



ישראל 15

Becoming one of the
15 Leading Countries in the World

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Main documents of the [Israel15](#) Project



**Letter from the Founder and President of the Reut Institute
Israel15 - Becoming one of the 15 Leading Countries
The Reut Institute's vision for a socio-economic leapfrog in Israel**

The "Israel 15 Vision" is comprised of issues and actions involved in achieving a significant socio-economic advancement that would put Israel among the fifteen leading countries in terms of quality of life within fifteen years. Accomplishing this vision requires a 'Leapfrog in Quality of Life': a significant and continuous improvement in Israel's socio-economic performance in comparison to other countries.

There is no recipe for leapfrogging. It is the result of a virtuous alignment in economic policy, socio-political trends, and national leadership that seeks to enlarge the national pie and to distribute the fruits for the sake of increasing citizens' quality of life. Few countries have experienced a leapfrog that reduced gaps in quality of life in comparison to rich countries. Ireland, Singapore, Germany, Japan, South Korea, Chile, and Israel between 1950 and 1970 are among the select list. Each country leapt differently. Israel did so in the past and must do so again in the future.

There are seven features common to countries that have leapfrogged:

- A rich and textured vision
- Identification of engines of growth
- Incorporation of unique advantages and disadvantages
- Cooperation between the government, the workers, and the employers based on trust
- Improving the government's ability to exploit opportunities and remove obstacles
- Defining the key indices relevant for measuring performance in comparison to other countries
- Initiating a thorough and intense national discourse

Prosperity is a central element of 21st Century Zionism and is required for its success. Without it, Israel will fall behind in its competition for human capital, technology, and foreign investment.

The "Israel 15 Vision" is ambitious, but achievable. It requires the government and the legislature, the employers and the workers, academics and NGOs to unite. The Reut Institute serves the vision through its pro-bono decision support services to the Government of Israel and other organizations aligned with the vision.

We are pleased to offer our knowledge and experience to those who are weaving Israel's socio-economic future.

Sincerely,

A handwritten signature in blue ink, consisting of a stylized 'G' followed by a horizontal line and a vertical line.

Gidi Grinstein
Founder and President

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Concept

Israel15 Vision

10.26.2006

Definition

The concept "Israel 15 Vision" ("Israel 15") is comprised of issues and actions involved in achieving a significant socioeconomic advancement that would put Israel among the 15 leading countries in terms of quality of life within fifteen years.

Background

Israel 15 is the organizing idea of the Reut Institute for its work on Israel's socio-economic development. Israel 15 sums up Reut's vision regarding the State of Israel and is the organizing principle behind Reut's mode of conduct in this context.

The Israel 15 Agenda

The Israel 15 Agenda will include the following elements:

- **A rich and textured vision** – Formalization of a comprehensive understanding of Israel's characteristics when it becomes one of the 15 most developed countries in terms of its quality of life. The vision will materialize after a period of time of at least several years ("episode") in which the Israel 15 Agenda is pursued. In addition, this element includes a broad understanding of the global economy in which Israel operates and will operate when Israel is in the Top 15.
- **Engines of growth** – Identification of the engines of growth of quality of life in Israel and recognition of the ways in which their potential can be unleashed. This element could include identification of key industrial or business sectors (such as water desalination or alternative energy) or social capabilities (such as education or environmental quality/management) towards achieving the Israel 15 Vision.
- **Israel's unique circumstances** – Development of a line of thinking and action to minimize the negative impact of Israel's liabilities and to extract the potential of Israel's unique assets, amongst others the defense burden, the (low) rate of labor force participation or Israel's links with the Jewish World.
- **The public sphere** – Identification of the structural changes in the governmental and business sectors that are required to create incentives for achieving the Israel 15 Vision. This element includes legislation, regulation, and mechanisms for conflict management.
- **Process design, management and implementation** – Identification of policy lines and consolidation of measurement and control tools that are required to reach the Top 15, while considering the internal and external systemic links.
- **Indices** – Identification of the indices that are relevant for examining the quality of life in Israel and its rate of progress towards the Israel 15 Vision. This element will be based on the analysis of indices that are globally accepted or on indices developed specifically for Israel.
- **National discourse** – Initiation of a thorough and intense public discourse regarding the Israel 15 Vision and the various components of the agenda as listed above.

Concept

Leapfrogging vs. Growth

12.31.2007

Introduction

This document identifies the key differences between the concepts of 'leapfrogging' and 'growth' within the context of the Israel 15 Vision, which requires leapfrog in the quality of life.

However, as the concept of 'quality of life' is elusive and its variables are widely debated and change in location, time or context, **the following comparison will relate to income per capita**, which is generally considered as the most important variable of quality of life.

It is understood that not every leap in average income translates into improvements in quality of life (For example, in China in spite of the rapid growth, health and education have been less than impressive).

Definition

	Growth	Leapfrogging
Definition	An increase in average income (GNP per capita) that does <i>not</i> necessarily improve a country's wealth <i>relative to</i> other countries.	Sustained and continuous improvement in a country's average income <i>in comparison to other countries</i> .
Rate of Growth	Annual growth in average income in the range of 3%-5% is considered high growth.	4%-6% ¹ annual growth is a minimum for leapfrogging.
Length of cycle	Growth occurs in business cycles that commonly last of 3-5 years.	A minimum of six years, but in certain cases 15 to 20 years. ²
Frequency	Nearly all countries have experienced growth. Nearly 80 instances of Growth Accelerations have been identified in the last fifty years. ³	Very few countries have experienced a leapfrog. They include, for example: Israel (50'-70'); Singapore (60's-90's); Ireland (80's-00'); Japan and Germany (50's-70's).

¹ Relative improvement requires faster growth than leading countries. If wealthy nations can attain growth of 5% during growth episodes, to leapfrog a country must grow at a rate of at least 6%.

² Leapfrog is an a-cyclical phenomenon that outlasts typical business cycles and demonstrates resilience to external shocks.

