

# Israel's March of the Lemming

first article in four-part **Socio-Economic Roadmap** series

by Dan Ben-David

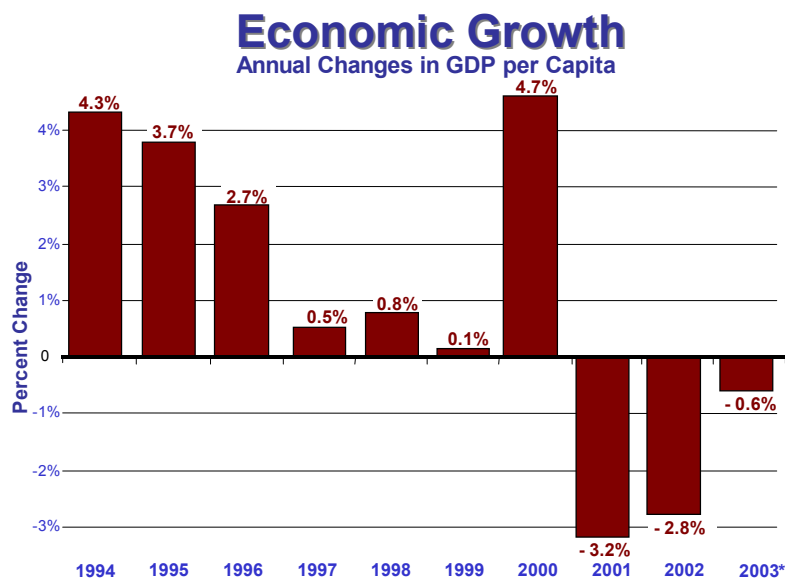
Their population multiplies at astronomical rates, thanks to years of high breeding. The rapidly increasing congestion and the daily pressures for survival lead them toward geographical expansion. "Behavioral changes intensify and [they] show more than their usual pugnacity, offering fight [in situations] they normally would avoid." Finally, they crowd together into a large, sweeping herd and march together blindly towards the edge of the cliff – and jump off it, to their deaths. Such is the behavior, says Encyclopaedia Britannica, of the Scandinavian lemming.

It is difficult to avoid parallel comparisons with other realities within a different setting. Our leaders tell us repeatedly that Israel is approaching the precipice, but their behavior and frequent "emergency" plans suggest that they themselves have not yet internalized how serious our situation really is.

Israel's economic growth is slower than the West's while its rate of unemployment is higher, as are its rates of poverty and inequality – and not just during the past couple of years. These three indicators reflect trajectories that are leading us in a steady and measured manner directly towards the rim of the socio-economic cliff. These trajectories are so steady, that they may appear as though etched in stone. They are not, however, the inflexible result of some heavenly decree.

Our destiny is in our hands, and if we understand the underlying sources of the problems – both in the short and long runs – we will be able to channel Israel's immense latent talent toward steady state paths that are not only better, but also sustainable over the long run. The objective of this four-part series is to detail Israel's main socio-economic problems, their sources and implications. The goal is to describe the interrelationships between issues and to lay out a road-map indicating how it is – still – possible for us to change direction. This article, the first in the series, focuses on the immediate, burning, issues, on the mistakes and misdirections in a public debate that is further and further reducing our ability to make relevant and courageous decisions.

As is shown in the graph, per capita growth (the common measure used by economists to gauge changes in standards of living) was quite high – in comparison with most industrialized countries – during the years 1994 and 1995. With the lone exception of the year 2000, stagnation and subsequent decline have been pretty much the main economic traits characterizing Israel since 1996. It should be pointed out that our growth slide began while other countries were still flourishing – long before the war with the Palestinians and the recession in the West that began in the end of 2000 and the beginning of 2001, respectively.



