



TAUB CENTER

for Social Policy Studies in Israel

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From the Director

The English version of this year's *State of the Nation Report: Society, Economy and Policy in Israel 2010*, has just been published in English by the Taub Center and is available on the Center's website.

This past fall, the Taub Center inaugurated its Herbert M. Singer Conference Series with a conference on the Socioeconomic Impact of Education. Three of the world's leading researchers – Robert Topel (University of Chicago), Eric Hanushek (Stanford University), and Adam Gamoran (University of Wisconsin) – presented cutting edge research on education's effect on societies and economies and on ways to improve educational systems. The findings were presented to senior Israeli policymakers and to the general public, and were followed by a roundtable discussion with Stanley Fischer (Governor of the Bank of Israel) and Amnon Rubinstein (Interdisciplinary Center and former Minister of Education) pertaining directly to Israel. Those interested in viewing the lectures and discussions directly can do so on the Taub Center website.

A follow-up document that I wrote on this issue, *The State of Israel's Education and Its Implications*, provides a synopsis via a brief visual roadmap (each page contains one or two graphs accompanied by a brief explanation) underlining the importance of education for Israel's society and economy, the state of the country's education, and the implications. This document can be downloaded from the Taub Center website.

This summer was one of unprecedented (in Israel) social protest. One of the primary issues underlying these protests was the perceived high cost of living in Israel. One of the articles in this Bulletin provides empirical corroboration for this public sentiment. While these issues brought people out into the streets in 2011, they represent only the tip of the socioeconomic iceberg facing Israel – issues that are covered in depth on an ongoing basis by the Taub Center's Policy Programs and researchers.

Dan Ben-David
Executive Director, Taub Center

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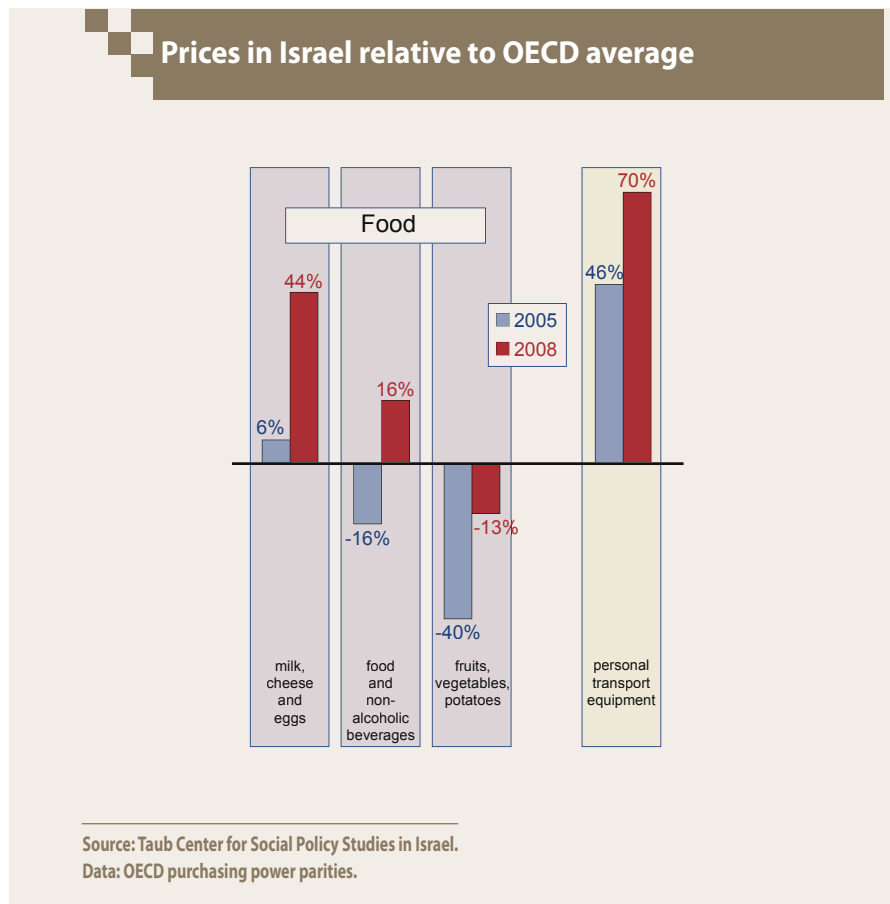
The land of (expensive) milk and honey

A summer of protests – high prices, low incomes, and a growing realization of what is only the tip of the socioeconomic iceberg.

