Reichman University

Aaron Institute for Economic Policy

In the name of Aaron Dovrat z"l

Advancement of the Arab Society as a Major Growth Engine for the Israeli Economy

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This is a short summary, for the full paper (in Hebrew) see

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Aaron Institute for Economic Policy

Dedicated to the memory of Aaron Dovrat

The vision of the Aaron Institute for Economic Policy in the Tiomkin School of Economics is to support sustainable economic growth and social resilience, along with poverty reduction. To achieve these goals, the institution strives to design a strategy based on measurable goals, which can be subjected to international comparison, and propose detailed plans for economic policies based on the most updated international knowledge. We focus primarily on reforms towards economic growth stemming from increasing employment and raising the GDP per hour worked (labor productivity) in Israel.

The key measure of sustainable economic growth – GDP per capita – is still low in Israel compared to leading developed countries, and so is labor productivity. Through its economic studies, the Aaron Institute presents goals, innovative policy tools, and reforms to promote growth, high-quality employment, and labor productivity.

The Institute's mission is to help shaping the socioeconomic policy in Israel through the development of long-term plans that address the full range of economic and social issues facing the Israeli economy. Our main focus is families with less than median income, who comprise significant parts of the Arab and Haredi (ultra-Orthodox) populations. In these groups specifically, increasing employment and productivity would greatly contribute to achieving the goals of growth, social resilience, and poverty reduction. In addition, our studies aim to influence the professional discourse, and to stimulate discussion based on reliable information and socioeconomic research that offers practical tools to achieve these goals.

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The Center for Economic Policy of the Israeli Arab Population

The Aaron Institute has established The Center for Economic Policy of the Israeli Arab Population with a vision of advancing the manufacturing and business economy in Israeli-Arab population, and enhancing its integration in the Israeli economy. The activity of this center is part of Aaron Institute's comprehensive economic strategy for the Israeli economy, which aims to achieve sustained growth in GDP and labor productivity, along with reduced poverty and inequality. The center's activity focuses on presenting government decision-makers with recommendations for implementation of long-term economic policies for Israel's Arab population, and promoting their enactment in practice.

In accordance with the center's vision, activity revolves around designing strategies and devising policies in the fields of education, employment, and infrastructure, through collaboration with various government offices, and particularly the Ministry of Finance and the Authority for Economic Development of the Minority Sectors. Policy recommendations include proposals for detailed programs which are based on up-to-date data regarding the Arab population in Israel, as well as economic knowledge acquired nationally and internationally, while taking into consideration existing customs and cultural norms in Israel, including political limitations. Research findings and recommendations are presented at public roundtable discussions held in Arab localities, with participants including Arab and Jewish professionals such as researchers, decision-makers, and senior figures from the business and public sectors. Our collaboration with government offices, especially the Ministry of Finance, enables us to enhance the center's impact and to translate its proposals into government decisions with allocated funds, which engender the implementation of long-term policies in various fields.

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Advancement of the Arab Society as a Major Growth Engine for the Israeli Economy in the Next Decade

During the decade between 2012 and 2022, there has been a rapid growth in the labor income per individual among Arab men and women, and the gaps between Arabs and non-Haredi Jews have decreased.[1] The narrowing of this gap, alongside the growing size of the Arab society as a share of the overall Israeli population, have led to an increase in the share of the Arab society out of the total labor income, which serves as an indication of its contribution to the GDP. This positive trend of Arab men and women integrating into high-quality employment has taken place against the backdrop of a government policy aiming to develop the Arab society, boost incentives for work, and promote education. Analyzing the changes in education, employment and income of individuals aged 25-44 during this decade shows that around two thirds of the increase in labor income per individual (an annual increase of 4.2% between 2012 and 2022) have stemmed from an increase in the wages of employed Arab men. The remaining third has stemmed from shifts among Arab women, in particular an increase in their education level.

