

A Tale of Two Countries

fourth and final article in the **Socio-Economic Roadmap** series

by Dan Ben-David

The contribution of Jews to science, literature and to the overall development of human knowledge, is in no way proportional to the Jewish people's population share in the family of nations. The number of Jewish Nobel Prize laureates during the past century provides a hint of this contribution.

The Jewish state has provided a non-negligible contribution of its own. The very fact that modern Israel arose at all, against every conceivable odd, shows what a group of determined people – only 672,000 Jews in 1948 – with incredible resourcefulness and a remarkable ability to think outside the conventional boxes in areas of defense and policy are capable of creating. Instead of drowning in a sea of immigrants, the multivariate talents arriving on Israel's shores were channeled into strong currents of creativity and prosperity. At the same time, Israel was one of the countries with the highest degrees of income equality, while simultaneously becoming a country with one of the highest economic growth rates in the modern world.

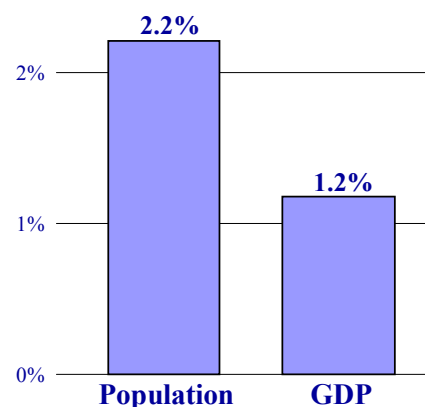
In key areas crucial to its survival, the Jewish state continues to shine. Its universities are at the world's knowledge frontier and push forward the technological envelope. World-class researchers educate generations of students from which some of the best and brightest are accepted to the most prestigious graduate schools in the world. Some of our graduates led a high-tech sector in Israel that produced one of the most innovative and successful revolutions outside Silicon Valley, while other Israeli graduates in the field of medicine are among the world's leading researchers and physicians. The Israeli army is one of the best – per soldier and pilot – in the world. Its fighting techniques are copied abroad and its fighting tools are desired trademarks in other armies.

This is a country that has not simply managed to survive in areas that are key to its existence, it has become a symbol of excellence, creativity and daring. That is why the anomaly of Israel is so great, for this is a country with other attributes as well. Over the years, it has become one of the least equal countries in the West, with poverty and income inequality rising steadily year after year, decade after decade, with no signs of slowing down on the horizon – let alone signs of the trends changing direction. As the chart indicates, a population that in 1998 was 2.2% of the U.S. population was able to produce just 1.2% of what America produced. In other words, Israel's GDP per capita – which represents the average income level per person – is considerably lower than GDP per capita in the States.

Israel's per capita income level in 1950, just a couple of years after the country's birth, was only 37% of America's. It managed to close the income gap throughout the fifties and sixties, reaching 61% of the U.S. income level in 1972. Since 1973, we have been falling farther and farther behind. As the year 2003 comes to a close, our standard of living has declined to 47% of America's (i.e. American income levels are currently over twice as high as Israeli incomes, compared with "just" 65% higher in 1972). We have fallen back, in relative terms, to where we were in 1960 – though then we were in the process of catching up to the western leaders, while now ...

What's happening in Israel? This is not simply an academic question aimed at explaining one of the greatest socio-economic anomalies in the world. It is a question for which we must find the answer before we pass the point of no return, lose this country's most valuable assets – and fall into a terminal abyss.

Comparison of Israel and U.S., 1998



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

On the face of it, the latent qualities of the Israeli people reflect an ability that can turn the country into one of the world's wealthiest. But we are not only unable to close the gap with the leading countries, this gap is getting progressively larger as we have been steadily falling behind in relative terms for the past 30 years. This is a country that tried to ameliorate every political, ethnic and ideological sector – while not being able to draw the line between the many varied desires and the very limited resources. The inability to make decisions and resolve issues, alongside a culture of non-enforcement of laws and norms, have led the country to a gradual loss of its scarce resources and is reducing the possibility of ever being able to collectively agree to policies that will enable us to change direction.

Why do we produce less than the Americans? Two simple comparisons, shown in the chart, provide a hint to this answer. First, Americans work more than us. They don't work more hours – the length of the average U.S. work week of employed workers in 1997 was identical to the Israeli average work week. The difference is that 20% more working-age Americans actually participate in the work force.

The prevalence of non-work lifestyles costs us a lot of money. More money must be taken from the few (relative to the Americans) who do work in order to support the many more (again, relative to the Americans) who do not participate in the work force. But this is just one type of cost. We also lose what those people could have produced, had they worked – and we are not talking about small amounts here. If the labor participation rate in Israel would rise to U.S. levels, GDP would increase by an additional 47 billion shekels.

