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Some Perspectives on the Israeli Economy: Stocktaking and Looking Ahead

ABSTRACT

The overall economic record of Israel in the last decades has been a rather mixed one. It involved secular—albeit not uninterrupted—growth coupled with extremely high income inequality and increasing poverty, and with rising concentration and excessive market power, hampering competition in a number of significant industries. This record is the main concern of this article, which comparatively examines its main attributes and implications, and addresses some of the pressing issues that have surfaced in the intensive debates (culminating in the recent social protest and its aftermath) on economic policies and Israel's socio-economic prospects. In discussing these issues, the fundamental question—what are the socio-economic regimes that the Israeli society could adopt, given its values, needs, and preferences—is considered.

The stabilization program of 1985 and its related reforms, ending the spiral of accelerating inflation, led to significant changes in Israel's economic regime. These were epitomized by a gradual retreat of the state from its deep involvement in and control of the economy, accompanied by privatization of a variety of government companies and services. Within the regime of lesser government involvement, an increasing role in economic life has obviously been delegated to the market, a process that carries with it a potential for allocative advantages and growth enhancement. A good part of this potential has indeed been realized, but the overall economic record of the last decades has been rather mixed.

Considering the aggregate macroeconomic picture, it was one of secular—albeit not uninterrupted—growth, with the liberalized economy becoming well-integrated into the global markets and successfully absorbing the massive immigration waves of the 1990s. But this rosy picture has been stained by extremely high income inequality and rising incidence of poverty, and by the concentration of excessive market power, hampering competition in significant markets and making consumers suffer from high prices and rising cost of living.

These interrelated patterns—the move toward lesser government and the mixed record of growth, distribution, and constrained competition—are examined in the first two sections of the article. The last section is devoted to the fundamental question: What is the socio-economic regime that Israel could adopt in the coming years, given the socio-economic problems that need to be addressed, and in view of the values and preferences of the Israeli heterogeneous society?

The selection of the subjects to be discussed in the article should not be taken to belittle the significance of other matters that are not addressed here. I refer primarily to the complex issues involving Israel's occupation cum settlement policies, which, besides their political, legal, and ethical ramifications, have imposed a substantial burden on the Israeli economy and may affect its future.[1] The way that these issues have been so far handled by the state, and how they will be handled in the coming years, are crucial for the prospects of Israel as a polity, society, and economy, and are thus instrumental for the perception of Zionism in the twenty-first century. As such, they certainly deserve a thorough multifaceted analysis, but this task cannot be fulfilled within the confines of this article.

TOWARDS LESSER GOVERNMENT

Two distinct factors should be considered when assessing the nature and extent of the involvement of governments in the economies of their states. One is the size of government, commonly measured by the percentage of public expenditures in the state's Gross Domestic Product (GDP),[2] and the second involves the means that the government may employ in order to guide, control, and regulate non-public economic activities. Some of these means could be budgetary in nature such as specific taxes and subsidies, and others could include administrative and regulatory measures as well as direct intervention in the economy by government-owned companies and other productive assets. Obviously, the more extensive these means, the more effective would be the capacity of the government to control economic life, regardless of its size.

The economic story of early Israel illustrates just that. Take for instance the relatively stable period of the first half of the 1960s. In those years the size of the public sector was rather modest, with public expenditures accounting for no more than 29% of GDP, of which defense outlays amounted to about 6%.[3] Nonetheless, the government continued to play at that time a highly interventionist role in economic life, effectively directing the allocation of public and private productive resources, even as the heavy burdens of defense and the mass immigration of the first decade of statehood, have been eased.

A major instrument for guiding the economy, apart from the state ownership of most of the country's land (93%) and from the government regulatory powers, was its complete control of the capital market. This was largely facilitated by the government being in those years the institutional destination for most of the country's capital imports. These inflows, which consisted mainly of unilateral transfers made by World (mostly American) Jewry, German reparations, and loans and grants-in-aid provided by the US government, were the main sources of domestic investments. The government used part of these resources for public investments in infrastructure and housing, and other parts, combined with additional discretional means (such as subsidized allotment of land, imports restrictions, tax concessions, and strict control of bank credits) for initiating and guiding private investments according to its national-economic agenda.[4]

The intensive economic interventionism of the Israeli government may have been linked to three factors. One was the traditional mistrust by which labor-Zionism held the market, viewing its allocative mechanisms based on profit considerations as contradictory, almost by definition, to the economic agenda and objectives of Israel's nation-building. The second was the post-Depression and post-WW II prevailing attitudes in Western (mainly European) countries that adopted the *Keynesian Consensus* promoting government involvement in economic life, and embraced even some degree of state-guided economic planning, at least at the indicative level. The third factor relates to the targeting of manufacturing as a leading industry, which made the industrial structure aimed at by the government of Israel converge on the structural objectives of economic nationalism typically observed in new, post-colonial states.[5]

These factors, coupled with political inertia and bureaucratic path dependence, made the Israeli governments continue to intensively utilize the administrative, discretionary, and regulatory measures of deep economic interventionism well beyond the 1960s, overcoming even the 1977 political "changing of the guard" from Labor to Likud.[6] It was not until the successful implementation of the 1985 stabilization program and its subsequent reforms that the gradual retreat of the government from its excessive intervention in the economy earnestly began.

The noticeable reforms of the post-1985 era were the release of the capital market from the strong governmental grip; the liberalization of foreign trade and exchange, allowing also for free international capital movements; and the launching of privatization of government business undertakings and of some public economic and social services.[7] Most of these reforms, which coincided with the sharp decline in the economic strength of the Histadrut, served useful purposes of improving resource allocation and enhancing economic freedom, as Ephraim Kleiman rightly observed: "*Etatisme* has long outlived its role in Israel and is justifiably being abandoned."[8]

Moreover, healthy integration of Israel into the open global economy did certainly require that the market be assigned a larger role in determining the allocation of resources within the domestic economy—an objective that the reforms mostly aimed at. They were likewise invigorated by external developments such as the worldwide erosion of the *Keynesian Consensus* following the stagflation of the 1970s and the strengthening of market forces, including the privatization of state enterprises that have become a significant element of public economics around the world since the early 1980s.

A second extensive round of movement toward "lesser government" was initiated in Israel in 2003 by Benjamin Netanyahu, Israel's finance minister at the time, and pursued with various intensities ever since. This round has been characterized by: (a) continued and intensified privatization of both state enterprises and public organs providing social services; (b) major pension reforms, abolishing the institutionally funded pensions in the public sector (*budgetary pension*) and restructuring the pension funds in the economy—exposing them to the open capital market and substantially reducing the government's responsibility for keeping their returns at a stable predetermined level; and (c) trimming social services, including welfare benefits that were amended so as to tighten the criteria for eligibility and to incentivize welfare recipients to move from welfare to employment.

The reforms of the 2000s were partly designed to protect the Israeli economy from a potential financial crisis that the recession of 2001–2002 might have prompted and to curb the fast rising costs of some of the welfare programs. But besides that, they reflected Netanyahu's deep and unshaken conviction, inspired by Anglo-American neo-liberalism, that the smaller the (believed to be relatively inefficient) public sector became, the more productive resources would be available for the private sector to use in generating faster economic growth. And furthermore, that the growth enhanced by the increasing weight of the private sector in the economy would ultimately trickle down the socio-economic ladder and make a good part of the welfare support payments redundant.

This approach was reflected on the revenue side of the budget by the steady reduction over the last decade of corporate and individual income tax rates, particularly on high earnings.[9] The policy of tax rates reduction was based on the (erroneous) belief that cutting the tax rates would increase overall tax revenues and on the presumption that it would encourage work efforts and entrepreneurship. This policy was pursued even at the cost of reduced progressivity of the tax system and despite the limitation it imposed on the ability to reduce the public debt to GDP ratio.[10]

Following these remarks, and before turning to the quantitative dimensions of the government, some elaboration on the concept of privatization, which became an instrumental vehicle in Israel (and globally) for advancing the lesser government agenda of the last three decades, is called for.

In its core, privatization is a process in which governmental assets and activities are transferred, either fully or partially, from the public to the private sector. Privatization may be materialized via two main avenues. One is by selling government assets to private buyers, and the other is by outsourcing the provision of certain services to private business firms or to Non-Profit Organizations (NPOs). In Israel, as in other countries, the privatization process has been carried through by using the two avenues; the selling avenue has usually been saved for government companies, and the outsourcing mainly for social services.

