

DRAFT REFORM OF THE ISRAELI DISABILITY PENSION SYSTEM: AN INITIAL ASSESSMENT BY THE OECD

1. Since April 2017 discussions have been held within the Israeli government concerning a possible revaluation of disability pensions. The amount of these allowances, which are worth as much as 27% of the average income, is relatively low in the OECD context, particularly compared to many European countries where this ratio reaches 40%, although comparable to the levels paid in, for example, the United States, the United Kingdom, Canada and Australia. In any case, these amounts seem insufficient to adequately protect such vulnerable Israelis (who currently number 235 000 or 5% of the working-age population) from the risk of poverty. Hence, while there is some case for increasing the value of the disability pension, care should be taken as to the magnitude of the increase and its overall cost. But most importantly any additional resources for the disabled should be part of a package that strengthens the employment focus of the programme by standardising assessments of work capacity and requiring more job-search and training efforts. This note is intended to contribute to the public debate by assessing the advantages and disadvantages of the current reform proposal and the experience in other OECD countries.

2. To address this issue, the government's reform proposal, as it now stands, would adopt the following provisions:

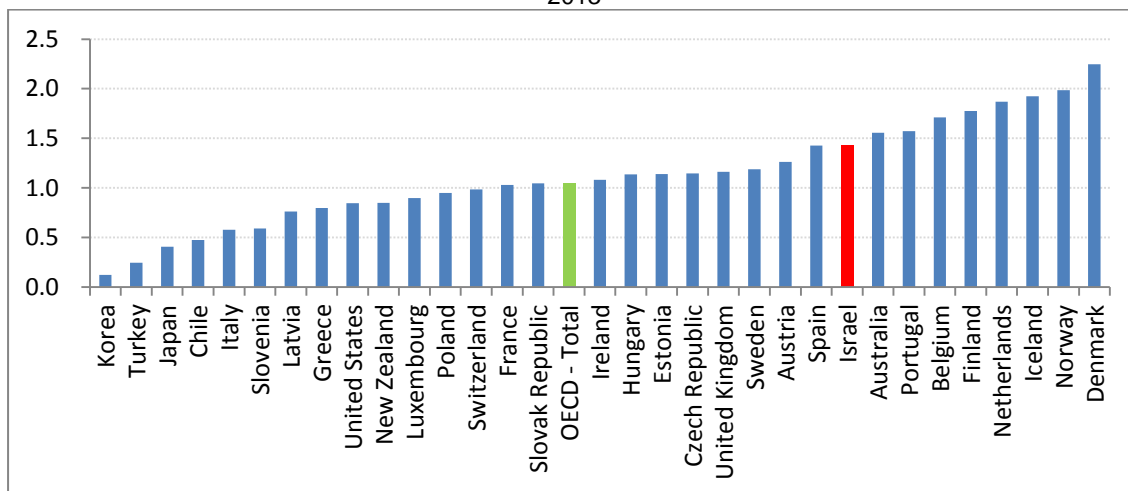
- Raising the allowance for people with disabilities who are under the poverty line to NIS 3200 per month (with a dollar exchange rate of around 3.5 this amounts to over USD 900 per month or almost USD 11 000 per year). Today the sum is between NIS 2432 and 2793 per month with no regard to economic status besides labour income. This change would increase the allowance by 22.5%.
- Creating a new addition to the allowance, so that people with severe disabilities (over 90% medical disability) and with no ability to work according to existing criteria will get an allowance of NIS 4000 per month. For these people, their total allowance would thus increase by 53%.
- Indexing the disability allowance to the minimum wage. Today most of the social security allowances, including disability pensions, are indexed to the CPI.
- Raising the bar of labour income that a person can earn and still be entitled to the full amount of the allowance, before the offset begins. Today the bar is set at NIS 2900 per month, and the proposal is to raise it to NIS 4000. Consequently the total income that a disabled recipient could get without a reduction of his/her allowance would increase by 20-45% depending on the severity of his/her disability.

The overall short-term direct fiscal cost of these proposed changes is estimated by the Ministry of Finance at NIS 1.5-2 billion (i.e. 0.15% of GDP), but double that once fully implemented.

3. Analysis of these proposals shows that the government's reform strategy has largely focused on measures to increase pensions. This is justified to some extent. Nevertheless, the Israeli disability system is quite complex, and, for some, benefits can be high when adding up all components, especially for people with low earnings potential and also for young people who have never worked. Indeed, international comparisons show that total public disability spending in Israel is higher than in other OECD countries and has increased since 2000 (**Figures 1 and 2**). In 2013 it accounted for 1.4% of GDP for disability pensions only (compared to 1.0% for the OECD average) and 2.1% of GDP, when sick leave pay, workers' compensation payments and other disability-related benefits are included (1.7% for the OECD average). On the other hand, the share of disability beneficiaries is not particularly high in Israel by international

standards (Figure 3). All in all, these indicators suggest that, before taking into account the proposed reform, the Israeli disability system looks comparatively generous, even if some of its provisions are not. Although the relative poverty rate of 24% of disabled people is above the national average of 19%, it is substantially below the average poverty rates in the Haredi and Arab-Israeli communities which stand at around 50%.

