

May, 2020

## **An Israeli Economic Exit-Strategy from the COVID-19 crisis**

### **Short term challenges and long term solutions to the local labor market**

The outbreak of the COVID-19 pandemic and the health and economic crisis it created met the Israeli economy and society at a major cross road – on the one hand, the macro-economic environment in Israel was at an all-time pick. In February 2020 unemployment rate was the lowest ever recorded – 3.4%; dept-to-GDP ratio was only 60.0%; the banking system was stable; and the mean wage constantly rose. On the other hand, the socio-economic inequality remains high and narrowed only slightly in recent years, and different public systems such as the public health system and the public education system were left behind and have been short of budgets, which prevent them from providing more efficient services to the citizens of Israel.

Due to the social distancing restrictions imposed, and the quarantine implemented in Israel, unemployment rate rose to an all-time pick – 26.3% (1.14 million people). The Macro Center for Political Economics estimates that the dept-to-GDP ratio would increase at least by 5.8 percentage points to 65.8% and that GDP is expected to shrink by 5.3%. As of the end of April 2020 it seems that the first wave of the outbreak of the pandemic has been contained and the disease is in retreat. Now, following the health recovery, Israel should develop a strategic exit plan from the economic crisis. The plan should not only provide response to the short term challenges Israel's economy is facing, but also provide long term opportunities. **Side by side with the economic challenge that the COVID-19 crisis provides, it also constitutes an opportunity to change the current social-economic priorities of the Israeli government, so it would enable both a quicker recovery and a response to future similar challenges. This document provides an English summary of such a plan based on local data and international comparisons.**

Some of the steps mentioned in this economic exit-strategy plan should be implemented immediately in order to ensure the return to operation of the Israeli economy and a return to the positive macro trends which characterized the market.

Other steps should provide long term solutions to obstacles that characterized the Israeli economy and facilitate stable and durable growth. In the short term, Israel should abandon its policies which encourage unemployment and adopt policies that support employment and re-absorbing workers to their previous work places. In addition, there is a need to create a relief plan for self-employed workers. The Macro Center for Political Economics estimates that cost of the employment support plan is 3.4 billion NIS more compared to a situation where Israel is providing only unemployment benefits, for a period of 3 months. In addition the support for self-employed and the business sector should be of 14 billion NIS for the same period of time. **Without implementing those policies unemployment rate is expected to be 10.0% at the end of 2020 compared to 6.0% if it is implemented. In addition, its implementation means that the damage to the GDP will be only 3.2% compared to 5.2% if it is not implemented.**

In addition, the long term plan includes steps to improve the labor productivity in the Israeli market by a meaningful investment in both physical infrastructure such as public transportation, and in the human capital of the Israeli workers, mainly via vocational and technological education. It is also suggested, to change the current priorities with regard to public spending on services such as health and education. The capacity of the public health system to deal with the crisis has been proven to be vital both to public health, but also to the stability of Israel's economy. An efficient education system would also increase labor productivity and provide a quicker return to stable growth. **The implementation of this long-term plan should begin with the approval of the next state budget, its cost is estimated to be 67 billion NIS and it should lead to an increase of 1.5 percentage points to the GDP growth.**

### **Encouragement to return to full employment and support self employed**

**Employment encouragement and working relations** – unlike many other OECD countries, thus far, Israel's policy in the labor market encouraged unemployment via the leave of absence mechanism. However, there is an urgent need to change the policy to a one that supports employment. From past experience, it is assumed that

