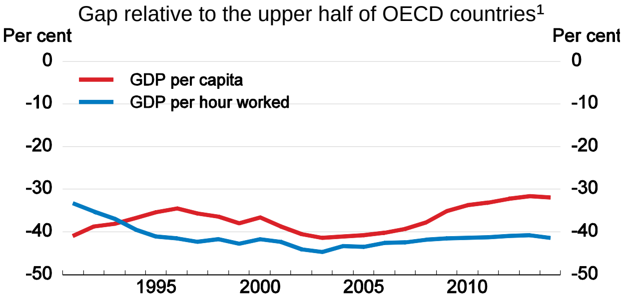
OECD ECONOMIC SURVEY OF ISRAEL 2016

BETTER POLICIES FOR BETTER LIVES

The economy has strong fundamentals, but productivity performance has been weak

Per capita GDP and productivity

Gap relative to the upper half of OECD countries[1]



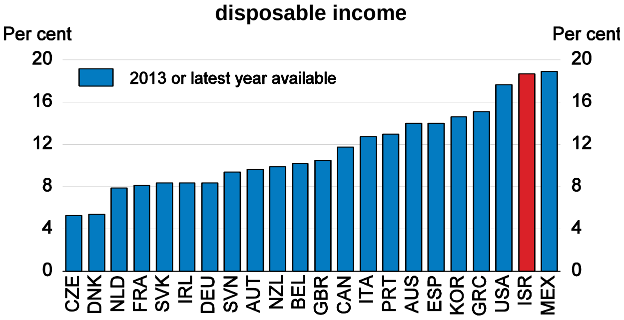
1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GPD per hour worked (in constant 2010 PPPs).

Source: OECD, National Accounts and Productivity databases.

Thanks to prudent monetary, financial and fiscal policies, growth has exceeded most other OECD countries' rates for more than a decade. Employment is rising, inflation is low, the external surplus is comfortable, and the public finances are in relatively good shape. However, although income per capita has gradually been catching up with the most advanced countries, this has not been matched by similar convergence in productivity. Indeed, highly dynamic tradable goods industries coexist with an inefficient sheltered sector to an unusual extent, dragging down overall economic performance. Substantial deficiencies in product market regulation and competition, especially in the entire food chain, banking and electricity, are weakening productivity and reducing incomes.

Income inequality and poverty are high

Poverty rate relative to threshold of 50% of median disposable income



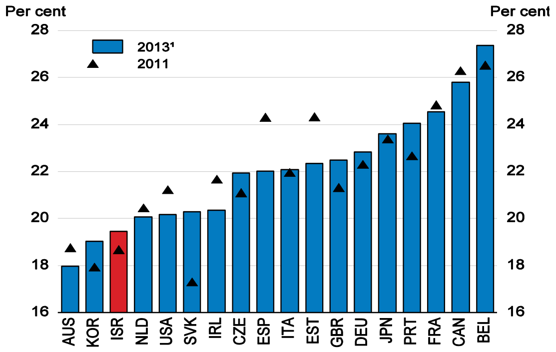
Source: OECD, Income Distribution database.

Israel is also characterised by high poverty and large gaps along many material and non-material dimensions of well-being. Poverty is especially high among the elderly, in part because of low basic pensions. Employment rates for Ultra-Orthodox (Haredi) men and Arab-Israeli women remain low. Rising housing prices impose an additional affordability burden, increasingly even on the middle class. Relatively high price levels due to weak competition, in particular in the food sector, impose a greater cost, in terms of living standards, to socioeconomically disadvantaged groups.

The fiscal framework is not conducive to inclusive growth

Expenditure on educational institutions

Per student, relative to GDP per capita



1. Or latest year available. For more details, see Figure 9, Panel E.

Source: OECD (2015), Education at a Glance 2015; OECD, National Accounts database.

The tax burden and public civil spending are low and income redistribution is limited. Despite substantial increases in recent years, education spending per student remains low relative to per capita income compared to most other OECD countries. Insufficient infrastructure, especially in transport, hampers private-sector efficiency. The cap on spending growth in the public debt-reduction strategy implies the share in GDP of civil spending will shrink further over time, restricting the room to finance useful public spending initiatives.

web

http://www.oecd.org/eco/surveys/economic-survey-israel.htm

OECD ECONOMIC SURVEY OF ISRAEL 2016

OECD BETTER POLICIES FOR BETTER LIVES

MAIN FINDINGS	KEY RECOMMENDATIONS
Monetary policy and the fiscal framework and policy	
Inflation is below the official price stability objective.	Maintain the current expansionary monetary policy stance. Implement further macro-prudential measures if risks to the financial system (from housing prices) rise.
The cap on government spending implies further declines as a share of GDP, even as civil spending is very compressed.	Reduce the structural deficit and pursue the gradual debt-reduction strategy by raising fiscal revenues, preferably by removing inefficient tax expenditures, such as the VAT exemption on fresh fruit and vegetables, and raising environmental taxes including by, for example, establishing a carbon tax. To the extent that savings can be made on military outlays and debt service and sufficient revenues raised, increase civil spending on education, infrastructure and poverty reduction. Implement effectively the envisaged plan to ensure consistency of commitments for future expenditure and tax reduction with the spending ceiling and deficit target rules.
Product market reform	
Product market regulations are far from best practice.	Ensure that the planned reduction of the regulatory burden relies on high-quality regulatory impact assessments.
Food prices are high.	Further cut tariffs and non-tariff barriers, in particular by adopting the EU import procedures on food and agricultural goods. Replace quotas, guaranteed prices and customs tariffs with direct payments to farmers. Consider screening the anti-competitive provisions in the food sector using the OECD competition assessment toolkit.
The banking sector is concentrated and inefficient.	Follow through on plans to allow the entry of new competitors in retail banking, in particular by non-banking credit entities, with appropriate prudential and consumer protection regulation.
The electricity market is still dominated by a heavily indebted publicly owned, vertically integrated company.	Turn the Israel Electricity Corporation into a holding company, and create a separate infrastructure operator.
Competition law enforcement is not fully effective.	Expand the leniency programme, and increase financial penalties for competition law violations. Create independent regulators with well-defined mandates in the telecoms, postal services and gas sectors.
Inclusive growth and pension system	
The quality of education, especially for Haredim and Israeli Arabs, is poor, and these groups are not well integrated into the labour market, resulting in widespread poverty.	Increase education funding for disadvantaged groups. Develop vocational education and training more fully for young adults. Require Haredi schools to teach mathematics, science and foreign languages. Expand the earned income tax credit and active labour market policies. Introduce a mandatory community service programme for Israelis who are currently exempted from military service.
Restricted supply is raising house prices, reducing well-being, especially for young families.	Complete the streamlining of the administrative requirements for planning and building a home. Further develop public transport infrastructure to make it easier to live in lower-price housing areas, and promote labour market participation for those living in remote areas.
The pension system has solid foundations, but the poverty rate among the elderly is high.	To reduce elderly poverty, as the second pillar matures, seek a way to increase first-pillar pensions without creating work disincentives. Moderate the impact on net current income of relatively high mandatory contributions to pension savings for low-wage workers. Gradually raise women’s statutory retirement age to equal men’s. Index the retirement age to life expectancy at age 65. Require pension providers to offer low-cost pension funds as their default option, for example, by proposing passively managed (indexed) assets or streamlining distribution channels.