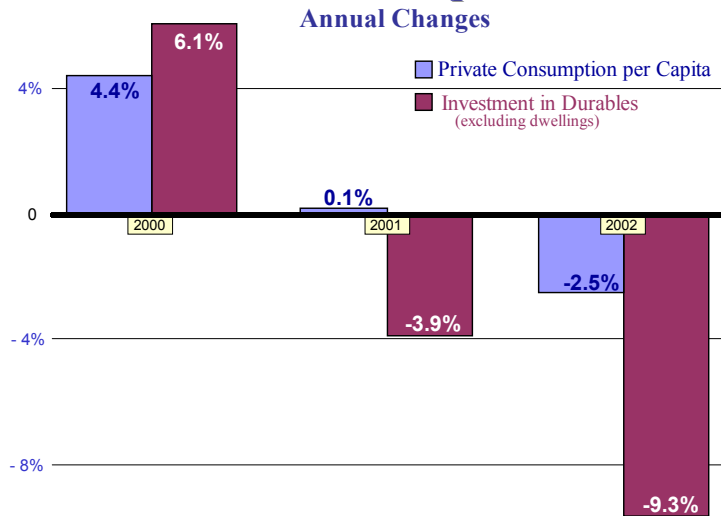
Source: Dan Ben-David, Tel-Aviv University, Data from Israel Central Bureau of Statistics (CBS)

\* Forecast of CBS

In the years 2001 and 2002 alone, the negative growth rates were reflected in a cumulative drop of 6% in our per capita incomes. The year 2003 apparently ended with a further decline.

On the one hand, negative growth means less tax income for the government. On the other hand, it also means greater welfare expenditures, which are tacked on to the already increased defense expenditures related to the war with the Palestinians. When tax income cannot cover the government's expenditures, the resultant deficit means that the government is forced to borrow in order to finance its overdraft. The only way for the government to persuade investors to

## Investment and Consumption 2000-2002



Source: Dan Ben-David, Tel-Aviv University, Data from CBS

at a time when economic growth requires stability and the minimization of uncertainty, Israel's economic policies left much to be desired in the realm of credibility and reliability. Unrealistic assumptions on the state of the economy, upon which one budget after another were based, in conjunction with accounting "magic" aimed at concealing failures, led to a substantial – and unnecessary – reduction in public confidence in our elected officials' ability and intentions. The resultant increase in uncertainty played a major role in the growth decline that we experienced.

When uncertainty of this magnitude is supplemented with the perception of a lack of vision in either the social, the economic, the diplomatic, and the defense spheres, then the socio-economic manifestation of the consequences should not come as a surprise to anyone. A vision radiating hope for better days increases the inclination to consume more today and to invest more for that future. The lack of vision, or the existence of a gloomy vision, radiates just the opposite – with the accompanying growth outcomes that this implies. It is no coincidence that the consumption and investment in the years 2001 and 2002 – as reflected in the graph – behaved as they did.

Trustworthiness requires an accurate and reliable public presentation of our predicament and the resolve to take serious steps to extricate the economy from the crisis. One of this government's stated objectives is to reduce government expenditures. The objective is correct, but the methodology for attaining the objective is extremely problematic.

Israel's public expenditures are indeed very high. They represent a greater proportion of Israel's GDP than in each one of countries belonging to the Organization for Economic Cooperation and Development (OECD), the organization of industrialized countries. In 2001, public expenditures reached 54% of Israel's GDP, compared with just 37% on average in the OECD countries. This difference reflects an excess of 80 billion shekels in Israel's public expenditures.

In contrast to the prevailing common perception, our budgetary difficulties do not begin and end with large defense expenditures. Even excluding defense expenditures in Israel and in the OECD, our government's civilian spending exceeds civilian public spending in the OECD by 11% of GDP, as is shown in the figure. In other words, if Israel were to reduce its non-defense expenditures to the average OECD level, we would save 52 billion shekels! It has been very convenient for Israeli governments over the generations to promote the perception that our security predicament precluded resolution of other difficult, but cardinal, issues. The time for resolving these issues has arrived since our cup runneth empty.

It should not come as a surprise that a country which imposes such a heavy tax burden on its people should have plenty of public money – compared to other countries – available to spend. The problem is not a lack of public money, but a lack of national direction. We do not have clear and defined goals that reflect our available resources and the reality that we live in – and we sorely need

lend it – rather than to invest their money in the private sector – is by raising the interest rate that it pays. This yields two resultant outcomes, both of which are problematic: a drop in private sector investment, which is the oxygen required for future growth in the economy; and interest payments of roughly 30 million shekels a year, more than the entire education budget, or alternatively, more than all of Israel's public expenditures on health. This is valuable money that simply goes down the drain because our country does not know how to live within its means.