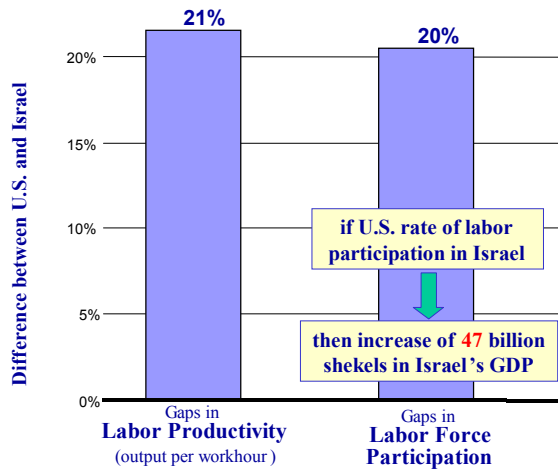
Just working more provides only part of the additional output that Israel could attain. The second comparison is one of productivity. The average American worker produces 20.5% more each hour than his Israeli counterpart, and this is not due to any genetic deficiencies inherent in the Israeli worker. After all, as was pointed out above, in the areas that are central to the growth and defense of the country, the accomplishments of Israelis are among those that push the international envelope.

The primary problem is one of a country that is simply choking its inhabitants. For example, Israel placed people in what is referred to here as the “periphery” without supplying them with the minimal tools and conditions for survival in a modern and competitive world. It begins with a disgraceful physical infrastructure that inhibits free flows of workers and goods and it reaches the neglected human capital infrastructure that does not provide the necessary skills for a large part of the people. The wonder is not why we compare so badly vis-à-vis the United States, but how did we even manage to reach the achievements that we did. But we are steadily losing a large and growing share of the Israeli society that is becoming a burden that the rest of society is slowly collapsing under.

The solution must be comprehensive and system-wide with two primary targets: (1) a reduction in gross income inequality and poverty, and (2) faster economic growth. Improving education in the periphery, for example, without providing the other important infrastructures, will lead to a weakening of the periphery towns from the resultant brain drain instead of strengthening them as inexpensive places that it would be worthwhile to invest and reside in.

There are still many Israeli policy-makers that have yet to shed the mistaken concept that a country cannot take care of its needy and also grow at the same time. Those policy-makers are under the impression that emphasizing one must come at the expense of the other and therefore, a country must find the optimal point of balance between the two. What is the source of this mistake? If there is an emphasis on poverty, than this is taken to mean that welfare payments must be increased, which then implies that

Comparison of Workforces in Israel and U.S., 1997



Source: Dan Ben-David, Tel-Aviv University, Data from ILO and World Bank

taxes must be raised in order to finance the payments and this will act as a negative incentive to invest, which in turn harms growth.

But this is only a symptomatic treatment of poverty. The alternative is to deal with the source causes of poverty, and this is based on the same central elements that contribute to economic growth. One important key – though not the only key – in this regard is education.

A growing economy undergoes a process of structural changes that require a work force which is continuously becoming more educated and more skilled. That is why, as education levels increase, so do incomes and the chances of finding work. As a result of the importance of education in both these instances, the number of people who even bother to look for a job declines the lower their level of education.

The role played by education can be seen in the figure. For example, out of the working-age population with 0-4 years of education, 89% do not even try to look for work. Of the remaining 11%, 14% are unsuccessful in finding work and remain unemployed. Fortunately for Israel, this is a relatively very small group – but the relationship between education, unemployment, and labor force participation should be clear.

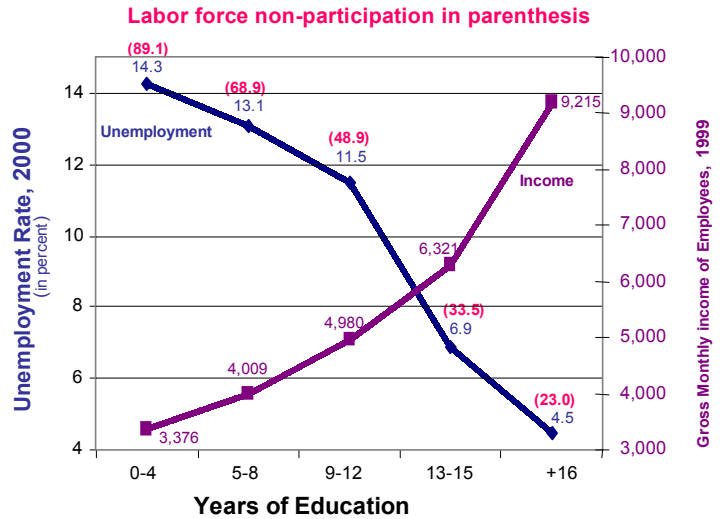
It is possible to divide Israel's population into two main groups: those with up to 12 years of education, and those with more than 12 years of education. As the chart indicates, the two groups are of nearly identical size. But they are substantially different in their incomes and in their job prospects. Herein lies one of the main keys for reducing poverty and inequality and for increasing growth.

