



Israel's Economic Potential for Growth

January 2008

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**