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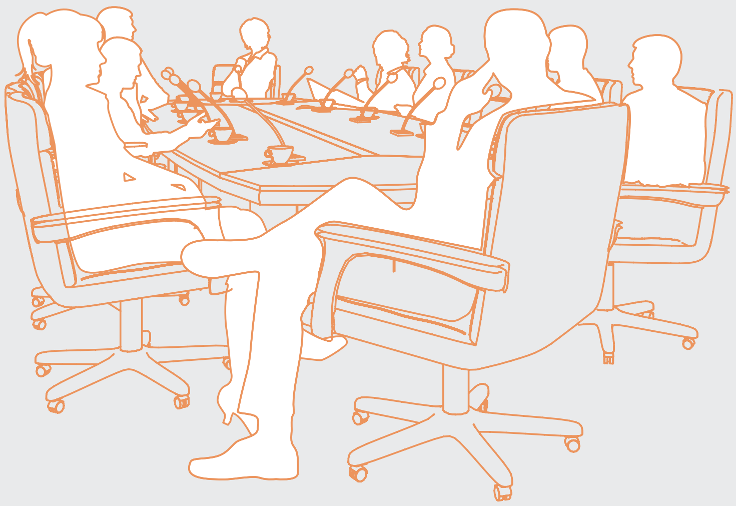

The Eli Hurvitz Conference on Economy and Society

Caesarea Economic Forum
EST. 1992

June 27–28, 2012 | Royal Rimonim Dead Sea Hotel

Summaries of Working Group Papers

Conference Chair: Minister of Finance Dr. Yuval Steinitz
Conference Director: Mr. Yarom Ariav

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Foreword

Conference Director: **Yarom Ariav**

Foreword

This year we celebrate the 20th anniversary of the Caesarea Economic Policy Planning Forum at a time of unprecedented challenges to Israel's economic vitality. In honor of IDI's former Chairman, who passed away last year, this year's conference will be called The Eli Hurvitz Conference on Economy and Society.

The annual conference is the culmination of a comprehensive effort aimed at enriching professional discourse on economic–social issues and assisting the formulation of economic policy in Israel. The recommendations of the working groups and the input from the conference sessions will be conveyed to the relevant decision makers.

Starting this year, the Forum is undergoing a change. The new discourse in Israel's public square will be highlighted in the form and content of the conference, and in the inclusion of the public in questions on the communal agenda.

This year, the conference will be focusing on five topics. The conference sessions will summarize the concerted effort of the professional working groups over the past several months.

1. **Pension Savings in Israel – Is There Cause for Concern?** — Although 17 years have passed since the pension reforms were introduced, Israel's financial system is still confronting many serious challenges. The first is ensuring economic certainty for pension savers at the time of their retirement. Prof. Eytan Sheshinski will present the recommendations of the working group on this subject.
2. **Are the Financial Media in Israel Independent?** — In recent years, the importance attached to financial information has grown in Israel, with a parallel surge in the amount of media attention devoted to economic issues. In light of these changes, we must ask ourselves whether the financial edia in Israel independent? Dr. Roei Davidson will present the findings of the working team on this subject, and a panel of media and business people led by Emmanuel Rosen will share their experience and insights with us.
3. **The State Budget in Light of the Social Protest** — During the social protests that erupted in the summer of 2011, a broad spectrum of groups from the Israeli public called for greater state involvement in the social sphere and improved public services. Prof. Zvi Eckstein will be presenting the conclusions of the working group on this subject, and will be outlining the challenges that the state budget will be forced to address next year.
4. **Alternatives to the Tal Law: An Equal Burden or the Burden of Equality?** As the expiration of the Tal Law approaches, this session will focus on the

repercussions of drafting the ultra-Orthodox into the IDF.The discussion will be led by MK Yohanan Plesner, Chair of the KESHEV Committee (a Hebrew acronym for “promoting equal sharing of the burden”) tasked with increasing ultra-Orthodox enlistment rates. This will be followed by a roundtable discussion moderated by Dr. Ilana Dayan.

5. **International Panel of Bank Governors** — The international perspective is important to the continued stability of the Israeli economy. This session, which will be held at the foot of Masada, will be moderated by the Governor of the Bank of Israel, who will engage the Governors of the Bank of Finland and the Bank of Iceland in a discussion of the European financial crisis as it affects the Israeli economy.

In addition, we will convene, talk, and listen to the Finance Minister, the Governor of the Bank of Israel, senior Bank of Israel officials, high-ranking personnel from the Finance and other ministries, members of Knesset, academics, chairs of public committees, prominent members of the business sector (chairs and directors of companies, corporations, and NGOs), journalists, and overseas guests.

Let’s get to work to find solutions from our combined experience, and formulate suggestions that will help Israel’s decision makers.

The success of the conference depends on all of us!

Looking forward to seeing you at the conference,

Yarom Ariav
Conference Director

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Pension Savings in Israel — Is there Cause for Concern?

Working Group Chair: **Prof. Eytan Sheshinski**

Working Group

Chair	Prof. Eytan Sheshinski, Professor Emeritus of Public Finance, The Hebrew University of Jerusalem
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	Prof. Efraim Sadka, The Henry Kaufman Chair of International Capital Markets, Tel Aviv University
	Yoav Ben Or, CEO, Amitim
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Pension Savings in Israel – Is there Cause for Concern?

Working Group Summary

Over the past twenty years, the pension system in Israel has undergone numerous reforms, which have led to substantial changes in the structure of citizens' long-term savings and to the creation of a new pension system, which is still being developed.

