

# 19

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**19<sup>th</sup> Caesarea Economic Policy Planning Forum**  
**The College of Management Academic Studies**

June 19–20, 2011

**Rishon Lezion**

**Abstracts and Working Group Recommendations**

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**The Israel Democracy Institute**  
**19<sup>th</sup> Caesarea Economic Policy Planning Forum**

June 19–20, 2011

**Forum Sessions**

1. Young Adults: Ages 18–22
  - The Forgotten Age in the Ultra-Orthodox Sector
  - The Invisible Age in the Arab Sector
  - Military Enlistment – A New Approach
2. The Internet Economy in Israel – A Growth Engine for the Future
3. Cutting Red Tape – A Boon to the Economy?
4. The Global Economy and Israel

**The Forum is sponsored by:**





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Research Division, Center for Behavioral Studies, IDF Personnel Directorate

(To be distributed at the Forum)

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## Foreword

The Caesarea Forum is convening for the 19<sup>th</sup> time this year and will deal—in accordance with past tradition—with issues central to the public debate in Israel in the social and economic fields. Israel's acceptance to the Organization for Economic Cooperation and Development (OECD) is a badge of honor that underscores the strength of the Israeli economy. Joining the organization has provided a driving force for the advancement of important reforms, foremost among them the increasing of the level of participation in the work force and adapting the government bureaucracy to the international standards that the OECD is advancing.

After much thought, learning of lessons, and assessing the needs of the economic policy makers of Israel in 2011, we decided to change the format of the annual forum. We determined that the major mission is to serve as a high quality, efficient stage for a discussion that will, in turn, serve the economic leadership of Israel. For this reason we decided to present the participants with a larger selection of position papers in each field of discussion. The papers, however, will be concise and highly focused.

The first session—Young Adults: Ages 18–22—will be devoted this year to the entry into adult life. It will be divided into two main topics. The first session will be devoted to the young adults in the ultra-Orthodox (haredi) and the Arab sectors. The second session will focus on conscription to the IDF. In the first session, Dr. Reuven Gal, Mr. Gilad Malach, and Mr. Hagay Levin will describe the desired policy in the eyes of haredi youth and the recent changes in government policy in this area. Dr. Aviad Hacoen will present an up-to-date picture of haredi society in this age group and the issues of employment and academic studies from the view point of this sector of society. (Dr. Hacoen's paper was prepared with Dr. Lee Cahaner.) Dr. Momi Dahan and Professor Zvi Eckstein will present data on the employment and academic situation of young adult Arabs in Israel.

The second session will focus on the desired model for army service and will present the findings of five working groups. Professor Avi Ben-Bassat will propose a model for reducing the period of mandatory IDF service, based on a 2006 report of a government appointed committee on shortening the period of mandatory army service. Mr. Yossi Kucik will review the changes that have taken place in Israel in

recent years and how they influence the relevance of the people's army model. Mr. Yaacov (Kobi) Haber will present recommendations for retaining the people's army model. Professor Asher Tishler will review the models of conscription in various countries. (Professor Tishler prepared this paper together with Mr. Sasson Haddad.) Major General Avi Zamir, head of the IDF Personnel Directorate, will present these issues from the IDF perspective.

The study of the influence of the Internet on the economy is a new and extensive international project that was initiated by Google as part of an effort to determine the impact of the Internet on the global economy. The second session—The Internet Economy in Israel – A Growth Engine for the Future—will be the final session of the first day. Ms. Dana Maor will present a study conducted by McKinsey Israel, commissioned by Google Israel. The study examined the size of the Internet based economy in Israel, Internet usage, and employment in the local Internet economy in various sectors. There will be a discussion in this session of ways to advance the Internet economy in Israel as an important growth engine and as a significant factor for the local economy.

The third session—Cutting Red Tape – A Boon to the Economy?—will open the second day of discussions and will focus on the amount of influence the public sector has on the private sector. Mr. Haim Shani and Dr. Udi Nissan will present various projects conducted under the auspices of the Finance Ministry in the past year that aimed at improving government services. Government regulation from the perspective of the business community will also be the central focus of the discussion by Mr. Motty Shapira and Accountant Shahar Ziv. (This paper was prepared together with Mr. Eyal Rubinfeld, Adv., CPA, Mr. Shaul Ben Shimol and Mr. Sagi Ben Simon.)

In the fourth and final session—Israel and the Global Economy—Professor Jacob Frenkel will oversee two panels that will analyze the macro economic trends in the global economy and their impact on the Israeli economy. The first panel will be comprised of four renowned experts: Professor Niall Ferguson, Laurence A. Tisch Professor of History, Harvard University and William Ziegler Professor of Business Administration, Harvard Business School; Professor José Viñals, Financial Counsellor and Director, Monetary and Capital Markets Department of the International Monetary Fund and the past deputy governor of the Bank of Spain; Dr. Edward Morse, Global Head of Commodities Research for Citigroup Inc., and an international expert on the gas and oil industries; and Ms. Abby Joseph Cohen,

Investments Strategist and President, Global Markets Institute at Goldman Sachs. The second panel will be comprised of senior Israeli businessmen who are involved in global markets and they will discuss opportunities and obstacles that face the Israeli economy in its attempt to integrate into the global economy.

The findings of the working groups and the recommendations presented in this booklet will serve as the professional groundwork for a very worthwhile and relevant gathering on the current problems facing Israel. We wish to thank Mr. Yosef Kalmanovitz, coordinator of the working groups and research assistant, and all those at the Israel Democracy Institute who have for months been faithfully working on both the organizational and content preparations for the 2011 Caesarea Economic Forum.

Sincerely,

Dr. Arye Carmon



President, The Israel Democracy Institute

Professor Zvi Eckstein



Academic Advisor to the Forum



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# Young Adults: Ages 18-22

The Forgotten Age in the Ultra-Orthodox Sector

The Invisible Age in the Arab Sector

Military Enlistment – A New Approach





## Ultra-Orthodox Young Adults

Reuven Gal, Gilad Malach

In 2008, Israeli ultra-Orthodox (haredim) numbered 637,000, comprising 8.8% of the country's population. Of these, 63.4% were under the age of 20. According to the *Israel 2028* report, it is expected that by 2028, haredim will account for more than one fifth of the Jewish population of Israel.

Haredi society is a “society of learners,” where education and employment levels are very low. As a result, it is marked by high rates of poverty and by reliance on transfer payments. A growing number of voices among public-policy makers and members of haredi society have argued for years that the dependence on state support on the part of a steadily increasing population is liable to lead to a social and economic crisis. These assertions have led in recent years to new policy initiatives directed at haredim in the areas of the army and civilian national service, vocational training, academic studies, and employment. Concurrent with these undertakings, there has been a drop in the size of transfer payments, in particular child allowances, which has also had an impact on the need for haredim to enter the work force.

The preferred approach, in our view, for promoting change in haredi society is to hasten the entry of this group into the labor market and to improve its economic situation, without harming its unique character.

This position paper focuses on young haredim between the ages of 20 and 29, and the gaps in training and employment between them and the Israeli population as a whole. The proportion of those who have studied or are studying in academic institutions in this age group stands at 11% of haredim as opposed to 42% of the secular public. Only 49% of the haredi population in this age group participate in the work force, as compared with 70% in the secular public. The employment gap is most pronounced among males: 72% of young haredi men are not part of the work force, in contrast to 35% of non-haredi men. The gap is also expressed in terms of job parameters (full-time vs. part-time): 50% of haredi workers aged 20–29 work less than 35 hours a week as opposed to 26% of the secular public in this age group.

As a result of the rapid growth of haredi society (some 5% per year), the share of young haredim in the 20–29 age group is greater than their proportion in the

population as a whole. In 2009, haredim aged 20–29 constituted 13.5% of the Jewish population in this age group, while in 2021 the proportion of young haredim is projected to reach 22% of this population. This figure, coupled with the low percentage of haredim who are employed, means that the entry into the work force of young haredim aged 20–29 will have a major impact on the future of the economy.

Three different scenarios can be constructed regarding the entry of young haredim into the labor market by 2021:

- **First scenario:** Employment tracks for young haredi men will not be expanded. As a consequence, the employment rate among young haredi males will drop to 17%, and the overall rate of participation in the work force among young Israeli males will decrease from 60% to 54.5%. **Level of probability: low.**
- **Second scenario:** The number of applicants to the new programs will rise in keeping with the growth rate of haredi society. As a result, the proportion of young haredi males in the work force will continue to stand at 28%, but due to the high rate of growth in the haredi sector, the employment rate of young Israeli males as a whole will drop to 57%. **Level of probability: high.**
- **Third scenario:** The number of applicants to the new programs will stay at 10% annually. As a consequence, the proportion of young haredi males in the work force will increase from 28% to 51%, and the employment rate of young Israeli males as a whole will rise from 60% to 61.3%. **Level of probability: high, but dependent on various policy updates.**

## **Recommendations**

To promote the integration of young haredi men into the work force, the position paper offers several proposals in the following areas:

### **1. Secondary Education**

- a) Ways should be found to offer financial incentives to new and existing haredi yeshiva high schools (whose students take matriculation exams). At present, due to high tuition costs, only upper-middle-class haredim can afford to study there.
- b) Informal learning tracks should be launched to expand education in secular subjects or preparation for matriculation. These would be operated for

interested young haredim beyond the hours offered in the haredi secondary schools (*yeshivot k'tanot*), during evening hours and school vacations.

## **2. Higher Education**

- a) Establishing an academic preparatory program common to all the universities.
- b) Constructing programs leading to an academic degree for young women learning in alternative programs in women's seminaries, or opening up the possibility of commencing studies toward an academic degree as part of the seminary program.
- c) Opening the regular universities (Tel Aviv, Haifa, Hebrew University, Ben-Gurion, etc.) to haredi students by adopting the model of a haredi campus within the university.
- d) Alternative ways of financing studies (“Perach” work-study program, long-term loans).