Policies that will contribute to a movement of sizeable population from the right-hand side of the population pie in the chart to the left-hand side will contribute to a reduction in income inequality along three main routes. First, those who make the move will benefit. Second, there will be an improvement for those who remain on the right-hand side of the pie (i.e. with up to 12 years of education) as a result of reduced labor competition with other relatively low-skilled workers. Of course, it should be noted that we are talking about a normal country that is not losing its collective mind by adding hundreds of thousands of low-skilled laborers from Thailand, Rumania, and elsewhere to the right-hand side of the population pie. Third, an increase in the number of people with more than 12 years of education will dampen the wage increases of this income group. In other words, this is similar to a simultaneous pincer movement on both sides of the population pie that should lower the income and employment gaps between them.

But a policy that increases the overall level of education in Israel also acts as a direct impetus for increasing the nation's ability to assimilate, utilize and develop new technologies – and this is one of the keys to increasing economic growth.

Will there be enough jobs available for the increasingly educated workforce? An example

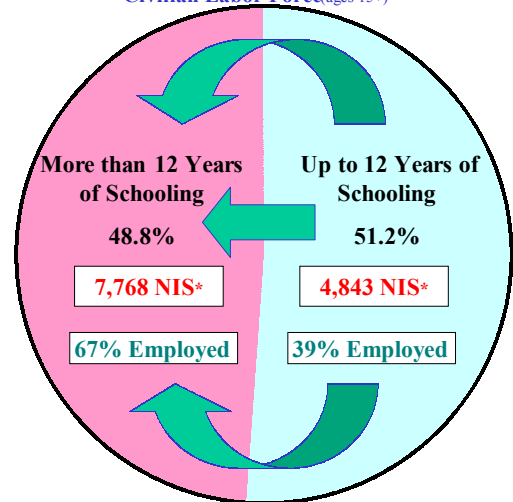
Relationship between Education, Unemployment and Income



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

Distribution of Education, 2000

Civilian Labor Force (ages 15+)



* Gross monthly income of employees

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

from the United States (in a well-known study by Chinhui Juhn, Kevin Murphy and Brooks Pierce) demonstrate how thirsty the modern economies are for skilled workers. The number of U.S. university graduates doubled during the 1970's and 1980's, an outcome that seemingly should have led to a reduction in wages of graduates, had these graduates flooded the market and found it difficult to find a job. But in fact, the American economy needed even more graduates than it received, and the competition between employers for available graduates led to a 25% increase in the salaries of people with B.A.'s.

The current high-tech crisis has led to the unemployment of many educated workers. But there is a need to distinguish between cyclical unemployment and long-run trends. The high-tech workers will eventually find jobs as things begin to turn around since this sector will become one of the pillars of production in the future. Those who will not fare so well, in steadily increasing numbers, are the poorly-educated – and the country has to provide them with the skills and the conditions to compete.

It appears that we will be able to continue on our current trajectories for only a limited period of time. When those who bear the increasingly unequal economic burden are also those who bear the increasingly unequal burden of physically defending the country, then no one should be surprised when the more talented and promising of our younger generation will read the writing that is on the wall and reach the inevitable conclusions while their special gifts are still marketable abroad. If this stream should ever become a torrent, our fate will be sealed. In any event, it should be clear: as long as the dependent segment of society is growing faster than the segment of society that is underwriting this support, and as long as we continue choking the engine of growth, then it is only a matter of time until the engine will no longer be able to carry the national load.

The path upon which we are blindly marching toward the precipice is entirely self-determined and it is totally avoidable. Our socio-economic trajectories are not etched in stone, even though they may seem to be. Our destiny is not in the hands of heaven – it is in ours. But there is limit as to how much marketing – as a substitute for serious stabilization and actual strengthening of the country's socio-economic foundations – can help the State of Israel in the 21st century to keep its citizens and to attract new ones from abroad. The desire to live here can be translated into considerable sums of money that many in Israel are willing to forego in order to take part in the building and strengthening of the Jewish people's only country. But there should be no illusions that this desire can perpetually withstand any cost and every man-made obstacle that we put before it.