One of the final straws leading to the major summer protests in Israel was the high price of cottage cheese. A comparison conducted by Nir Eilam, a Taub Center researcher, using OECD data from 2005 indicates that dairy products (specifically, milk, cheese and eggs) in Israel were 6 percent more expensive than the average prices in the OECD (see figure). By 2008, this gap grew to 44 percent. The prices of food and non-alcoholic beverages, which in 2005 were 16 percent cheaper than the OECD average, grew in the span of merely three years to 16 percent above the OECD average. Agricultural commodities remained less expensive in Israel, although the gap narrowed from 40 percent below the OECD in 2005 to 13 percent below in 2008.

Taub Center researchers found that prices in Israel were not higher in all areas. It turns out, though, that even in areas where prices were relatively low in 2005 – including education, health care, communication, and fruits and vegetables – prices had risen considerably by 2008; in some cases, prices that had been lower than in the OECD in 2005 exceeded prices in the OECD by 2008.

Two of the largest household expenditures are on cars and housing. In 2005, motor vehicles cost 46 percent more in Israel than in the OECD. This price differential grew to 70 percent by 2008. According to Professor Ben-David, Executive Director of the Taub Center, the lack of free competition in importing cars to Israel



allows a small number of importers to raise prices on vehicles disproportionately to the markup in Western countries.

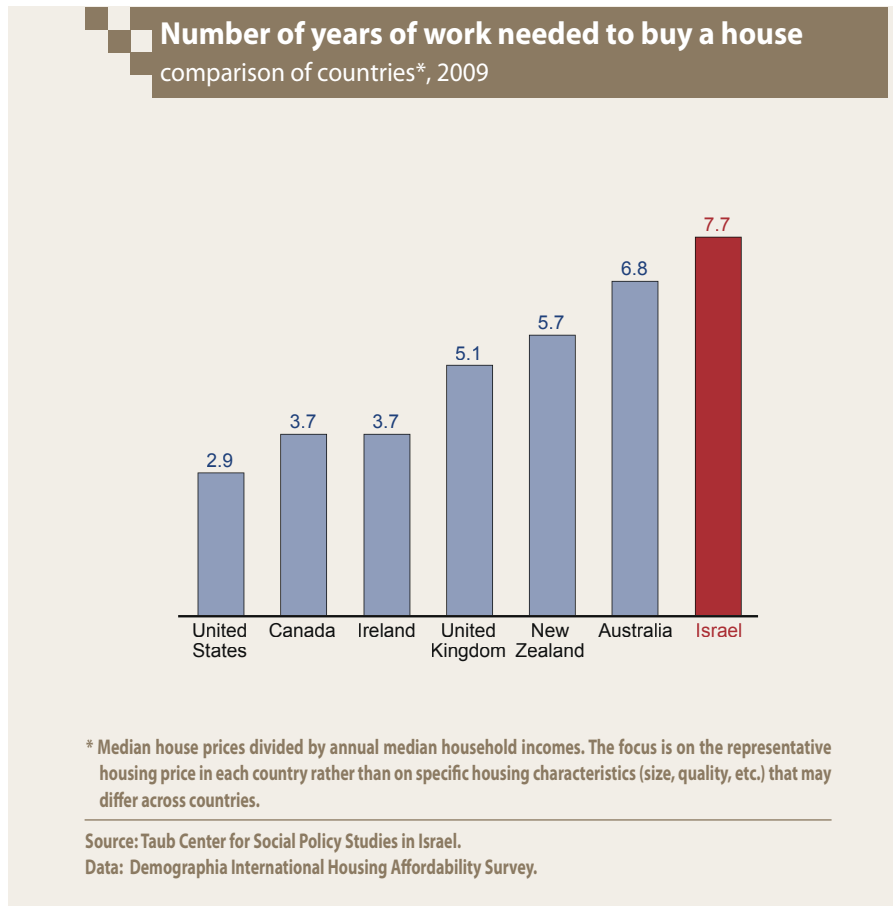
Housing in Israel is quite expensive as well. As a rule of thumb, it is generally considered very difficult to purchase an apartment if its cost is greater than five years of income. Data from the Demographia International Housing Affordability study divides median house prices by annual median household incomes (see figure) and shows that in the U.S. only 2.9 years of income are needed on average to buy a home. In Canada and Ireland this rises to 3.7 years, in England to 5.1, in New Zealand to 5.7, and to 6.8 in Australia. In Israel, it takes more years of work than each of these countries, with an average of 7.7 years of work needed to buy an apartment.