Although (or possibly because) privatization has been widely spread globally, it invoked intense debates about its objectives, execution, and outcomes. Some of these debates have been ideological in nature, and others involved economic issues concentrating on the efficiency of privatizing, particularly government monopolies, and specifically on the conditions that would make the privatized firms and service providers more efficient than their public counterparts.[11]

Note that privatizing government monopolies, as most of the public utilities and infrastructure companies are, would change the nature of their ownership, but—unless dismantled prior to privatization—not the extent of their market power. Under these circumstances, the choice to consider is often between a governmentally owned firm and a regulated private company. The efficiency justification of privatization becomes an empirical issue whose resolution hinges on the cost advantage (or disadvantage) of regulating the privatized firm versus retaining it as a government company.[12] It is for these reasons that one could argue, as convincingly stated by David Levhari, that it is competition that matters and not privatization as such.[13]

Having said that, the possible advantages of privatizing governmental businesses should not be overlooked. One such advantage could be the potential flexibility in handling the firms' labor force and the ability to incentivize managers and employees to raise their productivity and hence the economic efficiency of the privatized firms. Another advantage to consider is the distancing of the privatized public companies from the political arena in which politicians quite often tend to use government companies as instruments for advancing their own political interests.[14]

Although a thorough analysis of the impact of privatization on the economic performance of the privatized companies in Israel is still to be conducted, its contribution to the declining governmental intervention in the economy seems to be unquestionable. With regard to the promotion of competition, however, the story is much more complicated. Moreover, since a dominant method of privatization in Israel involved selling the government companies to private (strategic) investors, the process itself may have contributed to the concentration of economic power in few private hands.

Moving from business to social services, the basic question to ask should be whether outsourcing would reduce the cost of providing them without compromising, and possibly even increasing, their quality.[15] Analyzing the privatization of social services in Israel, Reuben Gronau has pointed in a recent article to the erosion of their wages relative to the business sector between 1995 and 2010, and suggested that this may have been caused by the outsourcing of some of those services, and been indicative of their quality deterioration.[16] In view of these outcomes it seems that the Israeli experience casts serious doubts on the claim that privatizing social services would be an efficiency-promoting move.

To turn now to the quantitative dimensions of the move toward lesser government. These are summarized in Figure 1, which displays the expenditures of Israel's general government in percentages of GDP between 1960 and 2012.[17] It is seen that the relative size of the public sector, after growing substantially from the mid-1960s to a peak of 80% of GDP in 1975, changed course in the mid-1970s and turned downwards, dropping to 42% of GDP in 2012.

This pattern was largely driven by changes in defense expenditures. Their GDP share rose sharply after the 1967 war, turning upward once more following the war of 1973 to reach a peak of 32.5% of GDP in 1975.

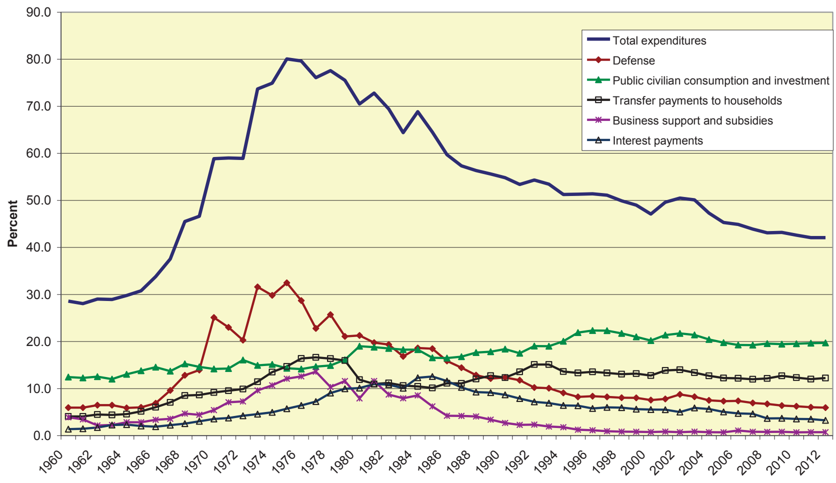

Figure 1. Public expenditures by type, percent of GDP, 1960–2012
Source: Bank of Israel, *Bank of Israel Annual Report for 2012*, Statistical Appendix.

But since then the burden of defense outlays did steadily decline—not the least due to the peace agreements with Egypt and Jordan—and got down to no more than 6% of GDP in 2012.

Examining Figure 1, it is seen that there were two additional components of expenditures that contributed to the overall declining pattern. One was business support and subsidies, and the other, interest payments. The former grew from the early 1960s to 1977, reflecting the government promotion of industrialization and its resort to subsidization of basic consumption goods in lieu of direct support payments to needy households. The mild and fluctuating decline of these payments between 1977 and 1985, and even more so their continuous shrinkage thereafter, was caused by the reduction of the subsidy elements embodied in various business support schemes and by sharp cuts in the subsidization of basic consumer goods that was replaced by rising transfer payments to households.[18] Similarly, government interest payments grew steadily from 1960 to 1985. But thanks to the reduction of budget deficits by the stabilization program and to the fiscal discipline kept by the government since its implementation, interest payments have declined continuously since 1986.[19]

Public consumption and investment outlays on civilian services, and transfer payments to households are the remaining two components of government expenditures. Their patterns have differed from the rest of the public expenditures since the late 1970s. Civilian consumption and

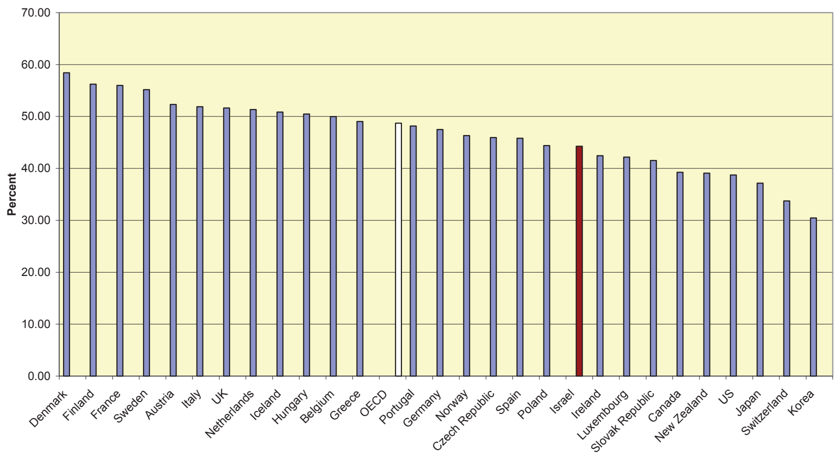

Figure 2. Total public expenditures, OECD countries, percent of GDP, 2009.
Source: OECD *statistics*, http://stats.oecd.org (1.9.2012).

investment expenditures did generally rise between the mid-1970s to the mid-1990s, but fluctuated mildly downwards thereafter.

Likewise, the nature and extent of transfer payments to households—reflecting largely the social security and relief components of the Israeli welfare state—underwent considerable changes over the years. From the mid-1960s through the early 1980s, the Israeli welfare system was gradually transformed from scattered relief programs and subsidization of employment provision and basic consumer goods, to a modern—west European type—welfare state based on comprehensive social security schemes. This development did obviously contribute to the growing ratio of transfer payments to GDP.[20]

After declining during the inflation-ridden and budgetary high deficit years of the first half of the 1980s, transfer payments grew in GDP terms during 1986–1992 to accommodate the increasing segment of the elderly in the population and the rising unemployment rates in the peak immigration years of the late 1980s and the early 1990s. Their GDP ratio remained rather trendless before the cut in social security benefits (2003–2007) became an instrumental part of the second extensive move towards lesser government.[21]

An illuminating perspective on the size, composition, and changes in Israel's public expenditures can be gained by comparatively examining them with the OECD countries, the standard reference group of which Israel became recently a full member. In Figure 2 the GDP ratio of total public

