The Outline for an Economic-Social Strategy

Israel's economy is characterized by light and shadow. Taking a superficial look, everything seems quite benign: no inflationary erosion, the employment rate is relatively high, and the economy sailed through the global crisis that erupted in 2007 with relative success. However, there is a trend of erosion of the fundamental basic components of the economy: the growth rate is falling, exports are very small, productivity has been low for years without any improvement, and non-competition is still the daily bread of many markets. In addition, despite some improvement in recent years, net income disparities and the poverty rate are still high as compared to those in developed countries and may crack the social cohesion, which is one of the assets of the Israeli society. Finally, there are serious problems at the "Author House" of the decision-making processes in the field of social economy: problems of governance, meritocracy, representation, and accountability are very onerous on these processes. Looking forward, if there is no change in any of these, they will constitute a weighty source of concern.

Below is a brief description of the main items in each of these contexts, which should be seen as being integrative. The full details of the analysis and recommendations are found in the report.

## **Recommendations for economic growth**

Increasing the GDP per capita and improving the relative position of Israel among the developed countries require a significant acceleration in the GDP per hour worked. This will be achieved by expanding the physical and human capital per worker and improving productivity. The main recommendations for attaining these goals include:

* Massive increase of investment in infrastructure, R&D, and (with an emphasis on technology education).
* Elimination of distortions in the tax system and in the law to encourage capital investments.
* Creation and significant increase of competition in monopolistic and oligopolistic sectors and the removal of barriers to doing business.
* Taking actual steps to resolve the conflict with the Palestinians.[[1]](#footnote-1)

## **Competition, growth, and lowering the cost of living**

Competition is the best mechanism for the distribution of business opportunities and therefore its existence is an important prerequisite for growth, entrepreneurship, and the opening of small and medium businesses, creating in turn employment opportunities. In addition, it is an important condition for reducing the cost of living. The main recommendations for achieving these objectives are:

* An authority to open monopolies to competition has to be formed, equipped with powers to take active initiatives.
* Introducing competition into import - exclusive import licenses should be withheld (and, where possible, existing exclusive licenses should be withdrawn).
* Orienting the government's policy toward creating competition in all the business sectors in which it operates directly.
* Legislation to prevent workers in vital infrastructures from striking, when such strikes are against the introduction of competition into their field of operation.

## **The Government's Economic and Social Policy**

## **Direct involvement: Restoration of public services**

The weight of public spending as a percent of GDP in Israel is declining, and in recent years Israel has been ranked in the lower third of the OECD countries. The ranking of civilian expenditure is even lower and is in the penultimate place among these countries. The decrease in the proportion of the GDP spent on civilian purposes is reflected in all public services. These findings point to the great importance of the restoration of public services, by means of the addition of resources, which should be contingent on making them more efficient. Moreover, in the Israeli society, which is divided between religious and non-religious Jews and between Jews and Arabs, and which is an immigrant society where newcomers and veterans coexist, public spending is especially important also for cohesion and reducing disparities. The main recommendations are:

* The rate of increase in public expenditure will increase at a fixed rate, similar to the long-term growth rate of the GDP.
* Since the share of the GDP allocated to public expenditure has reached its lowest point, in particular in the civil area, we must strive toward the median level of expenditure in developed countries.[[2]](#footnote-2) At the same time, a budget deficit that does not exceed 3% of the GDP should be maintained, and the average over time should not exceed 2% of the GDP.

**The tax system** - the government has granted numerous tax exemptions that have no economic or social justification. These exemptions impede efficient allocation of resources and the growth rate. Most exemptions are regressive and therefore intensify inequality. In addition, the share of indirect taxes in the total taxes is much higher than the OECD average. It should be noted that indirect taxes are regressive and affect people with a low income to a greater extent. The main recommendations are:

* Focus canceling tax exemptions that benefit primarily those who already enjoy a high income.
* Introduce estate tax.
* Refrain from raising statutory taxes as far as possible and avoid frenetic changes in tax rates.
* If the cancellation of tax exemptions will not be sufficient to finance the desired public spending, adjustment of the tax rates will also be required.