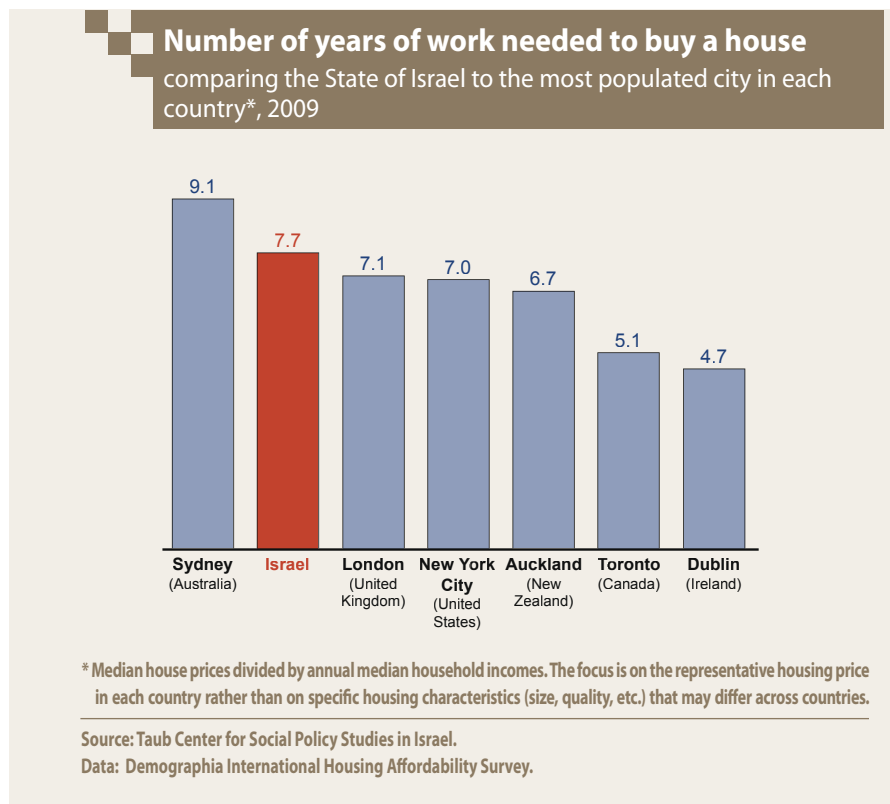
In fact, Israelis need to put in more years of work for a home than residents of 32 of the 33 English metropolitan areas (see figure on p. 4). Even in

London, "only" 7.1 years of work are needed to purchase a home. Housing in Israel is more expensive than in any metropolitan area in Ireland and New Zealand, and it costs more than in 174 of the 175 metropolitan areas in the United States. Even housing in New York City requires fewer years of work than housing in Israel.

