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Road Map to Prosperity (Extract)

Oct. 28, 2008

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Extract from Issue 15, November 10, 2008 of The Jerusalem Report. To subscribe to The Jerusalem Report [click here](#).

*Can Israel become one of the 15 most economically powerful countries in the world?
A group of leading experts explain how.*

With the world financial crisis deepening, it may seem like an odd time to deliberate how to transform Israel into an economic powerhouse, where global companies establish their headquarters, and a home for two of the world's top 20 universities.

But a group of leading academics and business executives, working under the support of the U.S.-Israel Science and Technology Commission (USISTC), is taking the long view, with a comprehensive study entitled "Israel 2028 - Vision and Strategy for Economy and Society in a Global World." They foresee a potentially golden future, with a possible sustainable growth path of at least 5 percent a year and a per capita GDP of \$53,000 within 20 years, lifting the country seven to twelve places higher than its current 22nd place in world economic ranking. In this vision, by 2028, Israel, with 9.8 million residents, will cut unemployment by half, decrease income disparities and enjoy an economically and socially progressive society.

But if the right policies are not implemented, the authors warn, Israel may find itself in a downward economic spiral that may even constitute an existential risk. The country is now at a critical juncture that will determine which scenario unfolds, they say, and they recommend adopting a national "meta-strategy" that would enable maintaining competitiveness, technology leveraging and reinvention, along with a high degree of social cohesion. The meta-strategy must be driven forward by the nation's top leadership, they assert.

The initial scope of the study that eventually grew into "Israel 2028" was much more modest. "The USISTC originally intended, four years ago, to study only the strengths, weaknesses, opportunities and threats to Israel's integration into global processes in science and advanced technology," explains David Miron-Wapner, director of the binational organization that was created by president Bill Clinton and prime minister Yitzhak Rabin in 1994. But the commission decided to expand the scope of the study in the light of Israel's complex economic reality: an advanced, globally-integrated technology sector existing alongside a broader sector that lags behind technologically and suffers from low productivity, broad income gaps, education disparity and low labor-force participation.

Instead of concentrating solely on research and development for advanced technology, they adopted a

more comprehensive, interdisciplinary approach. Beginning in January 2006, star-studded teams of business executives and academics gathered to study methods of stimulating development in broad fields such as global integration, public service, technology, traditional industries, labor policy, macro-economics, higher education, environment, and physical infrastructures. The project was chaired by Eli Hurvitz, CEO of Teva Pharmaceuticals, and directed by David Brodet, former director general of the Ministry of Finance.

The authors of the 300-page document do not intend for it to be yet another plan gathering dust in the bottom of a desk drawer. It was presented to Prime Minister Ehud Olmert in March, to the entire Israeli government in May, and was the focus of a six-hour seminar that included the director-generals of each of the government ministries. The commission, taking advantage of its joint American-Israeli mandate, has also made efforts to get U.S. congressmen interested in looking into ways that the United States can assist Israel in moving into the club of the world's top 15 nations.

But Miron-Wapner, who came to Israel from Los Angeles in 1978, after attending college at Berkeley and earning a law degree from Loyola, stresses that the study's very ambitious goals require a measure of planning and coordination that he regards as lacking in the current Israeli political system. "A lot of it goes back to the economic crisis of the 1980s, when authority for much of the budgeting and planning was transferred from the various government ministries to the Finance Ministry," he says. "That was important for getting the budget back under control, but it had two negative effects. One was a lack of a broad view in planning, because Finance Ministry economists have largely replaced the professionals in the different ministries but do not have their specialized knowledge of specific fields. The other problem is that focusing all energies on an annual budget means looking only one year ahead. Long term planning, over five, ten or twenty years, suffers as a result."

"In conducting the study, we decided not to concentrate solely on increasing GDP per capita," says Miron-Wapner. "Getting Israel into the list of top 15 economies by average income is not a minor matter, of course, but quality of life issues are just as important. There are values rooted in Jewish tradition that we cannot ignore, such as education, equality and concern for future generations. The 'dual economy' that has developed in Israel, in which a small number of people work in technologically advanced sectors and enjoy high incomes, leading to increasing social gaps, has to be dismantled - by bringing about a more equal sharing of income and wealth."