Despite the positive trends in education, employment (of Arab women) and wages, labor income per individual among Arab men and women still stands at around a half of that of non-Haredi Jews. Large gaps persist between the two groups in the labor market: a low rate of tertiary education, lower employment rates and particularly an employment gap between Arab women without tertiary education and non-Haredi Jewish women with similar education level, as well as wage gaps across all education levels between Arab men and women on the one hand, and non-Haredi Jewish men and women on the other.

A further reduction of the gaps between Arabs and non-Haredi Jews is critical to the growth of the Israeli economy in the medium and long term. Without any changes in the education, employment and wages of either population groups, the expected demographic shifts – in particular the growing share of Haredi society – may bring about a negative annual growth of 0.4% in labor income per individual of the 25-44 age group by the year 2035. Conversely, closing the gaps between Arabs and non-Haredi Jews holds a potential to alter the trajectory of the economy from negative to positive growth – fully closing the gaps in education, employment rates and wages of Arab men and women (combined with the demographic

[1] Labor income per individual is the income from work of all men and women of the relevant ages, including zero income for individuals who are not employed or have no labor income.

shift) will lead to an annual growth of 0.8% in labor income per individual (even if the situation in Haredi society remains unchanged).

While fully closing all gaps within a decade is not likely, we show that under two ambitious but realistic scenarios it would be possible to maintain the growth rate in labor income per individual obtained in Arab society between 2012 and 2022. First, in a scenario of closing employment gaps between Arabs and non-Haredi Jews within each education level, labor income per individual of Arab men and women will increase by 1.6% annually until 2035, and that annual rate will reach 4.7% if the current rate of wage growth within each education level is also maintained. In the second scenario, which sees the entire Arab society reaching by 2035 the same education levels and within-education level employment rates that currently exist in the Arab populations of mixed cities, the labor income per individual of Arab men and women is expected to increase by 1.6% annually, or 4.4% if the current rate of wage growth is also maintained.

For Israel's Arab society to remain a major growth engine for the national economy, ambitious targets should be set for 2035 in regard to the education, employment rates and wages of Arabs aged 25-44, representing a significant reduction in the gaps between Arabs and non-Haredi Jews. It would also be necessary to continue adopting and enacting the recommendations presented in our previous papers for boosting education and employment, as well as improving the quality of employment in the Arab society, in order to support the realization of these targets. In addition, it is necessary to proceed with the full implementation of economic development plans for the Arab society formulated in previous years, and to reinstate previously cut budgets in order to fund the relevant government resolutions, in particular Resolution no. 550. Full implementation of these recommendations will help maintaining the positive trends in the Arab society and the reduction of gaps in the labor market, while sustaining the impressive growth rate in labor income per individual among Arab men and women and across the economy as a whole. Thus, it will promote the social and economic integration of Israel's Arab society and the realization of its untapped potential, enabling it to continue acting as a major growth engine for the Israeli economy in the years to come.

1. Summary and Conclusions

The objective of this policy paper is to help formulating a policy aiming to advance Israel's Arab society and to reduce gaps between the Arab and non-Haredi Jewish society, by answering two questions: (1) what drove the increase in labor income per individual among Arab men and women over the last decade? (2) how would gap reduction in education, employment and wages affect the continuing increase in labor income per individual among Arab men and women in the next decade, and the further reduction of the gap between them and non-Haredi Jews?[2]

Labor income per individual among Arab men and women aged 25-44 has increased between 2012 and 2022 at an annual rate of 4.2%, from 3,900 to 5,900 NIS (in 2022 prices).[3] Among non-Haredi Jews, on the other hand, labor income per individual has increased during the same period at an annual rate of just 2.9%, hence the gaps between Arabs and non-Haredi jews have narrowed. The narrowing of the gap in labor income per individual, combined with the growing size of the Arab society as a share of the overall Israeli population, have resulted in an increase in the share of the Arab society out of the total labor income, which serves as an indication of its contribution to the GDP.