20% to 30% of the workers that have been put on leave of absence will not return to the labor market immediately. Meaning, the number of unemployed is expected to be around 400,000 people following the crisis. It is also suggested that by supporting unemployment, much of the efforts of the government in the past decade to increase the labor market participation rate of different populations, such as Arab women and Ultra-Orthodox men, has been reversed. **The employment encouragement plan should be trilateral and accepted on the government, the employers and the employees.** This is similar to the plans adopted in Germany, Denmark and even the United Kingdom. The government should offer support and compensation for employers and businesses that have been affected by the COVID-19 crisis, as long as they return as much workers as possible to their payroll. Employers should be offered **compensation of up to 80% of the total costs of their workers' salaries** and up to 10,000 NIS per worker. Those payments are substituted for unemployment benefits that the government is currently paying. In return for the compensation, employers and businesses are to ensure that no employees will be fired. If decided necessary employees that their salaries would be paid via this compensation mechanism are to give up on some of their days off in 2020, similar to agreements in other countries. **Cooperation between the government, the employers and the employees is crucial in order to encourage employment and a quicker return to the situation prior to the crisis.** The Macro Center for Political Economics estimates that the cost of such a plan is an additional 1.14 billion NIS per month, compared to a situation in which it pays only unemployment benefits. For a period of 3 months, the cost is of an additional 3.4 billion NIS compared to the current situation.

**Support Self-Employed and freelancers** – Side by side with encouraging the employment of workers, it is important to note that the affect that the crisis had on self-employed and freelancers is also severe. As a result of a month and half of quarantine there is a need to compensate many businesses so they would survive the crisis, namely small businesses and self-employed that do not receive unemployment benefits. In addition, some economic sectors have been affected more than other and should receive greater attention in the recovery plan such as tourism, accommodation

and food services activities, wholesale and retail trade, and art and entertainment. **In order to ensure the operation of the business sector it is important to implement a compensation system similar to the one given following security events, and to ensure full compensation for self-employed that their revenue was cut by 25% or more compared to their revenues last year in the same period of time.** Social security of unemployed is limited compared to social security of employees. **It is important to apply unemployment benefits also for self-employed in Israel.** Doing so would ensure social security for self-employed in future crises. In addition, by applying unemployment benefits for self-employed, in the future, they would fully fund their benefits via social security provisions. **The expected cost of such a plan is 14 billion NIS for a period of 3 months.**

### **Supporting labor productivity growth**

One of the major barriers in the Israeli labor market is the low labor productivity. Labor productivity measures the product per time unit. In recent years, the low labor productivity in Israel has become a crucial problem that prevents growth, wage increases and does not allow narrowing inequality, as the low labor productivity affects mostly unskilled workers. In addition, lack of attention to the root causes that prevents growth in labor productivity leads to the fact that the gap in labor productivity between Israel and the advanced countries in the OECD only grows. **Labor productivity in Israel is 41.2 USD per hour worked compared to 53.3 USD per hour worked on average among OECD countries.** Improving labor productivity could support a quicker return to full employment and to enable a better readiness for future crises. Furthermore, the COVID-19 crisis affects less economic sectors with high labor productivity such as the Israeli high-tech, the finance sector and the traditional industry. The majority of impact of the crisis focuses on economic sectors with low labor productivity. Therefore, improving labor productivity is crucial in narrowing inequality in the Israeli society, as well as an opportunity to improve one of the most problematic measurements in the Israeli labor market. In order to improve labor productivity two major plans are suggested – **investment in physical**

**infrastructure and improving the human capital by investing in vocational education.**

**Investment in physical infrastructure** – road congestion has become a severe issue in Israel, which according to OECD estimations has a heavy economic price tag to the country's economy – around 2.0% of its GDP – 28 billion NIS per year. The loss of product due the traffic is especially severe in Israel, as the OECD estimates that the average economic cost of road congestion is 1.0% among OECD countries. Israel is the country with the highest cars per road length ratio among OECD countries. Therefore, it is suggested that as part of the long term exit strategy from the COVID-19 crisis and the shift in priorities, projects related to public transport in Israel should be prioritized. Such projects include a much larger investment in public transportation infrastructures, increasing the number of busses, prioritization of public transportation, using negative incentives for usage of private cars, and encouraging the usage of alternative and eco-friendly transportation systems. As mentioned, the gain for the market is expected to be up to 28 billion NIS per year and to improve the lifestyle of many. **The suggested cost of this plan is 28 billion NIS, a cost that in the long term is expected to be fully return to the economy.**

