

Les Matinales du Club

Israel and the world economy: the power of globalization

Compte-rendu

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Assaf Razin

While anti-globalization forces are common now - especially in Europe and in the US -, Israel is still – in accordance with its tradition – clearly open to globalization.

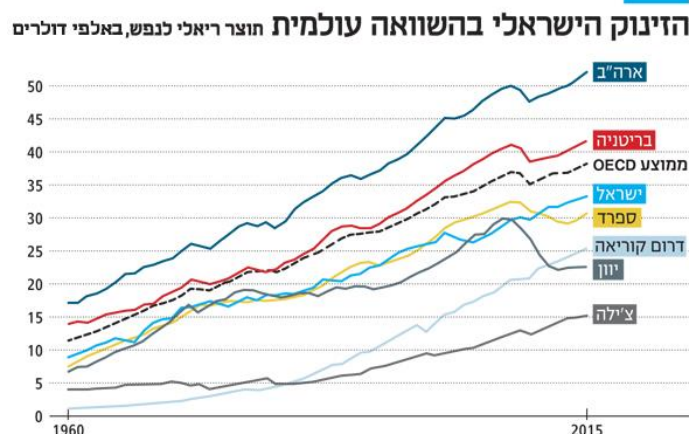
Since its inception, Israel has been remarkably open to the world –in terms of trade or immigration - specially to Europe and the US. This opening allowed Israel to build a high-tech industry.

The country used globalization to its advantage and its economic experience contains many highly relevant lessons: how to tame inflation, how to absorb immigrants, how to make the transition to high-tech, and to fight depression forces.

The book (“Israel and the World economy: the power of globalization”) also looks at major **global events that were game changers in Israel, showing how decisive globalization is for the country’s development:**

- The collapse of the Soviet Union brought many skilled workers in Israel.
- The Great Moderation in inflation and output- employment fluctuations in the advanced economies, and the convergence of Israel’s inflation to the low world inflation rates (whereas in the 1980’s inflation in Israel were more than 400%!).
- The 2008 global financial crisis (epi-centered in the United States, spreading violently to Europe), and the surprising robust performance of the Israeli economy
- The rise of the Asian markets, recently opened up to Israel’s exports, which also became an abundant source of foreign direct investments into Israel.
- The global information technology surge, and its spillovers to the fast- developing high- tech sector in Israel, aided by high skill immigration and joint ventures with enterprises from the Silicon Valley.

Israel among the OECD economies (Real GDP per capita)



In terms of GDP per capita, Israel ranks above Spain, South Korea, Chile and getting close to the average of the OECD.

Israel's immigration

Immigration is not just about the movement of workers from one country to another. They are people who integrate society as a whole and not just its Labor market.

There are two types of immigrants:

- The low skill ones, who are net beneficiary of the welfare state

- The high skill workers who are net contributors.

Of course controlling immigration is generally an issue, and as Jeff Sachs (2017) says: “If people were told that they could move, no questions asked, probably a billion would shift around the planet within five years, with many coming to Europe and the US. No society would tolerate even a fraction of that flow. Any politician who says, “let’s be generous,” without saying-” we’re not going to let the doors wide open”, will lose.”

However, Israel is an exception as it didn’t control immigration. Indeed, its “Law of Return” enables the Jews who were dispersed around the world to come to Israel, get immediate citizenship and get absorbed in the Israeli economy.

Here are two examples of two waves of immigration to Israel:

- **At the inception of the country, in 1950-1951**, Jews who were expelled from the Arab countries came to Israel. **This wave amounted to 13.2% of the established population in 1951!**
- Last wave, **after the collapse of the Soviet Union, amounted to 19% of the established population over the period 1989-2001. This changed completely the demography of Israel.**

Period	Immigrants as a Percentage of Established Population	Growth Rate of Population
1922-32	8.2	8.0
1932-47	6.4	8.4
1947-50	19.8	21.9
1950-51	13.2	20.0
1951-64	2.2	4.0
1964-72	1.3	3.0
1972-82	0.9	2.1
1982-89	0.4	1.8
1989-2001	19.0	-