## **3. Coordination between the Various Programs**

- a) Available information about learning and employment opportunities should be gathered under one roof. In this way, existing employment centers for haredim will be able to offer all the information about joining the work force, including the possibility and feasibility of higher learning.
- b) A dedicated body should be established under the auspices of the Prime Minister’s Office that will merge the activities for integrating haredim into the work force.

The proposed package of measures, which would be subject to ongoing review, would be a continuation of the activities being carried out by the shapers of public policy regarding haredim, without creating conflict or confrontation. The results could help many haredim who are interested in maintaining their ties with the haredi sector without impeding their chances of integrating into Israeli society, and lead to greater prosperity for Israel’s society and economy as a whole.



# **Government Policy on Integrating the Ultra-Orthodox Sector into Israel's Economy and Society**

Hagay Levin

Increasing the sense of partnership and equality among all the groups that make up Israel's social fabric, is one of the primary goals that shapes today's government policy. This approach—which is enshrined, inter alia, in government resolution no. 1586 dated April 22, 2007 entitled “A Social-Economic Agenda for Israel”—has been expressed in recent years in numerous policy measures and government resolutions.

With regard to integrating the ultra-Orthodox (haredi) sector in particular, a number of important government resolutions have been approved during the past year. These establish a theoretical foundation and long-term government policy objectives, on the one hand, and a series of individual policy measures that can help to achieve the designated goals, on the other.

As I understand it, government policy on the integration of the haredi sector is based on the perception that respecting and maintaining the unique character of the haredi sector does not conflict with further integration of this group in Israel's economy and society, and that such integration is a pressing need and important opportunity for both the haredi sector and the rest of Israeli society.

Of the major government resolutions, the following are noteworthy in this context:

- Government resolution no. 1994 dated July 15, 2010 on “Setting Employment Objectives for 2010–2020,” which sets forth the long-term objective of “reaching an employment rate in the 20–64 age group that matches the average employment rate of the 15 developed nations in terms of per-capita GDP, while continuing to reduce the employment gaps between all groups in Israel.”

The resolution also formulates specific goals regarding employment rates in the haredi sector:

- 63% employment rate for both haredi men and women between the ages of 25 and 64 by 2020
- Government resolution [no. 2614] dated December 19, 2010, regarding “scholarships and the promotion of the integration of yeshiva students into the labor market,” which states in its opening paragraph:

*The State of Israel sees as a major goal the integration of the haredi sector into the labor market as a means of breaking the cycle of poverty and dependence on welfare which is especially prevalent in this group; promoting equitable distribution of the financial burden in Israel's economy; and contributing to the integration of the haredi sector in the social fabric of Israel. Coupled with the above are recognition of the unique characteristics of the haredi population and support for the continued existence of the world of Torah study, along with support for other groups studying in institutions of higher learning.*

In addition to this statement of principles, the government resolution lays out substantial changes in the set of supports designated for this sector—in particular, turning the guaranteed-income benefit to haredim into scholarships (of set value and duration) with specific features that promote integration into the labor market.

- Government resolution [no. 2698] dated January 9, 2011, on “promoting military and civilian national service in the haredi sector,” which adds an important element to government policy on the subject. The explanation of the resolution includes the following:

*The resurgence of the haredi sector and the world of Torah study in Israel is a central component of the rebirth of the Jewish people after the Holocaust and of the Jewish identity of the State of Israel. At the same time, the rapid growth of this sector, and its transformation into a significant proportion of Israel's population (it is estimated that the haredi sector presently constitutes 11% of the total population of Israel) dictate the need to strengthen arrangements that promote the sharing of the security and economic burden by the haredi sector, while maintaining and respecting the cultural uniqueness of this group.*

The above government resolution defines in specific terms the extent and manner in which the ultra-Orthodox will be included in civilian and military service, with the goal of vigorously promoting an equitable distribution of the security and economic burden in Israeli society.

In accordance with the principles set forth in these government resolutions, the various ministries have recently taken steps to promote numerous additional policy measures that will enhance the integration of the haredi sector into Israeli society while respecting and preserving its unique character.

These policy measures include:

- **Vocational guidance and professional placement centers for haredim.** Establishment of a network of guidance and professional placement centers that are adapted to the characteristics of the haredi sector and will assist haredim who are interested in integrating into the labor market.
- **Establishment of technological schools for young haredi men, and tracks leading to a certificate in computer engineering for young haredi women in religious seminaries.** This is in accordance with the existing trends and demand in the haredi sector for professional training that will lead to a respectable livelihood.
- **Academic studies: the establishment of preparatory programs and dedicated scholarships that enable interested haredim to take their place in academic studies,** in keeping with the target set for itself by the Council for Higher Education's Planning and Budget Committee of achieving a total of 3,000 haredi students in academic institutions.
- **Students in the yeshivot:** Intensifying the monitoring to verify that religious studies are indeed taking place, while simultaneously providing the opportunity to combine religious studies with work: "half-day" study only (during set hours), with the possibility of working during the remaining time.





# The Potential for Integration of Ultra-Orthodox Young Adults Aged 18–22

Aviad Hacoen, Lee Cahaner

This position paper was written from a point of view that respects the values of ultra-Orthodox (haredi) society. At the same time, it points to obstacles that exist, and to a possible window for practical changes (both limited and far-reaching) in the lifestyle of the haredi sector, or at least some of its members, in the 18–22 age group. This is based on a broader perspective and a desire to improve their economic and social situation in the longer term, as well as a wish to make optimal use of their talents for the benefit of Israel's society and economy, and to enhance their integration in Israeli society (not as “outsiders” but as an organic part of it). The paper was also written in light of, and in comparison with, haredi society as it was until the 1980s and outside of Israel.

Members of haredi society aged 18–22 have a unique potential for integration into Israeli society. On the one hand, this age group in particular has greater difficulty finding its place in Israel's society and economy for several reasons, which will be enumerated below. Yet on the other, it is precisely this age group that has great promise, which can be wasted if left untapped. During these years, many individuals are at the peak of their physical and intellectual abilities; from the standpoint of the state, it is a pity to miss the opportunity to harness these skills for learning a trade and integrating into society. Some members of this age group who are still unmarried are not yet burdened with the responsibility of supporting a family, affording them greater freedom and flexibility in learning a profession and entering the work force without the need to care for children.

Like all groups, haredi society is not monolithic. It is made up of varied strata and sub-strata, each with its own unique characteristics. Over and above the broad common ground shared by the majority of the haredi population (for example, the emphasis on the role of Torah study and meticulous observance of religious commandments), haredi society should be divided into several subsets in order to focus on issues that require improvement in each area: **the sociological division** (hasidim, Lithuanians [i.e., *mitnagdim*], and Mizrahim, who differ from one another in their attitude toward studies, work, and the larger secular society); **the geographical division** (the crowded haredi centers as opposed to the sparsely populated outlying

communities); **the economic division** (the upper socioeconomic class in contrast to the lower socioeconomic class); and **the gender division** (men as opposed to women).

In general, it can be stated that the vast majority of Israel's haredi population in the 18–22 age group are **not** integrated into the country's society and economy. With regard to the men, the overwhelming majority are still found in yeshiva settings (or at least are registered as such), and only a scant few are serving in the army, learning a profession, or earning a livelihood. Among the women, it is important to distinguish between the ages of 18–20 and 20–22: Many members of the first group are not yet married, and are continuing their studies at the various women's seminaries or in post-seminary professional and educational training programs. By the age of 20, many haredi young women have already entered into marriage, and large numbers of these are engaged in supporting their family (which, for the most part, is naturally limited in size at this point), or—if they already have children—are also preoccupied with raising them while the husband is learning in *kollel* (yeshiva for married men).

From the haredi perspective, the more years that go by without the members of their community integrating into the work force, the harder it is for them to close the gap in future. And from the standpoint of the Israeli economy, the 18–22 age group comprises four “graduating classes” who are presumably at the peak of their physical and intellectual powers; yet these strengths are not utilized to acquire a profession that will maximize their skills for the good of the economy but instead are channeled toward a field of endeavor that benefits the individual or an extremely small group, and not society as a whole.

The annual growth rate of the haredi population, early marriage, and social pressure to have children in the first year of marriage combine to produce a very short generational span between parents and children, which exacerbates the state of poverty and the financial burden on the extended family. Despite the growing need, however, there are a number of obstacles that are preventing haredim from integrating into Israel's society and economy. It is necessary in this context to distinguish between objective and subjective barriers:

- **Objective barriers:** Mandatory army service (or more correctly, the status that one must acquire in order to be exempt from it); lack of education and vocational skills; lack of jobs suitable for the haredi population; disincentives to work, in the form of tax exemptions and grants from the state to yeshiva students; inability to finance studies; non-recognition of haredi studies for diplomas, etc.

- **Subjective barriers:** Ideology that opposes *bitul Torah* (“wasting” time that could be spent in Torah study) among men, and immodesty/straying from the right path among women; concerns about stepping out of the “enclave” due to fear of secular society and of the consequences of mixing with it; feelings of inferiority toward others with a different educational foundation who are studying or working; social pressure and fear of harming the family and one’s future prospects (to the point of being ostracized); the feeling that potential employers are unwilling to accept haredim; and more.