The pension system has shifted from what was largely a defined-benefits (DB) system, in the (pre-1995) "old" pension funds and unfunded pension plans, to a defined-contributions (DC) system, based on cumulative savings, in the "new" pension funds, provident funds, and life insurance plans. In addition, the investment structure was modified and an actuarial balance was computed for the old pension funds, the retirement age was raised for both men and women to bring it in line with longer life expectancies, mandatory pension was introduced for all salaried employees, and greater emphasis was placed on saving for a pension paid in monthly installments as opposed to one distributed in a lump sum.

As part of the reforms, the government reduced the share of designated bonds in old and new pension funds. This process was coupled with increased investment by the funds in such assets as stocks and corporate bonds. Between 2000 and 2011, the proportion of investment by pension funds in stocks rose from 2.9% to 25.9%.

Initially, the shift to investing in stocks allowed the pension funds to maintain high yields and low volatility, since, from 2003 to 2007, the capital market experienced continuous gains. During this period, the new pension funds achieved an average nominal yield of 7%–11% percent annum. But in 2008, the global financial crisis struck, toppling stock markets around the world and bringing interest rates down to nearly 0%. That same year, the pension funds, life insurance plans, and provident funds lost 10%–30% of their value. Although the world's stock markets recovered by 2009, and most of the pension and provident funds recouped their losses, the interest environment remained at a low level of between 0% and 3%, as did the yield for "no-risk" assets, even for long-term investments of 20–30 years.

The financial crisis has clarified the existing risks of pension savings. On the one hand, the low interest does not allow pension funds and insurance companies to achieve sufficiently high yields via low-risk savings vehicles to enable employees to increase their accumulated savings; on the other hand, investing in stocks and corporate bonds, which have the potential for high yields, exposes the saver to volatility and high risk (in comparison with such low-risk assets as government bonds and term deposits).

These processes led the members of the working group to address various plans and alternatives that could increase the level of certainty for employees, reduce volatility, and boost pension savings. The members elected to seek alternatives that would not entail significant change in the level of state involvement and would not increase the government's financial liabilities.

Accordingly, the working group chose to focus on three areas that complement one another (and are not mutually exclusive):

1. Method of allocation of designated bonds
2. HACHAM model (life cycle–based savings plans)
3. Dual role of severance pay —as compensation and as an important component of pension savings

1. Method of allocation of designated bonds

Designated bonds are non-negotiable, index-linked government bonds with a fixed interest rate that are issued solely for pension funds and constitute 30% of pension savings. The current interest rate on these bonds is 4.86%, which is higher than the average long-term market rate. Since it is the state that bears responsibility for the interest payments, this interest is, in effect, a subsidy given by it to the pension funds.

In the context of this paper, the working group chose to discuss the current method of allocating designated bonds, with the aim of achieving more efficient allocation that would maximize the advantages of this instrument.

- The participants looked at four alternatives, examining the allocation of designated bonds for all pension schemes based on monthly allocations: pension funds, life insurance, and provident funds.
- The participants proposed examining the possibility of increasing the number of designated bonds by lowering the guaranteed yield so that the budgetary cost to the government would not be affected.
    - This expansion is expected to have an impact on the capital market and on government financing methods, but these were not considered as part of this paper.
    - In particular, it should be ascertained that this move will not lead to an increase in the state's bond inventory and debt-raising needs beyond the debt necessary to finance the deficit (as stipulated in the fiscal rules), and will not undermine the debt management policy of the state.

  - It should also be ascertained that expanding the non-negotiable bonds market will not cause severe harm to the negotiable bonds market, in terms of liquidity and level of negotiability.

The following are the alternatives that were considered:

- **Alternatives A and B** propose allocating designated bonds based on the age of the employee so as to increase certainty in the years leading up to, and following, retirement age.
  - **Alternative A** would allocate designated bonds starting from age 60, at a proportion of 55% of the savings portfolio and with a real yield of 4.86%.
  - **Alternative B** would allocate designated bonds starting from age 40, using a graduated model, with a reduced yield of 4.2%, so that the proportion of the bonds would increase with the age of the investor.
- **Alternatives C and D** would allocate 70% of the savings to designated bonds up to an income ceiling, so as to create a new basic-pension layer, between the layer of Israeli social security and that invested in the free market.
  - **Alternative C** limits the allocation of designated bonds to an income ceiling of NIS 1,500, with a real yield of 4.86%.
  - **Alternative D** limits the allocation of designated bonds to an income ceiling of NIS 3,000, with a real yield of 4.0%.

In the paper, the members of the working group present a simulation that compares the various alternatives based on three wage levels: NIS 4,000, 8,000, and 16,000.

- An analysis of the results shows that increasing the proportion of designated bonds at the expense of lowering the guaranteed yield has a positive impact, in terms of lessening volatility and raising the yield for pension savings (based on the assumed yields of the simulation).
- **It was found that Alternative D is preferable for intermediate wage levels and below, while Alternative B is more suited to wage levels that are intermediate and above.**
- The simulation examined the alternatives in terms of the period up to retirement age. Thus the advantage of Alternatives A and B—in which emphasis is placed on the stability of pension payments during retirement itself—is not reflected in the comparison.
- The members did not examine the effect of expanding the proportion of designated bonds on government methods of financing or on the capital market.