[2] Labor income per individual is the real monthly income from work (before taxes) of all men and women of the relevant ages, including zero income for individuals who are not employed or have no labor income, and it is calculated by multiplying employees' wages by the employment rate. The analysis in this paper focuses on labor income (rather than capital gains, government allowances or other sources) since this is the relevant outcome variable for changes in output and growth, as well as being the variable affected by labor market policies and by the decisions of individuals responding to these policies, particularly in response to economic and other incentives.

[3] The analysis in this paper is based on data obtained from labor force surveys and expenditure surveys conducted by the Israel Central Bureau of Statistics (CBS). We use income, wages, employment and education data from 2022 as a reference point for both the past (2012) and the future (2035), because these data represent accomplishments and challenges at times of normalcy rather than during crisis or war, and also because wage data segmented by population groups were not available for later years at the time of writing. It should be noted that the war which started in October 2023 has affected employment and wages (Tehawkho et al., 2024), while legislation initiatives introduced by the coalition at the same year also have economic implications in the short and long term (Ater et al., 2023). Most of the analyses in this paper focus on the 25-44 age group, since this group is at the peak of its employment potential, affected by labor market policies, and relevant to the formulation of scenarios for the next decade.

The income growth of the Arab population has stemmed from several factors: an increase in the educational attainment of men and women, an increase in the employment rate of women within each education level (while the employment of men in most education levels has slightly decreased during this decade), and an increase in the wages of employed men and women within each education level.[4] Analyzing the changes during this decade in the education distribution of Arab men and women and in the employment rates and wages within each education level shows that around two thirds of the increase in labor income per individual among Arab men and women have stemmed from an increase in the wages of employed Arab men, particularly those without tertiary education, while the remaining third has stemmed from shifts among Arab women, in particular an increase in their education level. These positive trends in the education, employment and wages of the Arab society are a result of government policies aiming to boost incentives for work and encourage education, and of plans for economic development of the Arab society as part of the implementation of the various 5-year plans for the Arab society, primarily Resolution no. 550.

Despite the positive trends in education, employment (of Arab women) and wages, and despite the more rapid increase in labor income per individual among Arab men and women, it is still only a half of that of the non-Haredi Jewish population. Large gaps between the two groups persist in the labor market: the rate of tertiary education of any kind (academic or otherwise) among Arab men is around half of that of non-Haredi Jewish men, and the corresponding figure among Arab women is around 60% of that of non-Haredi Jewish women; employment rates of Arab men and women are lower, and this gap is particularly notable when comparing the employment rate of Arab women without tertiary education to that of non-Haredi Jewish women with similar education level; furthermore, there are wage gaps between Arabs (both men and women) and non-Haredi Jews across all education levels.

[4] The term "education distribution" in this paper refers to the relative share, out of population and age group, of each of the following education levels, defined according to the highest qualification obtained: (1) secondary education or lower without matriculation; (2) matriculation certificate; (3) non-academic tertiary education, in particular technicians and practical engineers (MAHAT graduates) or "grade 13-14" post-high-school vocational training; (4) academic education – Bachelor's degree; (5) academic education – Master's degree or higher.

Although the gaps between Arabs and Jews exist throughout Israel, Arab residents of mixed cities are characterized by higher education levels and higher employment rates, closer to those of non-Haredi Jews. We assume that, compared to the rest of Israel's Arab population, residents of mixed cities have higher exposure to Hebrew language from a younger age and enjoy access to better education and transportation systems, as well as more employment opportunities.

