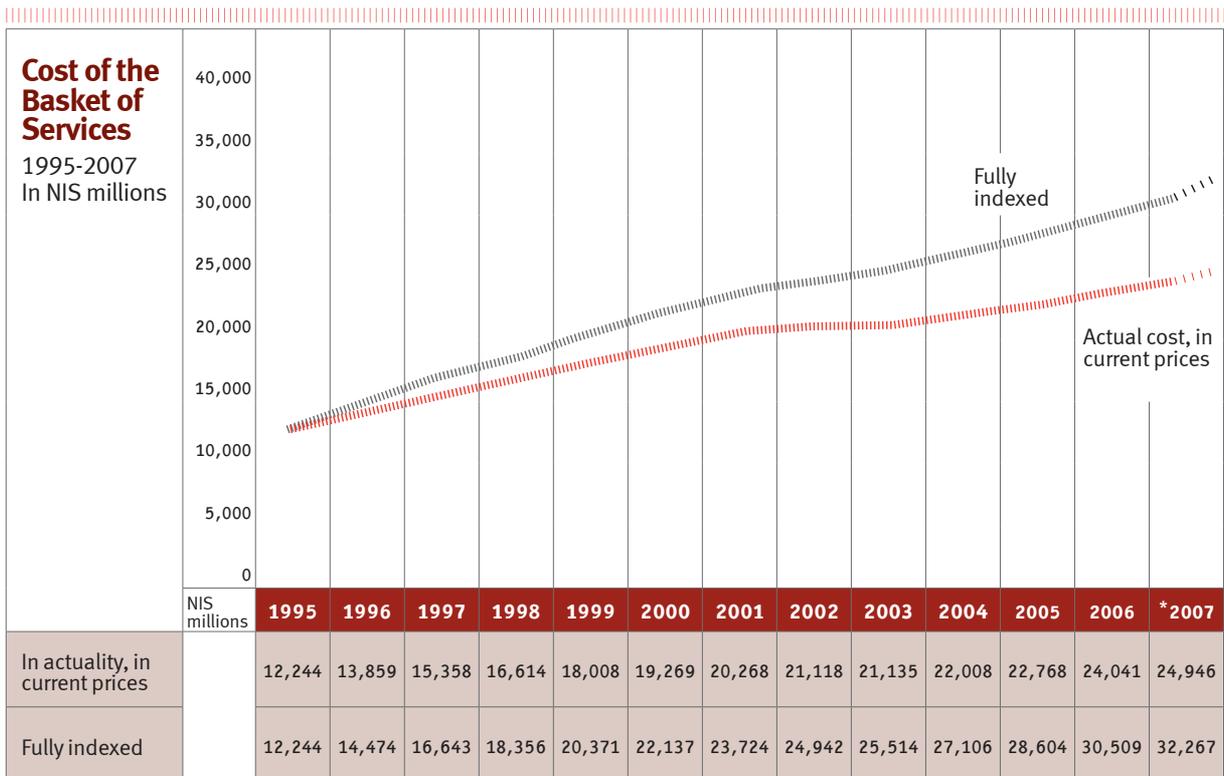
The last decade saw an increase of inequality also in the area of health.

When the National Health Insurance Law was passed in 1994, it included a generous basket of health services. The problem is that the law failed to include a mechanism for indexing the basket of services so that it kept up with demographic and technological changes.

In 1998, the first year of the period under examination, the government made a decision to decrease its share of funding of the basket

of services and to put the onus on the health funds. In turn, the health funds passed the onus onto consumers, by increasing co-payments for medications and services.

The table below presents the erosion in the state funding of the basket of health services; had the basket of services been updated in full on a regular basis, its allocation in 2007 would have been NIS 32.3 billion. In actuality it was approximately NIS 25 billion.



* Estimate

Sources: Adva Center analysis of Ministry of Health, Economics and Health Insurance Department, *The National Health Insurance Law: Statistics - 1995-2007*, edited by Gabi Ben-Nun and Nir Kadar, December 2007; figures for 2007 courtesy the Economics and Health Insurance Department, November 2008.

The Burden of HEALTH Payments on HOUSEHOLDS DOUBLED

As a result of the erosion of government funding of the basket of health services, the burden of funding for consumers increased. Thus, for example, only some of the new medications considered effective were added to the basket of services. Others became part of supplemental insurance programs marketed by the health funds and by insurance companies, becoming available only to persons paying premiums above and beyond the national health tax.