Due to the diversity of haredi society, and the pockets of resistance to change in general and to integration into Israeli society and economy in particular, it is recommended that efforts to generate change be focused on those sectors that are essentially more open to accepting any future solution that is proposed. This is of course without pondering or questioning the extent of their loyalty to Torah and its values or the strictness of their religious observance. These groups encompass **haredim born abroad** (i.e., they or their parents were born or raised abroad, and are well acquainted with the synthesis between maintaining a haredi lifestyle and involvement in the larger society and economy); **Mizrachi haredim** (who base themselves on more moderate halakhic traditions, and who also include a large share of *ba’alei teshuvah* [newly religious], for whom most of the objective obstacles cited above are not relevant); **the “modern” stream** (a bourgeois haredi class made up of those who hold influential municipal positions, businessmen, lawyers, academics, and others, who are familiar with modern Israeli society and come into daily contact with it); and **the drop-out youth**, who, to a certain extent, are already outside the bounds of haredi society. It is important to note that appealing to these groups without careful planning and without involving the community leadership is liable to be a two-edged sword, since it will be difficult to enlist mainstream haredi society in a process that includes only those on the fringes of the community.

The challenge of integrating haredim in the 18–22 age group lies before us. The task must be accomplished in collaboration with the haredi leadership, through a process that is voluntary and not imposed—a process that reflects the uniqueness of haredi society, respects its values while offering an answer to the economic and social difficulties confronting it, and helps haredim find their place in Israeli society.



## Young Adult Arabs in Israel

Zvi Eckstein, Momi Dahan  
Research Assistant: Yosef Kalmanovitz

### Part I: The Key Finding

- The objective of this paper is to examine the characteristics of Israel's young Arab population (aged 18–22). In 2009, the total population for this age group numbered some 570,000—of these, 430,000 Jews, and 140,000 Arabs.<sup>1</sup>
- The key finding in this paper is the relatively high proportion of young Arabs who are neither working nor studying. In 2009, nearly 40% of young Arabs were classified as economically inactive, i.e., not working, not studying (and not serving in the army or national civil service). This is significantly higher than the comparable figure for the Jewish population, which was 17.3%.
- The high rate of inactivity among the young Arab population is noteworthy in light of the dramatic jump over the past 20 years in the rate of learning among young Arab men and women: Between 1987 and 2007, the proportion of Arab young people in the 15–17 age group who were engaged in some form of study climbed from 66% to 86%. The most impressive rise was among young Arab women aged 15–17: During this period, the percentage of students in this age group soared from 59% to 88%, and today it is almost equal to that of the Jewish population.
- The high incidence of economic inactivity among young Arabs is not unique to recent years. The rate of inactivity has remained relatively stable over the past decade, with small upward fluctuations during times of economic slowdown and downward trends in periods of economic expansion.
- The impressive rise in rates of study among young Arabs combined with the relative stability in the scope of inactivity in the Arab population aged 18–22 is reflected in the rapid shift among young Arabs from studies to inactivity. In the 17-year age group, the gap between the proportion of inactive Arabs and the

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<sup>1</sup> The figures in this paper are based largely on the Labor Force Survey and Income Survey of the Central Bureau of Statistics (CBS) for the period 1987–2009.

corresponding figure among Jews comes to 10%. This gap doubles in size, to 20%, for the 18-year-old cohort. (The gap remains steady in the 19–22 age group.)

- There is a significant difference between Arab men and women in the younger age groups: the proportion of young Arab women who are inactive stands at 52%—double the rate of inactivity among young Arab men (26%). The gender gap is also striking in comparison with the Jewish population. The proportion of young Arab men who are inactive is 1.5 times higher than that of their Jewish counterparts (25.6% as opposed to 17.1%), while the rate of inactive young Arab women is three times greater than the corresponding figure for young Jewish women (52.1% versus 17.5%). Note that there is no gap between the genders in the extent of inactivity in the Jewish population.

## **Part II: Possible Reasons for Inactivity**

In this section, we present a number of theories that can explain the high incidence of inactivity among the young Arab population. Some of the gap in the economic inactivity rate between Jewish and Arab young people—which stands at 20 percentage points—can be attributed to differences in characteristics measured in this study, such as family status and education, while the remainder can be explained by other factors that have not been addressed in this work. The proportion of inactive Arab young people is 13 percentage points higher than that of Jews with the same characteristics in terms of education, place of residence, age, and family status.

### **1. Reliability of the Figures**

- One possibility is that the figures in the Central Bureau of Statistics (CBS) surveys are not an accurate reflection of reality, since they are based on self-reporting. Based on this theory, many of the young Arab respondents may in fact be working but nonetheless reported to the CBS pollsters that they were unemployed (the “black economy”). The bias in reporting, according to this argument, is more pronounced among young Arabs in comparison with young Jews.

- While the “black economy” theory cannot be rejected out of hand, it is hard to see it as the primary explanation for the widespread phenomenon of inactivity among young Arabs. The rate of inactivity changes noticeably in accordance with demographic variables. Thus for example, the proportion of economically inactive Arab young women is higher than that of Arab young men. It would be stretching the point to argue that the rate of inactivity stems from the fact that Arab women tend to be more active in the black economy as compared with Arab men. As we shall see below, the extent of inactivity also varies with level of education and family status, making it difficult to ascribe these differences to the black economy. Moreover, there is little reason to assume that married individuals tend to report less truthfully than do unmarried people. Hence these indicators do not totally offset possible bias in reporting, but they do substantially limit its scope. It is important to note that low wage levels in the young age group greatly reduce the incentive to conceal income for tax purposes.
- In the course of our research, it emerged that the Labor Force Survey of the CBS is liable to categorize the population that does volunteer national service as “inactive,” thereby skewing the results. In recent years, the flow of young Arabs enlisting in National Service has increased, though the absolute numbers are still small. According to statistics provided to us by the Finance Ministry, the number of young Arabs performing national service in 2009 stood at 1,000 men and women, which represents less than 1% of the Arab population in the 18–22 age group.

## **2. Differences and Preferences**

- This paper examined to what extent the high incidence of inactivity among young Arabs is due to cultural differences. Compared to Jewish young people, Arab young people tend to marry earlier, and consequently, to become parents earlier. This phenomenon is more pronounced among women. These gaps in age of marriage and parenthood represent cultural differences between the Jewish and Arab populations. Based on the figures presented in this paper, a particularly high proportion of married Arab women report that they are not studying and not working (in the labor market).

- The share of married people among the young Arabs who reported to the CBS pollsters that they were studying was 2%, with this figure climbing to 15% among young Arabs who reported that they were not studying and not working. This jump in the figures is more significant among women. Similarly, the number of children among inactive young Arabs is substantially higher than that of young Arabs who reported that they were studying or working.

### **3. Differences in Opportunities**

- This paper examined the strength of the correlation between inactivity and economic opportunities available to young Arabs as compared with those of young Jews.
- At the end of their school career, young Arabs or Jews can choose between entering the labor market and continuing their studies, if they meet the requirements of the institutions of higher learning. The wages being offered are a major factor in the decision of whether to enter the labor market or to continue relying on parental financial support. Analysis of the CBS Labor Force Survey (2009) shows that the wages of an Arab worker are 16% lower than those of a Jewish worker with similar characteristics (education, area of residence, age, and personal status). In other words, the labor market is less attractive to young Arabs in comparison with young Jews.
- The economic incentive to acquire higher education is also weaker for young Arabs as opposed to young Jews. The return on their education is significantly lower than that for Jews, at 5.6% (compared with 9.4% among Jews).
- This paper also investigated the effect of the Arab population's geographical distance from Israel's major financial centers on the likelihood of inactivity. Surprisingly, we did not find a strong correlation between distance from the center of the country and wages of Arab workers. The earnings of Arab workers living in a location far from the country's center are not significantly different from those of Arab workers who reside closer to the center. These findings cast doubt on the arguments that attribute the wage gap to obstacles of distance and lack of access to transportation. (By contrast, among Jews there is a close correlation between wage levels and distance from the center: The closer to Tel Aviv, the higher the wages of Jewish workers, even after factoring out such variables as education and age.)



- In addition, no association was found between distance from the center and extent of inactivity. The incidence of inactivity among young Arabs in outlying areas of the country is not significantly different from that of young Arabs living near the center. In light of this finding, it is necessary to reexamine the argument that the chances of entry into the work market are noticeably affected by the geographic distribution of the Arab population (distance barriers).
- The figures at our disposal did not allow for testing the influence of language barriers on the relatively high incidence of inactivity among young people in the Arab sector. Poor mastery of Hebrew on the part of Arab young people is liable to make it difficult for them to gain entry into institutions of higher learning and the labor market, causing them to be inactive, but the degree of importance of this factor was not examined here.

#### **4. Policy**

- Over the years, there has been a substantial reduction in the gap in public resources between the Jewish and Arab school systems. However, there is still a certain disparity in the resources directed by the state to Arab education in comparison with the Jewish educational system. Based on figures in the study by Zussman et al., the per-capita allocation for pupils in the Arab primary school system is NIS 6,900 per annum as opposed to NIS 7,800 per annum in the state school system and over NIS 10,000 per annum in the state-religious school system.<sup>2</sup> As a result, the average level of education among young Arabs is lower than that of their Jewish counterparts.
- The present study finds a strong correlation between low level of education and inactivity. The average number of years of schooling is lowest among young Arabs who are inactive, at 9.5 years (meaning pupils drop out during tenth grade). This is in contrast to the relatively high level of education among young Arabs classified as active (studying, studying and working, or working).

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<sup>2</sup> Central Bureau of Statistics, Working Paper No. 25, "Public Expenditure on Primary Education in Israel, 2003," Table 20, by Noam Zussman, Merav Pasternak, Adnan Mansour, Dmitri Romanov, Ofer Rimon (Jerusalem, 2007).



# **A Summary of the Working Group Report on Military Service Models and the IDF's Social Mission**

April 2006

## **Background**

The working group for this topic, led by Yossi Kucik and Major General Udi Shani, convened during 2006. Among the issues discussed were changes in Israeli society and their ramifications for the IDF; possible IDF recruitment models; and the relevance of the social missions performed today by the IDF.

## **Part I: Changes Since the Founding of the State**

In the decades since the state was established, significant social changes have taken place in Israel that directly and indirectly affect the nature of IDF service.