³ Eighty periods of sustained growth over 8 years were identified according to the Penn World Tables. Many more episodes of shorter growth spurts exist. (Hausman, *et. al.*, [Growth Accelerations](#), August 2005).

	Growth	Leapfrogging
Product Space	A gradual upgrading of country's product space to products that are consumed by 'rich countries.'	Most leapfrogs require a dramatic shift in the product space to products that are consumed by 'rich countries.' ⁴
Is there a recipe?	It is commonly held that principles embodied in the 'Washington Consensus' based on macroeconomic stability ⁵ and a few other broad policies must be well set.	There is no recipe. Each country leaps uniquely.
Is a Vision necessary?	No. Countries may grow without a shared vision and ambitious long term objectives.	Most leapfrogs require a broader long term vision that informs structural reforms, massive investments in infrastructure and change of priorities, patterns of conduct or habits.
Perspective	Time series. Growth is assessed in comparison to past performance.	Leapfrogging is tied to evaluating performance relative to other countries. It generates 'catch up' with the rich countries.
Cooperation between the public and private sectors		Close collaboration between the sectors transforming the product space which requires significant investments in human resources, regulation and infrastructure.
The Public Sector's Role	Common view: the government should do very few things: openness, sound monetary policy and preserving property rights.	Effectively identifying obstacles and opportunities for the expansion of the economic activity and acting on them.
The Business Sector's Role	Growth can occur when the business sector addresses its own needs while other sectors see their condition worsen.	The business sector is bound to the ideal of increasing the pie and dividing it such that 'everyone' benefits.

⁴ Some countries may have already done so and need to concentrate on diffusing in the new part of the product space. Others may need to jump to long distances just to achieve moderate growth.

⁵ The term "Macroeconomic Stability" describes a national economy that has minimized vulnerability to external shocks, which in turn increases its prospects for sustained growth. Stability is attained through managing national debt, inflation, and currency fluctuations. See Reut Term: Macroeconomic Stability.

Concept

Leapfrog in Quality of Life

12.25.2007

Definition

A 'Leapfrog in Quality of Life' is a significant and continuous improvement in the Quality of Life of a country's citizens in comparison to other countries.

Context

The Reut Institute views the concept Quality of Life as referring to a one's economic security, social wellbeing, the degree of personal and physical security and the added Jewish value.⁶

In order to achieve a Leapfrog in Quality of Life, a country must exhibit a growth acceleration in average income in comparison to previous performance as well as to other countries.⁷

In addition, in order to leapfrog in Quality of Life, a country must translate its wealth into improvements in non-material aspects of Quality of Life like personal, physical, and social wellbeing.

Why Do Countries Leapfrog?

The literature studying the causes of growth is inconclusive.⁸ Among the engines for a rapid rise in Quality of Life that have been identified are the following:

- **Macroeconomic stability and structural reforms;**⁹
- **Efficient and effective democratic institutions** – The structure and culture of institutions in existing democracies vary greatly and contribute significantly to growth. Better functioning democracies tend to grow faster. Characteristics of well-functioning democracies include:
 - A shared vision of the country's future and its position in the global economy;
 - Cooperation between government agencies and collaboration with employers, labor, and civil society – There are two routes to fostering cooperation and collaboration: developing trust between the key stakeholders, which contributes to continuous growth,

⁶ See Reut concepts [Quality of Life](#) and Quality of Life in Israel.

⁷ According to the [Economist Quality of Life Index](#), GDP per capita explains 50% of the inter-country difference in Quality of Life (The Economist Intelligence Unit, Quality of Life Index, 2005). Leapfrog in Quality of Life therefore depends on a growth acceleration, a sustained rapid acceleration in economic growth lasting eight years or more (Hausman, *et. al.*, [Growth Accelerations](#), Harvard, August 2005).

⁸ Growth economics literature is unable to explain fully the differences in inter-country growth rates. (Elhanan Helpman, [The Mystery of Economic Growth](#), Harvard College: Boston, 2004).

⁹ Structural reforms and [macroeconomic stability](#) are correlated with growth accelerations (Hausman, *et. al.*, [Growth Accelerations](#), August 2005). Though subject to heavy criticism by developing countries, the Washington Consensus proposes a set of policy recommendations meant to stimulate growth, including: macroeconomic stability, investment in infrastructure, liberalization of foreign investment, market deregulation, privatization of government firms, and protection of property rights ("[The Washington Consensus](#)", Center for International Development at Harvard University, April 2003).

or heavy-handedness on the part of the executive, which can provide limited spells of growth but exacts a high cost in resources and social unrest;¹⁰

- Ability to design, plan, manage and execute policy;
- **Foreign Trade¹¹ and Investment** increase import and export markets, and their spillover effects improve human capital and corporate competitiveness;
- **Immigration;**¹²
- **Exploiting comparative advantages** by leveraging unique values and containing unique burdens.

Measurement

Various international indices measure Quality of Life, though none capture its essence completely. An alternative approach is to define the components of Quality of Life and then to choose appropriate indices that measure each separately.¹³

Case Studies: Singapore and Ireland

- **Ireland** – In the depths of economic crisis, Ireland signed a tri-partite agreement committing the government, the employers, and the workers to a shared vision. As a result, Ireland enjoyed 6% annual real growth per capita between 1987 and 2003. Today, the Economist ranks Ireland first in terms of Quality of Life. "Ireland is now one of the richest countries in the world by any measure. It enjoys social calm combined with civil and political liberties, which, surveys show, are not bettered anywhere."¹⁴
- **Singapore** – Singapore has transformed from an agricultural economy to one of the world's richest in little over 50 years. Since independence in 1965, the economy has continued to grow rapidly. Social and ethnic tension pitting Malays against ethnic Chinese have been quelled through shared enjoyment of the fruits of growth. The Economist ranks Singapore 11th in terms of Quality of Life.¹⁵

End.