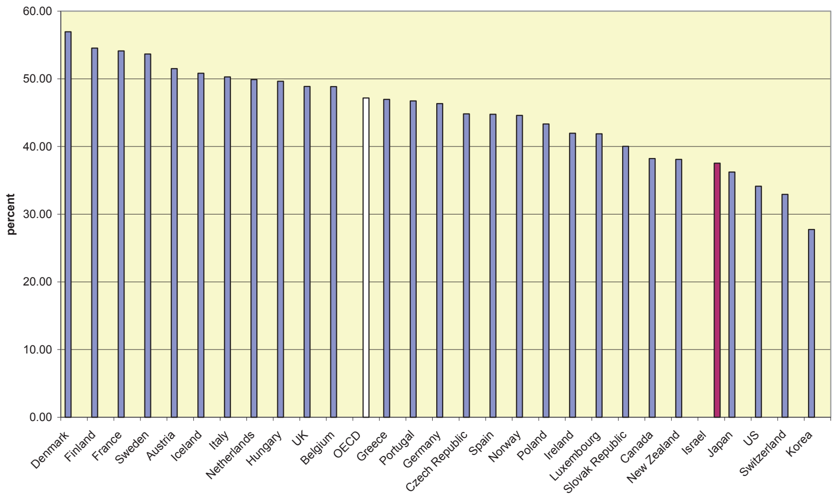

Figure 3. Civilian public expenditures, OECD countries, percent of GDP, 2009. Source: OECD *Statistics*.

expenditures is presented for most of the OECD countries (28 in number) in 2009. It is seen that the weight of overall public expenditure in GDP in Israel was comparatively low. Moreover, given the state's high defense outlays, the comparatively modest extent of total public expenditures in Israel makes, naturally, for its much lower ranking in terms of non-military expenditures (Figure 3).

With 38% of GDP, compared to the 43% of the OECD average, Israel's GDP ratio of non-military expenditures in 2009 was fifth from the bottom among the listed countries. Although the 2009 numbers may partially reflect the high governmental expenditures in the OECD countries (since they were affected more severely than Israel by the great recession of 2008–2009), Figure 4 shows that the gap between the GDP weight of the public civilian expenditures in Israel and their OECD average began widening already in 2002. Similar patterns are observed for the behavior of social security, housing, and relief payments and of public expenditures on education per pupil.[22]

It can thus be summarized that the decline in the size of government in Israel has been of substantial magnitude in comparative terms. This has been particularly the case in the 2000s, during which Israel bypassed many of the trend-setting countries of lesser government, particularly in Western Europe, and became a front runner in the shrinkage of social expenditures in GDP terms within the OECD "club".

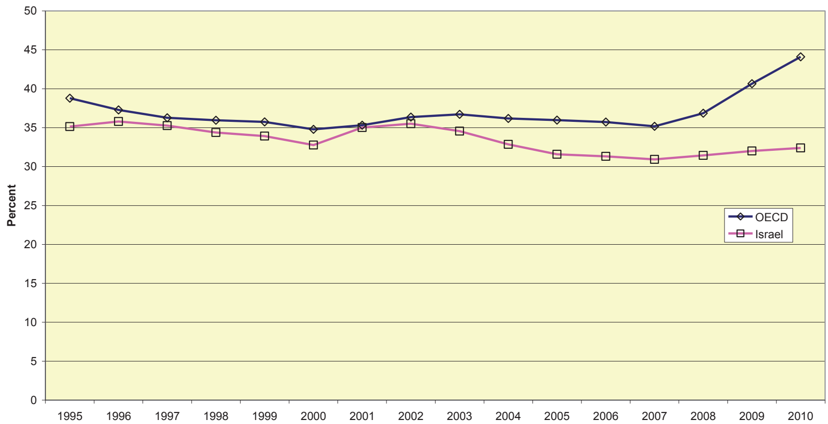

Figure 4. Civilian public expenditures (without interest payments) Israel and OECD average, percent of GDP, 1995–2010.
Source: Dahan and Hazan "Orders of priority in the Government budget."

ISRAEL'S SOCIO-ECONOMIC RECORD: GROWTH AND DISTRIBUTION OF THE ECONOMIC PIE

The essence of Israel's socio-economic record since the mid-1980s is best presented by two salient patterns: on the one hand secular, albeit not uninterrupted, pace of economic growth, and on the other hand increasing income inequality and rising incidence of poverty.

As for the growth record, the Israeli economy expanded in terms of real GDP (i.e., GDP in constant prices) in all but three years (1953 and 2001–2002) between 1950 and 2012, growing at an average, though fluctuating, rate of 6.1% per annum over the entire period. This quite impressive economic expansion enabled the fast growing population (at an average rate of 3.5% a year since statehood) to experience an increase of 3.0% annually in GDP per capita between 1951 and 2012.[23]

The long-term averages, however, conceal substantial differences between two major periods. The first period, 1950–1972, largely coinciding with the "golden age" of economic growth in the post-WW II Western world, was characterized by an exceptionally fast rise of GDP (9.9% per year) and GDP per capita (5.4% annually). This achievement exceeded, for example, the average growth performance of the G7 group of major industrialized economies, raising Israel's relative level of GDP per capita, from about 47% of the G7's level in 1950 to 72% in 1972.[24]

The remarkable expansion of the Israeli economy in those years could be attributed to three major factors: the substantial influx of labor; the fast growth of capital, largely invested in physical infrastructure, housing, and education (mainly by governmental initiatives and directives); and the fast rise in productivity. A major factor in facilitating the productivity advance was the process by which the mass immigration of the very early years of statehood was successfully absorbed into the economy.[25]

In the second period, 1973–2012, economic growth slowed quite substantially both in Israel and in the global economy, turning the Western world (including Israel) into an epoch of diminished expansion. In Israel the "lost decade" of 1973–1984, starting with the war of 1973 and the oil crises, continuing with another (the first Lebanese) war in 1982 and with an accelerating inflation, was particularly noted for its slow growth (1.1% yearly of GDP per capita).[26] Following the implementation of the 1985 stabilization plan and its subsequent reforms, faster growth resumed. But it reached only 1.9% a year from 1985 to 2012, leading to an average yearly increase of 1.7% in GDP per capita between 1973 and 2012.[27]

Contrary to the earlier two decades, Israel's post-1972 growth of 1.7% did not exceed that of the G7 economies, whose GDP per capita grew at the same rate between 1973 and 2011.[28] Moreover, in comparison with the entire OECD "club", Israel's relative level of GDP per capita shrank in the last 15 years from 95% of the OECD average in 1997 to 84% in 2010, while its ranking among the 34 OECD countries by GDP per capita declined from 20th to 24th place.[29]

The level of GDP per capita can be decomposed into three components. One is the weight of employed persons in the population, which is determined (apart from the proportion of working age people in the population) by the rate of labor force participation and by the overall state of employment.[30] The second component is the number of hours of work per employed person, and the third is the level of GDP per hour of work—the standard measure of labor productivity.

As for the rates of labor force participation and employment, they are presented in panel A of Table 1 for the prime working ages of 25–64 in Israel, and comparatively in the G7 and the OECD countries. It is seen that in Israel both rates grew rather steadily between 2000 and 2012, with the rise of labor force participation being largely induced by the expansion of higher education, due to the fast increasing supply of colleges that met the growing demand.[31] In the G7 and the OECD countries, on the other hand, labor force participation rates stopped growing, and the rate of employment has even declined since the onset of the great recession in 2008.

Table 1. Labor force, employment and labor productivity, Israel, G7 and OECD averages

A. Rates of labor force participation and employment 25-64 years of age, 2000-2012

	Labor force				Employment			
	Israel	G7	OECD	Israel's place in the ranking of OECD countries	Israel	G7	OECD	Israel's place in the ranking of OECD countries
	(percent)				(percent)			
2000	72.2	77.2	74.6	24/33	66.9	73.4	70.7	24/33
2005	73.2	77.8	75.3	28/34	67.5	73.6	71.0	26/33
2007	74.6	78.3	75.8	25/34	70.1	74.7	72.2	25/34
2011	75.9	78.0	76.1	25/34	72.1	72.8	70.8	19/34
2012	78.7*			18/34**	74.0			16/34**

B. GDP per hour of work, average annual percentage change over the decades: 1990-2000, 2001-2011

	Israel	G7	OECD	Israel's place in the ranking of OECD countries
	(percent)			
1990-2000	0.9	2.1	2.2	24/25
2001-2011	1.1	1.5	1.8	22/34

* Part of the rising rate of labor force participation in 2012 is due to methodological changes of measurement made by the Central Bureau of Statistics. They include incorporation of militaty service people and widening of the sample.
** the rankings for 2012 is based on the Israeli figures of 2012 and of the OECD figures for 2011.