From a social standpoint, Israeli society has become divided, polarized, and more “sectorial.” In addition, over the years, Israel’s liberal orientation has intensified at the expense of its collectivist orientation; in other words, the good of the state is no longer the central focus but has been supplanted by the good of the individual. As a result, many are questioning whether it is in fact justified for the IDF to continue to “constrain” large numbers of young people into service. Moreover, there have been changes in the nature of Israel’s security concerns (the growing threat of terror, the specter of a nuclear Iran) coupled with the rise of advanced technologies. This new reality makes it possible to save on manpower.

## **Part II: Military Service Models**

In this section, we present three basic military service models. The **first model** is the “people’s army” model, whose salient feature is full mandatory service for all. This model retains the notion of the individual’s responsibility to the state and the nation, and sees the army as an instrument for preserving our shared national identity. To implement this model, the working group recommended a number of principles, of which the most important are: **(1) universal service:** ideally, maximal service for all population groups, and a reduction in benefits for those who do not

perform full army service; **(2) bolstering the army's image as a state institution;** **(3) equality of opportunity** by integrating all population groups into all systems; **(4) economic efficiency.** Note that this model does not offer a full solution to the economic harm caused to the individual and the economy as a result of lengthy, all-inclusive conscription.

The **second model** is the professional volunteer army, whose key feature is abolishing mandatory service so that the army will be forced to compete freely in the labor market to enlist soldiers. This model (which is prevalent in many Western armies) casts doubt on the army's need to enlist a standing army on a large scale, and recognizes that regular army service constitutes a significant economic-social burden. Note that this model leaves several questions unanswered, including: **(1)** the capacity of a professional army to handle the necessary security tasks; **(2)** the social ramifications of abolishing mandatory service and forgoing the IDF as a cohesive factor.

The **third model** is an intermediate one, based on an acknowledgment of two opposing principles: on the one hand, the IDF of today is de facto no longer a "people's army," yet on the other, we cannot totally relinquish mandatory enlistment and the **aspiration** to be a "people's army." In practice, this model comprises the following principles: **(1)** mandatory service would remain in place; **(2)** the duration of regular army service, which applies to all enlistees, would be reduced; **(3)** for some military professions, regular service would be longer. To round out this model, it is necessary to consider how to "persuade" soldiers to enlist also for those tasks where the duration of mandatory service is longer.

### **Part III: The IDF's Social-National Roles**

At present, the IDF is engaged in a wide range of social missions: settling the land (Nahal), volunteering in the community, fostering ties with Diaspora Jewry, etc. The vast majority of these tasks are not related to core security issues.

Under the **people's army model**, IDF involvement in social missions is vital and desirable, since the army is the body that unites the entire population.

Under the **professional army model**, the IDF must focus on security tasks per se, and refrain from excessive involvement in various types of social projects.

Under the **intermediate model**, the working group recommends that the IDF continue to engage only in those social missions that have a clear connection to mandatory service: inculcating good citizenship and unifying values, teaching Hebrew and Judaism.

#### **Part IV: Ramifications for the IDF's Image**

The IDF is the body that enjoys the greatest degree of trust among Israelis. Given this fact, the implementation of the intermediate model is liable to harm the IDF's image and undermine the basis of its legitimacy, both because of differential service, which distinguishes between different population groups, and because of its focus on security missions and its (almost total) lack of social involvement.

To address this problem, the working group recommended maintaining the trends begun by the IDF in recent years: **(1)** increasing transparency vis-à-vis the media, families of soldiers, and the general public; **(2)** eradicating unacceptable ethical norms; **(3)** engaging in open, public debate on complex subjects related to the future image of the IDF; **(4)** rejecting any attempt to politicize the army.



# **Mandatory IDF Service\***

Avi Ben-Bassat

## **Objectives**

- Maintaining the security of the state while preserving the ethos of a “people’s army”
- Producing security more efficiently, thereby contributing to growth in GDP
- Reducing the heavy financial burden that is intrinsic to mandatory service
- Enhancing the welfare of Israeli youth
- Reducing the inequity in mandatory service between genders and population groups

## **Factors considered**

- Extent and nature of threats to security of the state as a result of geopolitical changes in the region
- Demographic changes in size and composition of the population since the early 1990s
- Technological and structural improvements in the IDF

## **Principal conclusions**

- Israel is under constant threat of war, and cannot afford to lose even one battle. A large, qualitative army is therefore needed in times of emergency. The most efficient and inexpensive way to achieve this is by combining a regular army (of conscripts), a reserve force whose professional skills are constantly maintained, and a standing army of limited size.
- The country’s defense apparatus should be improved by creating incentives for choosing an efficient combination of production factors – less mandatory service

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\* This abstract is based primarily on the report in Hebrew of the Committee to Examine Reduction of Mandatory IDF Service, 2006

and more alternative methods, such as technology and a standing army for a brief period.

- It is vital to improve the mandatory service model through uniform and equitable conscription, financial remuneration, and post-service opportunities.

### **Implementation model**

- Aim for universal mandatory service of two years. The reduction would be carried out gradually, taking into consideration all the objectives and processes cited above.
- Reduce the inequity between males from different population groups and between men and women.
- Take steps to decrease draft evasion among men and women, in particular making it more difficult to obtain exemptions unfairly.
- Increase the proportion of women serving in positions and roles designated until now for men, and abolish the special tracks for men.
- Avoid the use of soldiers in the regular army for civilian tasks; the latter should be financed by the state budget.

### **Stage 1: Mechanism for increased efficiency and continued reduction of mandatory service, 2011**

- A regular army (based on mandatory service) is a resource that is costly for the economy, but inexpensive for the army, raising concerns that it is not utilized efficiently. For example, there is a tendency to overuse regular soldiers and to underuse the standing army, technology, and outsourcing.
- The demand for all military tasks is not identical, nor are the skills and physical condition of the soldiers. Consequently, there is hidden unemployment in the regular army (primarily among non-combat soldiers) stemming from uniform duration of service.
- To render mandatory service more efficient, and create an incentive for the proper utilization of all factors involved in the production of security, it is proposed to reduce the service of some soldiers by four months, in accordance with the needs and decisions of the army.



- Combat soldiers, and soldiers with technical professions and tasks that require a relatively lengthy training period, would not be eligible for reduced service, but to avoid discrimination, they would be compensated fairly (via an extended-service benefit) based on wages for 21 year olds in the civilian labor market.

#### **Advantages of the extended-service benefit**

- Early discharge of soldiers not needed for the current term of service would save the army the cost of the extended-service benefit, which could be used to procure other resources.
- The proposed mechanism establishes a financial cost for the use of regular soldiers, allowing the duration of regular service to be determined by efficiency considerations. This would create an incentive for the army to expand the group doing minimal service, and with the amount saved, it could procure technological resources or employ soldiers in the standing army. In this way, the defense budget would be allocated among a range of inputs, making the production of security more efficient.

#### **Stage 2: Universal reduction of regular service, 2012**

- The present term of regular service is very lengthy. It diminishes the motivation to serve in the army, greatly delays young people's professional training and entry into the labor market, and exacerbates tensions between those who serve and those who evade army duty.
- Mandatory service for all males would be shortened by four months. The reduction would not apply to men and women in shortened service tracks. The principle of paid differential service would be maintained, such that the duration of regular service would range from 28 to 32 months.

#### **Stage 3: Additional universal reduction of regular service, 2013**

- Regular service for all males would be reduced by an additional four months. The reduction would not apply to men and women in shortened service tracks. The principle of paid differential service would be maintained, such that the duration of regular service would range from 24 to 28 months.



## **Conscription versus a Professional Army: The Effect of the Recruitment Method on Israel's Military Strength**

Sasson Haddad, Asher Tishler

In recent years, the rate of enlistment in the IDF in the 18-year-old cohort (and especially, the issue of conscription of the ultra-Orthodox; young women who declare themselves to be religious; Arabs; and others) has garnered much attention in the press. Underlying the public discourse is generally the assumption that there is no reasonable alternative to conscription. But mandatory enlistment, which typified most of the world's armies until the late 20th century, is on the decline, with less than 50% of armies relying on conscription at present.

What, then, is the best method of recruitment for the State of Israel? This paper reviews the accepted methods in various countries, and proposes a model that focuses on the economic-strategic feasibility of a professional army as opposed to a "people's army." Under this model, the state would bear responsibility for bringing the army to its peak capabilities, subject to budgetary constraints and the supply of manpower in the economy. Such a model would make it possible to create the optimal mix between an army of conscripts and a professional army.

In light of the global processes of abolishing conscription, shortening the duration of service, and switching to a professional army, it appears inevitable that there will be a greater shift in Israel than we are seeing at present to the use of a professional army. In any event, it is clear that the burden of military service, which is becoming less and less equitable in Israel with time, will provide an additional push in this direction. For this reason, it is highly important to carry out the process of change—which will ultimately take place in any case—in an intelligent and appropriate manner, and to channel it in the right direction to maintain the military strength that is a vital cornerstone of Israel's existence.



## **The National Value of Army Service\***

### **A. Introduction**

The committee on army service as a national value, led by Kobi Haber and Elazar Stern, held discussions in September 2007 and December 2008 against the backdrop of a decline in the rate of enlistment for regular army service and a rise in the drop-out rate from the IDF. Specifically, 5,000 Jewish young men (11% of the Jewish population of eligible age) were exempted from service under the category of “Torah study as sole occupation.” Exemptions for young women under the “declaration of religious observance” category are also on the rise (among female graduates of secular educational institutions as well). There has been a similar increase in the rate of exemptions for emotional or physical reasons, coupled with a drop-out rate of 17%, primarily during the first year of service and largely among lower-scoring inductees (on the comprehensive evaluation scale for incoming soldiers).

