Press Release

(*embargo until 6 am on Wednesday, June 27*)

The benefits embedded in Israel's pension system are not being fully utilized to prevent poverty among the country's elderly. This is one of the main conclusions drawn by Sarit Menahem-Carmi and Professor Ayal Kimhi in a new study published by the Shoresh Institution.

Major findings and policy recommendations noted in the new study, "A Primer on Israel's Pension System: Where it is Today and Suggestions for the Future:"

- **The benefits embedded in Israel's pension system are not being fully utilized to achieve the system's main objective: poverty prevention among the elderly. Menahem-Carmi and Kimhi propose the following measures to make the system more progressive:**
  - **Ensure that the value of the old age allowances of the National Insurance Institute is not eroded by inflation;**
  - **Rescind tax incentives on pension contributions that benefit mainly high-income individuals;**
  - **Provide a more equitable distribution of earmarked bonds allocated to pension funds.**
- **Longer life expectancies and lower birth rates have caused many countries to update their pension systems (for example, by raising the retirement age and instituting an automatic linkage of retirement age to life expectancy). In contrast to the situation in most of the developed world, the retirement age of Israeli women has remained low, despite their relatively long life expectancies that are expected to keep rising. In the Shoresh Institution study, Menahem-Carmi and Kimhi calculate the degree to which raising the retirement age of women would increase their projected pension allowances. The researchers show that, the longer a decision on raising women's**

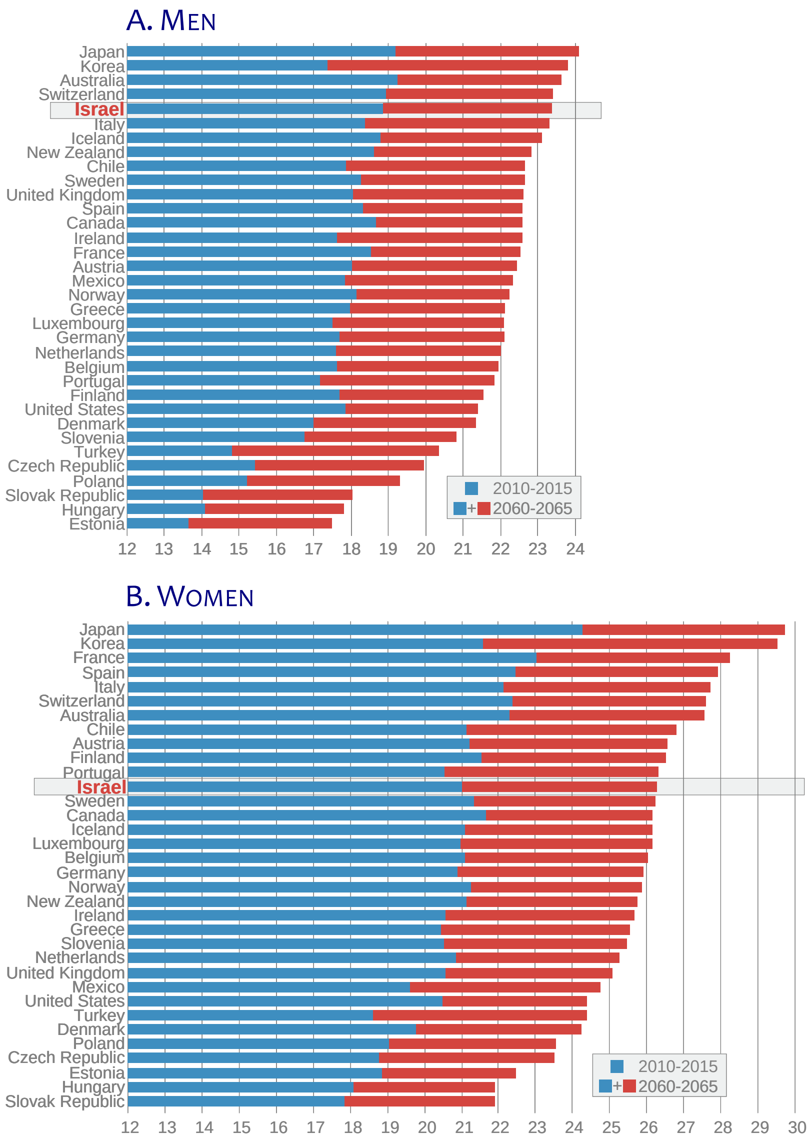
retirement age is deferred, the more women will be destined to small pension allowances.

