

Labor Market Changes

Zvi Eckstein, Osnat Lifshitz and Tali Larom*

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* Prof. Zvi Eckstein is Head of the Aaron Institute for Economic Policy and Dean of the Tiomkin School of Economics, Interdisciplinary Center Herzliya, zecsktein@idc.ac.il. Dr. Osnat Lifshitz is Vice Dean at the Tiomkin School of Economics, osnat.lifshitz@idc.ac.il. Dr. Tali Larom is a senior researcher at the Aaron Institute for Economic Policy, tlarom@post.idc.ac.il.

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Two main processes have characterized the labor market in Israel since the early 2000s: a major increase in employment and an increase in labor income. The employment rate of the main working age population (aged 25-64) has risen from 66.8 percent in 2002 to 76.6 percent in 2016, and it is currently higher than in the US and the OECD. The closing of the gaps with these countries was partly because their employment rates plummeted following the crisis and have not yet recovered while Israel was hardly affected by the crisis, since (among other things) the policy changes described below encouraged employment, supported economic stability and reduced the crisis' adverse effects. The growth in employment occurred across all population groups, education levels and age groups; the employment rate of men aged 25-64¹ began increasing in 2002 following a few years of decline, and reached 81.4 percent in 2016; meanwhile the employment rate for women is lower than for men and stood at 72 percent in 2016, but it is characterized by more rapid and consistent growth.

One of the commonly made claims in the analysis of the labor market in Israel is that the source of the growth in employment in recent years has been the increasing integration of Arab men and ultra-Orthodox women in the labor market; however, this claim does not provide a complete picture. The employment rates of these two groups has indeed risen significantly and rapidly (76 percent of Arab men and 73 percent of ultra-Orthodox women were employed in 2015), but the entry of Arab men and ultra-Orthodox women is not the only source of growth in employment, nor even the main one. Decomposing this growth during the period 2002–2015 indicates that most of it—68 percent for men and 73 percent for women—is in fact the result of the increase in employment among non-ultra-Orthodox Jews (herein: "others"). Despite the increase in employment among all the groups, the gaps between them remain, particularly with respect to the low employment rate among ultra-Orthodox men (50 percent) and Arab women (32 percent). These two groups are also the only ones that are still distant from the targets set by the government for 2020 (63 percent and 41 percent, respectively) and it is doubtful whether they will be achieved. The rest of the targets for the 25-64 age group have already been achieved and even surpassed.

¹ The rest of the section relates only to this age group.

Another common claim is that the new employees have a low level of education, which is also only partially true. Although the fastest growth was among the group with up to a high school education (with matriculation for men and without for women), employment at the other levels of education, and particularly post-secondary and academic education, also grew. The gaps in employment between education levels remained large, particularly between those with a matriculation certificate and those without (11.5 percentage points for men and 20.4 for women). During this period, there was also a major rise in the level of education, particularly in the proportion of those with a bachelor's degree, which was due to, among other things, the opening of the colleges. The increase in education level is one of the most significant elements in the employment growth and is responsible for about 20 percent of the total increase for men and about 40 percent for women.²

Another major trend worth mentioning is the significant entry of the 55-64 age group into the labor market, in parallel to the increase in their proportion of the population - 74 percent of men and 60 percent of women in this age group were employed in 2015, in contrast to 61 percent and 39 percent in 2002. This change can be attributed primarily to the raising of the retirement age, which also affects younger workers who delay their retirement. It is possible that the changes in the welfare system, particularly the tightening of eligibility for a disability allowance, were also a factor.

Another important characteristic that influenced the employment rates and the changes in them is family situation, since decisions regarding the allocation of time between the labor market, leisure and housework (primarily childrearing) are made jointly in the household by both spouses and are dependent on, among other factors, their utility from children and childrearing expenditure. The main conclusion in this regard is that the entry of Arab women into employment was accompanied by a drop in their number of children; the proportion of married Arab women with three or more children fell from 40 percent in 2002 to 30 percent in 2015. The reduction in fertility may be one of the causes for the increase in employment but it is also possible that it is the result of this increase. In contrast, the employment rate of ultra-Orthodox women has increased dramatically without a corresponding reduction in family size. Among other households there was no major change, apart from the slight drop in the rate of marriage.³

² The rest of the growth is due to the increase in employment within each of the education levels.