These figures raise concerns that the rate of men completing their army service will drop below 50% (of those eligible for conscription) in the next few years. In practical terms, this means the potential collapse of the “people’s army” model, bringing with it grave security, social, and ethical consequences. Likewise, a decline in the enlistment rate is liable to wreak severe damage on the economy due to the strong correlation between not serving in the army and non-participation in the labor market.

### **B. Rejecting Extreme Solutions**

The committee’s working assumption is that the model of a “people’s army” is vital to the State of Israel for the foreseeable future, due to Israel’s security and political situation, among other reasons, which render the model of a professional army inapplicable. Accordingly, the committee rejected the option of adopting the professional-army model (i.e., abolition of conscription) as well as the option of

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\* This English abstract is a summary of a longer Hebrew document summarizing the discussions of the Committee on Army Service as a National Value written by Professor Baruch Nevo and his research assistant Ms. Natalie Davidi Zeller. The research was never published. The abstract included here for the 2011 Caesarea Economic Forum was prepared by Yosef Kalmanovitz, and was amended by Kobi Haber and Elazar Stern.

imposing across-the-board mandatory service, since the latter would provoke intense political and social conflicts and could not be implemented in practice.

### **C. Defining Objectives**

In the committee's view, establishing the "people's army" model as the dominant one is a central objective, and steps must therefore be taken to increase the rate of enlistment and reduce the drop-out rate from active duty. To this end, educational and social activities should be initiated that position the IDF as the "people's army." In addition, an effort must be made to include all sectors of the population in mandatory army service.

### **D. Proposed Solution**

The committee recommended an integrated solution comprising five elements. It should be noted that it also suggested accompanying these measures with a comprehensive marketing process to "rebrand" the IDF. This would involve presenting army service as a national value, and bolstering the image of enlistees in general and of combat soldiers in particular, while highlighting Zionist values and a sense of mission as well as the added personal benefit for the individual soldier.

The following steps were recommended by the committee:

#### **1. Reducing the "lost alternative"<sup>1</sup> in army service**

Increasing the personal benefit of mandatory service for enlistees, decreasing the "lost alternative," and reducing the sense of inequity between those who serve and those who do not. The following practical measures were proposed:

- a.** Reducing regular army service to two years, gradually and on a differential basis, with remuneration adjusted accordingly, in keeping with the recommendations of the Ben-Bassat Committee (2006).
- b.** Extending national-civic service to 24 months (imposing mandatory national service should also be considered).

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1 Referring to the gap between those who serve in the army and those who do not serve, but work and earn while others fulfill their mandatory army service.

- c. Benefits basket for soldiers during and after service
  - Raising of wages for regular service (perhaps differentially for combat troops and special populations)
  - Granting of benefits that have symbolic meaning and do not entail heavy expenditure (discount on fees and public transportation)
- d. Benefits for army veterans
  - Opportunity for higher education (academic or vocational) to all soldiers following discharge (scholarships, free tuition, etc.)
  - Courses to complete high school matriculation and prepare for the psychometric test (university entrance exam)
  - Increase in the number of academic preparatory institutions
  - Preference in hiring at government workplaces for those who completed army or national service

Some of the measures enumerated above have significant budgetary ramifications (along with benefits for the economy, growth, and the labor market). Acknowledging the budgetary constraints of the State of Israel, the committee called for adjusting the priorities of the state budget in general and the defense budget in particular in order to implement these recommendations. In its view, preventing a crisis now would be much less costly than addressing one in future.

At the same time, some of these measures might provoke claims of undermining of equality. For this reason, the committee felt that when the recommendations were translated into practical steps, their legal implications should be carefully examined on an individual basis.

## **2. Reducing the gap between civilian life and army service**

Making an effort to lessen the gap between military and civilian life: The goal is to ease the army experience, and make it more pleasant. The following practical steps were proposed:

- a. Better policy re: army furloughs
  - More army furloughs
  - A differential “furlough scale,” based on the difficulty of the service role.
- b. Improved service conditions
  - Living conditions and working (office) conditions

- Standard of food

It should be noted that the committee members were divided on the question of how important this point is.

### **3. Reducing the rate of false declarations of religious observance (among women)**

This is assumed to be an easy way to obtain an exemption from service that does not involve social stigma; as such, it must be vigorously opposed. The following practical steps were proposed:

- a. Exemptions only at the end of the high school year (to lessen the effects of peer pressure)
- b. Obligatory assessment by the school principal of the young woman's (religious) lifestyle
- c. Special professional committee to decide on exemptions for girls who attended secular schools
- d. Closer examination of the accuracy of the declaration
- e. Stricter sanctions against girls who make false declarations
- f. Marketing of enlistment to religious girls, making army service more attractive to them

### **4. Increasing the rate of army service among the haredi population**

With regard to the haredi (ultra-Orthodox) population, the committee feels that, the army should not act in a sweeping or aggressive manner but should formulate solutions based on ongoing dialogue, understanding, and collaboration. The following practical steps were proposed:

- a. Recognition of the heterogeneous nature of haredi society
- b. Response to special needs of haredi enlistees (professional-technical training in the army, and expansion of such tracks as Shahar Kahol, which train enlistees as air force technicians and Shahar Yarok, which trains enlistees for the military intelligence corps)
- c. Appointment of a special advisor to the Chief of General Staff who will focus on being a liaison with the haredi sector: assistance in enlisting; creation of special service tracks; ongoing handling of problems, etc.
- d. Increased enforcement re: budgetary allocations to yeshivot whose students do not serve



- e. Dialogue with haredi communities (emphasizing the financial aspect)
- f. Consideration of a total exemption from service for a set period of several years for yeshiva students who have reached 23 years of age, as an incentive to bring them into the labor market

In this context, it should be borne in mind that the addition of large numbers of haredim to the IDF is liable to cause a major change in the nature of the army. Among other consequences, their inclusion is apt to make it more difficult to integrate women into the IDF (due to the modesty requirements of the haredi enlistees); create problems regarding the source of authority (rabbinic authority versus military authority); and undercut the sense of equality of soldiers who are not haredi (due to the preferential conditions that the haredi enlistees will receive). The military establishment should prepare for this in advance, and find the means and the tools to cope with these issues.

## **5. Emphasizing the role of education and welfare in the Army**

Restoring to the army some of its historical roles so as to reinforce the importance of service in the eyes of the soldiers. However, the members of the committee were divided over the question of whether these social roles are still relevant to the army in this day and age.

## **6. Handling the problem of drop-outs**

Providing a comprehensive answer to the problem of soldiers' dropping out of army service. Among other things, there is a need to address the common feeling among soldiers (primarily those who serve in the rear) that their army service lacks meaning (a feeling of "waste"). The following practical steps were proposed:

- a. Applying the Discharged Soldiers Law only after 18 months of service (and not 12)
- b. Enhancing the sense of purpose among soldiers in the combat support system (solidifying group identity within units)
- c. Improving the transparency of the selection process, and expanding it
- d. Continuing to fight dropping-out and non-enlistment on medical and emotional grounds

- e.** Asking physicians to make clear to those seeking an exemption the future consequences of their professional opinion
- f.** Increasing cooperation and sharing of information between the various government bodies
- g.** Increasing the oversight of military physicians regarding exemptions from army duty
- h.** Operating a system to identify those with a tendency to drop out and respond to them individually

## Appendix: Statistical Data\*

### Exemption from Army Service

(IDF Personnel Directorate figures, as of 2007)

#### 1. Exemption under state arrangements

- a. *Torato omanuto* (men whose sole occupation is Torah study): Some 5,000 young Jewish men (11% of the eligible Jewish population) are exempted each year from army service. At least half of them are capable, physically and emotionally, of enlisting in the IDF. And a large proportion of them are, in any case, not suited for the style of learning and the demanding requirements of yeshiva study (i.e., they are not Talmudic “prodigies”).
- b. Declaration of religious observance (for girls): Use of this exemption is increasing over the years, among graduates of non-religious high schools as well. This avenue of draft evasion does not entail any stigma or practical difficulty.
- c. Exemption on medical-emotional and physical grounds: This type of exemption is showing a (slight) increase. It is reasonable to assume that this does not reflect a rising incidence of illness but rather a decline in motivation to serve in the army.

#### 2. Dropping-out during service

- a. The drop-out rate is 17%, mostly during the first year.
- b. The period between 2002 and 2006 saw an increase in the rate of early discharges; however, in 2007 there was a drop of 1.1%.
- c. Some 40% of discharges of male soldiers take place in the first half of the initial year of service, and 22% in the second half of the year.
- d. The drop-out rate among new immigrants stands at 22%, and among native-born Israelis, 15%.
- e. Between 2005 and 2007, there was a downward trend in the drop-out rate of native-born Israelis.

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\* The figures are correct as of the date of the committee’s deliberations.

- f. Some 63% of soldiers with early discharges are from the administrative echelon.
- g. Dropping-out is more common among those at the lower end of the inductees' evaluation scale.

### **Motivation of Military Service Candidates**

(IDF Behavioral Sciences Division surveys, 2000–2007)

1. High, stable level of readiness to enlist in the IDF: nearly 70% of males, 80% of females.
2. Some 75% feel a high degree of pride leading up to their enlistment.
3. Among young men, 50% are interested in serving in the officers' track of a volunteer combat unit.
4. Rise in the number who feel that "many young people do not wish to serve" (over 50%), and that "Israeli society is tolerant of draft evaders" (approx. 40%).
5. Decline in the number who think it is possible to succeed in Israeli society even without serving in the army (40%).

### **Education**

1. In the 15 years between 1990 and 2005:
  - The proportion of haredi elementary school pupils rose by a factor of 2.5 (250%), while that of secondary school students grew by a factor of 3 (Table 1).
  - The number of pupils in the haredi elementary school system tripled; in the secondary schools, it quadrupled (Table 2).
2. As of 2005:
  - Some 25% of elementary school pupils study in the "other religious" (haredi) school system.
  - A total of 31.8% of pre-schoolers are part of the "recognized but unofficial" (haredi) school system.
  - The younger the age group, the greater the proportion of respondents who define themselves as haredim (Table 3).