## **Reducing economic inequality**

Inequality increased steadily from the early 70's until 2003, and is today one of the major problems of the Israeli economy. The Israeli tax policy and the policy for the transfer of payments by the National Insurance moderated the economic inequality, but to a lesser degree than in most developed countries. Regarding the poverty rate, Israel is in second place among the OECD countries, and in the index of inequality, Israel is ranked fifth. Even among families with five or more persons with two breadwinners the poverty rate is very high. Reduction in income inequality is an economic, social, and ethical value, especially in light of its high level in Israel. Reducing inequality not only does not interfere with economic growth, but also enhances it. The main recommendations are:

* Direct measures should be instituted to alleviate poverty among working families.
* Labor grants to low-income workers, mandatory core studies in funded schools, the expanded building of day-care centers and nurseries, and the extension and targeting of vocational training courses to the demands of the economy.
* Labor laws should be enforced by increasing the number of inspectors to the rate accepted in the developed countries.
* Inequalities in education spending per student should be reduced
* The number of foreign workers should be reduced, along with a substantial improvement in the enforcement of all labor laws.
* The old age pension should be increased and the child allowance should be increased for the first three children only.

## **Governance and the process of determining socio-economic policy**

To plan updated economic and social policies that are capable of accelerating growth, reduce inequality, increase competition, and long-term competition requires a government that can function effectively. The low level of governability of the government in Israel has many roots, such as the antiquated structure of government departments, lack of serious research departments and the pronounced centrality of the Ministry of Finance in the decision-making process. An improvement in governance requires a series of reforms in many aspects of the executive branch. The main recommendations are:

## **The budgeting process**

* The way to enjoy both fiscal discipline and efficient allocation of the budget is through dividing the process into two phases. In the first phase, all the budget aggregates will be determined: spending, taxes, and the deficit. Since the fiscal discipline is derived from the aggregate budget, it is proposed at this stage that the Prime Minister and the Minister of Finance be granted a prioritized status in the decision-making process. On the other hand, in the second stage, in which the composition of the budget will be decided - it will be done through a collaborative process, with the involvement of the expenditure ministers in determining the total composition and also the budget composition of each office, because most of the knowledge and expertise in the variety of services supplied is located in the ministries that supply these services.
* When discussing the budget proposal, the government members have to be presented with detailed information at a level that is presented to the Knesset in the budget principles book.[[3]](#footnote-3)

## **The structure of the government**

The structure of the government and offices leading the public policies is obsolete, frequently changing, and exposed to political pressures. The structure of the governmental system is not based on rational and professional thinking that relies on updated public needs. The political arrangements, which often change after the elections, are those which determine the distribution of portfolios, the establishment of offices, and sometimes even their internal structure and their span of control. Therefore, the main recommendations are:

* The structure of the government in Israel should be redesigned to include a maximum of 15 ministries.
* Each government office should be required to establish a research unit to help formulate knowledge and understanding of the processes in the areas of the office’s responsibilities.
* The powers of the Prime Minister's Office should be strengthened as the headquarters and as a coordinating office between the other ministries.

## **The Knesset's function**

The Israeli Knesset wears two main hats: legislation and supervision over the executive branch.[[4]](#footnote-4) Control of government activity is neglected relative to other parliaments and requires a significant overhaul. The main recommendations are:

* To set a quota for the bills that each Knesset member similar to the amount accepted in Europe, and the weekly quote of private bills should be reduced.
* To set the limitation of the number of ministers and deputy ministers by law, to allow a sufficient number of MKs to serve in the committees.
* The activity areas of the committees should match the ministries' structure.
* To grant the committees hearing powers and sanctions for non-appearance.
* To add to the committees one working day and activity hours at the expense of plenum sessions.

## **The activity of lobbyists in the Knesset**

Governments in modern times take into account the implications of their decisions on the welfare of all sectors of society, including the business sector. Stakeholders and external parties are invited to the various committees to voice their opinions, and useful information and external insights can improve policies. However, the main concern of the lobbyists is for the interests of a very small group, often at the expense of all or most of the citizens of Israel. The ability of the wealthy to finance lobbyists is far greater than that of non-profit associations and organizations that represent the interests of the general public. The lobbyists' efforts to slant the legislation so that it benefits businesses and in particular larger companies also affects the public image of the Knesset. Therefore, it is recommended that lobbyists be prevented from appearing in the Knesset Committees.