- In light of these points, the members did not reach a consensus regarding a recommended alternative. Several members of the working group supported Alternative D, others favored Alternative B, and the remainder felt that, due to the limitations noted above, it would not be appropriate to formulate any recommendation at this time.

2. HACHAM model (life cycle–based savings plans)

Under the HACHAM model, the risk level of the investment of pension savings is affected by the age of the employee such that the level of risk is reduced as he or she approaches retirement age. In this way, young employees with a long investment horizon can invest in pension products that have a high risk level and high potential yield, while investors with a short investment horizon will invest in conservative products and avoid volatility in their pension savings.

- It emerges from the findings of the working group that, compared to a portfolio with static management, the HACHAM model makes it possible to reduce the risk level of the older investor without diminishing yield (and at times, even raising it) and without increasing the overall risk level of the savings plan.

The members also based themselves on publications of the OECD, which supports the adoption of strategies of this type, particularly in countries like Israel, where pension savings are mandatory and defined-contribution pensions are the norm.

- Accordingly, **the members of the working group support the implementation of the HACHAM model as the default option for pension savings in Israel.**

3. Dual role of severance pay

Severance pay is a form of compensation to an individual who has been dismissed from his workplace, as well as a means of helping him to maintain an income during the transition between jobs. Taken together, these monies constitute over 30% of pension savings. In recent years, we are witnessing a growing trend whereby investors withdraw their severance pay before reaching retirement age. There are several reasons for this tendency, among them: changes in the labor market and frequent movement between jobs, shortsightedness of investors, and taxation reforms that force employees to decide on the future of their compensation monies immediately upon their dismissal.

The members of the working group did not reach a consensus on the way to address this issue, but they did agree that suitable changes must be implemented so that the bulk of the severance pay is channeled into savings for retirement age.

Are the Financial Media in Israel Independent?

Working Group Chair: **Dr. Roei Davidson**

Working Group

Chair	Dr. Roei Davidson, Lecturer, Department of Communication, University of Haifa
Members	Dr. Yuval Dror, Head of Digital Media Studies, School of Media Studies, The College of Managment Academic Studies
	Dr. Linda Efroni, Lawyer, Economist, and Jurist; Expert on the Labor Market and Labor Relations
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	Pinchas Landau, Economic and Financial Consultant
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Are the Financial Media in Israel Independent?

Working Group Summary and Conclusions

The importance of financial information in Israel has grown in recent years with the shifting of responsibility for the economic fate of Israeli citizenry from collective bodies—such as the state, trade unions, and employers—to the citizens themselves. Research in the field has shown that such information exerts a major influence on financial decision-making. Alongside the structural changes in Israel's political economy, the extent of the media's focus on financial issues has swelled. Newspapers that in the past paid scant attention to financial topics now dedicate entire daily supplements to them, which take up a sizeable portion of the editorial content of the papers. Likewise, electronic media have begun to produce daily programs on economic subjects both on television and radio. The explosion in financial media is reflected in the publication of three financial dailies—a considerable number when compared with many other developed economies that are larger than Israel's. Interest surveys also indicate that the attention paid to financial media in Israel is higher than in other countries.

In light of the above, the members of the working group sought to understand the nature of the financial content disseminated to the public, the institutional framework that produces this content, and possible alternatives to the existing frameworks. **Roei Davidson** found indications that financial coverage in the Israeli media tends to focus on short-term tactical developments. The daily chronicling of events often takes priority over presenting these immediate developments in a broader context. The scope of the coverage is tied to the weekly fluctuations of the world's stock markets. In Israel's print media in general, and in the country's highest-circulation newspaper specifically, large fluctuations in stock indices, in particular downward trends, have led to stepped-up financial coverage, at least in 2011. In other words, the press that serves the general public devotes attention to daily developments that hold no importance to that public and could even be potentially damaging if misunderstood. The capital market is also a prominent topic of discussion on radio and television, which have made a ritual of allocating a spot at the beginning or the end of the news to the daily movements of the stock indices.

Davidson also reviewed Israeli financial discourse before, during, and after the wave of social protests that swept the country in the summer of 2011. The findings suggest that the change in the media discourse was limited. Especially striking is the return to the status quo in Israel's popular press, where mention of key terms from the protest movement (such as “social justice,” “cost of living,” and “economic concentration”) has reverted to the minimal levels that characterized them prior to the protests. By contrast, in early 2012, the online media continued to address the topic of social protest with even greater intensity, as did several of the daily financial papers.

Linda Efroni showed that the increased focus on social/economic issues during and immediately after the main wave of protests was limited to specific topics; as a result, the most important structural solution to the problem of the cost of living—a cost-of-living adjustment—was almost totally ignored. According to Efroni, this only confirms the tendency of journalists to disregard the rights of employees, particularly those who belong to the relatively low income brackets. **Oren Persico** noted that since it is the well-heeled readers who tend to be consumers of the financial newspapers, it is not surprising that this press does not deal with economic/social issues from the perspective of the lowest income percentiles of Israeli society.