¹⁰ A Triangle of Trust consisting of a central brain with carrying capacity, a stable government able to change direction, and willingness among all sectors of society to sacrifice today to promise a better tomorrow is central to any Leapfrog in Quality of Life (See Reut document: [Triangle of Trust as Condition for Leap in Quality of Life](#)).

¹¹ Japan, South Korea, Singapore, China and Taiwan based their phenomenal growth rates on export led growth. Domestic consumption has come to play a more important role today. (Ari Kokko, "[Export Led Growth in East Asia](#)", **European Institute of Japanese Studies**, February 2002).

¹² Immigration to Israel played a significant part in persistent Israeli growth episodes during the early history of the state (Flug and Strawczynski, "[Persistent Growth Episodes and Macroeconomic Policy Performance in Israel](#)", **Bank of Israel**, July 2007).

¹³ While the [Economist Quality of Life Index](#) is preferable to the OECD and the UN's [Human Development Index](#), Reut has recommended measuring the various facets of Quality of Life in Israel by a combination of the [Global Competitiveness Index & IMD](#), the [EU Social Inclusion Index](#), the [World Health Organization's Statistical Information System](#), the [Environmental Performance Index](#), and Freedom House's [Freedom of the World Index](#).

¹⁴ McKittrick, "[Quality of life best in Ireland](#)", **New Zealand Herald**, 11/19/2004.

¹⁵ Lee Kuan Yew, [From Third World to First: The Singapore Story](#). Harper Collins, 2000.

Concept

Quality of Life in Israel

12.25.2007

Definition

'Quality of life in Israel' refers to the collection of areas that define an individual's well being. It is a byproduct of the different working, living, social and cultural environments a country provides for its citizens. Quality of Life is a complex concept affected by abstract factors and subjective perceptions.

The Reut Institute identifies the following areas as the pillars of Quality of Life in Israel: Economic Security, Social Wellbeing, Personal & Physical Security, as well as the 'Jewish added value.'¹⁶

The Context: The Israel 15 Vision

Quality of Life in Israel is fundamental to the 'Israel 15 Vision' – placing Israel among the 15 leading countries in terms of quality of life within fifteen years. The Reut Institute recognizes the importance of a thorough and intense public discourse regarding the various areas of Quality of Life in Israel. This debate is crucial to socio-economic policy design.

Areas

The Reut Institute identifies four major areas that affect Quality of Life in Israel:

- **Economic Security** is a person's ability to financially support himself and his family. It is determined by his material wellbeing (income level) and human capital development, as well as the presence of environment supporting growth.
- **Social Wellbeing** is a person's desire and ability to identify with society and to be an active member of it. It is determined by the amount of trust in the government's ability to design, plan and execute policies, the scope of an individual's rights and liberties, and the sense of belongingness to one's community and nation.
- **Personal & Physical Security** refers to an individual's safety from harm to his life and property. It is determined by the health services, the quality of the environment, and the protection from criminal violence, war & terrorism that the state provides.
- **The Jewish Added Value** refers to the amount of satisfaction an Israeli Jew draws from being part of the fulfillment of the Zionist vision.

Measurement

Various international indices measure the quality of life of individuals in different countries. While the Economist Quality of Life Index and the UN Human Development Index are some of the more prominent ones, none of them provide a perfect measure of the Quality of Life in Israel. Consequently, defining an index or a set of indices suited for Israel is one of the challenges facing Israeli decision makers.¹⁷

¹⁶ See Reut concepts: Economic Security, Social Wellbeing, and Personal & Physical Security.

¹⁷ The Reut Institute identifies seven international indices for measuring Quality of Life in Israel. See Reut paper: Measuring Quality of Life in Israel.

Comparative Viewpoint

Triangle of Trust as a Condition for a Leap in Quality of Life

11.2.2006

Executive Summary

1. This document identifies the shared traits of countries that experienced a leap in socio-economic development and quality of life as a result of government policy. We distinguish these countries from those that based their development on serendipity, like fossil fuel deposits.
2. This document is a component of the Israel 15 project, the goal of which is to transform Israel into one of the 15 most developed nations in terms of quality of life. Fulfilling the Israel 15 vision requires a socio-economic leap in Israel.
3. Of the countries that experienced a development leap, three macroeconomic characteristics are apparent: (a) increase in domestic savings and investment, (b) openness to innovation, and (c) stability as defined by low and stable inflation and a low debt burden. These characteristics are necessary for growth, but not sufficient.
4. Despite these commonalities, in terms of regulation; legislation; and the specific uses of investment, savings, and trade policy, the paths taken by each of the countries that have significantly improved their quality of life have been tailored to domestic needs.
5. The countries that have made a leap all managed their public sector in a way that aligned the interests of the government, the workers, and the private sector. One of this document's conclusions is that the public sector in these countries shared three attributes:
 - **A Central Brain with Carrying Capacity** that can design, plan, and implement policy directives.
 - **Tomorrow Before Today** - A commitment to allocate resources for investment instead of consumption on the part of the government, private business, and households.
 - **Stable Environment** - A combination between policy that creates a stable environment and the ability to change course in response to unexpected developments.
6. These three traits are interconnected.
7. To develop and sustain these three traits, cooperation between the government, labor, and industry based on shared interests and trust is required.

Preface

8. **Israel 15** – This concept refers to the goal of transforming Israel into one of the 15 most developed countries in terms of its citizens' quality of life. The Israel 15 Vision advances an agenda that seeks to generate a leap in Israel's growth and quality of life.
9. **A development leap requires an Episode of growth** – A definitive rise in Israel's quality of life relative to that of other developed nations requires a period of time (Episode) during which non-cyclical forces meaningfully raise the country's socio-economic status.

10. **The Israel 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 Israel 15 Vision.
11. This document addresses the question: What is the common denominator between countries whose quality of life has leapt dramatically? Countries whose growth is due to serendipity like oil wealth are excluded.

