



Israel's Economic Potential for Growth

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The Israeli Economy - Directions

- **Current status vs. needs**
- **2025 forecast - current direction**
Does it meet future economic needs?
- **Accelerated growth scenario**
- **Recommendations**

Critical Path for the Israeli Economy

In order to meet known future needs, Israel's economy must:

- Accelerate GDP per capita growth to 4.5%
- Obtain the capital (investment) needed for growth
- Increase the rate of participation in the workforce
- Maintain 8% annual growth of the high-tech sector

The Israeli Economy - 2007

| | Israel | USA | EU-15 | Ireland |
|--|--------|-----|-------|---------|
| GDP per capita (‘1,000’ US\$) | 21 | 44 | 36 | 55 |
| Rank | 22 | 6 | 17 | 3 |
| Participation in the workforce (%) | 56 | 66 | 57 | -- |
| Per capita growth (%) | 3.5 | 1.3 | 2.3 | 4.2 |

2006 - demography

Three economies

| | Total | Majority | Ultra-Orthodox | Arabs |
|--|-------|----------|----------------|-------|
| Population (thousands) | 7,053 | 5,022 | 636 | 1,395 |
| Percent of population | 100% | 71% | 9% | 20% |
| Fertility rate (per woman) | 2.9 | 2.3 | 6.0 | 3.7 |
| Rate of Participation in the workforce | 55.6% | 60.0% | 42.5% | 39.6% |

2007 - Problems

- **Problematic tax burden**

- Three economies
- The majority's rate of participation in the workforce is identical to world leaders
- Population groups with low participation rate

- **Increasing pressures in the majority**

- **Competitive disadvantage**

- **Insufficient growth rate**

- **1998-2007 – 1.6%**

- Last 20 years – 1.8%
- From 2002 – 3.5%

- **Consequences:**

- **Many countries are growing faster and will beat us**
- **Growing gap from world leaders**
- **Poverty and inequality**

Poverty and inequality

The Institute's extensive research –
Herzliyah Conference 2007:
Reducing Poverty in Israel
Economic Policy Recommendations

www.iep.org.il
www.modelim.co.il

Where are we headed?



The Israeli Economy – 2025 Basic Scenario

| | Israel | USA | EU-15 | Ireland |
|---|------------|------------|------------|------------|
| GDP per capita (‘,000’ US\$) (2007) | 31 (21) | 60 (44) | 49 (36) | 90 (55) |
| Rank | 23-4 | 7 | 17 | 2 |
| Participation in the workforce (%) | 57 | 63 | -- | -- |
| Per capita growth (%) | 2.3 | 1.7 | 1.7 | 2.4 |

Demography 2025 Basic Scenario

| | Total | Majority | Ultra-Orthodox | Arabs |
|--|-------------------------|--------------|----------------|--------------|
| Population - thousands (2006) | 9,577 (7,053) | 6,131 | 1,292 | 2,154 |
| Percent of population | 100% | 64% | 13% | 23% |
| Fertility rate (per woman) | 2.8 | 2.0 | 6.0 | 3.0 |
| Rate of Participation in the workforce | 56.9% | 61.8% | 47.9% | 44.7% |

Basic Scenario - Problems

- **Growth rate too slow to meet future needs**
- **Historical growth rate of 1.8% - can we maintain 2.3% for 20 years?**
- **Growing inequality and increased (relative) poverty**
- **A growing (tax) burden on shrinking majority (from 71% to 64%)**

“Not So Bad”(?)

Employment increase – basic scenario

The main challenge – creating jobs

| | 2006 | 2025 |
|--|-------|-------|
| Average rate of Participation in the workforce | 55.6% | 56.9% |
| Employment (thousands) | 2,574 | 3,740 |
| Required employment increase (thousands) | | 1,166 |
| Unemployed (thousands) | 236 | 282 |
| Required employment increase – including reducing unemployment (thousands) | | 1,248 |

Ireland's growth story

| | 1980 | 2007 |
|---------------------------------|------|------|
| GDP per capita (',000' US\$) | 16.1 | 55.3 |
| Rank | 22 | 3 |
| Population (million) | 3.4 | 4.2 |

- ▲ The Ireland story – 5.4% growth for 20 years (1986-2005)
- ▲ The Ireland story is relevant to Israel, but requires structural changes
- ▲ “Irish” growth scenario
2025 GDP per capita – \$54,000 (vs. 31,000 in basic scenario)

Accelerated growth scenario

- **Pressing problems** – creating jobs, burden on shrinking majority, poverty and inequality, maintaining growth rate.
- **The solution** - accelerate growth rate to 4.5% (3 times the historic growth rate) for 20 years
- **The result:** A jump in world ranking (17 in 2025; 13 in 2030).
- **The result:** major economic problems – solved; improved standard of living