## Tables

**Table 1. Distribution of Educational Streams in Jewish School System (%)**

	Grade 1		Elementary		Secondary	
	1989/90	2005/06	1989/90	2005/06	1989/90	2005/06
<b>State</b>	71.5	57.7	67.6	55.6	78.6	70.1
<b>State-religious</b>	22.2	19.3	20.5	18.7	17.6	17.9
<b>Other religious<sup>2</sup></b>	6.3	23.0	11.9	25.7	3.8	12.0

Source: Central Bureau of Statistics; data adapted by authors

**Table 2. Distribution of Educational Streams in Jewish School System (absolute numbers)**

	Grade 1		Elementary		Secondary	
	1989/90	2005/6	1989/90	2005/6	1989/90	2005/6
<b>State</b>	49,941	51,840	320,018	324,370	256,000	329,049
<b>State-religious</b>	15,507	17,340	97,047	109,096	57,323	84,023
<b>Other religious</b>	4,400	20,664	56,335	149,934	12,377	56,328
<b>TOTAL</b>	69,848	89,844	473,400	583,400	325,700	469,400

Source: Central Bureau of Statistics; data adapted by authors

**Table 3. Breakdown of Residents by Self-Defined Religious Identity and Age (%)**

	Total Jews	Haredim	Religious	Traditional	Secular	Non-Jews
<b>Total</b>	80.4	6.7	9.8	38.3	45.0	19.6
<b>Males</b>	80.3	7.0	10.2	37.6	44.9	19.7
<b>Females</b>	80.6	6.4	9.3	39.1	45.1	19.4
<b>Age 20–24</b>	76.9	11.7	10.4	35.1	42.8	23.1
<b>Age 25–44</b>	75.4	9.1	9.4	34.6	46.7	24.6
<b>Age 45–64</b>	84.4	4.1	9.4	41.2	45.0	15.6
<b>Age 65–74</b>	88.0	1.9	10.2	45.8	42.1	12.0
<b>Age 75+</b>	91.9	2.3	11.8	42.7	43.0	8.1

Source: Central Bureau of Statistics; data adapted by authors

<sup>2</sup> Other religious: Under haredi administration, as defined by the Central Bureau of Statistics.



# The Internet Economy in Israel

## A Growth Engine for the Future





# **Google Project Examining the Influence of the Internet on the Israeli Economy – Research by McKinsey Israel**

## **Introduction**

The Internet is changing the State of Israel, and being changed by it as well. Israel has embraced the Internet at all levels of society and rivals many of its OECD peer countries in both benefit from and contribution to the local and global Internet economies. A research study recently published by McKinsey reveals that in 2009, the Israeli Internet economy accounted for an estimated NIS 50 billion, or 6.4% of GDP. The Internet economy is likely to reach NIS 85 billion by 2015, or 8.5% of GDP. For the purpose of the study an extensive definition of Internet economy was chosen, which included all Internet transactions and all the access devices and infrastructure that enable Internet and intranet networks.

The McKinsey report, which forms the groundwork of Sunday evening's session of the Caesarea Conference, was commissioned by Google in order to advance understanding of the Internet's role in shaping the Israeli economy, and it is part of a similar global effort in over ten countries.

The complete report and additional supporting materials are available at the research website: [E-economy.co.il](http://E-economy.co.il)

Three main topics from the report were selected for this session:

- The Internet Economy – A Driver of Employment
- Leverage of the Internet for Small and Medium Business Growth
- The Public Sector and the Web

## **The Internet Economy – A Driver of Employment**

With its high share of Information and Communication Technologies (ICT)-related investment and net exports, the Internet's significant impact on the Israeli economy is evident. But for a country with a diverse and growing work-age population, an equally important metric is the number of jobs that the sector creates.

We estimate that a total of 110,000-130,000 people are directly employed in jobs that can be considered part of the Internet economy, representing approximately 4% of all Israeli employment. This group includes mainly computer and electronic engineers or technicians, system analysts and relevant production employees – a wide range of positions from a manufacturing floor worker in one of Intel’s fabrication facilities (Fab) to a computer programmer in a small start-up.

Most Internet economy jobs (approximately 80%) are driven by ICT-type companies, and only a small number come from the non-ICT sector. ICT-related jobs have grown twice as fast as non-ICT jobs since 2002, driven in large part by the Internet (despite a slight decrease in 2009 due to the global economic turndown). The main engine of ICT-related job growth was computer services jobs, which represent less than half of ICT jobs, but two-thirds of the growth. We expect similar growth patterns to continue, with Internet economy jobs still driving the expansion of ICT jobs.

ICT sector employees differ from their peers in the rest of the business sector – they are younger, more likely to be men and typically earn more. In fact, ICT employees earn twice as much as their peers elsewhere in the business sector despite being younger – a gap that has increased in recent years.<sup>1</sup> As a result, ICT-related jobs and among them, Internet-related jobs, represent a larger share (almost double) of total compensation (in the case of Internet-related jobs, approximately 4% of the jobs generate approximately 7.5% of total compensation).

Based on official data from the Central Bureau of Statistics (CBS), we estimate that approximately 25,000 people are employed in ICT-related research and development (R&D), either in local start-up companies whose business is software development, or in R&D centers established by foreign companies, which recognize Israel’s relative strength in human resources in this field. Determining the exact number of employees in Internet start-ups is somewhat difficult, as a significant number of them work in small and non-formal companies, and might not be taken into account in official data. Based on the CBS definition, which includes start-up companies as part of R&D figures, we estimate that a range of 5,000-10,000

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1 In 2005 ICT employees earned 78% more than other employees, while in 2009 this gap increased to 101%.

employees work in Internet economy start-ups. However, since many of the start-ups are not officially measured, we believe that the number could actually be double.

R&D is a key driver for the creation of new businesses (and industries) and strongly supports the innovation of the Israeli ICT industry. It should be mentioned that in early stage ICT companies and R&D centers, the ratio of engineers/scientists to other general employees (e.g., sales, administration) is about 1:1, whereas in more developed ICT companies it could reach 3-5 general employees for each engineer/scientist. This higher ratio is one of the reasons to encourage more start-ups to evolve into mature Israeli companies thereby increasing the number of employees within the Israeli Internet economy (while relying on the same number of engineers). As previously mentioned, computer engineers and computer programmers represent the majority of the relevant job growth.

Beginning in the early 1990s, a pipeline of qualified computer-savvy employees flowed into the economy. First, the massive immigration from the former Soviet Union brought in an unprecedented number of PhDs, and qualified engineers and programmers. Next, a large number of potential employees came out of the IDF, equipped with alternative training and experience. Finally, universities created additional slots for prospective students which were quickly filled by qualified applicants. However, since the early 1990s immigration has become a less relevant contributor. The army as well seems to have reached a peak of relevant positions and may slow that growth. Finally, there is no concrete plan for a significant increase in relevant graduates from the higher education system. As a result, the rate at which new, skilled employees are trained may become one of the main risks for the future evolution of the Internet economy.

Employment alternatives presented by the Internet may, however, prove to be most intriguing. The fast-growing Internet economy employment has created an opportunity to increase employment in certain sectors, such as the ultra-Orthodox and Arab sectors.

While Internet usage within the ultra-Orthodox sector has significantly increased in recent years, driven by increased availability of supervised or censored Internet services and content, there has also been an increase in Internet economy employment in this sector. By enabling remote and work-from-home arrangements, the Internet has opened up jobs that allow an attractive work-life balance for the ultra-Orthodox. Recent developments include the creation of job placement websites

operated by employment agencies specifically targeting ultra-Orthodox employees. One of Israel's leading companies in this area, Manpower, has gone as far as establishing a specific manpower company for ultra-Orthodox employees.<sup>2</sup> This segment of the population is still under-represented in the high-tech sector, with only about 2% of employees (compared to approximately 10% of the population), and only a small portion employed in pure high-tech jobs such as engineers and programmers. As opposed to the rest of the ICT sector, comprised of 64% male employees, 75% of ultra-Orthodox employees are female.<sup>3</sup> Some lack of formal academic education in the ultra-Orthodox sector may be partially compensated by short and specific training. While employment levels in the sector are still lower as opposed to other sectors, the Internet, coupled with government subsidies, could create significant growth in Orthodox employment.<sup>4</sup>

The Internet economic evolution has not yet had the same impact on the Arab sector. Despite accounting for 20% of the population, Israeli Arabs are estimated to account for only 8% of economic activity. Even with a relatively high Internet penetration among Arabs, we still do not see a high participation in Internet-related employment.<sup>5</sup> Part of this gap may be attributed to differences in education preferences: about 70% choose non-business related subjects, including teaching, social sciences, medicine and pharmacology.<sup>6</sup> Another often-cited reason is the inability to relocate from the Galilee, where 60% of the Arab population resides, to the center of the country where most of the jobs are located.

According to Tsofen, an Israeli non-profit organization established in 2008 to integrate Arabs into the Israeli high-tech sector, thousands of Arab university graduates with relevant high-tech education cannot find employment in Israeli high-tech companies while at the same time the Israeli high-tech industry is facing a

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2 Called "Manpower-Bereshit."

3 From Manpower-Bereshit CEO Chaim Guggenheim.

4 The Ministry of Industry, Trade and Labor has recently announced an allocation of NIS 100 million to encourage ultra-Orthodox employment, promising up to NIS 1,000 per month for employers for each employee, for a period of 30 months.

5 While some estimates place it at 60%, in most locations, it is in fact closer to the national average of 80% but is brought down by low internet usage among Arabs in the Negev (10-15%).