Methodology

12. This document is based on a study of the shared characteristics of countries that have successfully managed a development leap. We concentrate on those countries that resembled Israel in some way during their stages of development. None is an exact match, but each provides worthwhile lessons. Among others, we studied Ireland, Finland, South Korea, Taiwan, and Singapore.¹⁸

Common Denominator: Management, Stability, Openness, and Investment

13. The conclusion of Reut's comparative study is:
 - a. **Macroeconomic stability, exposure to foreign trade and knowledge, and investment are vital (but insufficient)** – The most common attribute of those countries that managed a development leap are a) increasing investment as a proportion of GDP, b) openness to trade and ideas, and c) macroeconomic stability in terms of stable and low inflation, relatively little national debt, and decreased public expenditure. Nevertheless, these conditions are not sufficient for growth.¹⁹
 - b. **We recognize no other similarity in policy components** – The individual stories of growth differ vastly across the sample countries. Excluding the macroeconomic policies described earlier, fiscal policy and the division of resources varies. Examples exist of development based on manufacturing for export, free trade, protectionism, and more.²⁰

¹⁸ When many of these countries began their development, they were significantly less developed than Israel. Likewise, not one country is a perfect copy of Israel's economy.

¹⁹ The World Competitiveness Report 2006-2007 of the World Economic Forum states: "In fact, there is overwhelming evidence that in the absence of a solid foundation of macroeconomic stability, growth will be anemic—viz. Argentina—or, at best, volatile—viz. Turkey." (Part 1, p.4).

²⁰ **Ireland's** growth is based primarily on Foreign Direct Investment (FDI) through the operations of multi-national firms on Irish soil; a cheap, educated, English-speaking labor force; the IDA's promotion of Irish business; and low corporate taxes.

http://www.ctf.ca/pdf/ctjpdf/2000ctj3_walsh.pdf

Japan and Germany played catch-up to US Total Factor Productivity and regained their positions as world leaders in manufacturing and exports. Gilchrist S., Williams J.C., "[Transition dynamics in vintage capital models: explaining the postwar catch-up of Germany and Japan](#)," *Finance and Economics Discussion Series*, Board of Governors of the Federal Reserve System (U.S) 2001.

- c. **Similarity in management of the public sector** – One common denominator that seems to be shared by all countries that have made the leap is the way in which the public sector is managed in relation to the most influential actors in the economy, specifically labor and employers.
14. **Core Issue: Government Conduct** – While the contributions of macroeconomic stability, open trade, and investment policy are well accepted by development literature, the centrality of government management and the specific factors that improve its performance are new and important contributions to growth literature.

This paper concentrates on elucidating the form of public sector management that leads to a development leap and identifies the conditions necessary for its creation.

Triangle of Trust as a condition for Development Leap

15. Countries that achieved a development leap shared three traits during their episode of growth:
- A "Central Brain" with Carrying Capacity** that could design, plan, and implement policy directives.
 - Tomorrow Before Today** - commitment to allocate resources to investment instead of consumption on the part of the government, private business, and households
 - Stable Environment** – combination between policy that creates a stable environment and the ability to change course in response to unexpected developments

These three components are connected systemically upon a basis of aligned interests and trust between the key players in the economy, especially the government, labor, and business.

16. **A planning body with the ability to govern** – A development leap occurs when the government acquires the ability to design, plan, and implement policy. We identify two components to this ability:
- Central Brain** - A group of people that has the ability to develop, design, and influence policy decisions and management of the public sector. It need not be formal, nor need it be officially within the government, but it must have the ability to approach challenges and opportunities from the perspective of the national interest. In most cases, the decisions and recommendations of this body are accepted and implemented by policy makers. Ireland and Singapore are two relevant examples.²¹

Singapore could never be an industrial power house like Japan or Germany. Instead, Singapore capitalized on its geography to dominate trade in its region and has since made itself a center of Financial Trading and technology development.

W.G. Huff, [The Economic Growth of Singapore](#), Cambridge University Press, 1997.

Spain, like other later entrants to the EU found itself progressively integrated into first the EEC and then the EU. Much of its policy was decided in Brussels, and much of the money came from EU development aid.

²¹ In **Ireland**, the Irish Development Authority had "autonomy from the civil service, extensive resources, and effective insulation from the political process." It had sole responsibility for attracting international investment, and its recommendations for that goal were accepted by Parliament more-or-less without question :

<http://www.idaireland.com/>

www.eucenter.scrippscollege.edu/publications/papers/Irish%20Labor%20Market.pdf

Singapore relied heavily on its Economic Development Board. Edgar Schein explores its importance in his book strategic pragmatism. Schein, Edgar, **Strategic Pragmatism**, MIT Press, 1996.

- b. **Carrying Capacity** – Carrying Capacity is the ability of a political element to make and implement decisions. It is built upon the following components:
- **Material** – Availability of human, financial or other physical resources.
 - **Legitimacy** – Public agreement to grant the leaders authority to make decisions that alter the socio-economic reality.
 - **Political** – Capacity of the top executive to stay in power and forge coalitions to pass decisions and required legislation in the relevant executive and legislative bodies.
 - **Legislative/Judicial** – Capacity to codify executive decisions legislatively and uphold them judicially.
 - **Institutional** – Capacity of branches of government to "get stuff done", i.e. to sustain cross-agency cooperation in planning and decision-making, as well as in the implementation of policies.
- c. **Vision is not a requirement** - The existence of a shared national vision is not necessary for growth. It is possible to create the momentum for development without the need for a centrally planned vision of tomorrow.²²

Nevertheless it is necessary to create an environment in which the interests of various influential sectors of the economy are aligned for the period of time during which the economy makes its development leap.