According to Professor Ben-David, a policy response focusing primarily on the symptoms is not the way to reduce housing prices. It is necessary to focus on the roots of the problem, and he proposes a number of policy directions:

- 1) Reform in the Israel Land Administration.** The State owns more than 90 percent of the land in Israel and the housing market is greatly affected by government behavior. A comprehensive reform of the Israel Land Administration is required so that it will cease to operate as a monopoly maximizing profits at the expense of the general public.





2) Developing the periphery and making it accessible. The low level of educational achievement in periphery areas and the lack of rapid, available and inexpensive access to workplaces in major cities prevent many young families from moving to towns where larger homes are available at lower prices. While comprehensive education reform is necessary countrywide, its importance is particularly critical in the periphery. In a country with only half as many cars per capita as the Western average, and roads that are more than twice as congested, the time has come to substantially increase the investment in transportation infrastructure, and to catch up after decades of lagging behind. Despite some increases in this regard, Israel's national investments in transportation infrastructure have risen to average OECD levels (as a share of GDP), but that is far from sufficient if the country intends to close the very large infrastructure gap that has opened up over the years.

3) Dormitories for students. Each of Israel's four major cities is home to at least one university, with 18,000-29,000 students in each. The time has come to build sufficient housing on the existing campus areas – by building dormitory buildings vertically

instead of horizontally – in order to significantly reduce student demand for what have become exorbitantly priced apartments in these cities. As a result, the investment demand for housing will decline and thousands of apartments will become available for young families who are unable to afford current prices. As a bonus, the students will live within walking distance of campuses, will be able to spend more time at their studies and will substantially reduce the congestion on the already-crowded roads.

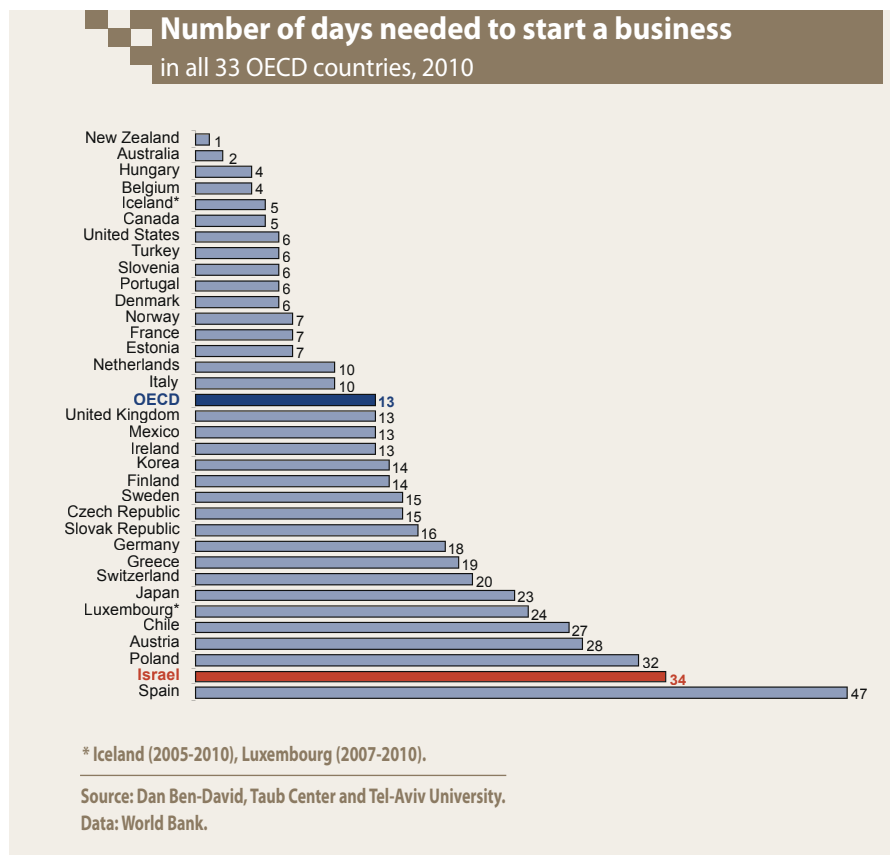
One common factor contributing to the higher prices in Israel, be they in homes, consumer goods, or other areas, is a very cumbersome government bureaucracy. For example, Dan Ben-David uses World Bank data and shows that the number of days required to open a business in Israel is higher than in 32 of the 33 OECD countries (figure on the next page). Whereas in Australia it takes two days to start a business, in Canada five days, in the U.S. six days, and in France seven days, in Israel 34 days are required – nearly three times the OECD average. Instead of resources being devoted to lowering costs and hence prices, a substantial amount of time and money is lost in what should be a routine process of starting a business.