³ The main part of the decrease in the rate of marriage occurred during the decade that preceded the period analyzed in this paper.

The increase in the employment rates of men and women is also reflected in the employment patterns of households. There was an increase in the proportion of couples in which both spouses work, from 52 percent in 2002 to 66 percent in 2015, while the proportion of couples in which only one spouse works or neither works decreased. This shift of households from one provider to two is characteristic of couples with and without children and is particularly evident among households with three or more children. The analysis on the level of households, which is unique to this paper, is important not only because employment decisions are made jointly but also because labor income is divided between all of the household members, and income per equalized individual is the relevant variable for an analysis of poverty rates and inequality.

In parallel to the increase in employment and despite the entry of relatively weak populations into the labor market, gross labor income also increased among all deciles and all population groups. Gross equalized income also grew, which indicates that despite the substitution between labor income and welfare payments, the overall effect of the increase in employment on household income was positive. Moreover, equalized disposable income also increased at a rate of between 33 and 47 percent, which implies that the increase in employment was accompanied by an improvement in households' standard of living. Nonetheless, it is important to emphasize that the increase among other households was more rapid than among ultra-Orthodox and Arab households, and therefore the gaps between the groups deepened and inequality rose. Two main factors contributed to this: lower employment and wages on the one hand and higher fertility rates on the other.

The proportion of labor income within total gross household income grew significantly, particularly among ultra-Orthodox and Arab households (62 percent and 75 percent in 2015, respectively), while the share of income from National Insurance allowances declined and the proportion of households receiving income support fell from 7.2 percent in 2002 to 2.7 percent in 2015. These changes are not only the result of the increase in employment but are also a main factor behind it. The tightening of conditions for eligibility and the major cut in the amounts of the income support allowance (from about NIS 2600 in 2002 to NIS 2100 in 2015) and in the child allowance (from NIS 700 to about NIS 400) changed the structure of incentives in the labor market, and incentivized households whose social welfare payments had declined to enter the labor market. The reduction in the individual and corporate income tax rates also worked in that direction, such that the reduction for individuals encouraged low wage individuals to start working and the reduction for corporations increased the demand for workers through the entry of new firms.

In summary, the increase in employment was primarily influenced by the following factors: (1) an increase in the level of education, which is responsible for about 20 percent of the total increase in employment for men and about 40 percent for women; (2) the raising of the retirement age, which led to a major increase in the employment rate among the 55-64 age group; (3) the cut in the income support and child allowances and the tightening of eligibility for the former, which incentivized households whose social welfare payments had declined to enter the labor market, as well as the cut in income tax rates which provided an additional incentive.

In view of the trends and causes described above and since, as mentioned, most of the increase in employment can be attributed to policy measures, the first recommendation is to continue the implementation of policy tools that supports employment and experience and even expand them - increasing the employment bonus (earned income tax credit), implementation "welfare to work" programs in which participation should be mandatory for individuals receiving welfare benefits and who pass an employment test and voluntary for other individuals, and focusing these programs on the Arab and ultra-Orthodox populations. The continued implementation of this type of policy is expected to further increase employment rates among these groups, while total employment also increases or at least maintained at its currently high levels. In parallel to the increase in employment, the hourly wages of Arab and ultra-Orthodox workers and also of individuals lacking a post-secondary or academic education have remained static, and therefore inequality in wages and income has risen. In order to raise the wages of these workers it is necessary to increase their productivity, and therefore the second policy recommendation is to develop and implement measures that increase human capital and in particular that of the lower half of the distribution, primarily by means of post-secondary technological and vocational education. A policy strategy that combines these two types of measures will not only increase the income of these workers and have a long-term effect on their potential earnings and their family and social environment, but will also contribute to the reduction of poverty and the enhanced growth of the entire economy.

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Contact details:

The Interdisciplinary Center Herzliya - IDC, P.O. Box 167, Herzliya, ISRAEL 4610101

Phone: 972-9-9602431, Email: aaron.economics@idc.ac.il, Website: aiep.idc.ac.il