17. **Tomorrow before Today** – Growth for the future is based upon investment today. For example, all countries that succeeded invested heavily in their infrastructure. This is reflective of a readiness to allocate resources from consumption to investment in the public sector, the business sector, and in the household:
- The government reallocates resources to seeds of growth such as infrastructure, R&D, and education instead of allocating it to transfer payments, subsidies, and government consumption.
 - The business sector invests in R&D and worker training instead of reaping profits.
 - The labor force shows willingness to delay pay increases to the future. This sacrifice is built upon the understanding that a piece of a larger future pie is worth more than an immediate pay raise today.²³

²² Southern European growth did not flow from an internal vision. It was a matter of catch-up with northern neighbors in the EU community. Beyond Liberalization, Privatization, and Deregulation – as more-or-less mandated by EU directives - growth does not seem to be the result of a manifest vision. As an example Spanish growth can in large part be attributed to four factors totally beyond domestic control:

- the continuing fall in oil prices;
- increased tourism;
- a sharp reduction in the exchange value of the United States dollar;
- a massive upsurge in the inflow of foreign investment;
- exposure to foreign competition in accordance with EC requirements.

Larre B. and Torres R., "Is Convergence a Spontaneous Process? The Experience of Spain, Portugal and Greece?" *OECD Economic Studies*, No. 16, Spring 1991.

²³ Trade unions were willing to cap wages in return for price caps on key necessities. "organizations accept wage moderation today in return for higher incomes tomorrow."

(See: Makus Jantti, Juho Saari, Juhana Vartianinen, "Growth and Equity in Finland", **United Nations University**, July, 2006).

18. **Stable environment with the ability to change policy** – A stable environment encourages long term planning. Conversely, the absence of stability forces the market to concentrate on short term planning, inhibits hiring workers and making capital investments²⁴, and increases the costs of risk management.²⁵

A stable environment results from the following trends:

- **Stable macroeconomic indicators** – A stable macroeconomic framework is identified by stable and low inflation, a small national debt burden, and efforts to decrease the public sector's share of the GDP.²⁶ National investment tends to be high in this framework as well.²⁷ The countries that developed quickly shared this trait.
- **Stable policy** indicates the government's ability to uphold its decisions in the face of political opposition.
- **The ability to change direction** recognizes the need to alter policy in response to unexpected challenges without falling victim to political opposition.
- **Conflict resolution** - A stable environment rests on the ability of the leading and competing sectors of the economy agreeing to pursue mutual interests instead of bickering over individual interests. This is necessary if labor unrest, political squabbling, and judicial intervention are to be avoided.²⁸

Irish Congress of Trade Unions and Irish Business and Employer's Confederation negotiated deals regularly. The foreign firms in the IBEC were happy to abide by the terms and reward excellent employees with non-wage benefits. Wage moderation did not stick in industries characterized by scarce talent.

Choice, Chance, or Coincidence?", ISSC DISCUSSION PAPER SERIES, 2003.
<http://www.ucd.ie/geary/publications/2003/wp14.pdf>

Spain – The Moncloa Pact were Spain's first Tripartite agreements and paved the way for economic development in the post Franco years. They included an agreement for wage moderation.

The Moncloa Pact (Spanish): <http://www.vespito.net/historia/transi/pactos.html>

- ²⁴ Bolivia confounded development economists because of its apparent perfect adoption of Washington Consensus Policies and non-existent growth. It seems that while the finance ministry was dedicated to growth, and the attendant fiscal austerity, the rest of the government was not. Corruption, favoritism, and cronyism conspired to halt development of the private sector. Without secure contract rights and stable regulation, businesses could not invest.

"Sustained Macroeconomic Reforms, Tepid Growth: A governance puzzle in Bolivia" by Kaufmann, Mastruzzi, and Zavaleta in In Search of Prosperity, edited by Dani Rodrik.

- ²⁵ **Argentina's** default on \$100B debt sent the country's economy into freefall and investors withdrew everything they could. Jennifer Rich, New York Times, 2/2/02.

<http://select.nytimes.com/search/restricted/article?res=F60C10FA3B590C768CDDAB0894DA404482>

- ²⁶ See #2

- ²⁷ In their research, Levine and Renelt "find a positive and robust correlation between average growth rates and the average share of investment in GDP." Theirs is a cross-country regression analysis with a sample of 119 countries. The result is particularly significant because the paper's stated purpose is to disprove the robust correlation between many economic variables and growth. The fact that investment is the only variable show robust correlation to growth is extremely important.

Ross L., Renelt D., "A Sensitivity Analysis of Cross-Country Growth Regressions", American Economic Review, Vol. 82, No. 4, Sep., 1992, pp. 942-963.

- ²⁸ Tripartite councils are common in Europe. Periodic negotiated agreements between the government, labor, and capital stymie labor unrest and political deadlock. They have been used to great success in **Spain** and **Finland** (see the #6), and the **Baltic** states.

- **Long and stable government tenure** – In most of the comparison countries, governments enjoyed long and stable tenures. Importantly, adherence to growth policies was maintained even during transitions.²⁹
19. **Triangular Relationship** - Between the three traits, Central Planning Body and Carrying Capacity ('Carrying Capacity'), Tomorrow before Today ('Investment'), and Stable Environment ('Stability'), exist systematic connections.
- **Carrying Capacity permits Stability** – The ability to govern, especially in the ability to legislate and implement laws in an organized fashion based upon an established platform, creates stability in the economic sphere.
 - **Stability permits Investment** - A stable environment permits economic actors to invest resources in growth instead of risk management.
 - **Carrying Capacity permits Investment** – Business and personal investment flow from the environment created by the government. A strong and legitimate government increases incentives for private sector investment. Additionally, Carrying Capacity encourages labor and business to enter into longer term agreements on the understanding that the government will act as a guarantor for their implementation.
 - **Investment permits Carrying Capacity and encourages Stability** – As more investment flows into the market, all parties develop incentives to maintain stability. Forces that maintain the political and policy status quo are strengthened.
20. **Trust at the Center of the Triangle** – An episode of cooperation between employers, employees, and the government promoted by aligned interests ('trust') is the basis for the triangle that permits growth and is necessary for its existence. In the absence of trust, no episode can be long-lived. Actors will hesitate to trust each other's promises and the national conversation will degenerate to division of the pie instead of making it larger.³⁰
21. **The foundation of an Episode of trust is long tenures and stable policy** – frequent power transitions and changes in policy direction diminish confidence in the private sector. They are characteristic of the absence of long term planning and describe an environment in which parties vie over division of the national pie. Conversely, stable policy and long tenures develop trust and permit cooperation for growth.