Sources: OECD, *statistics,* http://stats.oecd.org (1.9.2012) and Central Bureau of Statistics, *Labor force Surveys Monthly, February 2013* , www.cbs.gov.il (14.4.2013).

Thanks to the fast recovery of the Israeli economy from the downturn of 2008–2009, compared to the sluggishness of the OECD economies, its relative employment standing improved in 2011. However, the record of Israel before 2008 both in terms of labor force participation and employment was inferior to that of the G7 and the OECD totals, and its place in the OECD ranking did not rise above 24th place.

Turning now to overall labor intensity and productivity, the OECD figures show that while the employed persons in Israel are working more hours per year than the workers in most (25 out of 34) OECD countries,[32] GDP per hour of work in Israel is lagging quite substantially behind the G7 and the entire OECD "club" (Figure 5).

The large gap between labor productivity in Israel and in the major industrialized countries (of the G7 group) has not been just a very recent phenomenon. As Dan Ben-David has shown, the labor productivity gap, after narrowing substantially towards the mid-1970s, widened continuously thereafter, particularly since 1990.[33] The fast increasing gap between 1990 and 2011 is well illustrated in panel B of Table 1, which shows the much slower growth rates of GDP per hour of work in Israel, compared to the G7 and the OECD countries.

Part of this gap may be due to the lower rate of capital investment in Israel, 17% of GDP in 2000–2011, compared to the OECD average of 22% over the same period.[34] But in the main it was the slow increase of overall

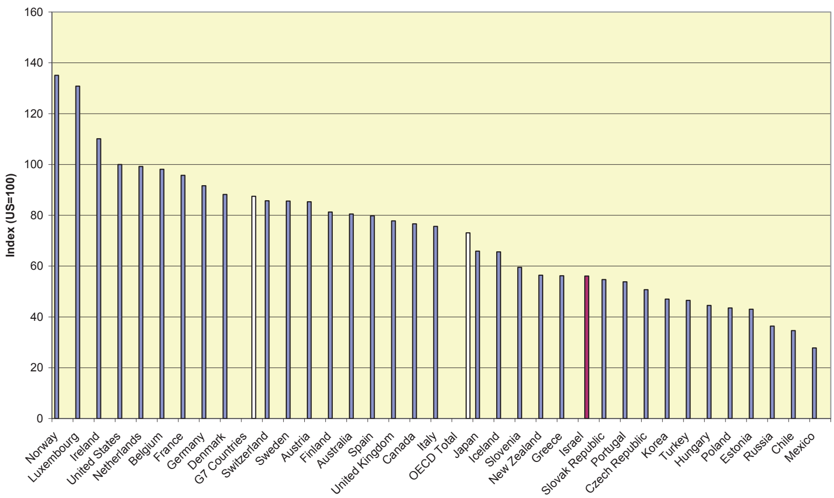

Figure 5. Index of GDP per hour of work, G7 and OECD countries, 2011
Source: OECD *statistics*.

productivity that made for the poor growth of labor productivity in the Israeli business sector, and probably in the economy as a whole in the last decades.

At first glance the relatively slow growth of (overall and labor) productivity may look rather surprising given the high proportion of R&D expenditures—a major source of technological advance—in the Israeli economy. Total civilian R&D expenditures in Israel reached 4.5% of GDP in 2004–2010, a rate unmatched by any of the OECD countries. In Finland, Israel's runner up in the OECD ranking, the share of R&D in GDP was 3.6%, and the OECD average was 2.3%.[35]

Most of the R&D activity in Israel (about 80% in current prices in the late 2000s) was performed within the business sector and was naturally concentrated in the high productivity high-tech industries, which generate about 55% of the entire manufacturing product.[36] Moreover, the output of the high-tech industries constituted in 2011 about 78% of Israel's industrial export and no less than 40% of its total exports of goods and services, which grew from about 28% of GDP in the early 1990s to 43% in 2011, thus becoming a major source of growth in the economy.[37]

This success story, however, remained confined largely to the high-tech industries. The rest of the business sector, consisting of the broadly defined less advanced industries and services (which employ more than 50% of all the workers in the sector), lagged behind in productivity, innovation, and

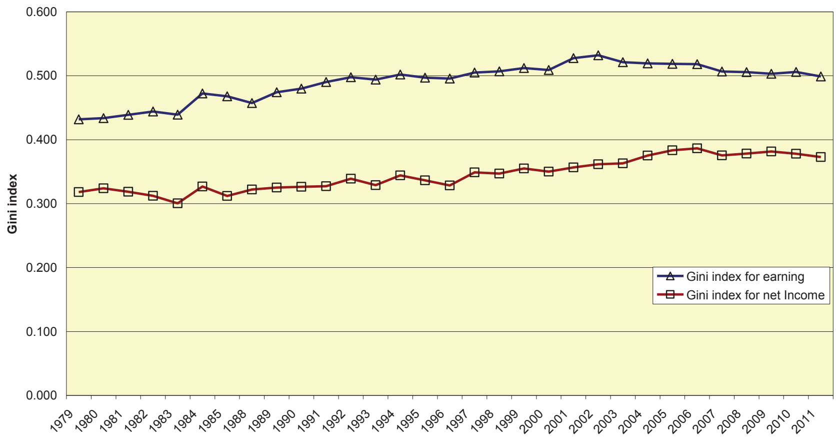

Figure 6. Gini index of income inequality among Israeli households (excluding East Jerusalem), 1979–2011
Sources: National Insurance Institute, *Annual Survey 2011* and *Dimensions of Poverty and Social Gaps, Annual Report 2011*, www.btl.il (13 December 2012).

output growth, while generating demand mainly for low skill and low wage labor.[38] Furthermore, producing primarily for the domestic market, and being still sheltered from foreign competition by protectionist policies, some of these industries (particularly in the production and marketing of food products) continue to operate in an environment of limited competition, which by itself may inhibit productivity. In addition, the lack of sufficient competition enables the effectively protected industries to utilize their market power and impose on the consumers higher prices than would be possible in truly open and competitive markets.[39]

On a more general level, productivity may have been negatively affected by structural deficiencies, for example in transportation infrastructure and services. Other deficiencies, such as administrative inefficiencies imposing unnecessary burdens on productive and business activities and discrimination of Arabs in the housing and labor markets, hindering the efficient utilization of their labor skills, may also have slowed the growth of productivity.[40]

The problems of the Israeli educational system may have added an additional negative effect on productivity. One noticeable problem is the substantial achievement gaps in international and domestic standardized tests in mathematics, sciences, English, literacy, and mother-tongue between Jewish and Arab pupils, and by socio-economic background. These gaps remained rather persistent, even as the Israeli pupils of all groups and

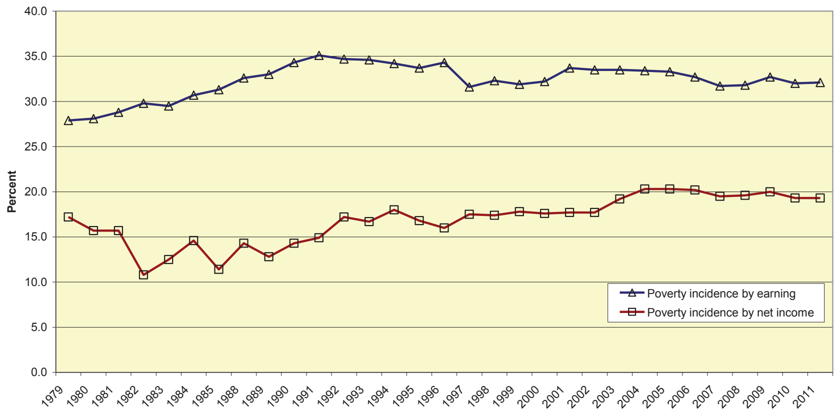

Figure 7. Poverty incidence in percent of Israeli households (excluding East Jerusalem), 1979–2011
Source: National Insurance Institute, *Annual Survey 2011* and *Dimensions of Poverty and Social Gaps, Annual Report 2011*.

backgrounds have exhibited quite impressive results in the latest (2011) international tests.[41] Another problem is the shortage of vocational schools and facilities of technological training, leaving about 50% of each cohort of high school graduates (excluding the ultra-Orthodox Jews), who are ineligible for admittance to institutions of higher education, with only limited opportunities for skill acquisition suitable for a modern economy.[42]

These observations lead to the conclusion that substantial segmentations and dualistic traits exist in the Israeli economy. They make balanced growth across groups, sectors, industries, and locations difficult to achieve, and contribute thereby to the rising socio-economic gaps within the Israeli society to which I turn next.

