

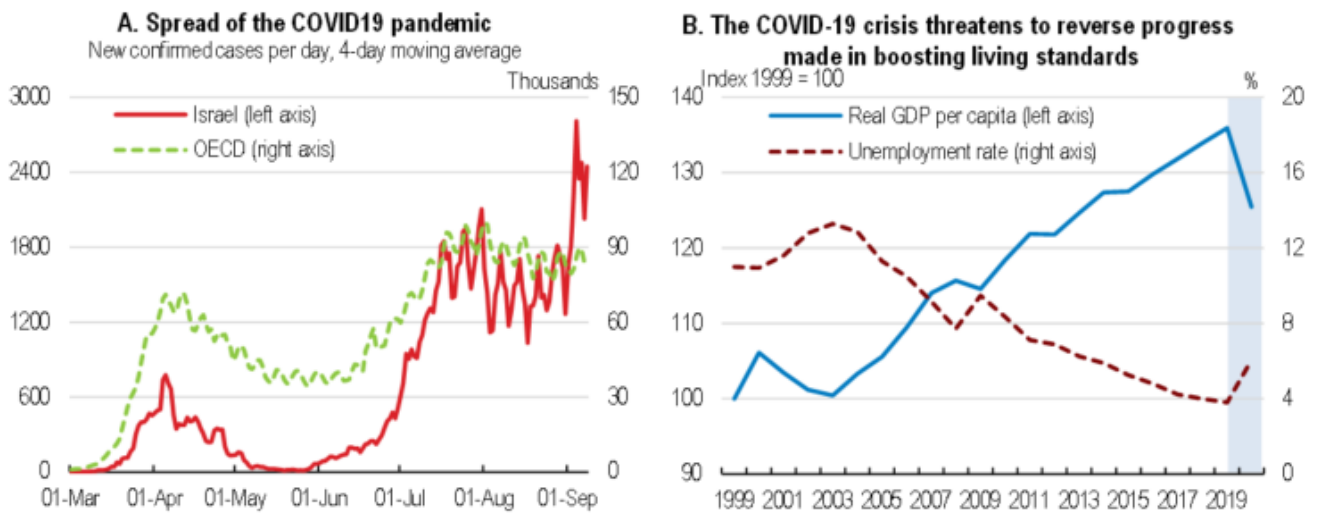
Ensuring a strong, inclusive and sustainable recovery from the COVID-19 crisis in Israel

by Gabriel Machlica and Oliver Röhn, Economics Department

The coronavirus pandemic has interrupted Israel's progress in boosting standards of living. Before the pandemic, Israel enjoyed strong employment growth and living standards had risen close to the OECD average. To contain the spread of the pandemic, the government reacted swiftly and introduced stringent confinement measures in March and April. The government and financial authorities deployed emergency measures quickly to support households' and firms' incomes and liquidity. After the economy had largely reopened, a second outbreak has given way to a renewed lockdown in September (Figure 1, Panel A).

As in other countries, high uncertainty and the containment measures necessary to limit the spread of the virus have led to a sharp drop in economic activity. The economy is projected to decline by around 6% this year (Figure 1, Panel B). At the height of the crisis, over a million employees were temporarily laid off. Many have returned to work as the economy reopened. However, the unemployment rate, broadly defined to include workers on unpaid leave and workers who have left the labour force due to the pandemic, remains high at 11%. Moreover, the crisis threatens to aggravate Israel's long-standing challenges of high poverty and wide productivity disparities between its vibrant high-tech sector and lagging sheltered sectors.

Figure 1. The pandemic is threatening to reverse some of the achievements made over the last decade



Note: The GDP and unemployment figures for 2020 are forecasts. Unemployment is narrowly defined according to the Labour Force Survey. Source: OECD calculations based on Ourworldindata; and OECD Economic Outlook: Statistics and Projections database.

The new OECD Economic Survey of Israel (2020) identifies measures that can help Israel navigate this crisis. In the short term, the government and financial authorities should continue to provide fiscal, monetary and financial market support to buttress the recovery, boost confidence and avoid widespread bankruptcies. The government has expanded the eligibility to unemployment benefits to workers on unpaid leave and extended benefits until next year. This should be complemented by stepping up active labour market policies, such as retraining and job search support, to help workers transition to new jobs with better prospects.