6 Irit Tamir, lawyer and General Manager of Kav Mashveh (Equal Measure), an organization set up by the Manufacturers Association, quoted in [www.globes.co.il/news/article.aspx?did=1000613569](http://www.globes.co.il/news/article.aspx?did=1000613569)

shortage of accessible, quality talent. Tsofen's data suggest that only about 3.5% of those employed in the high-tech sector are Arabs and that Arabs account for an even-smaller portion (approximately 0.5%) of those employed in software engineering, which may explain their low participation in Internet-related employment.<sup>7</sup>

### **Small Businesses – Huge Opportunities**

A study of the Internet's impact on the Israeli economy would not be complete without exploring small and medium-size businesses (SMBs). These businesses account for 55% of the country's jobs.<sup>8</sup> For the purpose of this report, we adhered to the CBS standard which defines an SMB as a company employing fewer than 100 people and generating annual revenues under NIS 100M. In Israel, this includes over 99% of all businesses.

Small and medium businesses have traditionally focused on meeting local needs and supporting larger businesses. The Internet allows them to both increase productivity and efficiency and reach beyond their geographical boundaries to engage new customers. As a sector considered both nimble and innovative, SMBs are well situated to gain from all that the Internet has to offer. It can help them overcome some of the traditional challenges facing SMBs, including tools and resources (such as enterprise software now available in cloud computing), training and learning alternatives, and elimination of bureaucratic barriers.

This potential led us to examine how Israeli SMBs have already adopted and adapted to the Internet revolution. We surveyed 401 Israeli SMBs and interviewed either their owners or relevant decision-makers.<sup>9</sup> In addition, we conducted nine in-depth interviews with companies we chose as case studies to illustrate the different opportunities the Internet offers to SMBs and how those companies use them to their advantage. We have divided SMBs into two groups, Web-active and Non-web, which our survey suggests are equally divided. Web-active are businesses that either own a website or engage in online marketing or selling; Non-web includes any business that

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7 Smadar Nehab, Executive Director of Tsofen quoted in [www.globes.co.il/news/article.aspx?did=1000613569](http://www.globes.co.il/news/article.aspx?did=1000613569)

8 Source: "SMBs in Israel and Developed Countries," The Knesset Research Center, 2007.

9 Dedicated survey of 401 small and medium businesses, performed by Geocartography, December 2010.

is not in the previous category (though most likely does use the Internet more typically for email or similar activities).

There is, however, a clear difference in the share of web-active businesses across different regions as evidenced by the mere 30% share in the South and 35% in Jerusalem compared to over 60% in the Sharon and Central regions. We also see a variation between sectors with the services sector having the highest share of web-active businesses as expected. More interestingly, we see a strong correlation between being “web-active” and success. Nearly 80% of the jobs created over the last three years by the SMBs surveyed come from web-active businesses. Moreover, nearly a third of web-active businesses reported an increase in employment over the last three years, compared to only half that amount for non-web active businesses.<sup>10</sup>

The real and perceived importance of the Internet to SMBs is significant. In our survey, almost one-third of all businesses indicated that the Internet is either very important or mandatory for their day-to-day operations, while over 40% of web-active businesses had a similar response.

The Internet connects people and businesses across geographical boundaries and allows businesses to create a presence in far-flung markets without the need for physical presence. For smaller businesses previously unable to expand beyond their local reach, the Internet offers alternative channels. The combination of a low-cost channel with significantly lower fixed costs allows these businesses to expand while limiting risk. Doing this, however, requires certain knowledge, and in fact, according to a survey conducted by the Israeli Export Institute, over 70% of exporting SMBs realized the need for training in effective usage of the Internet. One SMB, Pe'er HaSTaM, sells Judaica and other Israeli-related goods around the globe. The Internet is virtually its only marketing and sales channel to markets from the US to Hong Kong. A video of this SMB can be found on the research website.

Online marketing has also lowered the entry barriers for SMBs. With lower costs and new levels of sophistication for better budget control, segmentation and tracking of results, the Internet channel has become a significant advertising medium for the SMB sector. According to our survey results, web-active businesses invest an

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10 In this calculation, self-employed and companies that do not employ were dropped, as they did not grow by definition.

average of 24% of their marketing budget in digital channels, and 22% of those businesses spend more than 40% of their marketing budget in these channels.

One area where the adoption seems low is online payments. Less than 2% of businesses in our survey allowed customers to order and pay online (compared to approximately 20% in a similar survey done in the UK).<sup>11</sup>

The Internet also brings new levels of data management and information exchange allowing businesses to create more efficient processes and collaborate with both suppliers and customers. Online systems and tools offer any smaller business access to capabilities that once required large investment. Changes in business models, such as the recent move to cloud computing and software-as-a-service, further eliminate a category of fixed costs, and provide broader services and capabilities to SMBs without the need to invest upfront in an era of tight financing.

As we demonstrated in the industry sectors deep dive of this report, the Internet serves as a disruptive force, reshaping industries and rules of the game. SMBs that are by definition smaller and more agile and nimble are taking advantage of these changes, and sometimes even leading them.

Beyond reshaping industries, the Internet is also enabling the creation of new economic sectors with their own value chains and business opportunities. Marimedia is an online ad network taking an active part in the revolution the Internet sparked in the advertising field, operating in a market that did not exist a decade ago.

## **The Public Sector and the Web**

We estimate the size of the Internet economy in Israel in 2009 at approximately NIS 50 billion or roughly 6.4% of Israel's GDP. This figure implies that the Internet has gained a substantial foothold in the Israeli economy. The Internet's share of Israel's GDP is probably one of the highest in the world and comparable to that of the United Kingdom, a world-leading Internet economy due to a highly developed e-commerce market.<sup>12</sup> Comparing Israel's Internet economy to those of the United Kingdom and France reveals that Israel has a lower share of e-commerce, but a higher share of

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11 "The connected kingdom," BCG report, 2010.

12 "The Connected Kingdom," the report on the UK's internet economy estimates the UK's internet economy at ~7.2% of GDP.

investment and net exports. Overall, the relative size of Israel's Internet economy<sup>13</sup> is slightly lower than that of the United Kingdom (7.2%), but significantly higher than that of France (3.2%).

Government expenditure is also affected by the rise in spending on Internet-related products and services. We estimate total Internet-related government spending to be approximately NIS 6 billion, which represents about 3% of total government expenditure, or 0.8% of Israel's GDP, which includes both civilian and defense spending:

- The most significant element of this expenditure is the civilian portion of Internet-related goods and services, which amounts to NIS 4.3 billion. This figure includes spending on Internet-related personnel, both for in-house and outsourced personnel.
- We estimate the defense Internet-related portion to be around NIS 1.7 billion, though this might be conservative. Assessing the relevant share of defense internet-related spending is a complex challenge, as information is classified. However, drawing from various public sources and by comparing international benchmarks on defense ICT expenditure, we estimate the portion of defense expenditure which is Internet-related to be slightly above the civilian portion<sup>14</sup>

The Internet-related economy has been one of the major growth engines in Israel. From being nearly non-existent in the early nineties, it now represents 6.5% of Israel's GDP. Looking forward, the well-established Internet economy still has significant growth opportunities across all the components of GDP. We project that the Israeli Internet economy will grow at a rate of 9% per year and reach around NIS 85 billion in 2015. If we assume GDP growth of 4% per year, the Internet economy's relative share of GDP will grow from 6.4% to 8.5%.

While some government ministries have significantly increased their Internet-related activities,<sup>15</sup> other areas in the public sector (e.g., local authorities, education

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13 As a percentage of the country's GDP.

14 Out of total government expenditure of about NIS 185 billion, approximately NIS 135 billion is civil and approximately NIS 50 billion is defense.

15 The Tehila Project responding to the growing need of government ministries to be connected to the Internet is an example. Another is the gov.il site with almost NIS 7 billion of online transactions.



sector) are still in the early stages of adoption. Looking forward we expect to see the government narrowing this internal gap and supporting the increase in government spending on Internet-related activities as a portion of total government expenditure from 3% to 5%.<sup>16</sup> This is reflected in the overall growth of government Internet-related expenditure from 0.8% of GDP today to 1.2% of GDP in 2015.

To measure the country's Internet connectivity and to show how Israel fares compared to other countries, McKinsey has developed a multi-dimensional index – the e<sup>3</sup>.

Israel's overall rank on Internet connectivity is 19 out of 34 OECD countries – slightly better than Israel's rank (23) on GDP/capita among OECD countries. Israel's Internet performance places it ahead of countries such as Belgium, Ireland and New Zealand, yet trailing countries such as Denmark, the United States, and Korea. Israel performed best on *e-ngagement*, average on *e-nvironment* and it emerged weakest in *e-xpenditure*, ranking in the lower third of the OECD.

Israel ranked in the top half of OECD countries in the *e-ngagement* parameter, driven mostly by individual and business usage. Israel ranked particularly high on personal computers per person (7), business internet usage (6), and businesses with broadband (3). In government usage, on the other hand, Israel ranked closer to the middle of OECD countries (18). As recently shown by the Knesset Research Center, the number of computers per student in public schools was much lower than the average in developed nations.<sup>17</sup> Nevertheless, the high rankings on the business and individual usage indicators helped offset Israel's relatively lower position on government Internet usage.

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16 Nearly half of the government's roughly NIS 2.5 billion IT expenditure is for direct and indirect labor.

17 [www.knesset.gov.il/mmm/data/pdf/m02438.pdf](http://www.knesset.gov.il/mmm/data/pdf/m02438.pdf)



# Cutting Red Tape

## A Boon to the Economy?



## **Regulation and Bureaucracy: Barrier to Economic Development**

Motty Shapira

Regulation, bureaucracy, “red tape,” and “rule of the clerks and gatekeepers” are all terms commonly used by citizens and business owners to express their desire for freedom of action and independent judgment. In their view, it is these institutions that prevent them from acting freely, from expediting the work of government bodies, and from doing away with any and all factors that hamper their development.