"Europeanization of Employment Policy Making in the Baltic States", Kerstin Jacobsson and Charlotte West Södertörn University College Stockholm, Sweden
http://wage.wisc.edu/uploads/Events/Work&Welfare/West_Govconf.pdf

Japan reduced friction in the economy through its Iron Triangle of Government, Business, and Bureaucracy. Labor was implicitly represented through the business community's guarantee of life-long work.

²⁹ Alesina *et al.* show a statistical correlation between political instability and weak growth across 113 countries in the *Journal of Economic Growth*. The dominance of Lee Kuan Yew in Singapore and the LDP's monopoly on control in Japan are anecdotal evidence of the converse.

Alesina Alberto *et al.*, "Political instability and economic growth", *Journal of Economic Growth*, Volume 1, Number 2, June, 1996, pp.189-211.

³⁰ See the two papers that have formed the basis of trust research in growth:

Knack S., Keefer P., "Does Social Capital Have an Economic Payoff? A Cross-Country Investigation", *Quarterly Journal of Economics*, Vol. 112, No. 4, November 1997, pp. 1251-1288.

Bjornskov C., "How Does Social Trust Affect Economic Growth?", *Aarhus School of Business, Department of Economics*, (Working Paper 06-2), Denmark, 2006.

Analysis Base

Case Study: Incorporating the Global Competitiveness Index in Policy Planning

Executive Summary

1. Achieving a development leap in Quality of Life in Israel depends on Israel's ability to compete for Human Capital and investments in the global marketplace.
2. Effectively improving national competitiveness through policies is grounded in comparing Israel to a reference group of competing countries.
3. Indices that enable international comparison are useful tools for decision makers to identify challenges and estimate policy successes.
4. This paper demonstrates the usefulness of the Global Competitiveness Index in examining two aspects of Quality of Life: Human Capital and an environment that supports growth.
5. Decision makers can identify issues that require government action/attention by analyzing Israel's challenges and opportunities in light of existing government policies.

Using Comparative Indices to Examine Quality of Life

6. Different indices can assist strategic policy making in:
 - **Policy design and planning** – Indices provide reliable and relevant information.³¹
 - **Estimating policy success** – Indices measure the results of policy intervention.
7. In order for an index to be useful to Israel's decision makers, it should include components that are relevant to Quality of Life and allow for comparison of Israel's performance over time and relative to competing countries.
8. **The importance of analyzing various levels of an index** – A country's overall rank provides limited information. Index analysis using different resolutions – variables, clusters of variables³², and pillars – allows for a better depth of understanding of the issues facing a given country.³³
9. **Identifying issues that require government action** – Decision makers can identify unaddressed issues that require attention by analyzing challenges in light of present policies.

³¹ Indices can be used to create a common vocabulary within the political system and the public sphere. See Reut Institute papers: [Competitiveness Indices - Tools for Policy Design](#); Seven Indices for Measuring Quality of Life.

³² A cluster is a group of variables with a common theme. Variables are chosen from one or more pillars.

³³ Analyzing a country's rank by overall score, pillars or variables may produce different results. For example, according to the 2006-07 GCI report, Switzerland's rank of the pillar 'Macro-Economy' is high (18th). At the same time, single variables from that pillar have lower ranking: 'government surplus/deficit' (54th), 'government debt' (61st), 'real effective exchange rate' (57th). Nevertheless, Switzerland ranked first in overall competitiveness.

The Usefulness of the Global Competitiveness Index in Examining Quality of Life

10. Quality of Life is a subjective term determined by various components. Nevertheless, The Reut Institute has identified three major aspects of Quality of Life in Israel: economic well-being, social well-being, and personal and physical well-being.³⁴
11. The World Economic Forum's Global Competitiveness Index (GCI)³⁵ examines growth and human capital – two aspects of economic well-being.³⁶
12. **Considerations in determining a relevant reference group**
 - **Countries similar to Israel** – A reliable and comparative analysis requires identifying countries which are similar to Israel in factors that affect growth and human capital development. For example, Singapore, Ireland and Chile are each similar to Israel in some of the following areas: foreign trade, size of the economy, defense expenditure, innovation and technology, and geopolitical status.³⁷
 - **Leading countries** – Israel should compare itself to leading countries, because they compete with Israel on their ability to attract resources and human capital by providing a high Quality of Life.³⁸
13. **Index Limitations**
 - **Ranking may be misleading** – The absolute difference in the competitiveness between countries is masked by ordinal rankings.
 - **Misleading sub-index and pillar rankings** – For example, while Israel's 17th rank in the 'business sophistication' pillar is relatively high, Israel scores poorly on many variables within this pillar.³⁹
14. **Identifying challenges and opportunities** in improving Israel's Quality of Life can be done by analyzing an index on various levels: overall rank, sub-indices, pillars and clusters of variables.⁴⁰

³⁴ See: Reut Institute paper: "Quality of Life".

³⁵ The Global Competitiveness Index is published annually by the World Economic Forum. The index evaluates the productivity and efficiency of countries. See: Reut Institute paper: [Global Competitiveness Index](#).

³⁶ Economic well-being reflects an individual's ability to secure financial stability for himself and for his family. Other world renowned indices measure competitiveness. For example, the IMD Business School in Lausanne publishes the [IMD World Competitiveness Index](#). The index analyses the extent to which countries create a competitive business environment. The structure of the pillars in the index makes it less relevant to the Quality of Life in Israel.

³⁷ Singapore is similar to Israel in aspects such as: (1) geopolitics (2) innovation driven economy, with emphasis on biotech, ICT and banking (3) extensive foreign trade. See: Lee Kuan Yew, [From Third World to First: The Singapore Story](#). Harper Collins, 2000.