**Investment in human capital and vocational training** – another crucial way to improve the labor productivity is via vocational education and lifelong learning (LLL) among employees. One of the ways to achieve this is via the improvement of curriculums and the variety of vocational education programs offered in Israel. Vocational education programs should undergo a substantial reform – upgrading and adding more contents with cooperation of the government, employers and local academy. Training should provide tools to better cope with the digitalization and automation processes experienced in recent years in the labor market. It should also focus on providing advanced technological capabilities for workers, side by side with improving basic capabilities. Optimizing the vocational education systems in Israel based on models implemented in central European countries such as Germany, should

increase Israel's GDP by 1.5 percentage points, meaning an increase of 21 billion NIS per year. The economic cost of such a plan is estimated at 7 billion NIS, and its impact to the market is expected in the long term.

### **Reform in major public systems**

The COVID-19 crisis is another example that the efficiency of major public systems is crucial in order to provide the society and the economy to fully operate both during routine and during times of crises. First and foremost, the public system that was at the center of the efforts to contain the spread of the COVID-19 pandemic is the health system. A strong and functioning health system provides the basis for effective coping with such crises both by its success in halting the spread of the virus and by allowing the economy to continue operating. Second, another important public system that enables a quick recovery and return to normality is the education system. The operation of the education system following the first wave of the outbreak of the COVID-19 pandemic is crucial in order to ensure normal life, reduction of unemployment rate and return to a stable growth path. Therefore, as part of the exit strategy from the crisis, and as part of the long term change in priorities in Israel, it is recommended to improve those systems and to promote them via additional expenses and optimization of their operations.

**The health system** – a strong and functioning health system is crucial in the fight against this specific pandemic, or other health issues that might take place in Israel. In addition to taking care of patients in routine, the health system is the key function in dealing with crises situations such as this. As could be shown by the German case, a health system with the ability to absorb many patients and to provide a quick adoption to a crisis situation lowers the death rate and provides a quick and comprehensive response both to the health aspects of the crisis and to its economic aspects. **In Israel, the health system suffers from long term negligence**, and is at the bottom in two major measurements compared to other OECD countries – the number of nurses per citizens and the number of hospital beds per citizens. The public expenditure on

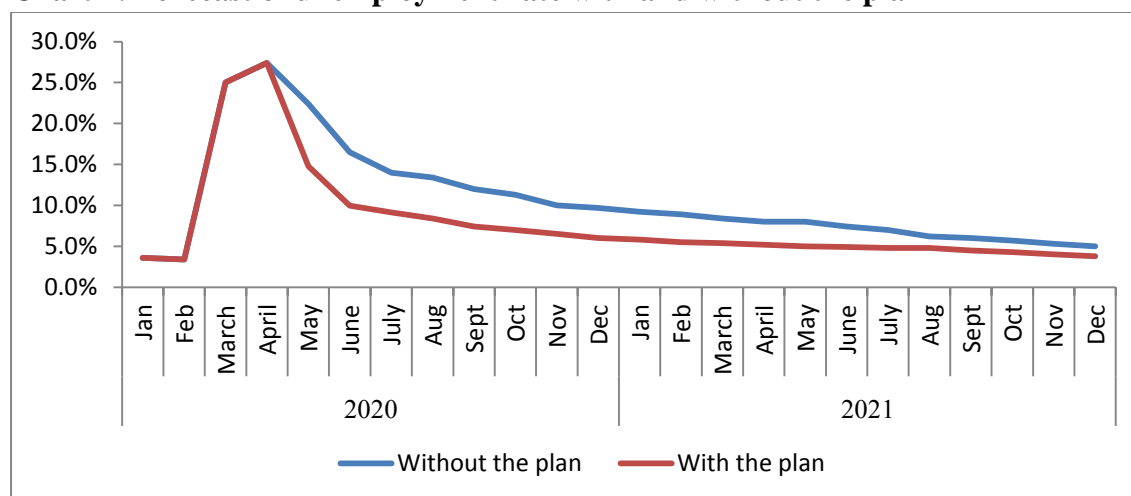
health in Israel is 4.8% from the GDP, while the average among OECD countries is 6.6% of GDP. **In order to compare the expenditure to the average among OECD countries Israel should increase its health budget by 25 billion NIS. However, it is important to note that increasing expenses is only the mean and not the goal. In order to ensure that the additional budget leads to a more efficient system, there is a need to establish a team consistent of health experts from different health bodies to ensure that higher spending leads to a more efficient system.**