Given the spotty coverage with regard to the capital market and the protest movement, the working group set out to explore the institutional framework in which financial content is produced in Israel. As emphasized by **Didi Lachman-Messer**, the bulk of financial news in Israel is produced by ad-based commercial media. This source of revenue, coupled with the financial and other interests of the owners of the various media outlets, places genuine limitations on the ability of journalists to engage in analyzing and criticizing the dominant financial bodies in Israel and those who control them with the freedom required of professional financial media. The decline in revenues from print-media ads as a result of the emergence of alternative advertising channels on the Internet (in a concentrated economic system marked by relatively low advertising expenditures) only exacerbates this dependence. The existence of alternative models of media financing is doubtful: The success of free newspapers indicates that the public has very limited willingness to pay for professional journalistic content of a high standard, whose relative cost is high. Similarly, public media around the world, and particularly in Israel, are suffering from dependence on the political establishment, which makes it difficult for them to offer independent coverage of political and economic issues. Philanthropic models of support for the press have not yet taken root globally—though there are several outstanding exceptions in the field of financial news—and will most likely encounter even greater obstacles in the small Israeli market. Lachman-Messer thus concluded that an independent financial press is in fact possible only if the media owners are interested in investing in it—which is a doubtful proposition.

In their report, the members of the working group variously noted that one of the barriers to the existence of a creative, critical, insightful financial press is the lowly status of journalists in Israel. **Yuval Dror** pointed to low salary levels, unclear paths to advancement, and fierce competition as factors making it difficult for journalists, including financial journalists, to mobilize the resources needed for critical coverage of the financial sphere. Basing himself on Karl Marx, Dror held that, given the milieu in which financial journalists operate, it is hard for them to form an awareness that would allow them to think outside the present financial box.

In this context, **Pinchas Landau** stressed the very shaky status of journalism as a profession. In contrast to other professions, journalism in Israel does not have an infrastructure for ongoing training within or outside the place of work. In previous decades, Landau argues, there were informal frameworks within the workplace for continued training of journalists in the different areas of coverage. The importance of this ongoing education is particularly evident in the financial field, which demands a great deal of knowledge and experience. But with the vanishing role of editorial offices as the nerve center of the journalistic organization, and the increasing acceptance of electronic communication among editors, these frameworks have ceased to function.

Findings from a study conducted jointly by Roei Davidson and Oren Meyers lend strength to these claims. Dozens of interviews with present and former journalists reveal that the dominant career model in the field of journalism today is that of the “unwilling entrepreneur.” Numerous journalists speak of the highly demanding nature of their work, which is compounded by poor salary conditions. They also note the lack of paths to advancement, which causes many journalists to leave the profession in favor of other occupations, especially “neighboring” media jobs. At times, journalists end up working for the sources that they once covered. The brief career that many journalists have impedes the development of professionals with broad knowledge and the ability to critically assess their sources.

Conclusions

1. The members of the working group are not optimistic about the prospects for an independent, critical financial press in Israel. They are aware of the attempts by journalists in many media organizations to cover the financial scene in a creative, critical manner, but underscore the numerous institutional barriers that make these cases the minority. A few of the members feel that there should be an effort to strengthen public media organizations alongside the existing commercial media, through both public funding (for example, via a license fee) and philanthropic monies. Such organizations would not replace the commercial media, but, as seen from the situation in the U.S., could contribute to more pluralistic financial

discourse. Most importantly, they could pave the way for a more “muscular” investigative financial press, which requires considerable resources and layers of insulation from outside influences.

2. In light of the fragile status of journalists in Israel, many of the panel members recognize the importance of the recent attempt by journalists to unionize under the banner of the new Israel Journalists Organization. Such a group can help strengthen journalists’ bargaining power with their employers, and at the same time, take on the responsibility of professional advancement of journalists, both in the practice of their profession and in the reservoirs of knowledge necessary for the fields they cover.

3. The evidence in the working group's report that investing in human capital will also be good for the bottom line should motivate even the owners of commercial media organizations to go back to investing in the training, wages, and other working conditions of journalists, since this can help turn out a better, more attractive product.

4. The appearance of new and innovative financial media in the shadow of the global economic crisis can also serve as a source of inspiration for new patterns of financial coverage. This would bring a broader historical and geographical context to the daily chronicling of financial events—one that would provide Israel’s citizens with the tools to navigate, and even change, a complex economic world, and not only to serve the needs of particular elites or of the financial system.

Financial journalist Henry Blodget recently stated that “if you want to invest intelligently, the first thing you should do is ignore 99.9% of what you hear in the financial media.”[1] It is the hope of the working group that the findings and conclusions of this report, if brought to the attention of the financial media and its consumers, will contribute, if only slightly, to reducing the amount of superfluous content that this press produces—for the benefit of society as a whole.

1 Henry Blodget, “Finally, Some Excellent Investment Advice: Don’t Play The Losers’ Game,” *Business Insider*, December 24, 2011: www.businessinsider.com/finally-some-excellent-investment-advice-2011-12#ixzz1n6JYlHsy

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The State Budget in Light of the Social Protest

Working Group Chair: **Prof. Zvi Eckstein**

State Budget

June 27–28, 2012 : Royal Rimonim Dead Sea Hotel

Working Group

Chair	Prof. Zvi Eckstein, Dean of the School of Economics, The Interdisciplinary Center, Herzliya; Professor at Tel Aviv University
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	Dr. Adi Brender, Research Department, Bank of Israel
	Alon Etkin, Budget Department, Ministry of Finance
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The State Budget in Light of the Social Protest

Working Group Summary and Recommendations

In 2011, the Israeli government and parliament adopted a multi-year fiscal policy plan that includes an annual expenditure ceiling in the state budget for each of the coming years and a requirement that the deficit not exceed 1.5% of GDP in 2013 and 1% of GDP from 2014 onward. Nevertheless, since adopting these principles,[1] the government has passed numerous resolutions that influence the projected expansion of the budget over the next few years; likewise changes have taken place in the macroeconomic environment relative to the expectations at the time these principles were established. Moreover, during the social protests that erupted in Israel in the summer of 2011, a broad range of groups called for greater state involvement in the social sphere and for improvement of public services—all against the backdrop of a significant reduction in the weight of government expenditures in the GDP during the previous decade (from 51% to 42%), followed by a steep drop in the tax burden.

