

Policy Position

Economic Fortitude Index for Evaluating Poverty in Israel¹

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Executive Summary

1. This document has been written for the committee appointed by the Prime Minister and Finance Minister to reevaluate the poverty index in Israel.
2. The Poverty Index should aid decision makers in long-term socioeconomic planning. Consequently, it must provide information that is relevant to the government's strategic goals.
3. The current Government of Israel has declared long-term socioeconomic growth and poverty reduction as national goals. In this context, the Reut Institute sees the 'Top 15 Vision' as the vision that should guide the State of Israel.
4. The Top 15 Vision is based on achieving a significant socioeconomic advancement that would put Israel among the fifteen leading countries in terms of quality of life within fifteen years. The vision requires significant and continuous growth of the Israeli economy in parallel with an improvement in the quality of life of all citizens. Cultivating human capital is the key factor in achieving this goal.
5. A clear correlation exists between poverty and human capital. A meaningful measure of poverty must account for the current use of and the potential to improve human capital. To permit effective policy design, the poverty index must identify the appropriate target population for government intervention.
6. In addition to the existing Poverty Line based on disposable income, The Reut Institute proposes the 'Economic Fortitude Index', which would measure the ability of Israel's citizens to live in comfort, to improve their wellbeing, and to cope with unexpected changes. This index will be an important tool for the development of human capital.
7. The 'Economic Fortitude' index integrates six pillars: disposable income, asset depth, consumption, employment security, health, and spare/free time.
8. An understanding of the segmentation of the poor population is needed to create policy that effectively cultivates Economic Fortitude and human capital.

Introduction

1. The Government of Israel has declared "[reducing] poverty while encouraging growth ... and creating leverages for balanced, long-term growth" as national goals.²

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² These goals were stated in the Socio Economic Agenda presented by the National Economic Council in the Office of the Prime Minister developed in cooperation with the Finance Ministry, the Bank of Israel, the

2. The 'Top 15 Vision' is comprised of issues and actions involved in achieving a significant socioeconomic advancement that would place Israel among the fifteen leading countries in terms of quality of life. The Reut Institute's activities in the socioeconomic sphere are guided by this vision.
3. Indices are tools available to decision makers as they plan and design policy. The Top 15 Vision requires characterization of suitable indices that will allow decision makers to analyze the population, the economy, and the effectiveness of national policy.³
4. The goal of this document is to define the guidelines of a poverty index that will assist decision makers in designing policy that will bring about a significant and continuous improvement in the quality of life of Israel's citizens.

What is a Relevant Poverty Index for Decision Makers?

5. Indices in general, and the poverty index specifically, affect the design and implementation of policy by:
 - a. **Identifying arenas of action** – Indices can identify population groups, geographical areas, institutions, or sectors of the economy that need to be addressed through policy.⁴
 - b. **Evaluating previous policy** – The success and progress of existing government programs can be evaluated through relevant indices.⁵
 - c. **Highlighting long-term trends** – Evaluating the evolution of index values over time can reveal trends and point to their underlying causes.⁶
 - d. **Making international comparisons** – Indices reveal a country's relative performance in the world, its region, or in comparison to a relevant selection of competitor countries.⁷
 - e. **Affecting the national discourse** – Indices and their media exposure guide the public's reaction to economic changes and, indirectly, generate incentives for politicians.⁸

National Insurance Institute, the Ministry of Industry, Trade & Labor, and the Office of the Prime Minister in April 2007. [A Socio-Economic Agenda for Israel 2008-2010](#) (2007).

³ The Top-15 Agenda includes seven components - (a) a robust understanding of the future environment in which Israel will be one of the 15 most developed nations, (b) identification of the engines of growth in quality of life, (c) management of Israel's individual burdens and exploiting her unique assets, (d) design, implementation, and management through appropriate budgetary or regulatory policies, (e) reform of the public sector, (f) identification of relevant indices by which to measure Israel comparatively, (g) and the creation of a national conversation that is guided by the Top-15 Vision.

⁴ For further information on segmenting the population in the context of poverty, see: UNDP, **Poverty Report**, Ch. 10: "[Monitoring Progress Against Poverty](#)"

On the need to apply different policy baskets to each segment, see: The Finance Ministry, [Response to the 2005 Poverty Report](#), Office of Public Relations, 8/30/06. (Hebrew only)

⁵ C.F. Citro, R.T. Michael, **Measuring Poverty: A New Approach**. National Research Council, Commission on Behavioral and Social Sciences and Education, 1995. For a summary, [click here](#).