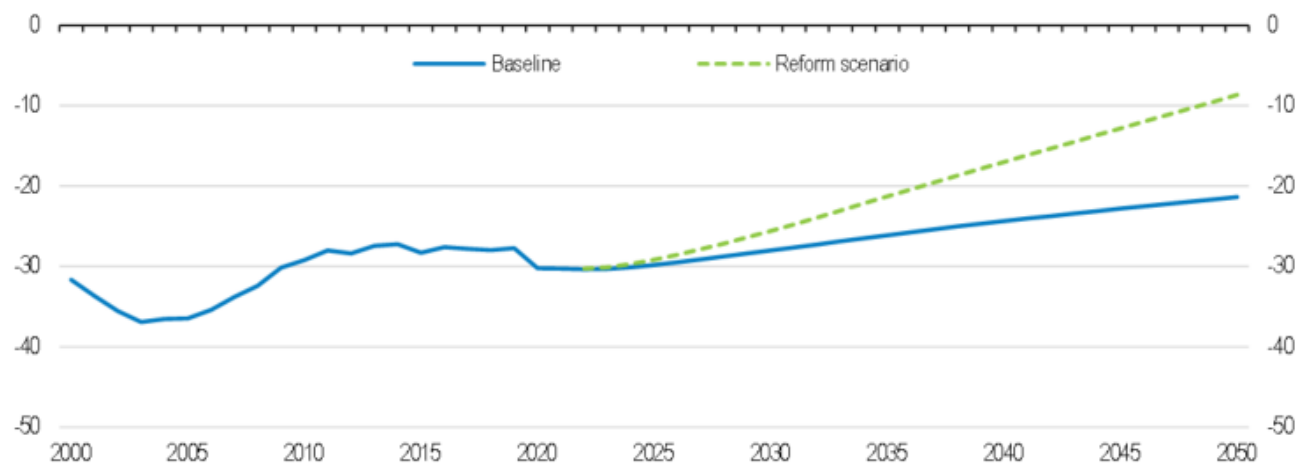
The Survey identifies priorities to put Israel on a stronger, sustained and inclusive recovery. Introducing ambitious reforms can improve the standard of living of the average Israeli citizen by some 15% by 2050 and help to reduce the gap in living standards vis-à-vis the upper half of the OECD countries (Figure 2). These measures and reform areas include:

- **Upgrading infrastructure.** Israel's core infrastructure stock is almost a third smaller than in other OECD countries. The availability and quality of public transport is also limited. Boosting public infrastructure investment can lift productivity and connect people to job opportunities.
- **Improving educational outcomes.** The gaps in students' outcomes between Arab-Israeli students and the rest of the population are significant, amounting to 4 years of schooling on average. Reducing gaps will require improving pre-school education, recruiting high-quality teachers, especially in the poor municipalities, and reducing disparities in students' outcomes between different school streams.
- **Strengthening the fiscal framework for local governments.** Poorer municipalities lack resources to finance adequate public services for their residents. This calls for supporting poorer municipalities through higher compensation from wealthier municipalities. Merging municipalities and promoting regional clusters can improve efficiency.
- **Supporting the poor.** Employment among groups with traditionally low labour market attachment has significantly improved. However, the income received from work was not enough to make a substantial dent in poverty, which remains comparatively high. Further expanding Israel's earned income tax credit would support the poor while maintaining strong incentives to work.
- **Simplifying the tax system and reducing economic distortions.** The tax mix is reasonably growth- and employment-friendly with a relatively low tax burden on labour. Nevertheless, ample room exists to simplify the tax system by abolishing inefficient tax expenditures and broadening tax bases, which would support revenues. The business and property tax system should be reviewed to reduce distortions.

- **Improving environmental outcomes and reducing health risks.** Poor air quality remains a concern for the well-being of Israelis. Introducing congestion charges would reduce traffic flows and air pollution, and can provide additional resources to boost the public transport infrastructure. Pricing fossil fuels according to their carbon content and other pollutants, while protecting the most vulnerable, would further lower carbon emissions, and make renewable energy generation more competitive.

Figure 2. Convergence in standards of living to the OECD level

Potential GDP per capita, gap to the upper half of OECD countries



Source: OECD simulations based on OECD Economics Department Long-term Model.

References:

OECD (2020), OECD Economic Surveys: Israel 2020, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-isr-2018-en.