Ireland is similar to Israel in (1) size (2) dependency on foreign trade (3) investment in technology and human capital. See OECD paper: [Economic Survey of Ireland](#), 2001.

Chile resembles Israel in its dependency on export and the need for high quality human capital. See World Bank paper: [Chile Country Brief](#).

³⁸ According to the 2006-07 GCI report, the ten most competitive countries are (from most competitive to least competitive): Switzerland, Finland, Sweden, Denmark, Singapore, United States, Japan, Germany, Holland and Britain. See the world Economic Forum webpage for the [2006-07 country rankings](#).

³⁹ See GCI Report article 21 on [business sophistication](#).

15. **Overall rank** – According to the 2006-07 GCI, Israel is ranked 15th out of 125 countries, indicating a marked improvement compared with the 2005-06 ranking (23rd).
16. **Rank in Sub-indices** – In the 2006-07 GCI report, Israel ranked 29th in the 'basic requirements' sub-index, 12th in the 'efficiency enhancers' sub-index, and 8th in the 'innovation and sophistication factors' sub-index.
17. **Pillar rankings**⁴¹ –
 - **Within the 'Basic Requirements' sub-index** – The relevant pillars to growth are: 'macro-economic stability' (10th), 'institutions' (29th), and 'infrastructure' (24th).
 - **Within the 'Efficiency Enhancers' sub-index** – The relevant pillars to growth and human capital development are: 'higher education and training' (20th), 'market efficiency' (14th) and technological readiness' (3rd).
 - **Within the 'Innovation and Sophistication factors' sub-index** – The relevant pillars to growth are: 'business sophistication' (17th) and 'innovation' (7th).
18. **Cluster Analysis** – Cluster analysis, a selection of related variables within a pillar or a grouping of variables from different pillars, provides a better understanding of characteristics relevant to growth and human capital development in Israel.
19. The following cluster analysis reveals that Israel has a 'Knowledge Economy':
 - **Innovation** – The World Economic Forum states that innovation is a key contributor to growth for countries with GDP per capita over \$17,000. Economies that rely on high-tech industries must have the ability to develop cutting edge goods and services in order to maintain their competitive advantage.

Within this cluster, the variables relevant to Israel are: quality of scientific research institutions (4th), company spending on research and development (7th), university/industry research collaboration (6th), intellectual property protection (21st) and capacity for innovation (8th).
 - **Technological readiness** – Technology level is related to differences in countries' productivity and competitiveness.⁴² This cluster measures an economy's ability to adapt existing technologies in order to improve productivity in various industries.

Within this cluster, the variables relevant to Israel are: technological readiness (4th), firm-level technology absorption (4th), laws relating to ICT (22nd), FDI and technology transfer (26th), cellular phones (6th), internet users (25th), prevalence of foreign technology licensing (22nd), government prioritization of ICT (45th), government success in ICT promotion (23rd), quality of competition in the ISP sector (3rd), extent of business internet use (14th), internet access in schools (16th), impact of rules on FDI (30th), internet hosts (19th).
 - **Non-banking financing** reflects the ability of businesses to finance activities by sources other than banks. The following cluster analysis reveals that Israeli businesses

⁴⁰ The GCI Report provides a detailed analysis for each country, including rankings based on: overall score, sub-indices, pillars and variables. For Israel's analysis see articles 14-21. For more information on the GCI see: Reut Institute paper: [Global Competitiveness Index](#).

⁴¹ Israel's 2006-07 GCI rank appears in parenthesis.

⁴² See: The World Economic Forum, The Global Competitiveness Report 2006-07, p.10.

have good access to non-banking financing:⁴³

Within this cluster, the variables relevant to Israel are: venture capital availability (2nd), financial market sophistication (15th), ease of access to loans (18th), and ease of access to loans (18th).

- **Human capital** is a key growth resource in developed economies with limited natural resources, such as Israel. Cluster analysis reveals that Israel has a relative advantage in human capital.

Within this cluster, the variables relevant to Israel are: nature of competitive advantage (12th) and value chain presence (17th).

20. The following cluster analysis reveals that Israel's public sector efficiency and productivity is relatively low:

- **Business supporting environment** – Within this cluster, the variables relevant to Israel are: recent access to credit (41st), extent and effect of taxation (58th), time required to start a business (50th), and number of procedures required to start a business (10th).
- **Trust in the political sphere** – Within this cluster, the variables relevant to Israel are: public trust of politicians (33rd), effectiveness of law-making bodies (30th), favoritism in decisions of government officials (38th).⁴⁴
- **Personal security** – Within this cluster, the variables relevant to Israel are: business cost of terrorism (121st), reliability of police services (42nd), organized crime (38th), business cost of crime and violence (36th).
- **Budgeting process** – Within this cluster, the variables relevant to Israel are: diversion of public funds (32nd), centralization of economic policy making (26th), wastefulness of government spending (28th) and burden of government regulation (23rd).
- **Macroeconomic stability** is a prerequisite for achieving an economic development leap.⁴⁵

Within this cluster, the variables relevant to Israel are: government surplus/deficit (71st), national savings rate (68th), inflation (11th), interest rate spread (27th), government debt (99th), real effective exchange rate (10th), country credit rating (41st), and recession expectations (28th).

- **Higher education and training** – This cluster has tremendous importance for economies aspiring to move from the production of simple products to complex ones.⁴⁶

Within this cluster, the variables relevant to Israel are: secondary enrollment (29th), quality of the education system (22nd), quality of math and science education (17th), quality of management schools (14th), local availability of specialized research and training services (10th), extent of staff training (23rd) and quality of public schools (24th).

⁴³ For the importance of credit to small businesses, see Koret Israel Economic Development Funds [publications](#).

⁴⁴ See: Francis Fukuyama, [Trust: The Social Virtues and The Creation of Prosperity](#).