⁶ The World Bank uses indices to identify trends in world poverty: [Poverty Analysis Overview](#) on The World Bank website: www.worldbank.org

⁷ On the importance of uniform measurement standards and the need to collect data internationally for comparison, see: United Nations Statistics Division, **Handbook on Poverty Statistics: Concepts, Methods and Policy Use**, (2006) p. 370

⁸ See the Finance Ministry's response to the Annual Poverty Report concerning the incentives generated by the current poverty index on the political sphere: "The most effective means of reducing the quantity of poor is by slightly raising the income of those closest to the poverty line ... without any attention to the extremely poor for

6. Any index that measures the extent and depth of poverty must meet accepted standards and serve decision makers in the long-term. The index should be:
 - a. **Statistically valid** – reliably and consistently measures the concept it investigates;
 - b. **Matched to the socioeconomic environment** – considers the unique characteristics of the target population and the trends and environment in which it lives;
 - c. **Practicable** – based on measurable components and available data;
 - d. **Clear and accessible to the public;**
 - e. **Able to make predictions** – includes components that suggest future outcomes from evolving trends;
 - f. **Systemic** – reflects the combination of issues that affect the central question from the decision maker's point-of-view.

7. So that the poverty index can serve as a tool for designing policy, it must be based on:
 - a. **A relevant definition of the concept 'poverty'** – Defining poverty is an age old problem argued by philosophers, social scientists, economists, and politicians.⁹ The current effort to redefine poverty in Israel will not put the issue to rest. Regardless, a relevant definition is one that reflects the issues that need to be addressed by the government. From this standpoint, the definition's relevancy is more important than its rightness.
 - b. **A relevant segmentation of the poor** – Data regarding distinct groups among the poor will provide decision makers with the necessary tools to evaluate the effectiveness of existing programs, to tailor policy to each group's unique needs, and to estimate budgetary needs.

The Starting Point for a New Poverty Index: Economic Fortitude

8. **Two Strategic Goals: Growth and improving quality of life** – The goals of the Top 15 Vision are significant and continuous growth of the Israeli economy in parallel with an improvement in the quality of life of all citizens.
Cultivating human capital¹⁰ is critical for achieving this goal.
9. **Human capital is the key to growth** – Human capital is Israel's main resource. Economic growth depends on Israel's ability to increase labor-force participation and productivity in both innovative and traditional industries. Continuous improvement of Israel's human capital is a necessary precursor for this goal.¹¹
10. **Human capital is the key to improving quality of life** – An individual's quality of life is

whom a slight increase in income would not remove them from poverty. On the other hand, narrowing poverty gaps requires directing most of the effort at improving the lot of the extremely poor. ... A politician that is interested in quickly achieving political goals will choose the first path." The Finance Ministry, [Response to the 2005 Poverty Report](#), Office of Public Relations, 8/30/06. (Hebrew only)

⁹ See A. Sen, "Poor, Relatively Speaking", *Oxford Economic Papers*, New Series, Vol. 35, No. 2. (Jul., 1983).

¹⁰ The appropriate definition for this work is the one used by the OECD: "The knowledge, skills, competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being" OECD, *The Well-being of Nations: The Role of Human and Social Capital*, (2001).

¹¹ For more on the importance of human capital for Israel's growth: The National Council on Economy, [A Socio-Economic Agenda for Israel 2008-2010](#) (2007); Dan Ben-David, [Wake Up Call: A Work Plan for a New Era in Israel](#) (2005).

influenced by material wellbeing and employment security.¹² An individual's ability to guarantee wellbeing hinges on the demand for his ability and skills in the labor market. Therefore, an individual's chances of improving his quality of life increase with additional human capital.

11. **Inverse relationship between poverty and human capital** – A clear correlation between poverty and lack of education has been found in Israel and the world.¹³ Technological innovation, free trade, and labor flexibility have increased demand for skilled labor and depressed demand for unskilled labor.

Moreover, Israeli growth is "education biased"¹⁴ in the sense that education represents a minimum standard for improving quality of life. Those with education manage to improve their situation in tandem with economic growth, those without education experience a relative decline.

12. **The path to poverty relief goes through utilization and improvement of human capital** – To encourage growth and reduce poverty, it is incumbent that the skills and abilities of the whole population, and weak groups in particular, be utilized and nurtured.