These developments confront the Israeli government with complex challenges in the area of fiscal policy. Under the present expenditure rule, in 2013 the state budget will grow by 4.8% in real terms—an exceptionally high increase that raises total government spending from 42% to 43% of GDP. However, estimates of the cost of the multi-year programs approved by the government over the past two years in the areas of education, health, social welfare, infrastructure, and defense are higher than the ceiling permitted under the expenditure rule. Assuming that the government carries out the necessary adjustments so that its expenditures do not exceed the spending cap, the projected revenue level based on current tax rates will be expressed in a deficit of roughly NIS 20 billion (some 2% of GDP) above the ceiling set by law, and a halt in the reduction of the debt-to-GDP ratio.[2]

Thus the government will have to reach a decision in the following areas:

1. To cancel or restructure the implementation of certain of the multi-year programs that it adopted, and to reduce expenditures on other items or raise the spending cap

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1 Fiscal rules capping spending and deficits, as set forth in the Deficit Reduction and Budgetary Expenditure Limitation Law (Amendment No. 11), 5770-2010.

2 The figures without sources in this report are based on calculations by the members of the working group, and do not necessarily reflect the views of the Finance Ministry representatives who were part of the group.

2. To raise the deficit ceiling while halting the decline in the debt-to-GDP ratio, or to increase tax rates so as to enable the decline to continue, whether through the plan stipulated in the above law or at a slower pace.

In addition, as a result of the social protests and the report of the Committee for Socioeconomic Change (known as the Trajtenberg Committee), parts of the Israeli public are calling for curbing the decline in the percentage of the budget allocated for public spending in the GDP, as set forth in the current fiscal rule. They are also calling for for achieving growth in the percentage of public spending through a parallel increase in the tax burden.

Three Policy Alternatives for the Government's Budgetary Framework

The size of the gaps between the current estimates and the targets stipulated by law for each of the parameters cited above is substantial. Consequently, we are speaking not of technical adjustments but of major decisions that must reflect a broad, long-term policy approach. The latter should be grounded on a values-based economic and political choice, and on a determination of the "balance of risks" of Israel's medium-term fiscal strategy. For this reason, the working group chose not to recommend specific targets for the various budgetary aggregates but rather to describe in detail the implications of the different alternatives, both in terms of their impact on the fiscal and macroeconomic aggregates, and the type of measures that will be needed to achieve the various objectives to be selected. We perform this analysis by presenting three alternative scenarios for the government's budgetary framework of the next five years, reflecting various policy approaches. They are intended to demarcate certain boundaries that, if deviated from, would have significant, undesirable financial repercussions, in the opinion of the working group.

- **Alternative A:** Maintaining the existing fiscal rules of expenditures and deficit targets while simultaneously carrying out necessary adjustments in the government's spending programs and the tax rates. This would mean holding public spending to 43% of GDP and a genuine reduction in the debt-to-GDP ratio in 2014–2018.
- **Alternative B:** Maintaining the spending cap in accordance with the present rules without raising taxes, so that the debt-to-GDP ratio would not drop below the current level. The primary outcome is that the deficit would be 3.6%–3.7% of GDP for 2013–2018.

- **Alternative C:** Raising government spending from 42% to 45% of GDP from 2013 to 2016 by concurrently raising the tax burden so that the deficit targets of Alternative A are met.

We analyze the alternatives in light of the macroeconomic processes that have taken place over the last decade, the existing fiscal rules, the social protests, and the demographic changes projected for the coming decade. Israel's fiscal policy over the next few years will be influenced to a large extent by the policies of successive Israeli governments over the past decade, particularly from 2003 onward. These were marked initially by a curbing of the growth in government spending, a moderate reduction in the direct tax burden, and a decrease in the public debt-to-GDP ratio, whose current level—74.2%—is similar to the (simple) average of the developed nations. These measures contributed a great deal to the recovery of Israel's economy from the severe crisis of the early 2000s, to the rise in Israel's financial credibility, and to the economy's ability to withstand the recent global financial crisis. In the aftermath, the weight of public spending in GDP is the lowest it has been in several decades, and civilian public spending is among the lowest of the developed nations. At the same time, despite the continued curb on spending, the aggressive tax reductions carried out by the government between 2007 and 2011 brought its structural deficit back to the level preceding the reductions—which does not support a continued lowering of the debt-to-GDP ratio. Moreover, the slowing of the growth in government spending reduced the government's involvement in transfer payments as well as the scale of public services that it was able to provide.

The first section of the working group's paper offers an overview of the major developments in Israel's economy in 2011 and early 2012, the demographic changes expected to affect the GDP growth rate during the next decade, and the government's fiscal policy over the past decade. These serve as a basis for discussion of the budgetary framework for the next several years. The past year (2011) was characterized by positive macroeconomic data: The Israeli economy grew by 4.8%; per-capita GDP rose by 2.9%, and unemployment dropped to 5.6%, the lowest level in three decades (6.7% according to the new formula of the Central Bureau of Statistics' Manpower Survey). Despite concerns raised by the continuation of the financial crisis in Europe, the first-quarter results for 2012 indicate a stable unemployment level and employment rate, and a slight acceleration in business-sector activity. GDP is expected to grow by 3.1% this year, and by 3.5% in 2013.