to download the policy paper
to download the press release

In a policy paper just published by the Shoresh Institution for Socioeconomic Research, Sarit Menahem-Carmi and Ayal Kimhi compare Israel's pension system to other pension systems in the developed world, and show the essential changes that need to be made in the Israeli system. The authors show how pension reforms in developed countries over the past two decades indicate a recognition of the issue's importance and the potential downsides of not addressing pension system problems – first and foremost, poverty among the elderly and overburdened welfare and healthcare systems. Many countries now have functioning pension systems, while policymakers work to improve them further, linking them more closely to ever-increasing life expectancies and to changes in work patterns over the lifecycle. Menahem-Carmi and Kimhi argue that Israel has a large gap to close between it and other developed countries, given the anticipated aging of Israeli society and current state of preparations for this future scenario.

PROJECTED LIFE EXPECTANCY AT AGE 65

IN YEARS, OECD COUNTRIES IN 2010-15 AND IN 2060-65



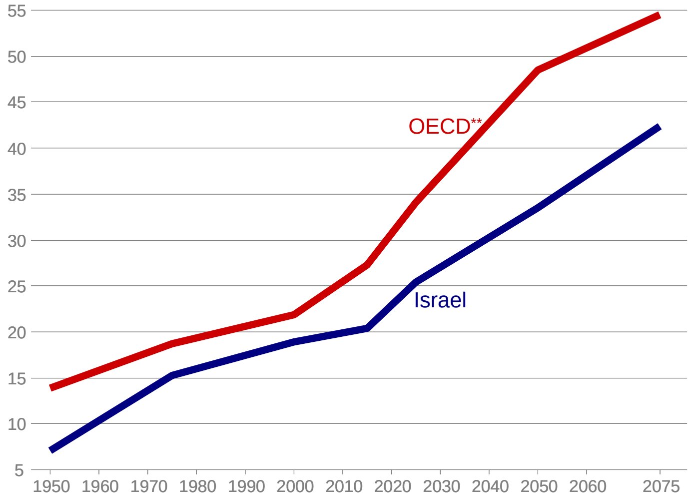
Source: Sarit Menahem Carmi and Ayal Kimhi, Shoresh Institution
Data: OECD Pensions at Glance 2015

1. Global demographic trends

The need to maintain and update pension systems is a result of global demographic trends, first and foremost that of rising life expectancies. There has been a 30-year increase in life expectancy over the past century: from 50 to 80, on average (see life expectancy figure). During the first half of the twentieth century life expectancy increased primarily as a result of lower infant mortality and fewer deaths from diseases among the working age population. By contrast, increased life-expectancy in recent decades is due primarily to the fact that older individuals live longer. These changes are attributed to improvements in standards of living and to improved access to healthcare. Rising life expectancies have been accompanied by declining birth rates. These two trends – higher life expectancies and lower birth rates – are leading to population aging. The old-age dependency ratio is defined as the number of individuals ages 65 and up relative to 100 working-age (20-64) individuals. The demographic trends are driving a steady increase in the dependency ratio (see old-age dependency figure).

OLD-AGE DEPENDENCY RATIO

NUMBER OF 65+ PERSONS PER HUNDRED 20-64 YEAR OLDS, 1950-2075*



* Projections for future years

** Weighted average for 34 OECD countries.

Source: Sarit Menahem Carmi and Ayal Kimhi, Shoresh Institution

Data: OECD Pensions at Glance 2015

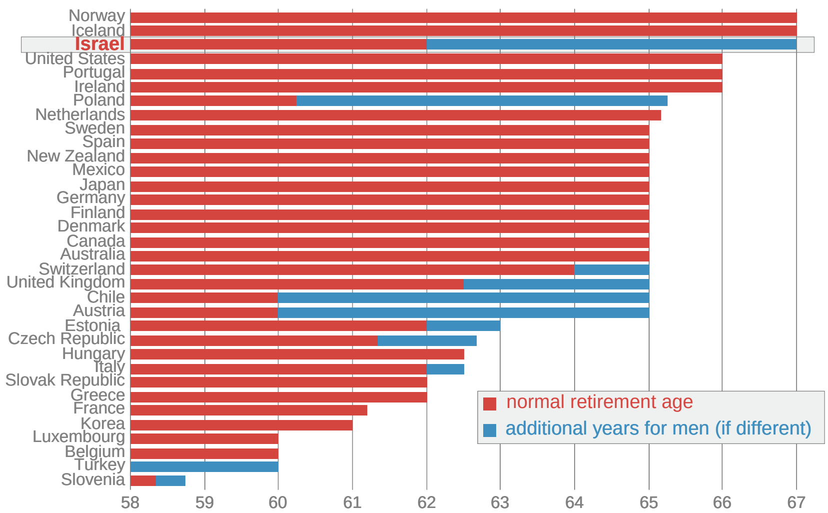
2. The need to update the Israeli women's retirement age

Because demographic characteristics have a major impact on pension allowances, the past two decades have been characterized by a growing need to adjust pension systems to this new reality. One of the main changes introduced to ensure consistency between number of working/savings years and rising life expectancy has been an increase in the retirement age. Menahem-Carmi and Kimhi find that Israeli women's retirement age is lower than that of women in other Western countries – with most not distinguishing between male and female retirement ages (see retirement age figure).