The summer protests in Israel did indeed touch a very basic nerve, even though they were based primarily on symptoms, or the "tip of the iceberg." The iceberg itself, which is the primary focus of much of the Taub Center's research, reflects standards of living that since the 1970s have been steadily falling farther and farther behind the West (the current major recession is an exception to these long-run trends) and rates of poverty and income inequality that are much higher today than they were in the 1970s and 1980s and considerably higher than in most OECD countries.

The combination of relatively high prices and low incomes in Israel – compared to the industrialized West – is taking its toll in a number of ways. One reflection of this during the past summer was the strike by the country's physicians, whose cutting-edge training and abilities put them on a par with the best in the West, while their incomes lag well behind. In protest, many of the younger doctors quit en masse and the courts intervened to prevent their resignations for fear of the severely negative impact that this would have on healthcare in general and on emergency care in particular. This issue has just been resolved in a manner that may have major reverberations on labor negotiations in the future.

In the academic realm, resignations have been substituted by a major brain drain from the country, one that is extremely severe in some fields that offer substantially higher compensation abroad. Here, too, major inroads have recently been made to try and reverse the process. Unfortunately, this is primarily symptomatic treatment for a major underlying problem.

Prof. Ben David summarizes that a situation combining state-of-the-art training with compensation that is increasingly not reflective of such ability is not a viable steady-state process. When living costs are also rising disproportionately in relation to the West, it is not surprising that 400,000 Israelis in a country with less than eight million people took to the streets on one summer night in protest. He adds that a combination of long-term planning focusing on a substantial improvement in the country's human capital and physical capital is needed to deal with the primary underlying problems faced by Israel. This needs to be complemented by a comprehensive policy emphasizing the common good versus that of narrow interest groups, one that is accompanied by appropriate regulation to deal with market failures. ■