The current labor market, affected by changes in the structure of the economy's key sectors, is characterized by increasing demand for human capital. Effective care for the poor in Israel requires continuous improvement and updating of human capital. **Therefore, resources should be allocated to areas in which human capital is not utilized or developed appropriately, or where there is danger of deterioration.**

13. **Identifying appropriate targets for government intervention requires a definition of poverty that reflects the status of human capital in the present and the ability to develop it in the future.**

Disposable income is neither sufficient evidence of a person's present ability to live comfortably nor indicative of future wellbeing.¹⁵

14. **Poverty is an absence of Economic Fortitude** – The Reut Institute defines 'Economic Fortitude' as an individual's ability to utilize the resources at his disposal to live in comfort, to improve his wellbeing, and to cope with unexpected changes in his personal, family, or employment situation.

This definition serves two purposes. It permits policy design that contributes to improving the economic standing of individuals by improving their human capital and it identifies those

¹² According to the Economist Intelligence Unit's Quality of Life Index, material wellbeing and employment security are two of the nine variables that offer a clear explanation of the differences in quality of life across countries.

¹³ See: Roni Frish, **The Causal Effect of Education on Earnings in Israel**, Bank of Israel, February 2007. A. B. Krueger and M. Lindahl, Education and Growth: Why and for Whom? **Journal of Economic Literature**, Vol. XXXIX (December 2001) pp. 1101-1136.

¹⁴ Bank of Israel Annual Report – 2006, [Chapter 8: Issues in Welfare Policy](#), p. 323.

¹⁵ Disposable income is not indicative of net worth, consumption, or human capital, all of which influence socioeconomic status. The EU's call to redefine the poverty index is a result of the inadequacy of disposable income as a measure of poverty.

M.F. Förster, G. Tarcali & M. Till, **Income and non-income poverty in Europe: What is the minimum acceptable standard in an enlarged European Union?** European Centre for Social Welfare Policy and Research (2004).

groups whose human capital is at risk.

Guidelines for the Economic Fortitude Index

15. This section will discuss the issues entailed in measuring a society's Economic Fortitude and by extension, identifying the poor, those with low Economic Fortitude.
16. **Unit of Analysis: Household** – An individual's Economic Fortitude is intertwined with the characteristics of his household. Therefore, as in other indicators used to measure poverty, the household is the appropriate unit of analysis.¹⁶
17. **"Pre-Post" measurement of taxes, transfer payments, and public services** – The resources and services provided by the state influence an individual's Economic Fortitude. To evaluate the relevancy and effectiveness of government policy, it is important to understand Economic Fortitude both before and after government intervention.¹⁷
18. **Forward looking measurement** - To properly reflect the society's Economic Fortitude, predictive variables that measure both the individual and the economy need to be included.
19. **Six Pillars of Economic Fortitude:**¹⁸
 - a. **Disposable Income** – Disposable income is the main variable used to measure the extent of poverty in Israel today.¹⁹ An individual's disposable income – reported and non-reported – influences his ability to guarantee his standard of living, investment, and savings.²⁰
 - b. **Asset Depth** – The concept 'Asset Depth' refers to a household's present and future net-worth, including savings, real estate, pension accounts, and debt.
 - c. **Consumption** – In general, consumption is considered a better estimator of standard-of-living²¹ than income and permits measurement of several aspects of Economic Fortitude:
 - **Severity of Poverty** – Low consumption is an indicator of deep and continuing poverty. It indicates the amount of time a household has suffered from low income and the household's potential to increase its fortunes.²²
 - **Continuing Standard of Living** – Consumption reflects the needs and abilities of the household economy. The ability to preserve a stable level of consumption

¹⁶ Additional research in which the household is the unit of analysis in poverty studies can be found here: OECD Policy Brief, [Combating Poverty and Exclusion through Work](#) (2005)

¹⁷ Bank of Israel Annual Report – 2006, [Chapter 8: Issues in Welfare Policy](#), figure 8.3, p. 319.

¹⁸ Each variable will be weighted differently in the calculation of the total index value.

¹⁹ The National Insurance Institute, [Annual Survey 2005](#).

²⁰ Unreported income reduces the reliability of income measurements. Sheinin recommends that all Israeli households be required to report income annually. Sheinin, **Recommendations for Economic Policy to Reduce Poverty in Israel**, Economic Models (2007).