To enable women to increase their pension savings, their retirement age was to have been updated in 2017. However, the relevant legislation was shelved. As the Shoresh Institution study shows, women's earlier retirement age compromises their future pension allowances. First, women earn less than men, meaning that they accumulate less pension savings over the course of their working years. Second, because women's life expectancy is higher than men's, their pension allowances are smaller since pension funds take into account that their retirement savings have to suffice for longer

RETIREMENT AGE

OF THOSE RETIRING IN 2014 IN OECD COUNTRIES

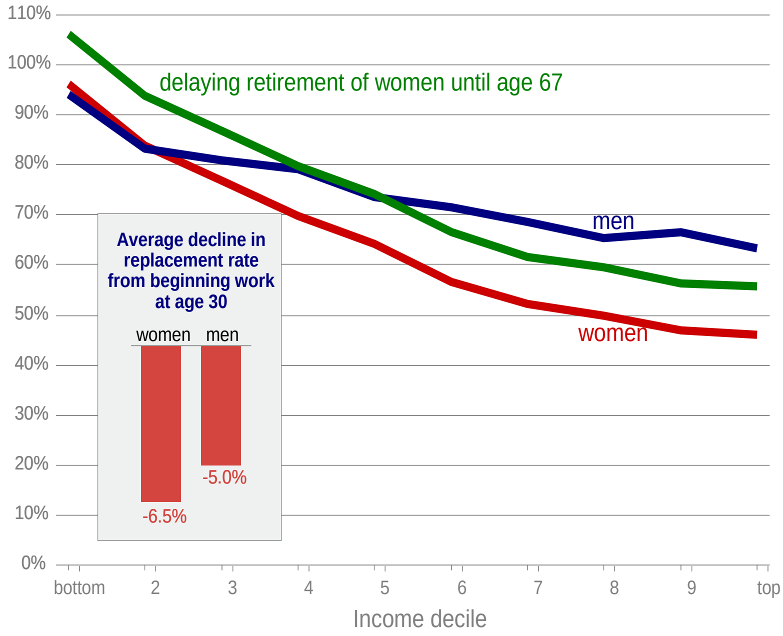


Source: Sarit Menahem Carmi and Ayal Kimhi, Shoresh Institution

Data: OECD Pensions at Glance 2015

periods. Raising the retirement age would give women more working years for the accumulation of pension contributions and returns on savings, which peak at the time of retirement. It would also defer and shorten the utilization period of pension savings.

REPLACEMENT RATES IN BASIC MODEL*



* Replacement rates (ratios of pension benefits to final labor income of individuals) for ages 25 to 62 (women) and 25 to 67 (men)

Source: Sarit Menahem Carmi and Ayal Kimhi, Shoresh Institution

Pension simulations carried out by Menahem-Carmi and Kimhi for men and women in different wage deciles indicate that equalizing women's retirement age with that of men would increase women's pension replacement rates (these are pension allowances as a percent of the last wage earned) by ten percentage points (see replacement rates figure). The authors also found that increasing pension contribution rates and reducing management fees – policy changes that have a positive effect on projected pension allowances – have less of an impact on women than on men, due to women's earlier retirement age.

Opposition to raising women's retirement age is based on the idea that many women already retire before the official retirement age, and that their income would substantially decline if the retirement age were increased. However, women's retirement decisions are also affected by retirement incentives. According to Menahem-Carmi and Kimhi, it is reasonable to assume that women would defer their retirement if the official retirement age were increased. According to the *Report of the Public Committee for Examining the Retirement Age for Women* (2016), only 8% of women in the relevant age group may be expected to suffer real harm from a retirement-age increase. In any event, the authors caution that, the longer the decision to raise the retirement age is delayed, the greater the economic cost that will be exacted by the delay.