A further reduction of the gaps between Arabs and non-Haredi Jews is critical to the growth of the Israeli economy in the medium and long term. Looking ahead to 2035, the expected demographic shifts – in particular the growing share of Haredi society in the 25-44 age group – may bring about a negative annual growth of 0.4% in the labor income per individual in this age group, in the absence of any changes in the education, employment and wages of either population group. Such a change in the labor income in the 25-44 age group approximates the growth rate of the national economy. Conversely, closing the gaps between Arabs and non-Haredi Jews holds a potential to alter the trajectory of the economy from negative to positive growth – fully closing the gaps in the education, employment rates and wages of Arab men and women (alongside the demographic shift) will lead to an annual growth of 0.8% in labor income per individual, even if the situation in Haredi society remains unchanged. In this scenario, the labor income of Arab men and women will grow at an annual rate of 5.8%, around half of which would stem from changes among men and the other half from changes among women.

While fully closing all gaps within a decade is not likely, we show that under two ambitious but realistic scenarios it would be possible to maintain the growth rate in labor income per individual obtained in the Arab society between 2012 and 2022. First, in a scenario of closing employment gaps between Arabs and non-Haredi Jews within each education levels, the labor income per individual of Arab men and women will increase by 1.6% annually until 2035, whereby 70% of this growth would stem from the shift among women. Furthermore, if the current rate of wage growth within each education level is also maintained, labor income per individual would increase by an annual rate of 4.7% until 2035.

In the second scenario, which sees the entire Arab society reaching by 2035 the same education levels and within-education level employment rates that currently exist in the Arab populations of mixed cities, the labor income per individual of Arab men and women is expected to increase by 1.6% annually, or 4.4% if the current rate of wage growth is sustained. Hence, the effect of matching employment rates within each education level to those of non-Haredi Jews without a change in education is equal to the effect of matching employment rates within each education level while also matching the education distribution to that of mixed cities.

For the positive trends to persist, and for Israel's Arab society to remain a major growth engine for the national economy, ambitious targets should be set for 2035 in regard to the education, employment rates and wages of Arabs aged 25-44, representing a significant reduction of the gaps between Arabs and non-Haredi Jews.[5] In addition, it is necessary to proceed with the adoption and enactment of the recommendations presented in our previous papers in regard to boosting education and employment, as well as improving the quality of employment in the Arab society, in order to support the realization of the aforementioned education, employment and wage targets.

In this framework, actions should be taken toward: (1) increasing the rate of tertiary education (either academic or technological) in the Arab society by increasing the potential at age 18, fostering skills with an emphasis on Hebrew language proficiency, utilizing potential through transition programs, and addressing the barriers limiting academic education; (2) significantly increasing employment rates, particularly among those without tertiary education and specifically women without such education, through regional employment centers, the creation of employment hubs in or around Arab municipalities, and addressing the unique barriers hindering the employment of Arab women; (3) improving wages and boosting integration in high-quality employment by encouraging entrepreneurship and supporting employers in productivity-enhancing efforts.

[5] Aaron Institute's recommendations for these and other targets, formulated in collaboration with the Budgets Department in the Ministry of Finance and The Authority for Economic Development of the Minority Sectors, are detailed in a separate paper to be published soon.

In addition to these measures, it is necessary to proceed with the full implementation of the economic developments plans for the Arab society formulated in previous years, and to reinstate previously cut budgets in order to fund the relevant government resolutions, in particular Resolution no. 550, at the expense of so-called “special allocations” which do not support growth. Finally, further research is necessary into the conditions of Arab residents in mixed cities which facilitate higher employment rates and education levels compared to the rest of Israel’s Arab society, in order to formulate practical plans aiming to match conditions and outcomes in Arab communities to those of mixed cities across all dimensions.

In light of the major challenges facing the Israeli economy and society, with rising defense spending and government deficit, it is important now more than ever to invest in the economy’s growth engines. Full implementation of the above recommendations will help maintaining the positive trends in the Arab society and the narrowing of gaps in the labor market, while sustaining the impressive growth rate in labor income per individual among Arab men and women and across the economy as a whole. Thus, it will promote the social and economic integration of Israel’s Arab society and the realization of its untapped potential, enabling it to continue acting as a major growth engine for the Israeli economy in the years to come.