The overall patterns of income inequality (in terms of the Gini index for the income distribution of households) and of the incidence of poverty (measured by the percentage of households with income lower than half of the median household income) are displayed in Figures 6 and 7.[43] The inequality and poverty parameters are shown for economic earning (E) net of direct taxes (T) and of governmental transfer payments (TP), and for net income (NI=E-T+TP), which includes them. As such, the calculation by earning could be interpreted as the extent of inequality and poverty that would have (counterfactually) prevailed in the economy if the government did not reduce them by means of direct taxes and transfers.

A comparative perspective on the extent of inequality and poverty in Israel is provided by Figures 8 and 9, which display the ranking of the

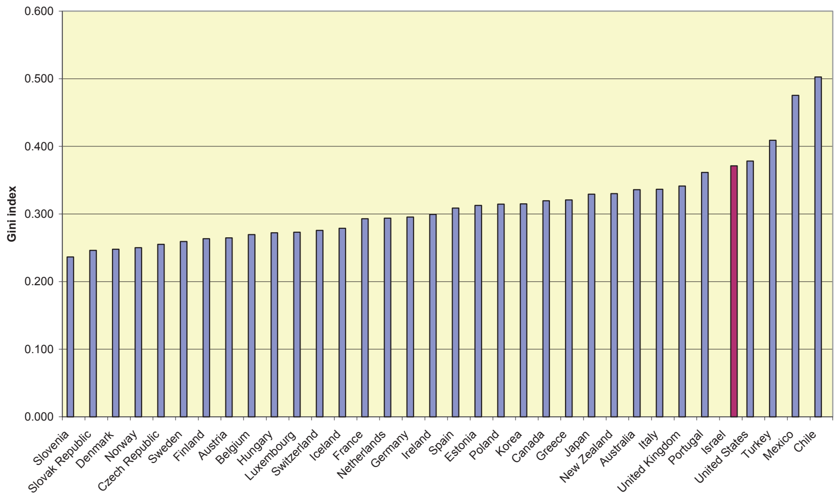

Figure 8. Gini index of net income inequality, OECD countries, 2007/2008. Source: OECD, *Society at Glance* (Paris, 2011).

OECD countries by the inequality of households' income and by the incidence of their poverty (in terms of net income) in 2007/2008 prior to the onset of the global great recession. Israel, as clearly shown in the two figures, occupies a rather infamous position in the OECD group. It is in 30th place among the 34 OECD countries in terms of income inequality, with only the US, Turkey, Mexico, and Chile having a more unequal income distribution. In the incidence of poverty the picture is even more extreme; Israel is located in 33rd place just before Mexico. Moreover, the poverty report just published by the National Insurance Institute for 2011 shows that Israel's position in both inequality and poverty remained unchanged within the ranking of the OECD countries in the late 2000s, even as her economic performance in the recession years was on the whole superior to that of the OECD "club".[44]

Returning to Figures 6 and 7, two prominent features are revealed by their exhibited patterns. One is the secular rise of inequality and poverty in net income terms between the mid-1980s and 2006, leaving them fluctuating thereafter around their mid-2000s high levels. The second feature is the declining contribution of the government taxes and transfer payments to the reduction of inequality and poverty. This is particularly evident in the years 2002–2006 during which measured inequality and poverty by net income continued to rise while the analogous measures by earnings exhibited a slight decline. These diverging paths reflect the diminishing

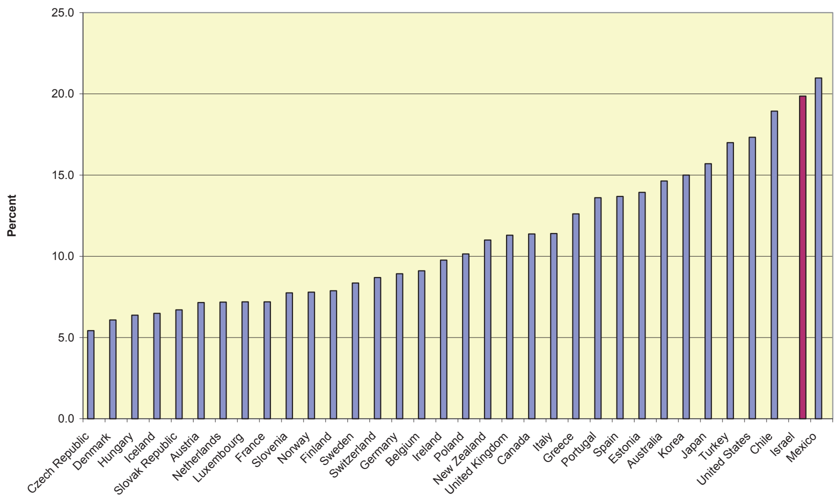

Figure 9. Percent of households living below the poverty line, OECD countries, 2007/2008 Source: OECD *Society at Glance* (Paris, 2011).

progressivity of the taxes and transfers system in the years of substantial cuts in welfare allowances—negatively affecting the low income segments of society and benefiting the high income ones.

Although the problem of inequality and poverty may not have been effectively handled, and even aggravated, by the government tax and transfers policy, its main causes are to be found in the labor market (partly affected by government policies as well). A most prominent characteristic of Israel's labor market is its large wage gaps. In 2009, a full time employee in the 90th percentile of the wage distribution earned a wage more than 5.2 times higher than the wage received by a full time employee in the 10th percentile (in the US, for example, the analogous wage gap in 2009 was slightly smaller, about 4.9 times). While the wage differentials by gender and by work experience have declined since the late 1990s, the earning gap by education has risen substantially. A worker with 13+ years of schooling earned on average 66% more than a worker with up to 12 years of schooling in 1998 and 80% more in 2009.[45]

The rising wage differential by education seems to have been driven by two sets of factors. On the upper educational scale, a rising demand for highly educated and skilled workers at a faster pace than the growth of their supply raised their real wage by about 1% in 1998–2009. On the lower educational scale, the relative decline in the demand for low skilled Israeli workers, caused in part by the supply of low paid foreign labor, made for

Table 2. Poverty and socio-economic dimensions (percent)

Poverty Rates (in net income terms) of households, 2011

By population groups:	Ultraorthodox	54.3
	Arabs	53.5
	All the rest	11.4
	Total	19.9
By number of children in houshold:	1 to 3	20.1
	4+	57.2
	5+	69.5
By number of breadwinners in household:	None	40.0
	1	25.9
	2	4.6

Percentage distribution of households by number of persons and breadwinners, 2009

		Ultraorthodox	Arabs	Newcomers in the periphery	All the rest
Persons:	1 to 2	14	16	52	47
	3 to 4	31	29	36	33
	5 to 6	26	35	10	17
	7+	29	20	2	3
Breadwinners:	None	33	26	40	22
	1	46	46	32	31
	2	21	28	28	46

Rates of employment, ages 25-64, 2011

	Ultraorthodox	Arabs	All the rest
Men	45.6	72.2	81.4
Women	61.2	26.8	75.4

Labor force participation rates, age 15+ by years of schooling, 2011

Years of	Jews			Arabs		
schooling	Men	Women	All	Men	Women	All
0-12	52.7	45.2	49.0	57.0	13.1	35.2
13+	73.8	73.0	73.4	68.5	49.9	59.1
Share of attending 13+ years of schooling in age groups						
25-34	65.1	71.2	68.2	34.2	37.0	35.6
35-44	61.4	62.4	61.9	23.1	21.8	22.4
45-54	52.8	55.5	54.1	24.0	16.2	20.1
55-64	50.6	51.5	51.1	20.7	9.5	15.0
25-64	58.4	61.1	59.7	26.9	24.4	25.7

Sources: Eyal Kimhi, "Income gaps in Israel," 101-133; Central Bureau of Statistics, *Statistical Abstract of Israel 2012* ; Bank of Israel, *Bank of Israel Annual Report for 2012* ; National Insurance Institute, *Dimensions of Poverty and Social Gaps, Annual Report 2011* .

a sharp decline (of about 7%) in the real wage of workers with up to 12 years of schooling between 1998 and 2009. The rising extent of low-wage contract labor and the poorly enforced minimum wage law added another contributing factor to the decline.[46]

The labor market preference for highly educated labor is reflected also in the labor force participation and employment rates by education. In 2010, 83% of the Israeli population of the main working ages (25 to 64) with 13+ years of schooling participated in the labor force, versus 67% of those with up to 12 years. The rates of employment of about 79% and 62%, respectively, exhibit a similar differential, which adds to the effect of the wage gaps on the economic disparities in the Israeli society.[47]

In the discussion so far I concentrated on the aggregate picture of rising inequality and poverty, but behind it lie, as one would expect, substantial differences between various segments of society and their demographic and socio-economic characteristics. A representative illustration of these differences from the perspective of poverty incidence is provided in Table 2.