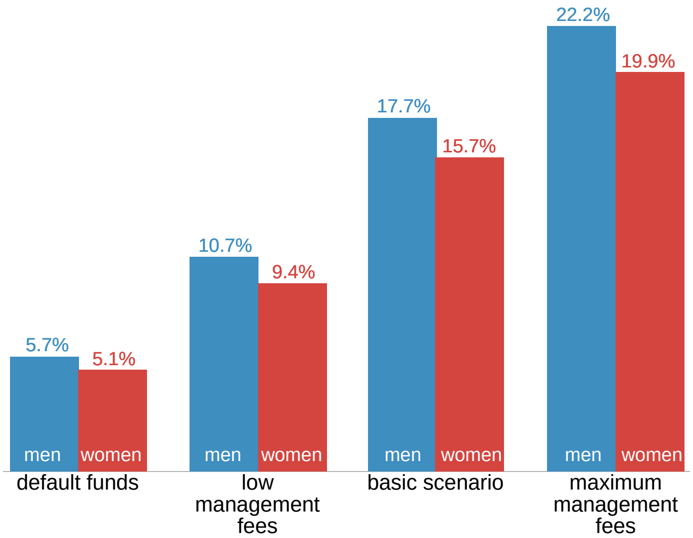
3. Key characteristics of the Israeli pension system

- As the Shoresh Institution policy paper shows, a striking feature of the Israeli pension system are savings incentives that mainly benefit high-income persons. The difficulty that individuals face in saving for their retirement, and the clear need for a monthly allowance to ensure that they can live in dignity, led Israeli policymakers to design a pension system that includes savings incentives. Even before the law mandating pension contributions was enacted, tax incentives had been offered to savers.[1]

- Menahem-Carmi and Kimhi note two main disadvantages of the tax incentives for retirement savings. First, the incentives' complexity reduces their effectiveness for savers, whose financial literacy tends to be limited, leading to a difficulty in making educated decisions in this area. Second, tax incentives on retirement savings contributions are regressive, as they do not pertain to workers who fall below the tax threshold. Their relevance as inducements increases with savers' marginal tax rates, i.e., with their incomes.
- Since pension contributions are now mandatory, the authors argue that tax incentives have become redundant, and that the amounts they subtract annually from government revenues could be put to more effective uses.
- Another regressive aspect of the system are the management fees paid by savers, which tend to be higher for low-income people. Menahem-Carmi and Kimhi show that individuals' ability to negotiate management fees with pension funds may have a substantial impact on subsequent pension allowances (see management fees figure).
- Another benefit embodied in pension savings is a financial benefit given indirectly via earmarked bonds with guaranteed returns that, at present, are considerably higher than the capital-market interest rate. These bonds are allocated relative to pension savings, up to a ceiling that becomes effective only for the highest income decile, meaning that only this decile fully utilizes the benefit. According to Menahem-Carmi and Kimhi, this tool can and should be used for a more progressive distribution of the benefit, through a greater allotment of the earmarked bonds to low-wage workers.

CUMULATIVE MANAGEMENT FEES*

AS PERCENT OF ACCUMULATED SAVINGS



* Management fees valued at end of saving period.

Source: Sarit Menahem Carmi and Ayal Kimhi, Shoresh Institution

Because current pension savings incentives are largely regressive, Menahem-Carmi and Kimhi conclude that Israeli pension policy does not adequately achieve its primary goal: ensuring basic pension benefits for all workers, especially those whose wages are low and whose accompanying pension savings

[1] Tax incentives for wage-earners comprise four separate benefits. The first two – exemption from tax on employer contributions and a tax allowance on employee contributions – work by increasing saver income in the present. The other two – exemption from tax on retirement-savings capital gains, and pension allowance tax exemption – work by increasing the saver's pension allowance.

are low as well. A more progressive allocation of the earmarked bonds would offer greater protection from capital market risk to those whose retirement savings are limited. Additionally, clear and attractive incentives could enable low wage workers to better verify compliance by their employers with regard to their legal benefits. Currently, despite the Compulsory Pension Law, there are wage-earners whose workplaces do not offer them pension arrangements. In most cases these are low wage workers.

The Shoresh Institution for Socioeconomic Research, headed by Professor Dan Ben-David, is an independent, non-partisan policy research center providing evidence-based analyses of Israel's economy and civil society. The Shoresh Institution informs Israel's leading policymakers and the general public, both inside and outside the country, through briefings and accessible publications on the source, nature and scope of core issues facing the country, providing policy options that ensure and improve the well-being of all segments of Israeli society and create more equitable opportunities for its citizens.

For details, or to arrange an interview, please contact:

Sarit Menahem-Carmi (052-6102284) or
Professor Ayal Kimhi (054-8820430)