**The education system** – similar to the health system, the education system holds a crucial role in the return to normality following the spread of the COVID-19 virus. The return of the Israeli economy to previous operation is dependent on the return of children to the education system, especially the return of younger children. However, there are some limitations on the education system in the post COVID-19 Israel – smaller class rooms and remote learning options. **Israel should promote a plan that would enable the continuation of small classes following the crisis, to promote digitalization processes and to support integration of technology in the school system.** According to many researches, this investment would lead in the long term to greater labor productivity and to improve the skilled workforce in the country. **Improving the education system and comparing the expense per student to the OECD average means an additional budget of 7 billion NIS.**

**To summarize, the long term economic exit strategy from the COVID-19 crisis includes three main components – the recovery of the labor market via employment encouragement program and compensation for the self-employed; improvement of labor productivity via larger investment in physical infrastructure and vocation education; and a reform in crucial public systems such as the health and education systems and comparing the expenditure on those systems to the OECD standard. The cost of the short term plan is 17.4 billion NIS. The long term plan, which includes a shift in priorities for the Israeli government costs 67 billion NIS.**

The Macro Center for Political Economics estimates that unemployment rate is to converge in a much faster rate to the original unemployment rate previous to the crisis if Israel adopts this plan. Adopting steps to increase labor productivity would bear fruits mostly in the long term, however could also improve the labor market statistics in the short term – providing vocational training for unemployed people in the coming months and focusing on soft skills such as writing C.Vs, providing skills to succeed in job interviews could benefit many and decrease the unemployment rate. The estimation is that if the plan is adopted by the end of June 2020 unemployment rate would be 10.0% compared to 16.5% without its adoption. **The gap is of more than 250,000 people.** By the end of 2020 taking those steps would decrease unemployment rate to 6.0% compared to 10.0% without its adoption. The gap is of 150,000 people. Without a second wave, unemployment is expected to reduce in 2021 and that gap would be 1.2 percentage points in December 2021 – nearly 50,000 people.

**Chart 1: Forecast of unemployment rate with and without the plan**



Naturally, a faster absorption of workers to employment and assistance to the self-employed and the business sector would improve to the macro-economic indices of Israel, mainly the GDP growth. In 2019 growth was 3.6%, an impressive number compared to other OECD countries. Yet, it is estimated that due to the COVID-19 crisis, and without steps that would encourage employment, growth is expected to shrink by 5.3%. However, if the plan will be adopted the shrink in GDP is expected to be only 3.2%. In 2021 the market is expected to recover, however the recovery will be



faster if the plan is adopted – growth with the plan is expected to be 6.8% compared to 4.9% if it is not approved.

**Table 1: Major Macro-Economic indices with and without the exit strategy**

<b>Year</b>	<b>Growth without the plan</b>	<b>Growth with the Plan</b>	<b>Unemployment rate without the plan by the end of the year</b>	<b>Unemployment rate with the plan by the end of the year</b>
2019	3.6%	3.6%	3.6%	3.6%
2020	-5.2%	-3.2%	10.0%	6.0%
2021	4.9%	6.8%	5.0%	3.8%