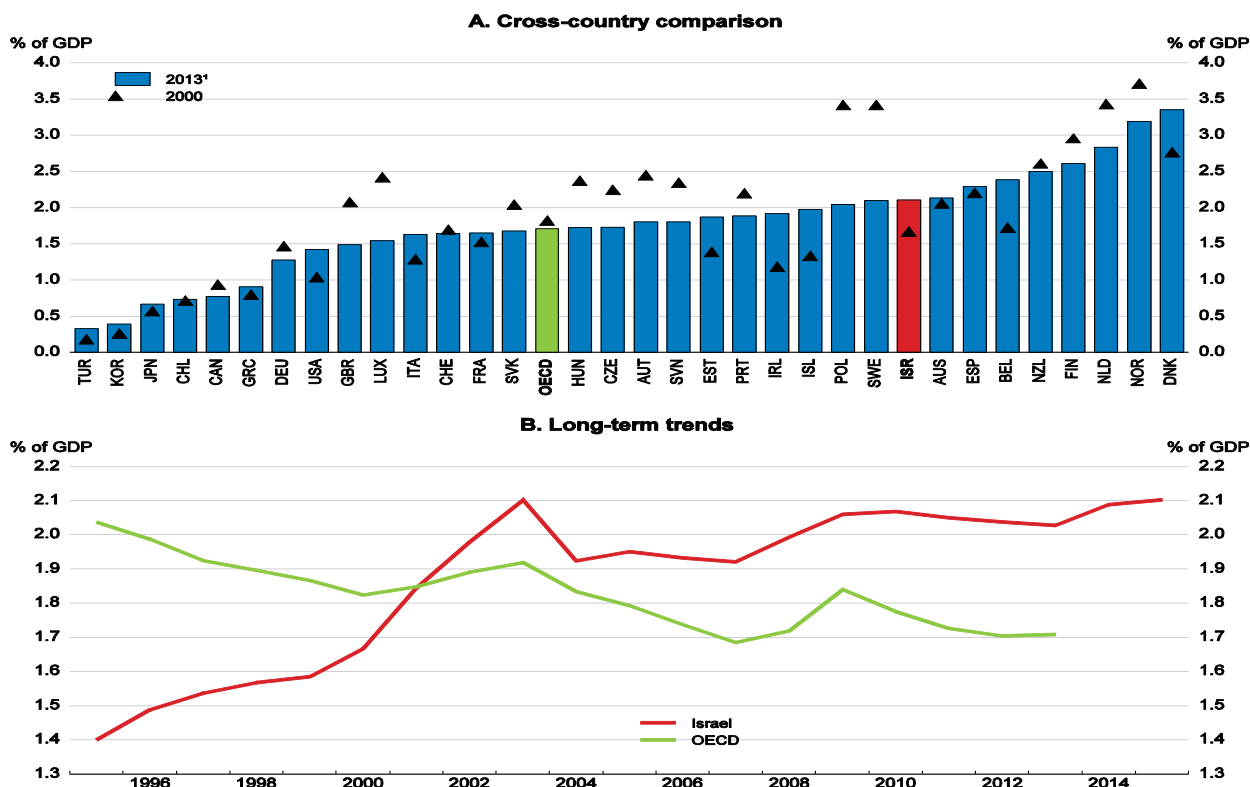
Figure 1. Public expenditure on disability pensions only¹
2013