Health service consumers pay more not only for medications but also for a wide variety of services, including visits to specialists and diagnostic services.

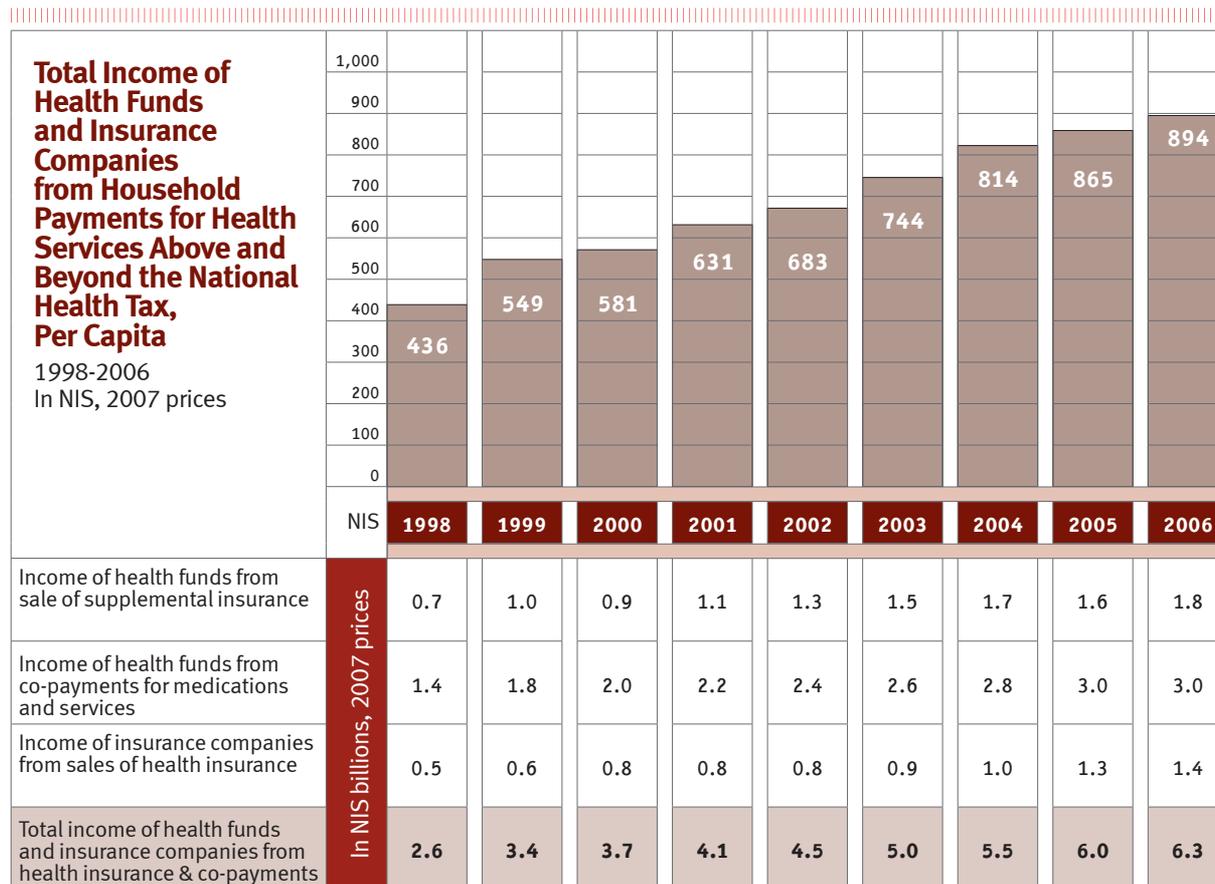
The new and higher co-payments increase the financial burden on health service consumers.

In 1998, this burden amounted to NIS 2.6 billion.

How do we know this? The figure cited above represents the total income of the health funds and the insurance companies from payments for extra health insurance and for medications and medical services.

In 2006, this burden grew to NIS 6.3 billion.

Per capita, the average financial burden for households more than doubled, from NIS 436 in 1998 to NIS 894 in 2006.



Sources for table: Adva Center analysis of figures received courtesy the Department of National Accounts at the CBS.

Sources for Figure: Adva Center analysis of figures received courtesy the Department of National Accounts at the CBS; Ministry of Health, Department of Economics and Health Insurance, *National Health Insurance Law 1995-2007*, Statistics, December 2007.

