The Israeli Economy
Fundamentals, Characteristics and Historic Overview
Summer 2011
Dear Readers,

We are happy to present you with this booklet, describing the fundamental characteristics of the Israeli economy, and giving an historic perspective on major developments throughout the years. This booklet is designed for both economists and non-economists altogether.

The booklet opens with a very broad description of the Israeli economy today: an advanced, resilient, innovation-driven and knowledge-based economy, which developed over the years into an R&D and High-Tech powerhouse.

The overview goes briefly through the historic development of the Israeli economy, surveying its growth, its population and society, its industry and trade, its public sector, inflation and currency.

The booklet also focuses on data-based graphs rather than text, as we believe that the numbers and figures complete the story in the briefest and clearest way. I hope you find it both insightful and useful.

Since this summer of 2011, Israel is undergoing wide social protests over the cost of living and several welfare issues, such that might influence our socio-economic priorities. I am confident that our economy will be able to contain the necessary adjustments in a responsible manner, while maintaining fiscal discipline. It will continue to demonstrate impressive results and become an ever more relevant market in the global economy.

Sincerely,

Dr. Yuval Steinitz
Minister of Finance
Dear Readers,

The development of the Israeli economy through the years was accompanied by dramatic events and evolutionary changes in the last sixty three years. But as breakthroughs were witnessed and crises were overcome, the features of stability and solvency were always present.

The International Affairs Department in the Ministry of Finance invites you to find out more about the development of the Israeli economy through the years and on our current days economic policy in the Ministry of Finance’s English website.

Sincerely,

Mr. Roni Hershkovitz,
Director, Overseas Economic Information
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Israel Today

Israel in the World Today

Comparative Look at GDP per capita:
According to the International Monetary Fund, as of April 2011, Israel's GDP per Capita in PPP in 2010 stood at $29,531, rating it 28th out of 180 countries in the world.

World Economic Forum Global Competitiveness Index
Over the last decade, Israel's rating ranged between 15th and 27th out of more than 130 countries.

IMD Global Competitiveness Index
Over the last decade, Israel's rating ranged between 13th and 33rd out of 60 countries.
Advanced Economy

The Israeli economy is a diverse open market economy. Being a relatively young state in the modern era, Israel is recognized as a developed market by many major indices. Israel also became a member of the OECD in 2010.

As of 2011, Israel has the largest number of companies listed on the NASDAQ after the United States and Canada, and more than 60 Israeli companies are traded on various European exchanges.

Resilient Economy

The Israeli economy showed great resilience during the latest global economic crisis. Israel managed to withstand the economic crisis due to its stable banking system, labor market elasticity, lack of complex instrument in the capital market and timely and targeted reaction of policy makers. In 2010, Israel was ranked 1st at the ‘Resilience of the Economy’ Index, as part of the WEF Global Competitiveness Index.

Cultural Advantages

- Challenging norms and ‘out of the Box’ way of thinking
- Creative at working under limited resources
- Direct, informal and task oriented approach

“Israel is, by many measures, the country (relative to its population) that has done the most to contribute to the technology revolution.” Bill Gates

“When you go to the Middle East looking for oil, you don’t need to stop is Israel. But if you go looking for brains, for energy, for integrity, It’s the only stop you need to make.” Warren Buffett
Innovative Economy: The Start-Up Nation

Israel is known for its unique entrepreneurial and innovative spirit. Israel excels in:

- Total Expenditure on R&D as % of GDP
- Entrepreneurship
- Skilled Labor
- Venture Capital Availability
- Quality of Scientific Research
- Utility Patents per Million

High-Tech Economy: The Silicon Wadi

Israel is home to many international high tech companies, who understand its cultural and economic benefits, as well as its innovative spirit. Along with local Israeli firms who became an international success, both international and local firms make Israel worthy of its description as ‘The Silicon Wadi’.

From Socialism to an Open Market

Israel's economy has changed drastically over the decades. In its roots, the Jewish national movement and the first pioneer communities were mainly socialist in nature. Since then, the Israeli economy has become a liberalized and open economy, with strong tenants of capitalism while keeping some aspects of social welfare. Major privatizations have been executed since the 1980’s, a trend that expanded during the 1990’s.
Historic Economic Growth

GDP Growth
Israel enjoyed intensive growth until 1973, with an average of 8.9% per year, and an average of 3.8% per year since 1973. Looking at the log of GDP (where the slope angle represents the growth rate), one can see Israel’s impressive historic GDP growth:

\[
\text{Log of GDP} = \text{Growth rate}
\]

Source: Central Bureau of Statistics

GDP per Capita Growth
Israel’s impressive economic growth also withstands taking the growth of population into account. Here too, Israel enjoyed an intensive growth rate of 4.9% per year until 1973. Since then, Israel’s growth rate per capita is approximately at the world’s level, with an average of 1.6% per year. Looking at the log of GDP per Capita, one can see Israel’s impressive historic growth in GDP per Capita:

\[
\text{Log of GDP per Capita} = \text{Growth rate}
\]

Source: Central Bureau of Statistics
Population Growth and Immigration: Aliyah

Israel’s population grew over the years from a little more than 800,000 at the end of 1948 to a little less than 8,000,000 at the end of 2010, a nearly 10 times fold, having a huge effect on its workforce.