The media have, understandably, highlighted the great success that Israel's knowledge-intensive sectors have experienced in recent years, serving as an engine of productivity, growth and exports. But that sector employs only 6 percent of the overall workforce and contributes 9 percent of business output. A very large traditional economic sector, consisting of relatively low-productivity manufacturing and services, such as textiles, food products, furniture and wood products, exists alongside the more glamorous high-tech sector of the electronics communications, aircraft, pharmaceuticals and software industries. The traditional industries find it difficult to respond to rapid global changes; and, as a result, the growth of the economies of China, India and Eastern Europe poses a competitive challenge. Workers in Asia are often paid wages that are one-tenth of that paid to workers in equivalent industries in Israel, and the huge producers in growing economies enjoy economy-of-scale advantages that are not possible in Israel, leading to low demand for traditional industry products made in Israel and consequently low wages.

As if this were not enough, Israel's labor force participation rate, at 55 percent, is extremely low. These factors together have brought about a situation in which Israel now has one of the largest income gaps among developed nations and a social polarization that threatens to curtail potential growth.

Israel's current standing in economic production benefits greatly from the superb education system, from elementary to post-secondary schooling, that developed in the early years of the state. But many

observers now express concern that the country is living off that accumulated educational capital but not replenishing it. Public education in a way mirrors the gaps of the general economy - a small percentage of students exhibit high levels of achievement while a majority are falling behind in international comparisons. In the 1960s, Israeli students were near the top of international rankings of math and science skills, but they have lately slipped to 33rd out of 41 countries. The salaries of school teachers are among the lowest in industrialized nations.

The universities are faring no better, as the scope of scientific research is diminishing and a steady "brain drain" is removing leading academics from the country. The opening of the academic year at the universities over the coming weeks seems likely to be delayed due to a strike led by the presidents of Israel's seven major universities, in protest over cuts in university budgets in recent years that have totalled about 20 percent.

The reductions in university funding is one aspect of recent Israeli policy that Miron-Wapner finds most incomprehensible. "Expenditure on education is one of the highest-yielding public investments," he notes. "To cut back on that investment, especially in a country building on advantages in human resources, is inexplicable. We were lucky to have a great educational system in the 50s and 60s. In the 90s, immigration from the former Soviet Union gave Israel a free influx of well-trained engineers. But that will not happen again, and we will suffer if the education system continues to be neglected."

In physical infrastructure and environmental protection, the general level of investment in roads, ports and public transportation in Israel falls short of the needs of an advanced economy. Israel's capital per employee is about half the level of that of the United States and labor productivity is only 60 percent of that in the United States. The investment rate in Israel (not including housing) accounted for 13 percent of GDP in 2007, significantly lower than even the less wealthy European countries, such as Greece, Spain and Slovakia, leading to little increase in capital stock. Finally, doing business in Israel is perceived as difficult. According to an annual World Bank report on Ease of Doing Business, Israel is ranked only 26th in the world in this category, mainly due to perceptions of having to deal with a difficult bureaucracy.

Leapfrogging into the top 10 to 15 world economies will be no mean feat. Israel's GDP per capita is currently 45 percent lower than that of the Euro bloc of nations and 50 percent lower than that of the United States. The goals of "Israel 2028" would require GDP per capita to increase by 4.7 percent on average per year, a very high rate by any measure - in contrast, over the past 30 years Israel's annual growth of GDP per capita was only 1.6 per cent. The authors of the USISTC study propose that the goal could be attained by leveraging technological advances to enable all industries to innovate in manufacturing, organization, management and marketing, instituting change and adopting productivity-increasing methods.

Miron-Wapner mentions the example of the diamond industry, a major Israeli "traditional industry." When it became apparent that Israel could not undercut countries with low-wage diamond workers, such as India, the local industry went high-tech, developing computerized methods of precision diamond cutting that ensured its place in the high-end market would be preserved and even expanded. "But innovation in all industries will require all workers, at every level, to attain advanced education," continues Miron-Wapner. "So education is vitally important, as is the quality of government and continued growth of knowledge-based industries."

The authors of the study also call for overall public sector expenditure as a percentage of GDP (which peaked in 1984 at 70 percent) to decrease over time from its current rate of 45 percent to 39 percent by 2028, alongside a tax burden decrease from 37 percent to 32 percent.

A reduction in the public debt/GDP ratio, from 84 percent to 45 percent, is considered no less important, as it would enable greater flexibility in budget planning. Such a level would put Israel at a

lower public debt rate than the European standard, but could provide a safety zone for increasing support for old-age pension funds and a cushion against exposure to security and economic crises. A stronger economy should, according to the authors of the study, strive to enable the income of the bottom fifth of society to increase by 10 percent beyond the rate of GDP growth per capita over the next five years, and an additional 5 percent between 2012 and 2018.

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