Equality Under Erosion

MORE INCOME = MORE HEALTH INSURANCE

When the burden of funding is imposed on households, there is a danger of increased inequality, as not all households can afford to pay more. There is cause for concern that eventually the increasing gaps in ability to pay will result in gaps in health among different social groups.

Between 1998 and 2007, the share of extra insurance in household expenditures on health increased from 14% to 25%.

All households paid more - but those whose incomes were larger were able to purchase more and better extra health insurance, while those whose incomes were smaller

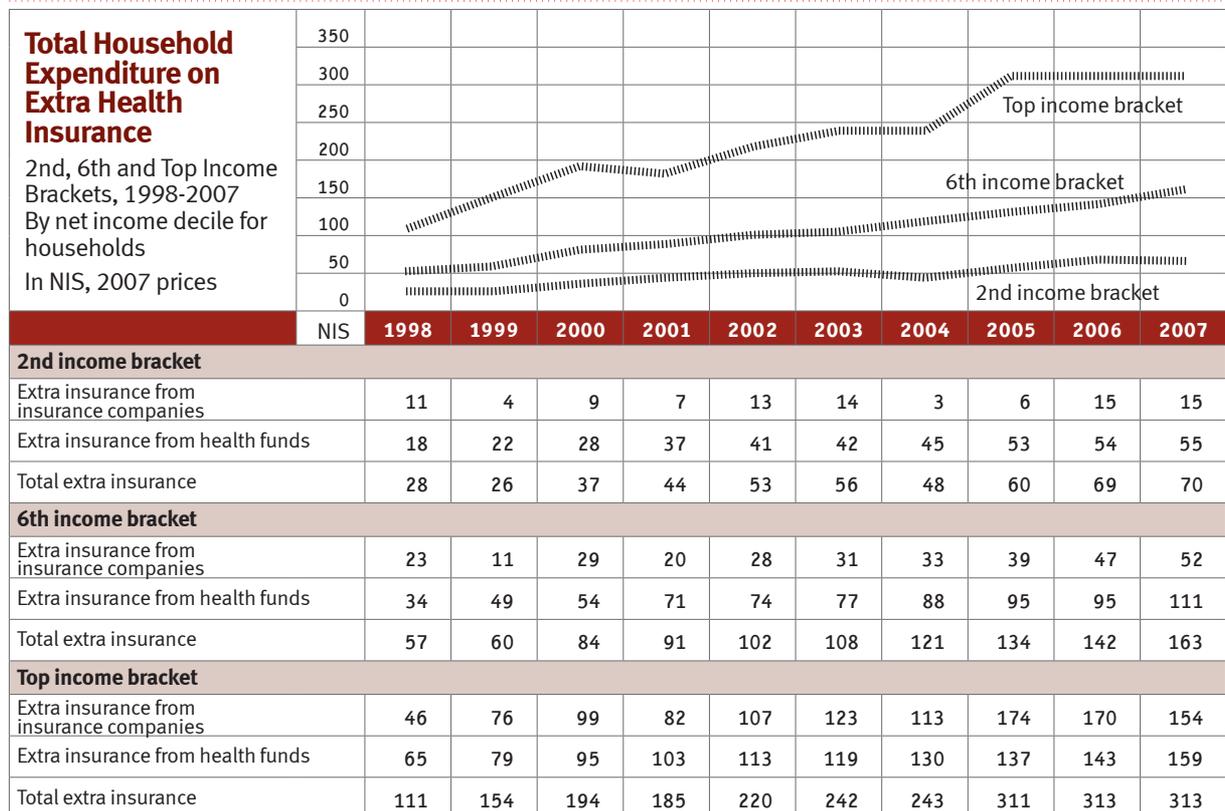
purchased much less.

In 2007, for example, households in the second lowest income bracket (decile) spent, on average, NIS 70 per month on extra health insurance, while households in the sixth income bracket (decile) spent NIS 164, and those in the top income bracket - NIS 313.

The gaps between high and low income households were especially large when it came to extra insurance marketed by insurance companies: in 2007, households in the top income bracket purchased insurance premiums at an average cost of NIS 154 per month, while households in the second lowest income bracket

purchased insurance premiums at an average cost of NIS 15. Moreover, the gaps between households in these two income brackets grew considerably in the course of the decade. In 1998, those in the top income bracket purchased extra insurance premiums at a cost 4.2 times larger than the amount spent by the second income bracket; in 2007 the ratio was 10:1.

It should be added that these figures represent averages for each income bracket - averages that conceal the fact that in the lower income brackets, many households do not purchase any extra health insurance at all.