In the population as a whole, about 20% of the households (19.3% without East Jerusalem) in 2011 received a level of net income lower than the poverty threshold.[48] But it is seen, not surprisingly, that the incidence of poverty increases with the number of children in households (note that 35.6% of the children in Israel lived below the poverty line in 2011)[49] and declines with the number of breadwinners. It should be stressed, though, that while the incidence of poverty in 2011 among households with two or more breadwinners (4.6%) was by far lower than among households with one (25.9%) or no breadwinners (40%), it more than doubled in the last 13 years (from 2% in 1999 to 4.6% in 2011).[50] In terms of population groups, the ultra-Orthodox and the Arabs clearly stand out by their exceptionally high poverty rates (54.3% and 53.5% of their respective households were identified as poor in terms of net income in 2011, versus 11.4% in the rest of the Israeli population).[51]

The differences in the extent of poverty by socio-economic attributes and by population groups are, obviously, interrelated. This is demonstrated in Table 2 by the distribution of the three groups, Arabs, ultra-Orthodox, and all the rest by household size, number of breadwinners, and rates of employment in the 25–64 age groups.

The intergroup differences in employment rates and in their derived number of breadwinners per household are concentrated primarily in the employment gaps by gender, with the ultra-Orthodox characterized by relatively low rates of employment of men and the Arabs by very low employment of women. Part of these gender-specific differences is undoubtedly culturally and socially driven. The unsuitability of the ultra-Orthodox education, particularly of males, to the needs of a modern economy and the conscription-related constraints on the employment of young ultra-Orthodox adult men should obviously be added to these factors.

It should be noted, however, that important as the group-specific cultural and social factors may have been, they have not been rigid enough to prevent market incentives from affecting, even if modestly, the labor market behavior of ultra-Orthodox men and Arab women. The rise in the rates of employment of ultra-Orthodox men (from 38.9% in 2001 to 45.6% in 2011) and of Arab women (from 19.6% to 26.8% in the same period) illustrates just that.[52]

Particularly significant in this respect is the very large difference (of 3.8 times) in the rate of labor force participation between Arab women with 13+ years of schooling and those with lesser education (the equivalent difference in the Jewish community was only 1.6 times). It should be emphasized, however, that although the proportion of Arab women with 13+ years of schooling reached 37% in the younger (25–34) age group in 2011 (exceeding the 34.2% of Arab men), the proportion of both Arab men and women with higher education remained substantially lower than among the Jews (Table 2). Part of this difference may be due to the relatively poor performance of the Arab educational system, as indicated above, and part due to the relatively limited employment opportunities for Arab academicians.[53]

Overall, a rising hourly wage gap between Arabs and Jews with similar labor market characteristics, from 12% in 1987 to 25% in 2005, has been observed by Noam Sussman and Amit Friedman. Likewise, Yousef Jabareen found that hourly wages broken down by gender and education, produced Jewish–Arab wage gaps of 27.6% for men with no secondary education and 24.5% for men with higher education, with analogous 16.2% and 13.9%, respectively, for women.[54] These widely observed wage gaps may be a prime factor in making for the large differences in poverty incidence between Jewish and Arab families with one and two breadwinners (of 3.6 and 3.3 fold, respectively, in 2007).[55]

Several factors have been suggested in the literature to account for these substantial gaps in earning. Prominent among them are: (1) spatial residential segregation and narrow economic bases in Arab localities; (2) concentration of Arab academicians in fields of relatively low returns such as education and health-care services, and overrepresentation in occupations and industries in which they are overqualified; (3) relatively large proportion of workers (43% of Arab vs. 28% of Jewish men in 2009) in low paying industries, such as manufacturing, construction, and agriculture (the concentration of employment in physically demanding jobs in these industries may partly explain the relatively early decline, starting at 45 years-of-age, in labor force participation of Arab men); (4) competition of foreign laborers in the lower occupational echelons and of skilled immigrants from the former Soviet Union in the higher echelons; (5) Security-driven barriers barring Arabs from employment in a significant number of establishments in both the public and the private sectors; (6) last but not least, sheer discrimination, which may have intensified following the October 2000 events and the outbreak of the second *Intifada,* and may have made for 20% to 30% of the Arab-Jewish wage gaps in the early 2000s.[56]

The professional and public discourse on poverty and inequality has naturally concentrated over the years on the inferior economic status of the susceptible groups (ultra-Orthodox, Arabs, people living in the periphery, single parent families, elderly, and newcomers) and on the policy measures called for to correct it. Recently, however, the discourse on social justice shifted attention to the middle class, perceived to be the backbone of society.[57] This new emphasis that began with the "cottage cheese protests" against high and rising food prices and culminated in the broad-ranged protests of Summer 2011, pointed to the middle class as another group suffering from economic hardship and from uncertain economic prospects.

Apart from expressing the grievances caused by the polarization of earning, the discourse focusing on the economic erosion suffered by the middle class (particularly by its young aged households) raised the claim, which is supported by the data, that the high costs of housing, food, and public utilities, which grew faster than earnings, put a substantial squeeze not only on the lower echelons of society but on its middle income segments as well.

The attention placed in the public discourse to the high prices of basic goods and services brought to the fore the issue of economic concentration, monopoly power, and limited competition which generate them. The Trajtenberg Committee identified in its report three basic governmentally affected factors making for these deficiencies: failed regulation; lack of effective exposure to international competition of various industries, including a variety of import barriers; and economic concentration, making for limited competition in a number of industries.

Noticeable cases accounted for in the Trajtenberg report are: (1) the high concentration in the production and import of food products, with a good part of their local production being sheltered from international competition; (2) the excessive power of organized labor in the big governmental monopolies of public utilities, hindering efficiency-enhancing reforms and keeping high consumer prices of their products and services so as to guarantee their conspicuously high wages; (3) the failure of the government (which controls 93% of Israel's land) to provide the needed supply of land for residential housing to match the rising demand, causing thereby a sharp increase in the cost of housing.[58]

While the advantages to the general public from the lifting of protection on local production and from the promotion of efficiency-increasing and price-reducing competition are quite obvious (see the cellular phone market), such moves are frequently objected to on the basis of their negative effects on employment in the "forced to compete" industries. These labor market effects, as well as other problems related to Israel's mixed socio-economic record of the last decades, are best addressed, though, in the context of a broader discussion in which the contours of possible economic and welfare regimes of choice are considered. It is this discussion that the next section is centered on.

IN LIEU OF SUMMARY: SOME THOUGHTS ON THE CHOICE OF ECONOMIC REGIME

As a departure point for the discussion, I am willing to conjecture that despite the strong criticism of the market-based business economy that was recently raised in Israel and elsewhere, a wide consensus does exist that the basic contours of the market economy should be maintained in any socio-economic regime in order to provide proper incentives for entrepreneurship and economic advance. It should be reiterated, though, that the motivational and efficiency advantages of the market are not derived from its being free, but rather from its being competitive.

The widely accepted need to strengthen competition in the markets for goods and services raises a corollary question concerning the functioning of the labor market. Or more specifically: How could the labor market be designed to maintain the rights of workers on the one hand and flexibility in employment on the other hand so as to support a competitive business sector and raise productivity in the public sector, without unduly harming the workers?