In the medium term, current demographic projections of the Central Bureau of Statistics regarding population growth among working-age individuals show that

Israel's growth rate during the coming decade will almost certainly be very low in comparison to that of the previous decade (3.6%). These forecasts suggest that the growth rate of the work-age population (25–64) will most likely slow from 2.3% in the previous decade to roughly 1.2% over the next ten years, and that the composition of this group will change. Specifically, the proportion of Arabs and ultra-Orthodox Jews (groups that are characterized by low employment rates) in the overall population is expected to rise, while the weight of the non-Haredi Jewish population (which is marked by high employment levels) will drop.

These figures form the basis of the growth forecasts of the working group. Thus the GDP for 2014–2018 is expected to rise by an average of 3.3%, under the optimistic assumption that employment and productivity will continue to climb. This offers a further reason for the recommendation in the final chapter of large-scale investment in policies that promote employment.

Analysis of the Policy Alternatives

In the key section of the paper, the three policy alternatives for a budgetary framework are analyzed. As stated, the present expenditure rule will lead to a rise in spending of 4.8% in real terms in 2013. This stems from an increase of 2.9% in government expenditure, in keeping with the spending cap, as well as a one-time price adjustment of 2%. Examining **Alternative A**, it emerges that a gap of 2.2% of GDP is expected in 2013 between the projected deficit, derived from the expenditure rule (an increase of 4.8% in real terms) and the deficit target (1.5%). Closing this gap by raising taxes means adding statutory taxes of NIS 26 billion (in 2012 prices). Reducing the deficit to 1% of GDP in 2014 (in accordance with the deficit rule) would necessitate additional taxes totaling NIS 5 billion. In other words, a choice must be made between a sizeable increase in the tax burden, a higher deficit target, and a rise in spending below the ceiling set by law.

With regard to spending, the position of most members of the working group is that given the relatively low level of civilian expenditure and the government's existing commitments, it would not be advisable to raise spending to a level less than the ceiling. It would therefore be preferable to raise the tax burden or increase the deficit target. The former is likely to slow the rate of growth, at least in the short term, but also to contribute to the continued drop in the ratio of public debt to GDP. This will increase the credibility of the Israeli economy, lead to a reduction in interest payments, and allow for flexibility in carrying out an anti-cyclical policy in the event of a financial crisis.

Raising the deficit target yields precisely the opposite results. In the case of **Alternative B**, under the existing conditions, spending to the permitted ceiling without raising taxes is expected to halt the decline in the debt-to-GNP ratio; however, it will not cause the ratio to rise. In such a situation, we project an annual deficit of roughly 3.6% of GDP; the debt ratio will be based on a level of 75%, with an average projected growth rate of 3.3% as noted above. It should be noted that a high deficit is liable to limit the government's ability to respond to financial crises; similarly, a change in policy with regard to deficit reduction could damage the state's fiscal credibility, exerting a negative impact on its credit rating and on the costs of raising capital.

From the discussion on Alternative A, it is evident that raising the budget above the spending cap, as proposed in **Alternative C**, would require an extremely large tax increase. Boosting the weight of public spending to 45% of GDP by 2016, and meeting the current deficit target, will require a cumulative addition of NIS 53 billion in statutory taxes (at 2012 prices). Increasing expenses without raising taxes will lead to annual deficits of over 4% of GDP, and a rise in the public-debt-to-GDP ratio. The position of the working group is that the government should continue its course of lowering the public- debt-to-GDP ratio, and in any case should certainly avoid a policy plan that would lead to a rise in the debt-to-GDP ratio. Thus it is clear that choosing Alternative C would necessitate a tax increase equal to at least the level of additional spending over and above the existing ceiling.

Accordingly, it is the consensus of the working group that **a tax increase of at least NIS 10 billion shekel will be necessary in 2013**. We are not presenting a detailed plan for this increase but are proposing guidelines for discussion along with alternatives for raising revenues in keeping with the target selected.

- In the first stage, we recommend focusing on revoking unjustified exemptions and on taxes that improve the resource allocation of the economy.
- In the second stage, bearing in mind the tax increase required, we propose that the major taxes—income tax, corporate tax, and VAT—be raised.
- We further recommend that a professional working group at the Finance Ministry construct several detailed recommendations for more efficient tax allocation by increasing tax receipts, in accordance with the deficit targets and the planned decrease in the debt level.

A general discussion, including figures on the different exemptions that can be revoked as well as the implications of changes in the various tax components, is presented in a special chapter on taxation.

Recommendations

Against the backdrop of the social/economic protests and the plan to increase employment, the members of the working group recommend assigning greater priority in the budget to the areas of employment and education.

- In the context of employment, it should be stated that Israel's budgetary expenditure on active labor market policies is lower in comparison with other developed nations and in relation to the resources needed to promote employment. We recommend a substantial increase in investment in policies aimed at boosting employment; these should focus on various programs to increase human capital and improve the access of population groups characterized by low employment rates. Our position is that judicious investment will lead to a rise in employment rates and a lesser incidence of poverty, and will help integrate the Arab and ultra-Orthodox sectors into Israeli society.
- **We recommend a cumulative supplement of NIS 1 billion annually over the next five years** for investing in active labor market policies such as professional training for young people and adults, technological colleges, employment centers for preferred population groups, incentives for employing Israelis in agriculture, tuition vouchers for professional training while integrating in the labor market, a Welfare to Work program, and increased enforcement of labor laws.[3]
- The working group supports the recommendations of the Trajtenberg Committee with regard to daycare centers, and calls for their implementation, with emphasis on the areas of the country with low participation in the labor market. Several of the members favored making benefits contingent on the parents' employment.