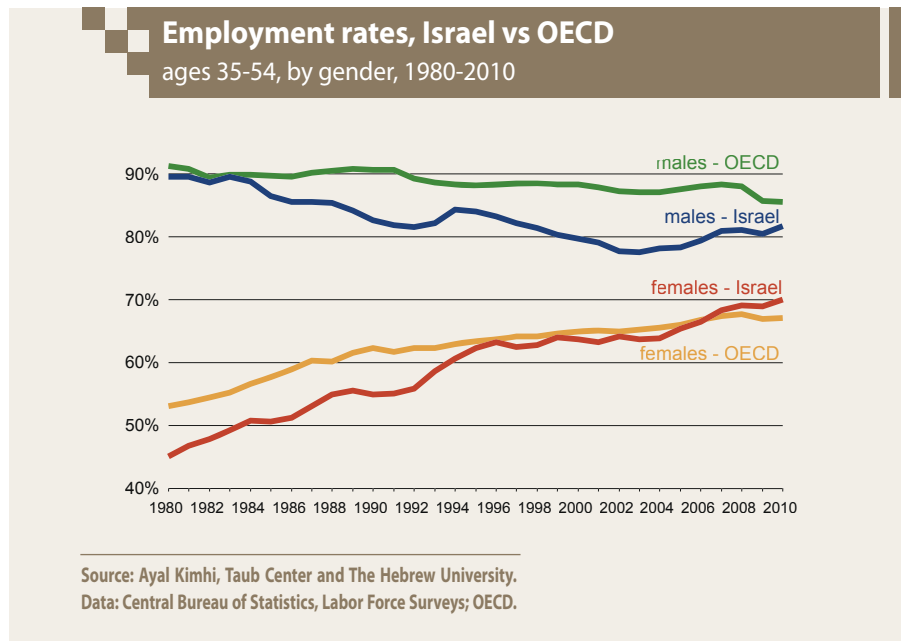


Employment patterns differ between generations, and depend on gender and education

The employment behavior of Israeli men and women born in different decades has changed from each generation to the next – with differences in education levels the key divider between groups.

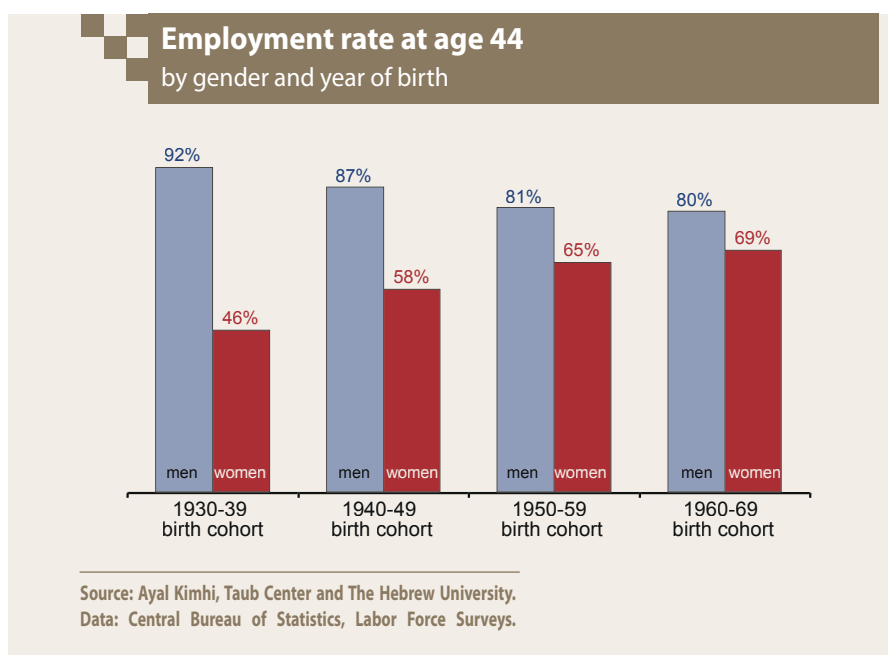
A major source of concern regarding the Israeli economy is that the rate of employment among Israeli males has declined markedly over the last three decades, and is considerably lower than in OECD countries. The female employment rate, on the other hand, has been rising continuously and is now higher than the OECD average (see first figure).

At the recent Sderot Conference for Society, Taub Center Deputy Director Professor Ayal Kimhi presented new evidence on the labor market changes underlying these trends.



One finding was that the changes are mainly due to changes between generations, rather than changes within them. Kimhi's study shows that the employment rates of each new generation of males are lower than

those of the previous generation. By contrast, each new generation of females tends to have higher employment rates than the previous generation, as shown in the second figure.



Another finding demonstrates the relationship between employment and education. Since men and women have much different labor force characteristics, the education gap has different effects on men and women. Nevertheless, within each group the impact of education is pronounced.

