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Pension Levels and Retirement Age in Israel and OECD Countries

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Abstract

Background

Most countries have a state-run pension system that supplements and regulates pension savings and is designed to ensure well-being in old age. This study discusses pension levels and pension coverage, the types of pension plans (private or public, defined benefit plans or defined contribution plans), the eligibility age for a pension, the options in place for lowering or raising the eligibility age, and pension plan funding methods – this, with reference to the situation in Israel and other OECD countries. The study also presents a review of the academic literature on the need for government intervention in the decision-making of individuals regarding their pension savings – the extent to which such intervention is required and the circumstances warranting it. In view of the situation in Israel compared with other OECD countries and based on the theoretical and empirical findings reported in the academic literature, the study team proposes recommendations for a policy that would improve the pension system in Israel. The study was commissioned by the National Insurance Institute and conducted in 2020.

Goal

The study was designed to characterize the pension system in Israel, discuss its advantages and disadvantages, and propose policy tools that would improve the services offered in response to the needs of the elderly while taking into account the budget limitations within which the pension system operates.

Method

Review of the academic literature and comparison of the situation in Israel with the situation in other OECD countries based on the OECD 2019 annual report on pensions.

Key Findings

- It emerges from the international literature that a significant percentage of individuals find it difficult to manage optimal saving for retirement.
- The literature indicates substantial variance in the adequacy of decision-making regarding pension savings. Most empirical estimates show that while the majority of individuals successfully manage optimal saving for retirement, a significant percentage of individuals fail to do so.

- The percentage of Israelis in the over-65 age group who receive basic old-age pension is slightly lower than the average of the comparable percentage in the OECD countries – this, since in Israel, a significant proportion of workers retire after the age of 65.
- The percentage of people receiving income supplement in addition to their old-age pension in Israel in the over-65 age group is similar to the average percentage in the OECD countries.
- In Israel, the amount of allowances that are not based on contributions – basic old-age pension combined with the income supplement – as a percentage of the average wage in Israel, is higher than the average in the OECD countries.
- Accrual rates in the second-tier plans (mandatory pension payments) in Israel are significantly lower than the average in the OECD countries.
- The retirement age of men in Israel, at which they are entitled to pension payments, is significantly higher than the average in the OECD countries.
- The retirement age of women in Israel, at which they are entitled to pension payments, is significantly lower than the average in the OECD countries.
- The ratio between pension income and final salary in Israel is similar to the average in the OECD countries for men and lower than the OECD average for women. This is due in part to the retirement age of women in Israel being significantly lower than the average in the OECD countries.
- Many OECD countries offer the option of receiving first tier pension payments (pensions funded by mandatory payments to the social security system) before reaching the normal retirement age, in exchange for reduced pension payments, or, alternatively, the option of pension deferral in exchange for a pension deferral increment. The option of receiving a reduced early retirement pension is unavailable in Israel while optional pension deferral is available. The pension deferral increment in Israel is lower than the average in OECD countries offering optional pension deferral.

Conclusions and Policy Recommendations

- The pension system in Israel is on par with the corresponding systems in other OECD countries and may thus be considered a reasonably adequate system.
- The coverage rate of income supplement to old age pension in Israel is similar to the coverage rate in the other OECD countries. However, given the significantly higher poverty rate among the elderly in Israel, easing the eligibility prerequisites for income supplement should be considered.

- The mandatory pension accrual rates in Israel are lower than in most OECD countries. Increasing the mandatory pension contributions should thus be considered.
- The retirement age of women in Israel is significantly lower than the average in the OECD countries. Accordingly, the replacement rate, which measures the ratio between an individual's pension income and his or her pre-retirement earnings, is low for women in Israel compared with the average in the OECD countries. Raising the retirement age of women should thus be considered.
- A more flexible pension eligibility scheme should be considered, offering individuals the option of receiving a reduced early retirement pension or, alternatively, the option of pension deferral to the post-official retirement age in exchange for a pension deferral increment.