In the area of education, we support the recommendations of the Trajtenberg Committee and call on the government to continue implementing them.

- The members of the working group view investment in education as an example of long-term thinking that is consistent with our recommendations in the area of employment, since devoting resources to education also has a positive effect on the acquisition of skills needed for the labor market and on increasing employee productivity. However, when developing the recommendation for free education for ages 3–4, it is advisable, first and foremost, to make this service contingent on both

3 The position of the Finance Ministry is that it would not be appropriate to recommend a specific sum in this context without a comprehensive examination of the government's priorities and of the budgetary resources at its disposal.

parents' working. Similarly, afternoon daycare for preschool children should be conditioned on the employment of both parents. Such a policy, of maximizing the parents' earning power by providing services that facilitate their participation in the work force, can be highly effective in encouraging employment at a time when the growth rate of the working-age population is on the decline.

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Alternatives to the Tal Law: An Equal Burden or the Burden of Equality?

Tal Law

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Alternatives to the Tal Law: An Equal Burden or the Burden of Equality?

Abstract

The origin of the arrangement whereby yeshiva students who fall into the legal category of "toratam omanutam" (lit. Torah study is their vocation) are permitted to defer their military service is a directive issued by Prime Minister David Ben-Gurion in 1948. The gist of the declaration was that yeshiva students were not obligated to perform military service. Over the years, this temporary arrangement, which affected only 400 yeshiva students at the time, has become the primary path for ultra-Orthodox young men, and has been largely responsible for turning the ultra-Orthodox community into a "society of learners."

The Tal Law, enacted in 2002, was intended to enshrine the above arrangement in law, yet also to create specific mechanisms for a more equal sharing of the burden of military service: a so-called "year of decision,"[1] special military tracks for the ultra-Orthodox, and the option of civilian national service. In February 2012, Israel's High Court of Justice struck down the Law by a majority vote. The Court determined that while the Tal Law had indeed aided in the establishment of military and civilian service tracks for the ultra-Orthodox, it had failed when it came to implementing them, as a result of the Law's intrinsic shortcomings. A Knesset committee comprised of members of the coalition government—the KESHEV Committee headed by MK Yohanan Plesner—was established to present an alternative law to the Knesset, which must be enacted by the beginning of August, 2012, when the previous law will expire.

This position paper offers a brief review of the development of the service-deferral arrangement over the years, focusing on the involvement of public committees, the Knesset, the Goverment, and the High Court of Justice in shaping the agreement. The paper brings current figures on deferral of army service, on ultra-Orthodox young men who are serving in the army or in civilian national service, and on the economic and social aspects of the arrangement.

We present three problems with the present situation:

1 Under the Tal Law, from the age of 22 an ultra-Orthodox yeshiva student is permitted to leave his studies for one year without being conscripted. At the end of this "decision year," if he opts to continue in the work world, and not return to yeshiva, he is formally subject to conscription (several months of military service or a year of civil service).

1. **ethical problem** - lack of equality among individuals and groups in Israel;
2. **operational problem** - manpower shortage in the IDF;
3. **economic problem** - result of the service-deferral arrangement.

The recommendations offered below are assessed in light of their contribution to reducing these problems, taking into account both the legal ability to implement the policies and their effectiveness in terms of the ultra-Orthodox community. The alternatives to the status quo are presented in the form of two scenarios. The potential benefits of each option are weighed against the drawbacks.

First alternative: Universal service with exemption quota

Under this alternative, ultra-Orthodox young men would be required to serve in the army upon reaching the age of 22, with the exception of a specific group, limited in number, to be determined by an outside examination or by giving exemption vouchers to yeshiva heads in accordance with the number of students in their institution. To implement this alternative, positive and negative incentives would have to be enacted into law. The incentives could be individual, institutional, or applicable to the entire ultra-Orthodox community.

- This alternative is expected to encounter across-the-board resistance on the part of ultra-Orthodox society and its opinion makers. Moreover, there is reason to assume that drastic measures aimed at initiating such sweeping social change will lead—at least in the short term—to a schism between the ultra-Orthodox community, on the one hand, and the secular and (non-ultra-Orthodox) religious population, on the other.
- In terms of equality, this alternative is the most consistent with the ruling of the High Court of Justice. Its economic benefits stem from the future entry of thousands of ultra-Orthodox into the labor market and the reduction of budgets for yeshivas and *kollel*s (institutes for full-time, advanced Jewish learning); however, the greater the success of this alternative, the higher its short-term financial costs will be.

Second alternative: Setting of clear recruitment goals for the ultra-Orthodox

According to this alternative, in theory the State of Israel does not demand that those who wish to learn Torah enlist in the army; yet at the same time, it is interested in conscripting the majority of young ultra-Orthodox men. As part of a gradual process extending over several years, a clear annual target would be established for the number of ultra-Orthodox males enlisting in the army or in civilian national service. Although the government already established enlistment goals for the ultra-Orthodox in 2011, under this scenario the recruitment efforts would be bolstered, for the first time, by negative incentives.