In fact, Israel's own policies were one of the main reasons for the serious socio-economic deterioration that occurred here since 2000. At a

leadership that internalizes the extent to which we are close to the precipice that they constantly preach to us about.

There are over a quarter of a million unemployed persons in Israel. In addition, the proportion of Israelis participating in the labor force is substantially lower than the labor participation rate in the OECD countries. Should the government succeed in its intention to raise Israel's labor participation to OECD levels by reducing incentives not to work – an important step in and of itself, had it been implemented correctly, as part of an overall plan meshing social sensitivity with basic economic fundamentals – the outcome will be 200,000 additional working-

age Israelis that will have to begin looking for a job. And if the government will really succeed in reducing the public sector, then even more working-age Israelis will begin looking for private sector jobs.

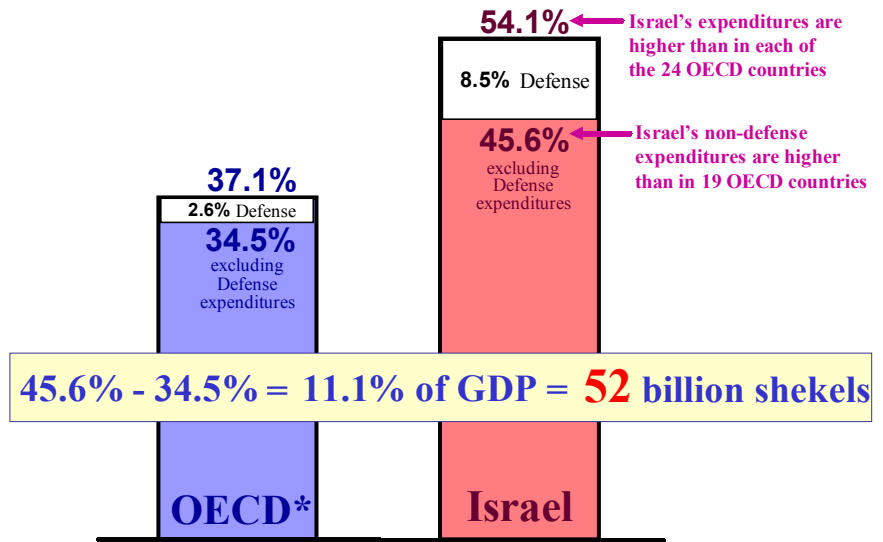
There is, however, one non-trivial problem. If over a quarter-million Israelis are already finding it difficult to land a job, then where will the additional hundreds of thousands work? And all this is occurring while the country continues to subsidize employers by allowing them to hire hundreds of thousands of foreign workers at a cost – according to paragraph 2 on page 84 of the original version of the Finance Ministry's economic plan presented earlier in the year 2002 – that is lower by 40-50% than the cost of an Israeli worker. That paragraph adds that this cost difference is due, among other things, to the fact that the Israeli employer does not pay for any social benefits for the foreign worker. Therefore, concludes the paragraph, there is a need to levy a 15% tax on wages paid to the foreign worker – without any mention of equating the social costs prior to the levying of the tax. As if this were not enough, MK Ayub Kara of the Likud and a member of the Knesset's Finance Committee, succeeded in lowering the proposed tax to only 8%.

Is this serious? Why would any employer be willing to pay an Israeli even the minimum required by law, when he is allowed to hire foreigners at substantially lower cost?

This is how many of our elected representatives (they represent us?) have been dealing with this issue for years – from the MKs to the Prime Minister. They know that they have nothing to fear from any serious investigative reporting in the press (democracy's "watch-dogs"?) on their personal and family relationships with the flourishing industry dealing with the import and hiring of foreigners in Israel. Does the expression "conflict of interest" still translate into the Hebrew language? Sometimes it seems as though the scent of bananas from republics across the sea is wafting towards us on the jet stream.