1. Poland and Greece: 2012; Israel: 2015.

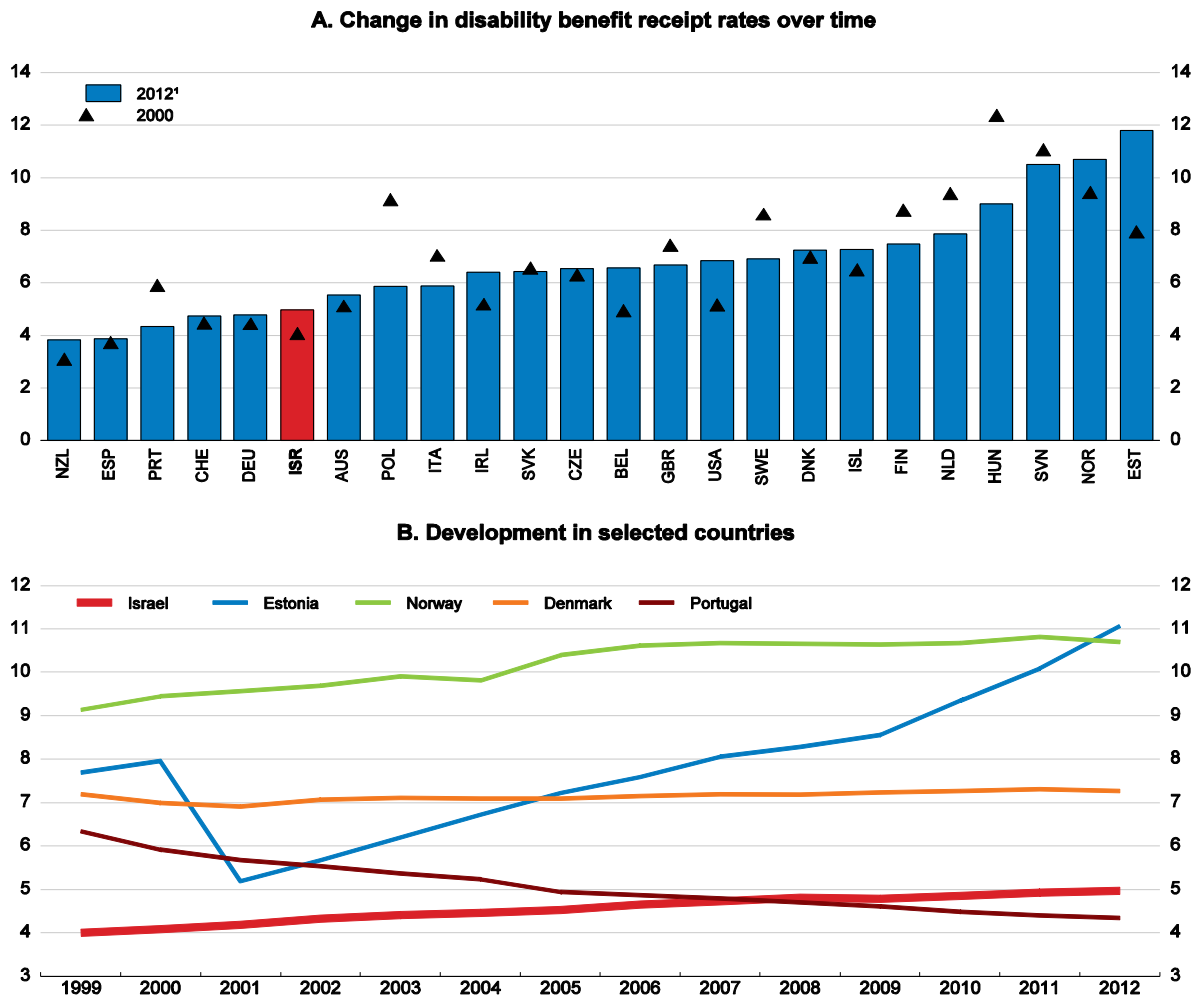
Source: OECD, Social expenditure database.

Figure 2. Public expenditure on total disability spending
(Including sick leave pay)



1. Australia, Canada, Latvia and Norway: 2014; Chile and Israel: 2015.
 Source: OECD, Social expenditure database.

Figure 3. Disability benefit receipt rates
 Benefit recipients as a percentage of the working-age population



1. 2010 for Spain, 2013 for Australia, Czech Republic, Finland and the United States, and 2014 for Estonia.
 Source: OECD (2010), *Sickness, Disability and Work - Breaking the Barriers*, Figure 2.9 with updates.

4. OECD experience with disability policy shows that substantial increases in benefits are not without risks for both public finance and labour market outcomes. The greatest risk associated with the proposed reform is linked to a possible reduction in labour market participation and employment, which would probably harm their integration into society and could at least partially jeopardise the progress made in this area since 2003 when the current Prime Minister led the effort to curb the growth of such pensions (see Figure 2, Panel B above). Indeed, according to OECD countries' experience:

- The higher the benefit, the higher the disability benefit (DB) receipt rate.
- The easier one can get a benefit, the higher its receipt rate.

- The more generous or secure DB is relative to other benefits (especially unemployment benefits and social allowance) and the easier the transition into DB, the higher the DB receipt rate.