The importance of this question is sharpened by the duality that has developed in the Israeli labor market over the years, not the least in reaction to union-protected rigidities. This duality is characterized on one side by a large body of tenure-secured employees, primarily in the public sector and in large government companies. And on the other side, by a growing number of contractual, mostly low paid, workers lacking tenure and fringe benefits, who are employed either by labor contractors or by various NPOs that are mostly engaged in the provision of social services. The latter reflect to a large extent the recently intensified government policy of outsourcing.

When thinking about possible labor market structures that could eliminate this duality, the option of *flexicurity*—the famous scheme initiated and successfully implemented in Denmark (and with some qualifications became a guiding model for the European labor market policy)—should undoubtedly be considered.

Flexicurity (combining flexibility and security) is composed of three basic components: One is the freedom of employers to hire, fire, and manage their labor force, which is much needed in order to remain competitive in today's rapidly changing economic and technological environment. The second component is a comprehensive safety-net for the unemployed, consisting of generous unemployment benefits applicable for substantial duration. And the third is an active labor market policy, activating the labor force through training programs, in which the unemployed have to enroll as the period of their joblessness lingers on. A main objective of these programs is to adjust the skills of the unemployed (as well as of employed people) to the fast changes in the demand for labor in the economic world of today.[59]

Thus, in supporting a dynamic and flexible labor market, *flexicurity* became (in Denmark and in other North European countries) instrumental for maintaining a highly competitive market economy based on a vibrant private sector, while providing employment security (rather than job protection) and facilitating the continuous employability of the working age population. Taking the concerted cooperation of government, employers, and trade unions in making (the Danish) *flexicurity* work, it epitomizes the possibility of a working symbiosis between the free market and the generous, universally based, and highly taxed welfare state; thus putting in serious doubt the validity of frequently made claims that a competitive growing economy is incompatible with "big government" and a comprehensive welfare state.[60]

In thinking about a similar symbiosis in Israel (which would obviously require the consent of the *Histadrut* and other labor organizations), it should be stressed that a flexible labor market could potentially enhance labor productivity, mainly but not exclusively, in the public sector and in its public utility companies, and reduce the efficiency losses and unduly high wage gaps stemming from excessive union power in those monopolistic establishments. Likewise, in a free and flexible labor market, coupled with effective enforcement of the minimum wage and other labor laws, the distinction between regular and contract labor would be blurred and the duality in employment conditions could be eliminated, with the potential of possibly reducing income inequality and poverty.

The loss of tenure and of seniority benefits in such a newly structured labor market could be compensated for by a balanced mixture of employment security and active labor market policy. These should provide both a comprehensive safety net and an effective incentive for individuals to remain or become employable, by retooling if necessary. Moreover, a well-designed labor activation policy could also ease some of the group-specific difficulties of employability by providing adequate and attractive training programs geared, for example, to the low labor force participatory groups such as the Arabs and the ultra-Orthodox Jews.

It should be emphasized, though, that for such programs, and for the entire *flexicurity* scheme, to become effective means of equality of opportunities the labor market (and other markets as well) would have to be discrimination free. In other words, discrimination of all kinds, particularly of Arabs in the labor, land, and housing markets, but also of other distinct groups (Ethiopia originated immigrants for example), would have to be abolished, and ethno-national and skin color blindness would have to become the order of the day in all markets.

Flexicurity, however, should not be dealt with in isolation but considered part of the fundamental question concerning the socio-economic regime that Israel could in principle adopt (disregarding for the sake of discussion possible political barriers to any such adoption). Apart from (getting back to) economic etatism, the range of adoptable regimes is bounded by two extreme alternatives with milder schemes in between. At one end it is bounded by the (neo)liberal regime based on a strong market economy and a slim welfare state maintained by a relatively small government. And at the other end, by the Nordic model, in which a comprehensive welfare state, financed by high taxes and managed by a large public sector, coexists with a capitalist private economy functioning within an institutional environment of competitive markets and free external trade.[61]

The choice of regime, be it one of these two extreme models or any scheme in between, requires naturally a political (and not an economic) decision. Such a decision should reflect the attitudes of the Israeli society to social equity and economic incentives and to the interplay between individual economic autonomy, the size of government, and the boundaries of its social responsibility. While the economic regime of the last decades has leaned strongly toward the (neo)liberal model, Israel could perhaps be ready now for a new choice of regime that would shape its socio-economic profile for years to come.

Notes

1. See the illuminating discussion on the economic aspects of these issues in Paul Rivlin, *The Israeli Economy from the Foundation of the State through the 21st Century* (New York, 2011), 143–65.

2. GDP is defined as the market value of all final goods and services produced within a country (or any other spatially identified area) in a given unit of time (usually a year).

3. Bank of Israel, *Bank of Israel Annual Report for 2012* (Jerusalem, 2013), Statistical Appendix. Accessed 8 April 2013. www.boi.org.il [Hebrew].

4. Ephraim Kleiman, "The Waning of Israeli *etatisme*," *Israel Studies* 2.2 (1997): 146–71.

5. For an elaborate account of these issues see *Idem*. See also Jacob Metzer, "From the Jewish National Home to the State of Israel: Some Economic Aspects of Nation and State Building," in *Nation, State and the Economy in History*, ed. Alice Teichova and Herbert Matis (Cambridge, 2003), 270–87.

6. Yoram Ben-Porat, "The Conservative Turnabout That Never Was—Economic Policy and Ideology Since 1977," *The Jerusalem Quarterly* 8 (1983): 3–10.

7. Avi Ben-Bassat, "The Obstacle Course to a Market Economy in Israel," in *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics*, ed. Avi Ben-Bassat (Cambridge, MA, 2002), 1–58.

8. Kleiman, "The Waning of Israeli *etatisme*," 166.

9. The reduction of direct taxes was terminated by the government, and even reversed, in early 2012, following the recommendation of the *Committee for Socio-Economic Change* (the Trajtenberg Committee), nominated by the government in August 2011 to deal with the issues raised by the social protest of Summer 2011.

10. Momi Dahan, "Economic Policy in Crisis: Winter is Here, but the Economy is Dressed for Spring," *Mishpatim* 40.2 (2011): 571–600 [Hebrew].

11. Useful discussions of the economic aspects of privatization and of the controversies about it both in general and in Israel are found, among others, in the Discussion Forum, *The Economic Quarterly* 43.4 (1996): 577–688 [Hebrew]; Shlomo Eckstein, Shimon Rozevich, and Ben-Zion Zilberfarb, *Privatization of Public Enterprises in Israel and Abroad* (Ramat Gan, 1998) [Hebrew]; Gérard Roland, ed., *Privatization: Successes and Failures* (New York, 2008); Chaim Fershtman, "Boundaries of Privatization," in *Disputes in Economics*, ed. Arie Arnon and Moshe Justman (Jerusalem, 2009), 67–86 [Hebrew]; Reuben Gronau, "The Privatization of Social Services in Israel: Questions and Worries," in *Report on the State of the State: Society,*

Economy and Policy 2011–2012, ed. Dan Ben-David (Jerusalem, 2012), 363–414 [Hebrew], and in the references listed in them.

12. See Fershtmen, "Boundaries of Privatization" and Gronau, "The Privatization of Social Services in Israel."

13. David Levhari, "Not Privatization but Competition is Important," *The Economic Quarterly* 43.4 (1996): 680–82 [Hebrew].

14. Fershtmen, "Boundaries of Privatization".

15. An enlightening discussion of these issues is found in Oliver Hart, Andrei Shleifer, and Robert Vishny, "The Proper Scope of Government: Theory and Application to Prisons," *Quarterly Journal of Economics* 112.4 (1997): 1127–61.

16. Gronau, "The Privatization of Social Services in Israel."

17. The expenditures of the general government (interchangeably called the public sector) include: the expenditures of the central government, the national insurance institute, the municipalities, the national institutions, and the public sector's NPOs, such as publicly financed institutions of higher education.

18. Momi Dahan, "Economic Policy in Crisis."

19. Ben-Bassat, "The Obstacle Course to a Market Economy in Israel"; Michel Strawczynski and Joseph Zeira, "Reducing the Relative Size of Government in Israel after 1985," in *The Israeli Economy, 1985–1998: From Government Intervention to Market Economics*, ed. Avi Ben-Bassat (Cambridge MA, 2002), 61–81.