⁴⁵ The 2006-07 GCI Report states: "In fact, there is overwhelming evidence that in the absence of a solid foundation of macroeconomic stability, growth will be anemic—viz. Argentina—or, at best, volatile—viz. Turkey." (Part 1, p.4)

⁴⁶ *Ibid*, p.8

- **Infrastructure** – Energy, communication and transportation play a key role in economic development because they encourage productivity and attract investments.⁴⁷

Within this cluster, the variables relevant to Israel are: overall infrastructure quality (23rd), railroad infrastructure development (31st), quality of port infrastructure (30th), quality of air transport infrastructure (26th), quality of electricity supply (17th), telephone lines (28th), quality of the roads (26th) and quality of telephone/fax infrastructure (10th).

21. The following cluster analysis reveals that traditional industries in Israel's private sector have relatively low efficiency and productivity:

- **Business Sophistication** – The World Economic Forum identifies innovation and sophistication as key contributor to growth for countries with GDP per capita over \$17,000. Economies with innovative and sophisticated industries produce goods and services with high added value. The 2006-07 GCI report reveals that Israel's business sophistication is a relatively low.

This cluster includes variables from the 'business sophistication' pillar and additional ones: local supplier quantity (34th), local supplier quality (21st), production process sophistication (18th), extent of marketing (21st), control of international distribution (12th), willingness to delegate authority (22nd), nature of competitive advantage (12th), value chain presence (17th), degree of customer orientation (20th), local availability of process machinery (31st), extent of incentive compensation (14th), reliance on professional management (21st), government prioritization of ICT (45th).

- **Public company management** – Public companies allow investment in sectors with a high growth potential. Inefficient management wards off investments.

The variables in this cluster are: ethical behavior of firms (26th), efficacy of corporate boards (29th), protection of minority shareholders' interests (30th), strength of auditing and accounting standards (19th).

- **Labor relations** – Stable labor relations promote economic growth. In countries that have achieved an economic development leap, relations between the government, employees, and employers are based on trust and cooperation. Cluster analysis reveals that labor relations in Israel demand improvement.

The variables in this cluster are: cooperation in labor-employer relations (33rd), flexibility of wage determination (65th), hiring and firing practices (35th).

Estimating Policy Success

22. Israel's performance in improving Quality of Life should be measured in relation to past performance and to competing countries.
23. Comparison of the GCI report from 2001-02 to 2006-07 reveals that Israel has achieved a marked improvement in some areas but has declined in others. For example:

Two components of Quality of Life advanced:

- **The growth component of economic well-being** – railway infrastructure development (+13), real effective exchange rate (+10), control of international distribution (+13).

⁴⁷ *Ibid*, p.6

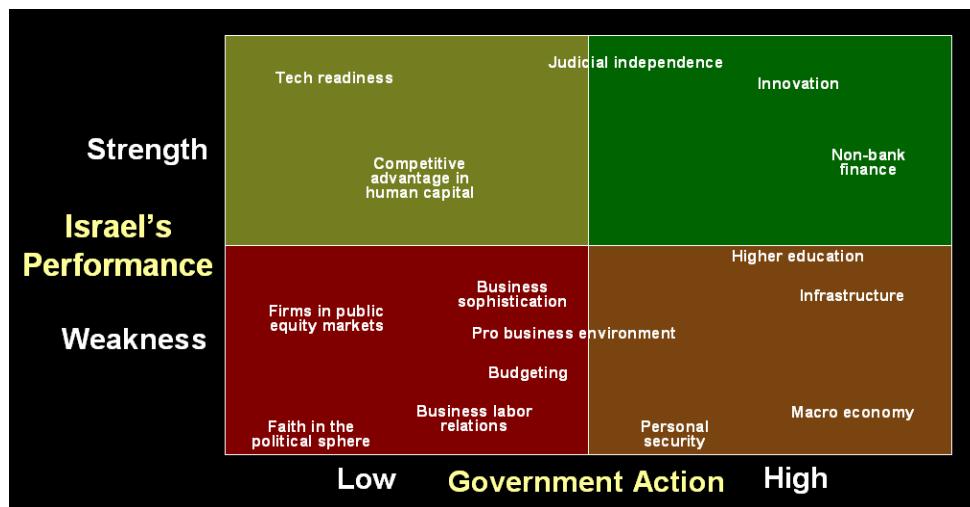
- **The Human Capital aspects of economic well-being** – quality of math and science education (+9), pay and productivity (+10), personal computers (+17).

Two components of Quality of Life deteriorated:

- **The trust and rights aspects of social well-being** – public trust in politicians (-14), favoritism in decisions of government officials (-18), private sector employment of women (-51).⁴⁸
- **The growth component of economic well-being** – government debt (-28), national savings rate (-14), FDI and technology transfer (-10).

Identifying Issues That Require Action

- Challenges facing Quality of Life improvement should be reviewed in relation to current policy in these areas.⁴⁹
- Analyzing current policies in light of the challenges raised by the index facilitates identifying issues that have yet to be addressed by policy.
- The following chart helps to communicate the need for immediate government action. For example, the lower left quadrant highlights areas of poor Israeli performance that have yet to be addressed by policy, such as labor relations, business supporting environment, trust in the political sphere and public company management.



End.

⁴⁸ Note that The Freedom of the World Index, published by Freedom House, is the most suitable index for measuring components of social well-being, such as trust, rights, and social cohesion.

⁴⁹ For example, current policies of the Government of Israel are already addressing specific areas of Quality of Life: The Bachar committee set the groundwork for competitive financial markets; the Shochat committee proposed reforms to higher education; initiatives exist for the privatization of public transport; and reforms in the electricity and port sectors have been proposed.



The Reut Institute is a non-partisan, not-for-profit organization working to improve the ability of the Government of Israel (GOI) to act strategically. Reut was established in January 2004 and serves the State of Israel on a pro-bono basis.

The mission of the Reut Institute is to sustain significant and substantive impact on the future of the State of Israel and the Jewish World by providing the GOI with real-time decision-support highlighting long-term impact of on-going decision and actions. Our objective is to make the Reut Institute a primary resource for strategic support for all agencies of the GOI.

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