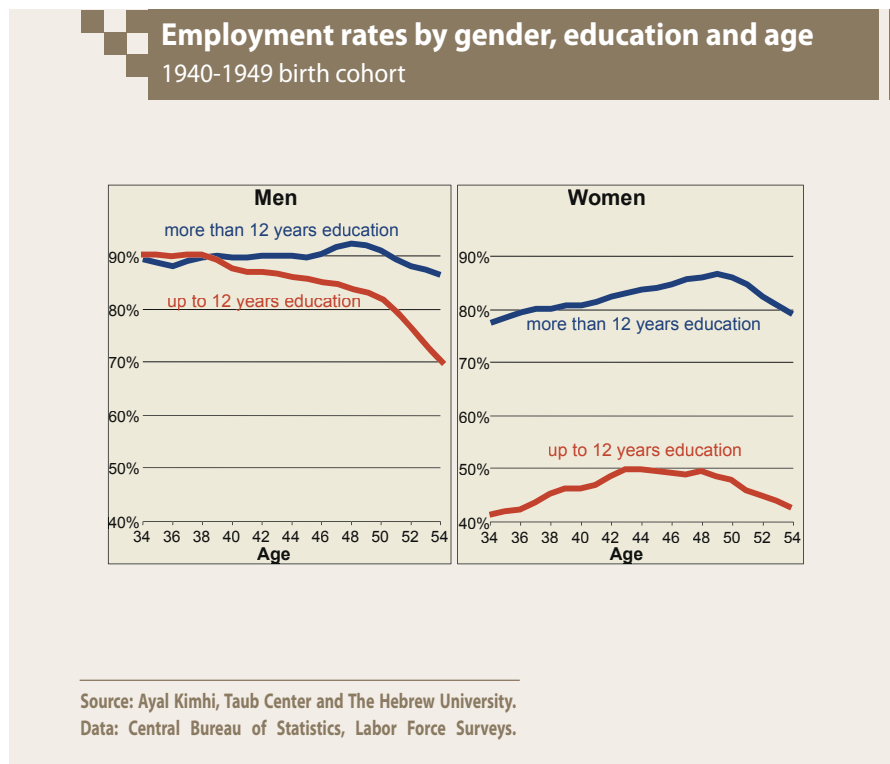
It turns out that the decline in Israel's male employment rate over the past decades was primarily among relatively older men with low education. For example, among men born in the 1940's, there is no observable relationship

between employment rates and schooling until their late 30's. Starting at around age 40, employment rates of men with 12 or less years of schooling decline continuously, while employment rates of men with more than 12 years of schooling start declining only at age 50 (see figure).

By contrast, Kimhi finds that the rise in the female employment rate is almost entirely attributable to the increased acquisition of higher education; the employment rate of women with over 12 years of schooling is nearly double that of women with up to 12 years of schooling. Employment rates among women with 12 or less years of schooling increase until age 43, then remain stable until they begin to decline at age 48. On the other hand, women with more than 12 years of schooling exhibit continuously rising employment rates through age 49 and only then does the decline begin. Thus, as Kimhi explains,

the substantial rise in employment rates in Israel is almost entirely attributable to the rise in female higher education whereas among men, employment rates tend to decline among younger generations in general and among the less educated men in particular.

Kimhi emphasizes that education is the key to reducing employment gaps among population groups in Israel. "The country should give top priority to providing pupils and students, who constitute the labor force of the future, skills relevant to the modern labor market. The issue isn't merely years of schooling. Equally important is the content of the curriculum – which should fit the demands of the modern labor market – the quality of teaching and its effectiveness, and a supportive school environment. As we see from the achievements of its pupils, Israel is still way off the mark in this regard." ■