A fundamental factor of this rise is waves of immigration of Diaspora Jews to Israel (Aliyah). Looking at the rate of change in Israel’s population, one can note peaks representing massive immigration waves, mainly in the beginning of the 1950’s by many Jews worldwide, and in the beginning of the 1990’s, mainly by Jews from the former Soviet Union.
Capital per Employee

Israel demonstrated an impressive growth in capital per employee in the 1990's and 2000's: from less than 200,000 NIS per employee in the business sector, to more than 400,000 NIS.

Human Capital Growth: Education

Lack of natural resources and regional political factors have led Israel to intensively develop its human capital, knowledge and technology. Israel enjoys a higher percentage of population with a tertiary education than the OECD average; with over 40% of its population attaining this level of education.
Society and Employment

Society

Israeli society is mainly Jewish, with a large Arab minority. The Jewish majority itself is very diverse culturally, as Jewish immigrants came to Israel from various places around the world. The Jewish population is also diverse by beliefs and norms of living; 42% are secular, 40% traditional, 10% religious and 8% ultra-orthodox (Haredi).

Participation Rate and Employment

Participation Rate in the Israeli labor force is relatively low compared to other OECD countries, mainly due to the low participation rates of Ultra-Orthodox Jewish (Haredi) men and Arab women. In the last decade, the average participation rate in the labor force in Israel stood at about 55.5%.

In the last decade, the participation rate in labor force in Israel consistently grew from 53.8% in 1999 to 57.3% in 2010.

Within the Labor Force, Israel enjoys a relatively low unemployment rate, in part, due to its relatively young population. Israel also showed resilience to the global economic crisis as unemployment was almost unaffected.

In the last decade, the average unemployment rate in Israel stood around 8.6%. Unemployment rate in the 2nd quarter of 2011 reached the historically low level of 5.5%.

Worker Unions: the ‘Histadrut’

In its roots, the Jewish national movement was mainly socialist in nature; worker unions played a major role in Israel’s economic history. The ‘Histadrut’ workers union was one of the strongest bodies in the economy, and one of the biggest employers, with a political affiliation to Israel’s Labor party and the left.

Since the late 1980’s and throughout the 1990’s the ‘Histadrut’ underwent a major reform, transforming it to a standard workers union like its counterparts abroad.
Industry and Trade
From Oranges to Software

Over the years, the Israeli industry has developed from small establishments that engaged primarily in processing of agricultural products and clothing, to an open, high-tech industry, that uses modern methods and advanced technologies for manufacturing. Looking at manufacturing exports by technological intensity in the past 20 years, low tech Industries did not vanish, but high tech industries flourished in a remarkable way:

Israel’s Main Trading Partners
Looking at Israel’s main trading partners by continents (Europe, America and Asia) in the last 20 years, Europe is the largest trade area to export to Israel. Also noticeable, is Israel’s tendency to open itself to foreign trade in the last two decades, as part of the government’s liberal economic policy.
Government Expenditures

Government Expenditures as a % of GDP

Government expenditure has always been relatively large compared to other OECD countries due to several factors. These include; the need to absorb massive immigration waves (especially in the 1950’s), increasing security and defense expenses (especially after 1967) and more. In the last two decades, Israel is demonstrating a gradual decrease in government expenditures as percentage of its GDP.

Security Expenditures

According to data by the Stockholm International Peace Research Institute (SIPRI), Israel’s security expenditures as a percentage of GDP have been slowly declining in the last two decades.
Historic Budget Deficit

As Israel’s government expenditures as a % of GDP have increased dramatically since 1967, and
started to decline since the mid-1970’s, Israel has also experienced increased incomes, yet milder
than its expenditures.

Therefore, Israel’s budget deficit has increased, and fiscal discipline was lost. The budget deficit was
financed mainly by loans and printing of money, therefore further increasing budget deficit, public
debt and inflation.

Israel underwent a major economic crisis in the early 1980’s, as the deficit, debt and inflation
increased dramatically. Israel’s Economic Stabilization Plan was established in 1985, aiming at
decreasing inflation, equalizing the balance of payments, and stabilizing Since the Economic
Stabilization Plan in 1985, Israel’s budget deficit was maintained in a relatively stable level.

Budget Deficit since 1985

Looking at the budget deficit as a % of GDP since the 1985 Economic Stabilization Plan, a few
cycles are noticeable throughout the 1990’s. With the beginning of the 21st century, budget deficit
rose up to 6% in 2003, and declined back to 0.57% in 2007, only to rise again to 2% in 2008, and
5% in 2009, with the outbreak of the global economic crisis. In 2010, the budget deficit started to
decrease again, as Israel withstood the global economic crisis and expressed solid sustainability.
Historic General Government Debt

During the first two decades, Israel relied mostly on its local market. The ‘Bonds’, an organization established by Israel in the 1950’s, was the main agent for foreign exchange raisings, as Israel suffered from a severe shortage of foreign exchange in those years. In Israel, the debt was linked to the Consumer Price Index (CPI).