We have reached the situation in which one in every eight workers in Israel is not Israeli. However attractive the hiring of foreigners may currently be today, it should be quite obvious that this exploitation can continue for only a limited time more. After they have been here long enough, it will no longer be possible – from a moral perspective, from an international reputation perspective, and from the perspective of their overall strength in the workforce – to continue to discriminate against such a large population that is planting its roots deeply in what is still referred to as the "Jewish State"? Then, their cost will become equal to that of the Israelis, and in the meantime, we will have substantially enlarged the unskilled and poorly-educated population that is in any event finding it difficult to compete economically in Israel's modern economy. In other words, this is a case of a few becoming very wealthy for a limited time only – with serious long-term consequences for Israel's society and economy.

## Total Government Expenditure, 2001 as a percentage of GDP



Source: Dan Ben-David, Tel-Aviv University  
using data from Bank of Israel, President's Council of Economic Advisors, CIA, OECD, U.S. State Dept.

\* 24 countries for whom the OECD publishes interest data

In the meantime, the government continues to permit thousands upon thousands of new workers from abroad unfettered legal entry into Israel each year since, after all, the publicly-stated objective of the government is to limit only the foreign illegals. The person most influential in toredpedoing any concerted effort in curbing the influx of foreign workers is none other than the Prime Minister himself, who personally benefits from the hiring of foreigners on his own farm.

Apparently, we are dealing with a very domestic form of “capitalism”. The intention is to force unskilled Israelis to compete in the labor market under any condition, without any comprehensive vocational program tailored to the needs of the economy. At the same time, employers continue to be allowed to legally import thousands of foreign workers to work here under illegal conditions. When the human and physical infrastructures are neglected for generations, and one bright day the strong and the weak are told to “compete” with one another in the labor market – is this capitalism? A “free market” does not mean implementation of the rule of the jungle in which the mighty trample to dust all of the rest. This is not the “invisible hand”, but the brutal hand.

Another domestic contribution to our current state of affairs comes from a different direction: wanton exposure of Israel’s citizens to terrorism. Even if we do not have anyone to talk to on the other side – if that is really the case – this does not mean that there is nothing that we can do.

According to Tel-Aviv University economics professors, Zvika Eckstein and Dani Tsiddon, most of the damage from the Palestinian terrorism – apart from the terrible and tragic human cost – emanates from acts of terrorism within Israel’s pre-1967 borders, where most of the country’s economic activity is located. In a study completed last year, together with Vered Dar and Avi Tillman, they find that terror within pre-1967 Israel costs the country 14-19 billion shekels in lost production each year. According to Major General (res) Uzi Dayan, who headed, until August 2002, the National Security Council, the total cost of erecting a physical barrier – including transit points – sums to 3-4 billion shekels. Is there another investment more attractive in all of Israel?

The Prime Minister announced two years ago that a security fence would be erected. After more than three years of war with the Palestinians, only one-third of the entire route from the Gilboa to the Dead Sea has been built. This is how the State of Israel “protects” its citizens lives and shamelessly enables annual losses at a rate of several billion shekels a year – all the while claiming that there is not even enough money to include life-saving drugs and treatments in the country’s official health basket.

As if this were not enough, the current plan is not to go with the straightest, cheapest, and most defensible fence but rather to build a fence twice as long as the internationally-recognized eastern border between Israel and the West Bank, a fence that will cost several billion extremely scarce shekels more than necessary, and will require more troops to defend than our standing army can allocate – with the obvious security implications. The resultant nasty foreign policy ramifications are almost beside the point, given the carnage, both in human terms as well as socio-economic terms, that our own government consciously permits to occur.

They say that there are insufficient funds to aid the weak and the needy while overall public expenditures are at high levels unheard of in the West. They say that they are dealing with the problem of foreign workers while continuing to allow their employment to remain economically attractive, and allowing the inflow of newcomers to continue unabated. They say that they are building a security fence, but two years after the declaration, all we have received are hundreds of additional deaths and an economy headed south. The overwhelming results of last year’s elections provide vivid proof that we have in Israel professionals who could give private tutorials to the former Iraqi minister of information on the most advanced methods known to man for projecting honesty and sincerity.

It is time for this society to remove its blinders and see where it is being lead. We still have the ability and the time to do what needs to be done, as difficult as it may be. But that requires leaders with the integrity and the courage to put everything on the table, to show us where they want us to go, what will be required for the journey – and what sacred cows we will have to leave behind.