20. Haim Barkai, *The Evolution of Israel's Social Security System: Structure, Time Patterns and Macroeconomic Impact* (Aldershot, UK, 1998); John Gal, *Social Security in Israel* (Jerusalem, 2004) [Hebrew].

21. Joseph Zeira, "Desired Size of the Government—Between Economics and Politics" (paper presented at the 17th Caesaria Forum, Jerusalem, 2009) [Hebrew]; Dahan, "Economic Policy in Crisis"; Momi Dahan and Moshe Hazan, "Orders of priority in the Government Budget," *The Economic Quarterly* (forthcoming) [Hebrew].

22. Dahan and Hazan, "Orders of Priority."

23. GDP per capita is widely accepted as a standard measure of economic growth in terms of material wellbeing. The growth rates were derived from data published in the Central Bureau of Statistics, *Statistical Abstract of Israel 2012* (Jerusalem, 2012). Accessed 16 September 2012. www.cbs.gov.il and in the Bank of Israel, *Annual Report for 2012*.

24. The G7 countries are: Canada, France, (West) Germany, Italy, Japan, the UK, and the US. The growth rates were derived from Angus Maddison, "Historical Statistics of the World Economy 1–2008AD." Accessed 1 October 2012. www.ggdc.net

25. Nadav Halevi and Ruth Klinov-Malul, *The Economic Development of Israel* (New York, 1968); Simon Kuznets, "The economic development of Israel," *The Economic Quarterly* 78–79 (1973): 189–209 [Hebrew]; Rivlin, *The Israeli Economy.*

26. Jacob Metzer, "The Slowdown of Economic Growth: A Passing Phase or the End of the Big Spurt?" in *The Israeli Economy—Maturing through Crises*, ed. Yoram Ben-Porat (Cambridge MA, 1986), 75–100.

27. Central Bureau of Statistics, *Statistical Abstract of Israel 2012*; Bank of Israel, *Annual Report for 2012*.

28. The Conference Board, *Total Economy Data Base*. Accessed 1 October 2012. www.conference-board.org

29. OECD, *National Accounts at a Glance* (Paris, 2011).

30. The labor force is composed of the employed persons and the unemployed who seek employment.

31. Bank of Israel, *Annual Report for 2012*.

32. OECD, *Statistics*. Accessed 1 September 2012. http://stats.oecd.org

33. Dan Ben-David, "A Macro View on the Economy and Society of Israel," in *Report on the State of the State: Society, Economy and Policy 2009*, ed. Dan Ben-David (Jerusalem, 2010), 17–44 [Hebrew].

34. Bank of Israel, *Annual Report for 2012*.

35. OECD, *Science Technology and R&D Statistics* (Paris, 2012). Accessed 2 October 2012. www.oecd-library.org

36. Bank of Israel, *Bank of Israel Report for 2011* (Jerusalem, 2012). Accessed 1 November 2012. www.boi.org.il [Hebrew].

37. Central Bureau of Statistics, *Statistical Abstract of Israel 2012* (Jerusalem, 2012). Accessed 16 September 2012. www.cbs.gov.il

38. National Economic Council, *Economic and Social Agenda for Israel 2008–2010* (Jerusalem, 2007). Accessed 1 October 2012. www.pmo.gov.il [Hebrew].

39. Between 2005 and 2011 food prices grew in real terms by 12.7% compared to an average of 3.6% in the 27 countries of the European Union, see Tamir Agmon and Ami Zadik, "The Rise of Food Prices in Israel," The Knesset Research and Information Center (Jerusalem, 2011) [Hebrew].

40. Bank of Israel, *Annual Report for 2011* and *for 2012*; Dan Ben-David, "The Start-Up State and the Domestic Threat," in *Report on the State of the State: Society, Economy and Policy 2011–2012,* ed. Dan Ben-David (Jerusalem, 2012), 17–82 [Hebrew].

41. National Authority for Measurement and Evaluation in Education (Tel-Aviv, 2012). Accessed 17 December 2012. http://rama.education.gov.il

42. "Report of the Government Commission for Economic and Social Change," chaired by Manuel Trajtenberg (Jerusalem, 2011).

43. The Gini index measures the extent of inequality of the income distribution in society. It receives a value of zero for complete equality—whereby each unit in society receives exactly the same level of income, and a value of one for complete inequality—one unit receives all of society's income. It follows that the farther the index gets from zero, the more unequal is the income distribution. The median income is the level of income that divides the units in society into two equal parts, one receiving a level of income below, or equal to, the median income, and the other getting an income equal to, or higher than, the median one.

44. National Insurance Institute (NII), *Dimensions of Poverty and Social Gaps, Annual Report 2011* (Jerusalem, 2012). Accessed 13 December 2012. www.btl.il [Hebrew].

45. Eyal Kimhi, "Income Gaps in Israel," in *Report on the State of the State: Society, Economy and Policy 2010,* ed. Dan Ben-David (Jerusalem, 2011), 101–33 [Hebrew].

46. Central Bureau of Statistics, *Labor Force and Income Surveys* (Jerusalem, 2010). Accessed 16 September 2012. www.cbs.gov.il [Hebrew].

47. *Idem.* and Bank of Israel, *Annual Report for 2011.*

48. NII, *Dimensions of Poverty and Social Gaps, Annual Report 2011.*

49. Bank of Israel, *Annual Report for 2012.*

50. NII, *Dimensions of Poverty and Social Gaps, Annual Report 2011.*

51. *Idem.*

52. Bank of Israel, *Annual Report for 2011.*

53. Noam Zussman and Amit Friedman, "Quality of Labor Force in Israel," *Bank of Israel Survey* 82 (2009): 7–77 [Hebrew]; Jousef Jabareen, "Arab Employment in Israel—The Challenge of the Israeli Economy" (paper presented at the 17th Caesaria Forum, Jerusalem, 2009) [Hebrew]; Eran Yashiv, "The Arabs in the Israeli Labor Market," The Program for Economy and Society, Van Leer Jerusalem Institute (Jerusalem, 2012).

54. Zussman and Friedman, "Quality of Labor Force in Israel"; Jabareen, "Arab Employment in Israel."

55. Jabareen, "Arab Employment in Israel."

56. Muhammad Asali, "Why do Arabs Earn Less than Jews in Israel?" Discussion Paper No, 06.03 The Maurice Falk Institute for Economic Research in Israel (Jerusalem, 2006); Zussman and Friedman, "Quality of labor force in Israel"; Eran Yashiv and Nitsa Kasir, "Patterns of Israeli Arabs' participation in the labor market," Research Department, Bank of Israel, Discussion papers series, 11 (Jerusalem, 2009) [Hebrew]; Jabareen, "Arab employment in Israel "; Yashiv, "The Arabs in the Israeli Labor Market."

57. The middle class is statistically defined as the population group including those whose income is higher than 75% and lower than 125% of the median income, see Bank of Israel, *Annual Report for 2011*.

58. Part of the high demand for housing has been fed by the low interest policy of the Bank of Israel, aimed at combating the recent economic slowdown.

59. Sonja Bekker and Ton Wilthagen, "Europe's Pathways to Flexicurity: Lessons Presented from and to the Netherlands," *Intereconomics* 43.2 (2008): 68–111; Torben M. Andersen, "A Flexicurity Labor Market in the Great Recession—The Case of Denmark," CEPR, CESifo and IZA (January, 2011).

60. See for example Daron Acemoglu and Robert Shimer, "Productivity Gains from Unemployment Insurance," *European Economic Review*, 44.7 (2000): 1195–224. They argue that unemployment insurance increases labor productivity by providing incentives for workers to search for high productivity jobs and for employers to offer them. See also Colin Hay and Daniel Wincott, *The Political Economy of European Welfare Capitalism* (Basingstoke, UK, 2012), who present a strong case for the compatibility of competitiveness with the welfare state.

61. The Israeli economics and business newspaper *The Marker* devoted a good part of its 2011 yearly magazine (*Markerweek*, 22 December 2011) to the Nordic economic model (including flexicurity), and published response articles on the possibility of adopting it in Israel by Eran Yashiv and Yoram Gabai (*The Marker*, 25 December 2011) [Hebrew]. Likewise, the *Economist* published a special report on the Nordic Model in its 4 February 2013 issue under the title "The next supermodel." This report was translated into Hebrew and published later in the month in the daily issues of *The Marker*.