As part of Israel’s major economic crisis in the early 1980’s, both the debt and the debt-to-GDP ratio expanded dramatically. Since the Economic Stabilization Plan in 1985, the general trend is a decrease in both the general government debt and the debt-to-GDP ratio, with sporadic increases.

General Government Debt in Recent Years

Israel’s first issuing abroad occurred in 1995. Looking at the debt-to-GDP ratio since 1995, the general trend of decline is noticeable: from close to 100% in 1995 to less than 75% in 2010, although the debt-to-GDP ratio did increase in the beginning of the first decade of the 21st century. The debt-to-GDP ratio continued to decline even throughout the global economic crisis in 2008. In the last few years, Israel only experienced a mild increase in its debt-to-GDP ratio in 2009, as in 2010 the ratio was decreased again.

Today, Israel tries to further decrease the debt-to-GDP ratio towards 60%. In recent years, the debt-to-GDP ratio reduction has been added as part of the overall expenditure target.
Inflation

Historic Inflation

The Israeli economy has known several inflationary epochs, with the most severe crisis occurring in the 1970’s - 1980’s. In the 1950’s, Israel suffered from a shortage in foreign currency, leading to a shortage in all consumption products. In order to avoid a sharp rise in prices, a rationing policy, known as “Austerity” (Hebrew: צנוע, “Tzena”) was enforced. As the depression ended in 1967, inflation started to rise, and after 1973 it began reaching new heights.

Israel’s Inflation Crisis and the Stabilization Plan

Since the end of the 1973 Yom Kippur War, the inflation level increased dramatically as government expenses rose, alongside the budget deficit and external debt. Several economic developments further worsened Israel’s economic crisis, and in 1983, stocks of the four largest banks in Israel collapsed, causing the nationalizing of all four of them. In 1984, the inflation level stood at 445%. Israel’s Economic Stabilization Plan was established in 1985, aiming to decrease inflation, equalize the balance of payments, and stabilize the economy. The plan included severe budget cuts, forbidding money-printing by the government, establishing the ‘Arrangements Law’, stabilization of prices level, setting a fixed exchange rate, and more.

The 1985 Economic Stabilization plan is known as a key point in Israel’s gradual development from a social-democratic market to a more liberal-capitalist one.

Unlike former attempts, the Economic Stabilization plan managed to achieve most of its goals and pull the economy out of the crisis. After 1985, the inflation level decreased to 20%, and during the 1990’s it further decreased to standard levels.
Inflation in Recent Years

Since the ‘Economic Stabilization Plan’ of 1985, with strict policies by the Ministry of Finance and the Bank of Israel, inflation dropped below the 10% level. Inflation in the first decade of the 21st century is characterized by a relative stability, except the years 2002-2003, and by Israel’s formidable withstanding of the global economic crisis towards the end of the decade.

The Israeli economy demonstrated a high level of stability compared to other countries throughout the global economic crisis, as seen in a brief comparison:
Currency

From Israeli Lira to New Israeli Shekel

The ‘Shekel’, a term as old as biblical times for a weight unit, was renewed in modern times as a membership fee in the Zionist Movement, before the establishment of the modern State of Israel. Israel was established out of a British mandate; therefore the formal currency was an ‘Israeli Lira’ which kept its name until 1980. In 1980, the ‘Shekel’ was re-established as Israel’s currency. As part of the 1985 ‘Economic Stabilization Plan’, Israel established the New Israeli Shekel (acronym: NIS, symbol: ₪), which depreciated the currency to 1/1000th of an old Shekel. The New Israeli Shekel is the current currency of the State of Israel.

New Israeli Shekel Exchange Rates

As the New Israeli Shekel was established as part of the 1985 ‘Economic Stabilization Plan’, a fixed exchange rate regime was introduced. Since 1989, Israel introduced a ‘Fluctuation Band’ policy, setting upper and lower intervention borders. Throughout the 1990’s, the Fluctuation Band’s slope angle was changed and its bandwidth expanded, bringing Israel’s policy close to a floating exchange rate regime. In 2005, the ‘Fluctuation Band’ policy was finally canceled, as it had no real effect on the NIS exchange rates.

Since the establishing of the New Israeli Shekel (NIS) in 1985, a 1$ worth in NIS rose to more than 4₪ at the end of the 1990’s. In the last decade, a 1$ worth in NIS fluctuates roughly between 3.5₪ to 4.8₪.

Source: Bank of Israel
Similar Publications by the Israeli Government:

- State of Israel Prospectus
  By the Ministry of Finance

- Facts about Israel
  By the Ministry of Foreign Affairs

- Israel in Figures
  By the Israeli Central Bureau of Statistics

- Invest in Israel
  By the Investment Promotion Center in the Ministry of Industry, Trade and Labor

- Israel - Global Center for Breakthrough Innovation
  By the Investment Promotion Center in the Ministry of Industry, Trade and Labor

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