²¹ Milton Friedman, **A Theory of the Consumption Function**, National Bureau of Economic Research, Princeton, N.J., 1957

²² Bank of Israel Annual Report – 2006, [Chapter 8: Issues in Welfare Policy](#), box 8.1, p. 325.

despite fluctuations in income is a sign of Economic Fortitude.²³

Consumption can be measured by calculating the total consumption of a household or by measuring the consumption of specific types of goods and services (consumer goods, vacation, higher education, etc.).²⁴

- d. **Employment Security** – Continuous employment is an important pillar of an individual's Economic Fortitude.²⁵ A valid measurement of employment security must include aspects of both the household's human capital and the trends and changes in the employment market. Employment Security is influenced by two components:
- **The likelihood of finding employment** – This component evaluates the household's ability to find gainful employment. Key factors include: demand for the household's skills in the labor market,²⁶ level of education, work experience, and knowledge of Hebrew or foreign languages.²⁷
- Measuring this variable post-State intervention can include access to training and placement services and the public expenditure on these services.²⁸
- **The likelihood of losing one's job** – This component evaluates the likelihood of losing the current source of income. Labor law and agreements within the specific industry that employs the household influence this component (salaried vs. self-employed, temporary vs. full-time, collective-bargaining vs. individual contracts).²⁹
- e. **Health** – The health of an individual in a household, whether a bread-winner or a dependent, impacts Economic Fortitude. Among the important variables worth considering are: total health costs, age, chronic ailments,³⁰ and environment (pollution and health hazards in office and living conditions).
- f. **Spare/Free Time** – The amount of time that an individual is able to dedicate to needs other than earning income is an important component of Economic Fortitude. It is indicative of the ability to nurture human and social capital and to cope with unexpected difficulties.

²³ Modigliani, F. & Brumberg, R. (1954): "Utility analysis and the consumption function: An interpretation of cross-section data", In: Kurihara, K.K (ed.): **Post-Keynesian Economics**, New Brunswick, NJ Rutgers University Press, pp 388-436.

²⁴ The Bank of Israel recommends measuring consumption in addition to income. see above

The European Union calculated consumption by measuring the consumption of specific goods and services divided into Basic Lifestyle Deprivation and Secondary Lifestyle Deprivation. See Förster, Tarcali & Till above.

²⁵ It is important to distinguish between employability and job security. See: S. K. Andersen & M. Mailand. [The Danish Flexicurity Model The Role of the Collective Bargaining System](#), Compiled for the Danish Ministry of Employment, 2005, p. 10.

²⁶ Eurostat, the European Bureau of Statistics, measures job vacancies across sectors of the economy.

²⁷ Work done by the OECD shows the strong correlation between employment security and an individual's ability to obtain education and training in and out of the workplace.

OECD, [Lifelong Learning to Maintain Employability](#) (1997)

²⁸ Eurostat measures Labor Market Policy by calculating the total value of appropriations for support, training, and activation programs.

²⁹ The likelihood of being fired is correlated to labor market flexibility. The WEF Competitiveness Index calculates flexibility by determining the ease with which employers can release employees. See "[Employment Protection](#)" in the OECD's glossary of statistical terms.

³⁰ Israel's [Central Bureau of Statistics](#) collects data related to health.

Spare/Free Time can be measured by the time spent at work weekly.³¹

20. An individual's and household's Economic Fortitude deteriorates as a result of weakness in a combination of the six pillars. Weakness in any one of the components need not necessarily mean low Economic Fortitude.
21. The Economic Fortitude Index will give decision makers a forward-looking indication of society's ability to live in comfort, to improve its wellbeing, and to cope with changes. The Index will encompass a systemic understanding of poverty that will provide a meaningful identification of the poor.

Segmentation of the Poor

22. Dealing with poverty requires direct policies that include support and training³² and indirect policies that remove social and cultural obstacles, grant incentives, and solve structural problems in the public sector and labor market.³³ Developing policy requires segmenting the poor in a way that serves policy goals.
23. **Relevant segmentation for human capital development policy** – Because an effective strategy for utilizing and developing human capital depends on appropriate policies, the suggested segmentation divides the poor by their specific needs regarding utilization and development of human capital.³⁴

The segmentation is as follows:

- a. **Labor Force Participants** – This group includes those with low Economic Fortitude despite willingness and ability to work.

In general, this group's ability to utilize and develop its human capital is influenced by policies aimed at increasing productivity, at removing structural obstacles to participation, and at increasing access to the job market.³⁵

Labor force participants can be divided into two groups:

- **The Employed (the working poor)** – Those, who despite employment, suffer weak Economic Fortitude are the working poor. A firm connection exists between human capital and income potential. Therefore the working poor are typically those with incomplete schooling or inadequate skills.³⁶

³¹ More complex measurements exist. The [ATUS: American Time Use Survey](#) compiles data on time spent on various activities including: gainful employment, child care, volunteering, and leisure.

³² The Danish system offers a combination of income support, training, and activation programs. T. Bredgaard, F. Larsen & P.K Madsen "[The flexible Danish labour market: a review](#)", CARMA, Aalborg University, April 2005.