Regulation—one of government’s primary instruments for implementing its policies (along with fiscal policy and allocation of state budgets)—is thought of primarily as being in the hands of the professional public-service echelon. But when coupled with legislation, regulatory policy also has unmistakably political components that represent the views of the party or parties in power at a given time.

There are those who wish to keep legislation out of the realm of regulation. Ori Arbel-Ganz, for example, in his work *Regulation—the Regulatory Authority* [IDI, 2003], attempted to formulate a comprehensive definition of regulation as “the formalization of the mutual interaction of values in a given society by an executive authority, which, by means of regulations, guidelines, directives or administrative orders, requires, sanctions, prevents or prohibits actions or behaviors by individuals and/or organizations in a society.” Note that in his definition he refers to “an executive authority,” and does not include legislation under the heading of “regulatory instruments.”<sup>1</sup> By contrast, we consider legislation to be an aspect of regulatory policy, and would add “the products of legislation” to the state’s regulatory system.

As part of a global trend in recent years, governments are tending to increase regulation with the goal of protecting their citizens from aggressive, unforgiving markets and from human behavior with the potential to cause harm to one’s friends, neighbors, or even family members.

“Some hold the opinion that in Europe, the ‘regulatory state’ is about to arise in place of the ‘dirigiste state,’” as argued by Prof. Itzhak Galnoor in his book *Public*

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1 Ori Arbel-Ganz, supervised by David Nachmias and Yedidia Z. Stern, *Regulation: The Regulatory Authority*, Position Paper No. 37, Jerusalem: Israel Democracy Institute, 2003.

*Management in Israel.*<sup>2</sup> It is difficult to single out the reason or reasons for the emergence of the regulatory state; undoubtedly, it is due in part to changes in the level of personal responsibility of officials in the public sector and to increased oversight and supervision of their activities.

The public sector, by its nature, seeks ways to divest itself of responsibility, even as it aspires to safeguard the rights and quality of life of its citizens. It would seem that the legislative branch, on the one hand, and the executive branch, on the other, view the expansion of regulation and bureaucracy as at least a partial sign of success in their roles. Members of the Knesset “compete” among themselves over the number of bills that they manage to pass, and members of the “classic” group of regulators (the Supervisor of Banks, the Capital Market and Insurance Supervisor, the Anti-Trust Supervisor, and the like), along with officials in the various government ministries and authorities, similarly view the regulation and bureaucracy that they themselves create as an integral part of their success.

As stated at the 2010 Caesarea Conference: “How can we know if government regulation is capable of achieving its objectives? And does its benefit truly outweigh its cost? At present, when laws or regulations are passed in Israel, there is no requirement to verify their overall impact on the economy in an extensive and consistent manner.”

A review of the papers and publications of international and regional organizations, and the actions of governments in the developed, the developing, and the undeveloped world indicates a global trend of seeking ways to improve regulation and to streamline and reduce bureaucracy. This trend can be summarized under the heading of “better regulation,” a term gaining currency in most countries and organizations. Apparently, those involved have come to understand that the government apparatus needs a dose of restraint as well as greater coordination and more efficient systems of bureaucracy and regulation—and that this process will not take place on its own.

The European Union and the OECD stipulate that all member states examine their policies of regulation and bureaucracy and how they are applied within their borders, and likewise propose ways of improving them. The British government has

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2 Itzhak Galnoor, *Public Management in Israel: Development, Structure, Functions, and Reforms*, Jerusalem: Akademon, 2007.

established a Better Regulation Executive, and has even launched a “Red Tape Challenge.” As part of this undertaking, an Internet site was launched where any citizen or business owner can suggest ways to improve regulation and bureaucracy. Australia has established an Office of Best Practice Regulation in addition to starting a site where all draft bills and regulatory proposals are presented for examination by citizens and the business community. In New Zealand, the Minister for Regulatory Reform has proposed a Regulatory Reform Standards Bill. In 2009, South Korea instituted a sweeping campaign to individually address some 11,000 regulations with the aim of improving its standing in the global Ease of Doing Business Index. Over the course of January–February 2011, US President Barack Obama issued an executive order to Government Secretaries on “Improving Regulation and Regulatory Review.”

The State of Israel has never taken upon itself a major government effort, at the central government level, to improve, streamline, and reduce regulation and bureaucracy. The decision makers may be convinced that Israel’s situation in this area is acceptable, but international reports on various aspects of business activity—level of competition, ease of doing business, transparency, etc.—all point to Israel’s low standing with regard to bureaucracy and regulation, or the areas affected by them. And Israel's place in the rankings appears to be dropping, primarily due to the impressive progress of many countries in this regard.

The fact that this subject is not being addressed in Israel may stem from an incorrect assessment of the situation or from a lack of courage on the part of public officials to take action. We believe that it is possible, inspired by existing examples around the world, to formulate a central government approach to dealing with this subject. This will not only boost Israel’s position in the world but will undoubtedly improve life for businesses and individuals in Israel—without impinging on the protection of citizens and their environment.





# **Analysis of Bottlenecks in Large-Scale Infrastructure Tenders**

Shahar Ziv, Eyal Rubin, Shaul Ben Shimol, Sagi Ben Simon

In this position paper, we will indicate the primary reasons for delays and cancellations of large-scale, government-issued infrastructure tenders in Israel, and will propose possible ways of overcoming these difficulties. This paper is based on interviews conducted with key figures involved in large-scale tenders in Israel, and numerous studies and articles published around the world on this topic.

The core problem in developing the field of large infrastructure tenders is the fact that Israel lacks a clear multi-year government plan, or a long-term policy and commitment with regard to building multiple projects in the future. The significant gaps in time between one tender and the next, with the accompanying uncertainty, make it difficult for entrepreneurs and the financing institutions to justify the necessary investment in setting up project-financing departments that specialize in complex tenders. In our estimation, the country must reach the point where at least two to three large-scale projects are launched every year.

Another major conclusion that emerges from our analysis is that there is reason to consider matching the scale of tenders to the size of the financing bodies and entrepreneurs that are active in the Israeli market, i.e., between NIS 100 million and NIS 1 billion per tender.

Distribution of the risks among the interested parties is the cornerstone of the contractual and financial framework of agreements. At times, concern on the part of the issuer of the tender (hereafter, the client) regarding aggressively priced bids and the future conduct of the concessionaire is liable to lead to a contractual framework that imposes greater risks on the concessionaire.

Additionally, as an answer to the lack of debt arrangers, and arrangers of bidding groups, it is advisable to boost the involvement of institutional bodies in large-scale tenders.

The Mandatory Tenders Law, in its current format, constitutes an additional bottleneck and makes it difficult for the state to conduct large, complex tenders in an optimal fashion. At present, there are restrictions on the ability of the party that issued

the tender to develop a dialogue with the bidders at the stage when the offer is being constructed—a point that harms the state’s ability to accept a bid that suits its needs and the ability of the bidders to learn about the expectations of the client.

The possibility of including foreign entities in large-scale tenders in Israel is naturally limited due to the small size of the market and to investors’ perceptions of the level of risk in Israel. Precisely for this reason, we must attach great importance to matching tenders in such a way as to ease the entry of foreign entities (companies and entrepreneurs, followed by the financing institutions).

The small number of companies competing for large-scale tenders is inherently problematic from the standpoint of the client (as was the case recently in the tender for thermo-solar power stations at Ashalim). To encourage entrepreneurs and companies to participate in tenders, there is reason to consider financial compensation for bidders who met the tender conditions but did not win.

In light of the existing bottlenecks in large-scale infrastructure tenders, we have proposed a number of possible solutions for improvement in this area, from the standpoint of timetables as well as budget and the well-being of the economy.

At present, after several large tenders encountered pitfalls along the way, the onus is on all parties in the field to generate successes in the near future. There are a number of projects that are coming to fruition at the moment (the national training center of the Israel Police, the desalinization plant at Shorek, the IDF’s training village, etc.). Business-like handling of tenders, and a relationship of trust among the three members of the “triumvirate”—the state, the entrepreneurs, and the financing institutions—has led in the past to impressive successes (Route 431, Highway 6, desalinization plants, the Carmel tunnels, private production of electricity, and various small-scale projects in local municipalities). From here on in, the matter depends on enlisting all the relevant parties in improving Israel’s infrastructures in efficient and productive ways.

### **Summary of Bureaucratic Obstacles: The Tax Angle**

In recent years, we have witnessed various reforms in Israeli tax legislation—some the result of a welcome initiative by the Income Tax Authority—which have led to a simplification and streamlining of the tax laws. The most significant of these are the reform in corporate tax, which established a gradual decrease in the level of corporate

tax—from 36% in 2003 to 18% in 2016; the tax reforms for preferred businesses, in accordance with the Encouragement of Capital Investment Law (Amendment No. 68), which simplifies the method of calculating taxes for a preferred enterprise; and the land-tax reform (Amendment No. 70) of March 15, 2011, which provides the possibility of executing land transactions and completing the change of ownership at the Land Registry Office without the need for confirmation from the capital gains tax authorities of full payment of taxes by the seller.

However, in contrast to the trend toward simplification of the tax laws by the legislature, it seems that there are more than a few bureaucratic obstacles in the tax system that require streamlining. Let us enumerate some of these: (1) the Income Tax Authority's policy of maximizing tax collection as part of the assessment process, as if it were a commercial party rather than its intended role as a quasi-judicial body; (2) lack of enforcement of the legal provision regarding binding timetables for handling a request for a pre-ruling; (3) non-implementation of many pieces of legislation due to their numerous provisions (for example the Law for the Encouragement of Construction of Rental Property, 5767-2007), and the exemption from participation for Israeli holding companies; (4) the overly complicated system of deductions at source for foreign residents, which should be simplified to make it easier for foreign residents to operate normally in Israel.

To continue the trend of removing obstacles, legislative amendments are needed along with complementary steps by the Income Tax Authority that emphasize the procedural aspect.





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