5. The current level of income support (amounting, for example, to NIS 1730 for an individual and NIS 2897 for a family of four with an income below the minimum required for subsistence) is very low. Unemployment benefits (UB) are also of very short maximum duration (i.e. 2-6 months), even though they are relatively generous at NIS 4725 per month on average. Therefore, the incentives for the beneficiaries of income support and for those exhausting UB to apply for DB will be extremely strong. Going forward, this incentive problem is even likely to worsen further: because of its indexation to the minimum wage, the value of the DB would increase faster than the value of other benefits, which continue to be linked to the CPI. Moreover, although the reforms envisaged include welcome provisions to make income from working with a disability pension more favourable, their advantages may be limited in the future because of ongoing demographic trends. Currently, only 20% of DB recipients work at all, part-time or full-time. Moreover, the rising proportion of people coming from Haredi and Arab-Israeli communities, where men (for Haredim) and women (for Arab-Israelis) are little inclined to work, is likely to weaken the attractiveness of the expanded possibilities of cumulating labour income and disability allowances. All in all, there are thus considerable risks that higher disability allowances could lower aggregate labour supply and have limited or even perverse effects on the poverty rate of disabled people, especially in the long term. Employment rates of people with disability have apparently increased in Israel in the past 15 years, contrary to most other OECD countries. This positive development would be at risk as a result of the proposed reform, despite the suggested improvements in combining DB with income from work.

6. The direct budgetary cost of the proposed reforms is also not insignificant, as mentioned above. In addition, their budgetary cost could be even higher than suggested, if, as seems likely (see below), the number of beneficiaries rises in response to the pension's enhanced generosity following the reform, or if political pressures lead to a rise in the value of other benefits as well. There is a case for unifying all benefits at a single rate for all working-age people to remove incentives to try to switch between multiple different regimes.

7. Budgetary costs may also increase in the future because of the proposed revision of the DB indexation mechanism: wages generally rise faster than prices because of positive productivity growth, and the minimum wage in turn depends on negotiations between the social partners. While this increased spending may not induce a higher public deficit thanks to the "numerator" budget rule now in force, the incentives for these private-sector groups, unions in particular, to seek higher minimum wages will be that much stronger, with the result that it may impinge on the structure and effectiveness of other public policy measures, either because of the crowding-out effect on other expenditure or because of the need to pay for this additional spending through higher taxes. Allowing some benefits to be uprated by the minimum wage and others either indexed to the CPI or revised in a discretionary manner is awkward. For example, Korean experience with its unemployment benefit, whose minimum value is linked to its minimum wage, generated the bizarre situation that it was temporarily above its maximum level, which was subject to discretionary adjustment.

8. All these considerations militate in favour of a detailed assessment of the proposed reform of the disability system before adopting it so as to ensure it follows international best practice. OECD countries' experience in this domain clearly indicates that to be effective disability programmes should be essentially labour market programmes with a strong employment focus. More specifically,

- Although putting more resources into disability policies and services for people with a disability or reduced work capacity is welcome, simply increasing the benefit is unlikely either to be good policy or to produce desired outcomes.

- An important consideration is whether any reform succeeds in promoting a higher take-up of the provision allowing DB recipients to earn additional income in the labour market. Currently low take-up seems related to the complexity of existing procedures and also the mistrust of guarantees attached to the existing scheme, which in principle permits a return to full-time disability benefit if, for instance, the individual quits his/her job. Strengthening the guarantees that disabled people may indeed move in and out from benefit receipt whenever it is justified and necessary is thus important, especially in the case of mental illness, which is often characterised by up-and-down patient phases.
- While increases in some allowances might be justified, more evidence seems needed to judge whether an increase in benefit levels is necessary; in any case, the impact of any such increase should be evaluated rigorously. It may also be better to increase benefits in steps and to take the second step only after evaluation of the first. Prudence would also call for avoiding a revision of the current disability pension indexation mechanism to the CPI.
- Moreover, further efforts are required to identify people's work capacity (not just their disability) and to treat those people with (reduced) work capacity differently (and differently again from those with no work capacity) – e.g. by introducing requirements for participation in training and job search of some sort, in line with the reduced work capacity, similar to the requirements imposed on the unemployed.
- Typically, there is thus a need for a stronger employment policy framework, e.g. more focus on the assessment of work capacity, on medical and vocational rehabilitation, which should become compulsory, and on wage subsidies of some sort and often stronger and well-implemented anti-discrimination legislation.

9. Modifying the sickness scheme is also often needed to make the scheme more rigorous – recognising that for many people, sickness or sickness benefit (which is a public benefit in most OECD countries) is a stepping stone towards disability and disability benefit. This in turn means putting in place a proper process with clear roles for the sick worker, the employer and the physician in this scheme. More specifically, since Israeli sickness cash benefits are regulated in collective agreements, it will be important to strengthen the connection with employers on this matter and the link between privately regulated sickness benefits and public disability benefits.