³³ On the government's role in maintaining a stable and efficient market, see: D. Rodrik, [Industrial Policy for the Twenty First Century](#), Harvard University (2004).

³⁴ The segmentation presented in this report does not obviate the need for alternative segmentations that might serve additional policy goals. Segmenting the population by sectors is useful for studying social exclusion and discrimination. Segmentation by geographical regions is useful for designing regional development policies. For additional segmentations that are relevant to Israeli situation, see: [Social-Economic Development: An Illustrated Overview](#), The Taub Center for Social Policy Studies in Israel (2006).

³⁵ See the OECD's recommendations in: [Jobs and Incomes: the Restated OECD Jobs Strategy](#), (2006).

³⁶ Both the Bank of Israel and the Prime Minister's Office see the issue of work-force participants below the poverty line as a dilemma that needs to be addressed.

Bank of Israel Annual Report – 2006, [Chapter 8: Issues in Welfare Policy](#), p. 338; [A Socio-Economic Agenda for Israel 2008-2010](#) (2007).

Improving this group's Economic Fortitude can be done financially (through income support or negative income taxes) or investment in on-the-job training programs.

- **The Unemployed** – The unemployed are unable to find employment despite actively searching for work.

Financial support during the job-hunt and investment in training and placement programs are examples of policies that can improve this group's Economic Fortitude.

b. **Non-Participants in the Labor Force** – are divided into two groups:

- **Youth** (the population below working age) – The Economic Fortitude of this group is dependent on the household in which it lives. It is important to relate to this group as future human capital.

The future human capital of this group is dependent on its access to suitable education that will permit it to join the labor market when it comes of age.

- **Adult Non-Participants** – This group includes people whose human capital falls on a spectrum. Policy baskets tailored to individual needs are the appropriate response. Nonetheless, it is important to draw the following distinction:

- **Those without potential to integrate into the job market** – This group includes the elderly and some of the physically and mentally disabled. The social welfare services are responsible for identifying these individuals. Since developing this group's human capital is limited by their status, their Economic Fortitude must be fortified by support and welfare.
- **Those with potential human capital** – This group includes those who could apparently work but do not participate.³⁷ They are a reservoir of potential human capital that is not utilized.

Utilizing and developing this group's human capital and guaranteeing its Economic Fortitude requires a combination of incentives to work³⁸ and individual programs aimed at social and cultural impediments to participation.³⁹

24. **A note regarding students** – Students in higher education or vocational institutions require specialized socioeconomic policies. Those with weak Economic Fortitude are considered to

³⁷ Some argue that the common denominator uniting this group is unwillingness to work. Willingness is difficult to define and measure, and specifically within the Haredi and Arab sectors, there is argument as to whether willingness is the only factor at play.

Bezalel Cohen, [Economic Hardship and Gainful Employment in haredi Society in Israel: An Insider's Perspective](#), **Floersheimer Institute for Policy Studies** (2005)

S. Abu-Badr and D. Gotlieb, "Poverty among the Bedouin as a Reflection of the Arab Population in Israel," speech at the **Van Leer Institute** "Economy and Society" Program (2006).

³⁸ On the effects of Israel's tax and welfare policies on labor force participation, see: John Gal and A. Doron, "Dealing with the elusive welfare-to-work issue: The case of poverty traps in Israel," **Social Policy and Administration**, Vol. 34, Issue 3, pp.253-273 (2000).

³⁹ Similar programs have already been discussed. On a program to employ Haredim and minorities in preferred geographical zones, see: L. Danish, "[It pays to employ minorities](#)", **Haaretz**, 4/22/07 (Hebrew Only).

For programs aimed at Arab Women, see: The Knesset Research and Information Department, [Background Paper: Employment and Initiative of Arab Women](#), 7/12/05. (Hebrew Only).

be working poor if they work or to be unemployed if they do not. They should be considered as a group that is investing in building their human capital.

The appropriate policies will allow them to maintain their Economic Fortitude while encouraging them to continue developing their human capital.

25. **Regarding soldiers in mandatory service** – Mandatory military service in Israel removes a significant portion of the country's human capital from the labor market. While their Economic Fortitude is mostly dependent on the household from which they come, their human capital is largely influenced by the nature of their military service.

In this context, mandatory military service should be approached as an opportunity for education, training, and development of human capital and Economic Fortitude.⁴⁰

End.

⁴⁰ A program aimed at increasing soldiers' human capital is being developed in cooperation with the IDF, the Ministry of Industry, Trade & Labor, the Joint, and the Manufacturers Association of Israel.
[Press Release](#), **Manufacturers Association of Israel**, 3/26/07 (Hebrew Only).