Israel's shadow economy

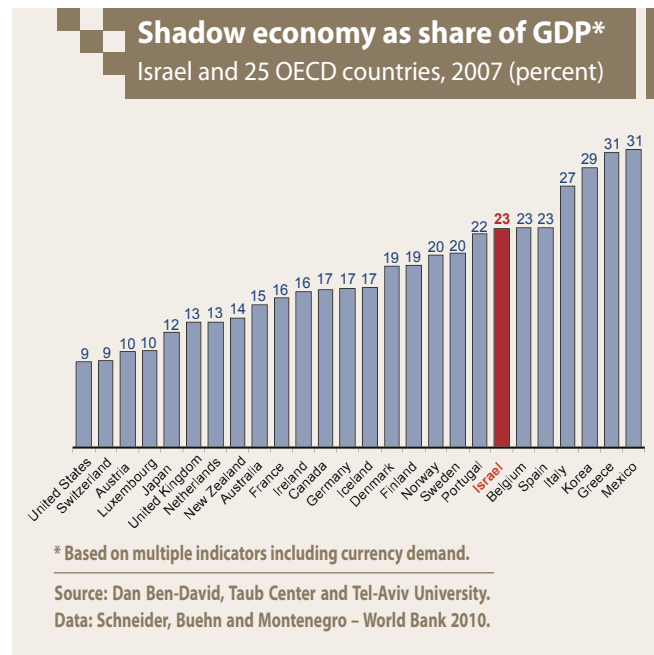
Economic activity that occurs under the tax radar has become a major weight on those who shoulder the burden. A look at Greece, Italy and Spain – among the very few developed countries with an even larger shadow economy than Israel's – shows where such national behavior can lead.

The severe economic problems experienced by a number of European countries emanating from the recent global recession have illuminated problems that are shared with Israel – even though Israel has thus far weathered the recession much better than most countries. Large underground economies in Greece and Italy seriously limit the ability of these countries to garner urgently needed domestic resources for dealing with their predicaments, and do not provide much of an incentive for the citizens of other European Union partner countries to grant financial support drawn from the taxes that they pay. Israel, a country that is not immune to volatility, must learn from their example the extent to which a large underground economy restricts a country's ability to respond effectively to an emergency situation. This article is an excerpt from the chapter, "Public Spending in Israel over the Long Run," written by Dan Ben-David, Executive Director of the Taub Center and a Tel-Aviv University economist that appears in the recently published *State of the Nation Report* by the Taub Center.

The extremely high rates of non-employment in Israel reflect not only problematic work habits by a large and growing segment of the population, but also what would appear to be – from an anecdotal perspective – quite extensive levels of tax evasion. The severity of non-compliance with the country's laws is very difficult to gauge, but its pervasiveness in some sectors of the population and business sectors is also difficult to ignore.

The anecdotal evidence receives empirical support from research as well. A recent World Bank study by Schneider, Buehn and Montenegro (2010) provides a glimpse into the size of Israel's shadow economy and how it compares with other countries. They rank 151 countries according to a rough estimate of the size of their shadow economies, based on multiple indicators including currency demand and the rate of official labor force participation. The figure looks at how Israel compares to 25 OECD countries.

While the apparent problems of Greece and Italy eclipse Israel's as far as shadow economies are concerned,



Israel, nonetheless, has some substantial economic activity that is hidden from the eye of the tax authorities. According to Schneider, Buehn and Montenegro, the size of Israel's shadow economy reached 23 percent of its GDP in 2007. This is considerably greater than Germany (16.7 percent), the United Kingdom (13.2 percent), Japan (12.1 percent), and the United States (9.0 percent).

This large a share implies an enormous amount of economic activity that is taking place outside of the formal public eye – a sum of 187 billion shekels in 2010 alone. Such an extensive shadow economy skews the shouldering of the public burden in a substantial manner, leading to high tax burdens on some portions of the population while other segments of the population who work – while formally appearing not to do so – not only do not bear their share, they actually artificially inflate the burden by receiving welfare assistance and subsidies while they appear to be much poorer than they actually are. ■

Established in 1982 under the leadership and vision of Herbert M. Singer, Henry Taub, and the American Jewish Joint Distribution Committee (JDC), the Center is funded by a permanent endowment created by the Henry and Marilyn Taub Foundation, the Herbert M. and Nell Singer Foundation, Jane and John Colman, the Kolker-Saxon-Hallock Family Foundation, the Milton A. and Roslyn Z. Wolf Family Foundation, and the JDC.

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