Source: Adva Center analysis of figures received courtesy CBS Consumption Department.

INEQUALITY among Tomorrow's SENIOR Citizens

Pension fund savings are common among employees from the upper middle class; they are far less common among blue-collar and service workers. Moreover, among employed persons with pension savings, there are large discrepancies in the amounts of those savings. These discrepancies will translate into big differences in standard of living after retirement.

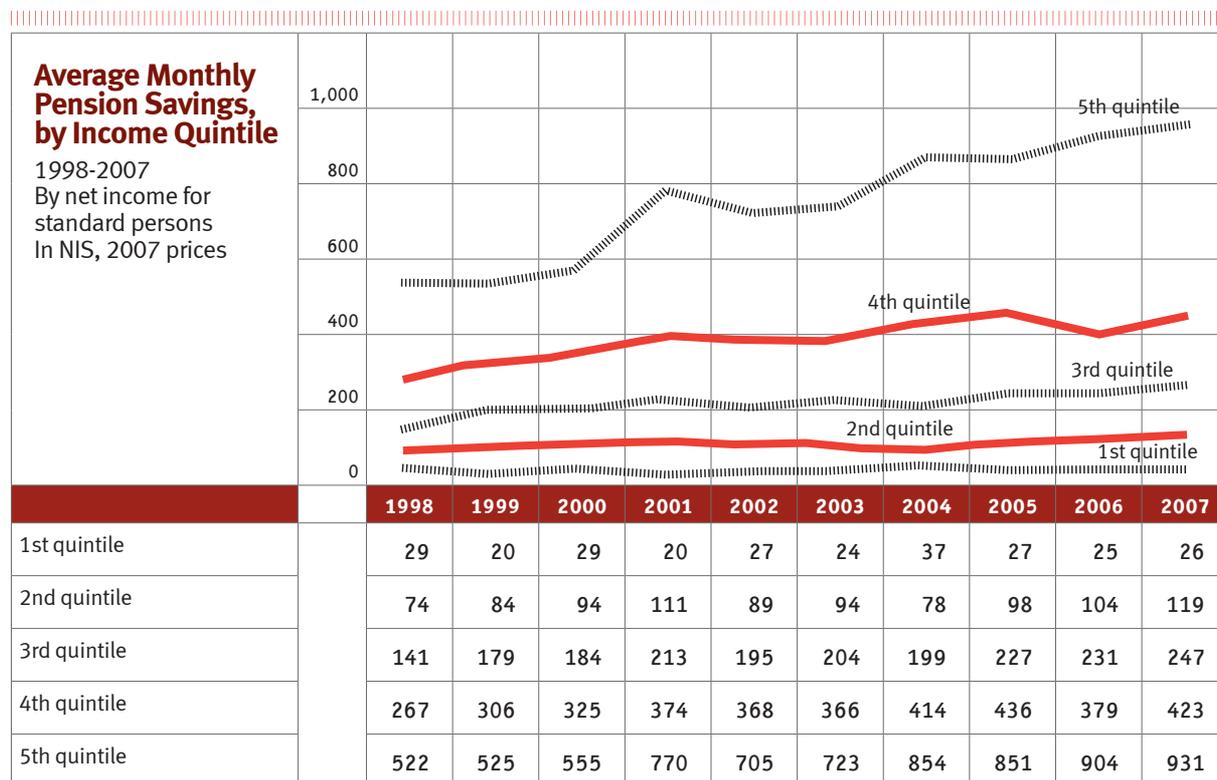
The table below presents the average expenditure of households for pension savings. It should be remembered that the average includes households with pension savings as well as those without.

In 2007, the average pension saving of households in the top income quintile was 36 times that of households in the bottom quintile, 8 times higher than that in the second quintile, 3.8 times higher than that in the third quintile, and 2.2

times higher than that in the fourth quintile.

It should be mentioned that in 2003 a very significant change occurred in Israel's pension system, when pension funds that were owned by the Histadrut and received financial support from the state were nationalized and then sold to insurance companies. In addition to this, their investment portfolios were drastically changed. Whereas prior to 2003, 70% of pension savings were invested in special government bonds with a guaranteed yield, beginning in 2003, 70% of pension savings began to be directed to the capital market and only 30% to guaranteed government bonds.

The significance of that change was revealed when the present global financial crisis reached Israel and the pension savings of Israelis registered significant losses.



Sources: Adva Center analysis of CBS, *Household Expenditures Survey*, various years; figure for 2007 courtesy the CBS Consumption Department.