- This alternative would be interpreted by the public as continuing along the lines of the Tal Law, since conscription would not be mandated for the ultra-Orthodox, unlike the general public, which is obligated to enlist.
- A law that sets recruitment goals but does not require individual ultra-Orthodox males to serve will have a limited effect on the number of ultra-Orthodox who choose military or civilian-national service. Consequently, it is doubtful whether the option of enlistment targets will meet the standard of equality set by the High Court of Justice. It does, however, pass the test of economic feasibility in the immediate term.

The position paper also examines the feasibility of **combining the alternatives** by enshrining the principle of universal service in law but applying it only to those aged 17 and under, who have not yet entered into the "Torah study as vocation" arrangement.

The basic elements of this proposal are as follows:

1. For the next five years, conscription would be based on the target model.
2. The model would test the effectiveness of making yeshiva funding contingent on enlistment in the army.
3. At the end of the five-year period, the universal service model would be implemented, with a quota of permitted exemptions.

The obvious advantages of combining the alternatives are avoiding an immediate confrontation with ultra-Orthodox society, and inculcating the notion of universal service (with an exemption quota) to be instituted five years from now. The principle of equality would be grounded in law from the outset, even if its implementation would be gradual.

Recommendations

Regardless of the alternative that is ultimately chosen by the policy makers, the paper proposes a series of steps that can **promote an equal sharing of the burden:**

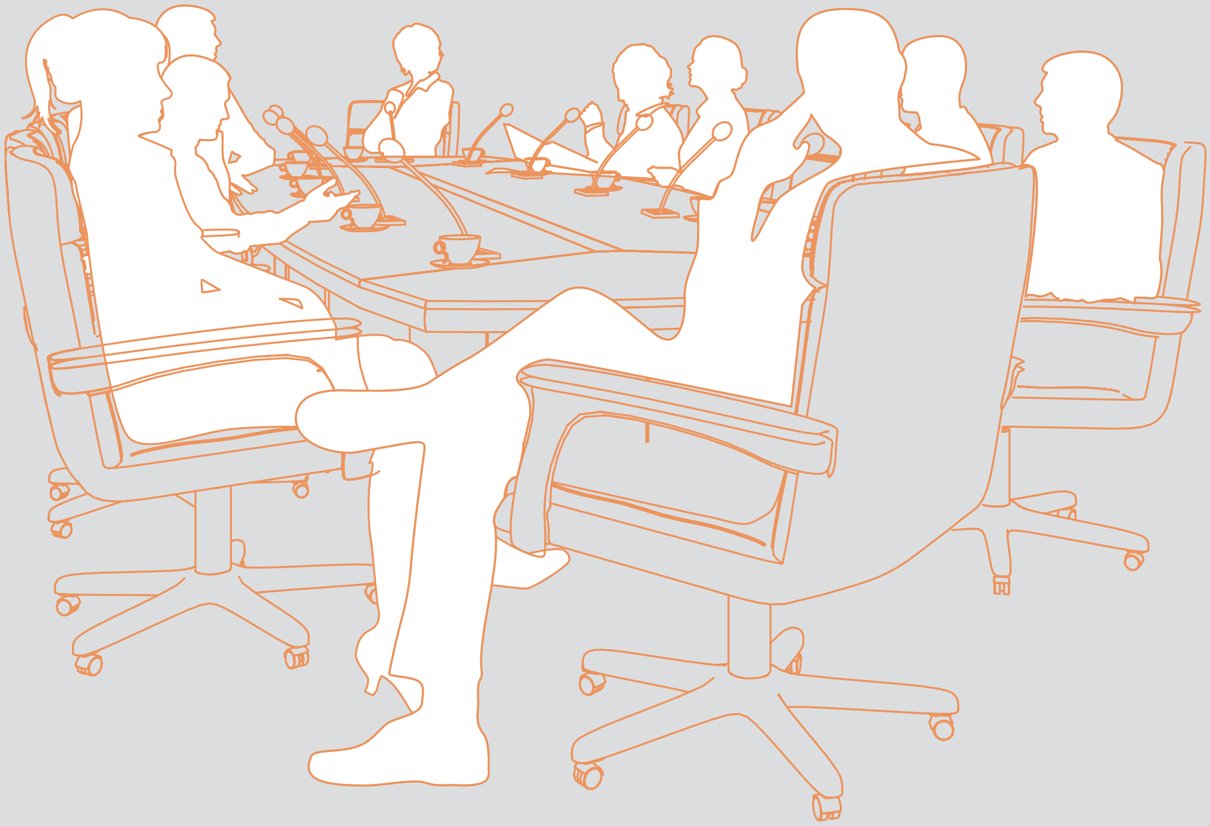
1. Remunerating soldiers in accordance with the duration and nature of their service.
2. Shortening army service while making it more meaningful for the ultra-Orthodox, by:
   a. extending civilian service

b. setting up tracks similar to the *hesder* yeshivas (which combine army service with yeshiva study), but aimed at ultra-Orthodox males who opt for combat duty.

These steps would be carried out in tandem with encouraging entry into the army and the workforce via the following:

1. Limiting financial support for *kollel* members, with the exception of a group of outstanding students up to age 24.
2. Joint oversight of the yeshivas and *kollel*s by the IDF and the Ministry of Education.

These measures are far-reaching, and should therefore be applied over a lengthy time frame and in stages. Prudent implementation of these steps to promote equal sharing of the burden is not only possible—it is crucial, if the State of Israel is to thrive and to maintain its values as a Jewish and democratic state.



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