## **The principles of meritocracy**

* Senior officials in the public service will be invited to a hearing procedure in the Knesset committee that is relevant to their field of function;
* The general directors of government departments will be appointed in accordance with strict professionalism threshold in the field of the office operations;
* Civil Service Commission will undergo a reform. The Civil Service Commissioner will be determined by a committee headed by a judge;
* Position tenders will be open to external applicants and there will be no appointments by tender of people who actually served in this position.

On integration as a Principle and in Practice

A significant key to the success of the Grand Strategy demonstrated herein is realizing the importance of integration both within and between the clusters. For example, integration within the cluster of science, technology, and education is highlighted in the ten insights selected, stressing the need for simultaneous implementation and the establishment of a national council that will guarantee such a coordinated implementation. In the society, economy, and government cluster, the intra-cluster integration emerges out of the understanding that it is impossible to reach the levels of GDP per capita of developed countries without treating the unbearable gap in income that divides the Israeli society into a thin layer of rich over a thick layer of poor, whose personal contribution to the GDP is low and who earn low salaries. It is also impossible to lower the cost of living without making major changes in the structure of the economy and preventing excessive centralization and crony capitalism. All this is impossible without a functioning, effective, and clean-hands government and the concomitant severing of ties between government and capital, and the establishment of a cadre of civil servants who see their work as being rewarded in accordance with their designation and not as a stepping stone to the private sector, which they oversaw only the day before. However, it is also impossible to raise the productivity of the large poorest classes without a dramatic improvement in their level of education and especially technical education (the science and technology cluster) and all of this profoundly affects the national strength, including its projection on the outside (the foreign and security cluster).

By the same token, a strategic plan for foreign affairs, defense, and international policy demands, like any other area, an understanding of all of the various arenas in which Israel operates and those that act upon it. An increasing number of political, social, economic, and scientific-technological contexts express themselves simultaneously in all corners of the globe and require the simultaneous consideration of a multivariate system. In this context of a global perspective, the relationship between Israel and the Diaspora is particularly sensitive, and especially that with Jews in the United States. Demographic and social developments in Israel, leading to a growing control of a Jewish nationalist Orthodoxy are a source of a rift with the US Jewry, most of which is liberal and Reform, distancing itself from Israel and from total identification with it. Israel's international and security status as a whole depends in not a small part also on its technological-scientific strength, but the infrastructure for this strength was made possible so far in the research institutions thanks to the generous assistance of world Jewry; and the products of this infrastructure have long-term consequences on the security-political status of Israel, in the region and the wider world in general, and vice versa.

The following are a few more examples, intended to draw the reader's attention to the inevitability of integration for the understanding of processes and removal of barriers to solve problems of strategic significance:

* + Economy and R&D: A basic problem emerging from the review of the economic cluster is the problem of productivity (expressed in, among other things, the quantity of capital per worker in the economy). An important source of growth lies in innovation that stems from R&D and projects. We already know now that the number of long-term savings assets in the economy is growing and is expected to grow at a fairly high rate (partly due to a mandatory pension law, etc.). The combination of these factors leads to the recommendation that the possibility will be examined that the financing of R&D will also be done with the help of long-term savings schemes (pension funds, education funds, etc.), which will invest some assets in encouraging R&D programs needed for the economy. This investment is expected to establish a large funding lever that is untapped today, while making all necessary adjustments. This will create a decentralized source of funding for R&D and industry that does not exist today and is independent of bureaucracy, such as the Investment Center, etc. Moreover, strengthening the sources of funding will enable further development of Israeli start-up companies in Israel, conservation of knowledge assets, and the opening of another channel for the construction of stable and broad industries that will contribute to strengthening the Israeli economy in the future.
		- Boycott of Israel. The international status and capabilities of the Israeli R&D community are largely affected by the state's geopolitical status (such as the impact on access to and participation in large programs of science and development and multinational flagships of future technology, cooperation, training of scientists in outstanding knowledge centers world-wide, and the exclusion and ostracism of Israel by scientists, organizations, and countries.) This risk should be taken into account in foreign affairs and security policies, and we have to prepare ourselves as far as possible to minimize this risk.
		- Society, education, and economics: A. In the last decade, the ruling axiom employed toward the public of teachers in Israel was: "if they will give – they will receive"; in other words, teachers' salaries will be raised only if "they will give," that is, if there is a dramatic turn for the better in the quality of teaching. This strategy is fundamentally wrong: those who want quality transformation must offer more at the level of compensation. In simple terms, you cannot raise quality while offering salaries bordering on misery to the teachers who are entrusted with the future of the country. As a result, the teachers' status in Israel has deteriorated alarmingly in recent decades. A review of the status and earning level of teachers in countries such as Singapore and Finland and the power multiplier it produces in their domestic economies shows an example of the tight link needed between the quality of education and the economy. B. The development of a special instruction track with individual contracts for academics/excellent teachers (teacher researcher), who will be launched as a task force to centers that foster excellence and eradication of disparities, seems, in the Forum's view, as a high priority task, aimed at improving the status of teachers and hence improving education and attracting students to study science.[[5]](#footnote-5) C. The next generation is the key to strengthening and leveraging the State of Israel. Boosting quality education is therefore the ultimate task and the cornerstone of the Grand Strategy. It should become a national project run continuously and without budgetary interruption, with an emphasis on the prioritization of the teaching profession also by economic means. A root canal treatment will be performed on both the world of content (curriculum) and the level of teaching quality. Positioning the continuum of education from kindergarten to university under one integrated national vision contributes in many countries to achieving the most significant results and we have no doubt that it would in Israel too. D. Strengthening all the components of the ecosystem necessary for a healthy and growing economic-technological society. Promoting Quality Science and Technology Education from kindergarten to high schools, strengthening basic and applied research, and encouraging academia-industry relations, tax breaks, and grants for the establishment/strengthening of factories with manufacturing infrastructure.
		- Governance, Economy and Society: The weakest link in Israel's scores on indices of international competitiveness is the element of government institutions. Therefore, a root canal treatment in the public sector is required as a derivative of the vision for the areas of (a) the issue of political appointments and meritocracy, (b) the elimination of corruption and a revolution in the war against it, and (c) aggressive enforcement of measures against pollutants of public tenders; tailoring, bribery, and coordination in tenders and government jobs form a very large part of the GDP.

In conclusion, as we noted at the beginning of the document, the reader will find that, although innovation is not lacking in specific areas as well, a more significant contribution is found in the comprehensive, connective, strategic, and long-term perspective, with the understanding that solutions at the national level will not be effective if they focus on one sector or on focal points, and that the range of problems in different areas has to be taken into account, as well as their interdependencies and the responsiveness between the domains. In the field of our discussion, this means between the economy, society, science, and technology and education, governance, security and international relations. We hope that the interested reader will benefit both in thought and in the fields of action by the principles and insights we sampled in this document.

1. While there is disagreement about the political success of the Oslo Accords, it certainly contributed to Israel's economic prosperity by lowering the country risk and considerably weakening the Arab boycott. However, these rewards are fragile and can be lost. The lack of some settlement with the Palestinians over time could undermine the legitimacy of trade with Israel, which is extensively based on export to the major trade blocs in the world. [↑](#footnote-ref-1)
2. Therefore, it is recommended that the share of general government spending in the GDP be increased by 1 percentage point during the next two years. The results of the change should then be examined, and, if there are no negative side effects, it should be raised in the following two years by an additional 1 percentage point of the GDP. [↑](#footnote-ref-2)
3. The low level of transparency in the data presented to the government in the decision-making process on the budget size and its composition is a serious problem. Although the power to decide on the budget proposal to be placed on the Knesset's table is in the hands of the government, its members receive very little data. The unsatisfactory data submitted to the ministers on the composition of the budget, and the short time allotted to them for forming their positions and discussing them, undermine the effectiveness of budget allocation. [↑](#footnote-ref-3)
4. The Knesset members put on the table in the last 15 years about 20,000 private bills, as compared to a few hundred in European parliaments. [↑](#footnote-ref-4)
5. [↑](#footnote-ref-5)