The Israeli economy - 2025 Accelerated growth scenario

| | Israel | USA | EU-15 | Ireland |
|--|------------|------------|------------|------------|
| GDP per capita (‘,000’ US\$) (2007) | 46 (21) | 60 (44) | 49 (36) | 90 (55) |
| Rank | 17 | 7 | 16 | 2 |
| Rate of Participation in the workforce | 59 | 63 | -- | -- |
| Per capita growth (%) | 4.5 | 1.7 | 1.7 | 2.4 |

Demography 2025

Accelerated growth scenario

| | Total | Majority | Ultra-Orthodox | Arabs |
|---|-------|----------|----------------|-------|
| Population - thousands | 9,460 | 6,386 | 1,013 | 2,060 |
| Percent of population | 100% | 67% | 11% | 22% |
| Fertility rate (per woman) | 2.6 | 2.1 | 6.0 | 2.3 |
| Rate of Participation in the workforce | 58.7% | 61.9% | 52.0% | 50.3% |

Accelerated growth scenario - summary

- Improved standard of living
- Reduced poverty rate and greater equality
- Reduced burden on the majority
- Reversing the majority “shrinking” trend

The question – How do we grow 4.5% a year?

Capital and product stock per employee in Israel and the USA – 2006 (‘,000’ US\$)

| | Israel | USA | Ratio Israel / USA |
|-------------------------|--------|-------|-----------------------|
| Product per employee | 55 | 92 | 60% |
| Capital per employee | 81 | 149 | 55% |
| Wages (\$ per month) | 1,664 | 3,628 | 46% |

Additional investment required 2007-2025 (billions U.S.\$)

| | Total | Excluding housing | Housing |
|--------------------------------|-------|-------------------|---------|
| Basic Scenario | 769 | 592 | 177 |
| Accelerated Scenario | 1,096 | 831 | 265 |
| 1988-1997 | 184 | 112 | 72 |
| 1998-2007 | 237 | 168 | 69 |
| Rate of growth within 20 years | 260% | 297% | 188% |

Current growth engines

- Military industry
- Electronic and communication industry
- Chemical Pharmaceutical industry
- Software industry
- Start-up companies

Israel's economy is export oriented and dependent on its growth to supply the required capital to increase employment

Export forecast according to industries 2006 (billions U.S.\$)

| | 2006 | 2025 Basic scenario | Average rate of change | 2025 Accelerated scenario | Average rate of change |
|---------------------------------|------|---------------------|------------------------|---------------------------|------------------------|
| Export | 71 | 171 | 4.7% | 238 | 6.6% |
| Advanced technology | 27 | 88 | 6.4% | 121 | 8.2% |
| Industry and agriculture | 8 | 15 | 2.9% | 20 | 4.6% |
| Tourism | 2 | 4 | 4.2% | 6 | 6.0% |
| Other industries | 33 | 64 | 3.5% | 92 | 5.5% |

Future growth engines

- **All current growth engines;**
- **Investment in infrastructure** (temporary engine - Booster)
– 50 Billion NIS (roads, trains, electricity, water, telecommunication);
- **Bio-Technology Industry** (high growth rate);
- **New industries and services** – HQ center;
 - In 1980 the technological export was - 0
- **Tourism (employment heavy) and 9 similar industries**

The critical path to a healthy economy

- **Accelerate growth rate of GDP to 4.5%**
- **Obtain the capital (investment) needed for growth**
- **Increasing rate of participation in workforce**
- **Maintain growth rate of 8% per year of the high-tech sector**

Recommendations

- **Aggressive investment policy**
 - General policy (competitive tax policy, removing bureaucratic barriers, supporting legal environment)
 - Economy guided sectorial policy (such as High-tech, infrastructure, tourism)
- **Maintain and develop current growth engines**
 - Old and new engines (especially in high-tech)
 - Be competitive (tax, financing, infrastructure, communication, bureaucracy)

Recommendations (2)

- **Increasing rate of participation in workforce – in particular within the Arab and ultra-religious sectors**
 - Cease foreign employees employment
 - Economic and demographic “separation wall”
 - Continue de-subsidizing unemployment (ages 18-35)
 - Solving the military service problem
- **Incentives for investments in services (as apposed to current policy) as well as industries.**

Recommendations (3)

- **Accelerated improvement in level of education**
 - Doubling amount of science graduates (within 20 years)
 - Improving level of education (Dovrat reform, measuring achievements, longer school day)
 - Subsidizing longer school day (instead of birth grants)
- **Modern infrastructure – growth and employment engine**
 - Investment policy (PFI, BOT)
 - Minimizing bureaucracy (“green light” paths to national projects)
 - Highways, trains, electricity, water desalination, housing

Summation

**Israel's economy "difficulties"
may become the trigger for
economic success**