

The “new” politics and economics

by

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Israel was once a country where three of its first four presidents were leading researchers in their fields. Today, this is a country where a Nobel prize-winning scientist from the Technion, whose focus these days is Israel's existential domestic issues, cannot even muster the support of 10 Knesset members required to qualify as a candidate. They promised us “new politics,” and they certainly delivered.

We were also promised “new economics.” What we received is not a new national agenda, but the invention of new economic principles that run contrary to the accumulated research knowledge in the field. Intuition, no matter how well-intentioned, cannot replace basic economics. On the one hand, there are those who exaggerate the accuracy of economic fundamentals and often view them as though they were the laws of physics in making precise economic forecasts. But one should be careful not to be lured into the opposite extreme and assume that intuition and conventional wisdom can substitute for basic economic principles and facts.

The excess hyperbole in the public discourse surrounding the recent decision to reduce housing prices by eliminating VAT on new apartments sold to young couples has completely obscured the borders between what we think and what we know. Economics is not an exact science, and a large number of social factors may cause the proposed policy intended to lower prices to actually raise them, or possibly lower prices somewhat — but that is not the point. What we do know with certainty is that this policy is not the most effective way to reduce the cost of housing. In the short term, the stock of apartments is relatively fixed — there is what is called in economics an “inelastic supply.” As a result, not only would a tax reduction increase the demand for apartments, but the benefits of the policy, paid for by billions of shekels in lost tax revenue, would go almost entirely into the pockets of building contractors, not those of the young home buyers. These outcomes follow from the most basic laws of supply and demand, taught in introductory economics courses. They could not possibly be what our policy makers have in mind.

A serious solution to the high cost of apartments must be long term: the provision of the best education in Israel's peripheral areas and the connection of these areas to the major cities with a rapid, cheap and reliable transportation infrastructure. After all, this is a small country where almost everyone lives within what should be no more than a half an hour from a big city. Cheaper land prices in the periphery would enable young families currently living in the cities to pay less for more living space without having to compromise on the quality of their children's educations or on their careers. And on the way to solving the housing problems of young families, we will upgrade the education of the children who already live in the peripheral areas — which will become suburbs — while bringing their parents closer to potential places of employment. In other words, on the way to a core solution of the housing problem, we will begin to provide solutions to Israel's core problems — high rates of poverty and inequality and low productivity.

This might be a new economic policy for Israel, but it is rooted in the most fundamental economic principles.