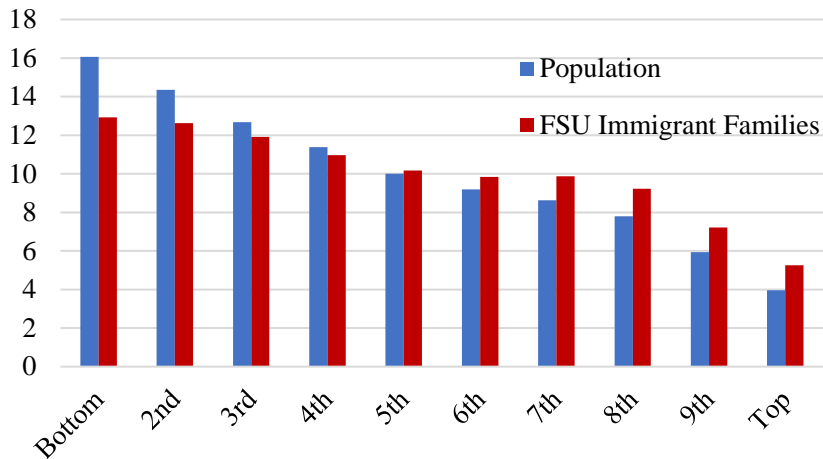
Source: Ben-Porath (1985) for the years 1922-1982, Central Bureau of Statistics (1992), Bank of Israel (1991b) for the years 1982-2001.

Another aspect of immigration is the change in policy, as immigrants participates in policy making.

Let’s focus on the last wave of immigrants (after the collapse of the Soviet Union). It can be seen as a “natural experiment” as it obviously hasn’t been triggered by Israel. After the collapse, many people from different parts of the Soviet Union tried to go to the US or to Germany, but these countries have decided to accept only part of this flow of migrants. **All the rest came to Israel by virtue of the “Law of return”.**

What were the characteristics of these migrants coming to Israel? **They were small household, with few kids and grand-parents. They were thus contributing to Israeli productivity** and were net contributors to the country. They had for a large part done higher education and got assimilated very quickly, at least economically.

A good way to measure how economically assimilated is a wave of migrants is to look at how the second generation divides among the different deciles of income:



It appears that the children of this wave of migrants (from the Soviet Union) have been remarkably assimilated, as the FSU (Former Soviet Union) children are more represented in the first deciles than the established population.

They also have been remarkably assimilated politically speaking. When in general, the first generations of immigrants don't participate a lot in elections, this wave of migrants to Israel tells a different story. Voting turnout patterns of Soviet-Jew immigrants to Israel in the 2001 elections, conducted by Arian and Shamir (2002) find no marked difference in the voting turnout rates between these new immigrants and the established population. Moreover, as these Soviet-Jews represent 19% of the population, their votes were decisive to the vote.

In my view, **these migrants were numerous enough to actually influence the design of Welfare State and they eventually made the Israeli welfare state less progressive.** Indeed, being net contributors they needed less redistribution and supported parliamentary coalitions eager to reduce taxes on high incomes as well as social security benefits.

The income distribution changed a lot in the late 1990's:

- Market-based inequality (inequalities before redistribution) was improved after the FSU (Former Soviet Union)
- Disposable-income (after redistribution) based inequality deteriorated
- All in all, the inequalities increased

However, it is striking that despite the rise in inequalities, the overall level of income of the population (both skilled and unskilled) increased.

At the same period, others factors of development (besides immigration) played their role in the country's development and the increase in average income:

- The stabilization of the inflation rate at the same level as western countries
- Hi-techs

- Globalization

Globalization clearly played a role in the deterioration of the disposable-income based inequality. Indeed, it is a factor of tax competition such as what happened between Member States in EU. And in the long term, the decrease in fiscal tax must be compensated by an increase in Labor tax, thus deteriorating the disposable-income based inequality.

The main pitfall of the Israeli system is that the Ultra-orthodox, who amount to 10% of the population but show an increasing fertility rate, are not integrated in the Labor market. This problem will gradually worsen as the Ultra-orthodox will represent a growing part of the population. However, the Arabs (20% of the population) are getting more and more integrated to the Labor market.

Hilel Rapoport

I found Assaf's book very interesting as it shows how Israel could take full advantage from the globalization through:

- Immigration
- Start-ups new technologies
- Opening to international trade and financing

Israel showed strikingly resilient to the 2008 crisis.

About immigration

I think Assaf's view on immigration might be a bit too pessimistic. Indeed, it seems to me that:

- The short term effects of immigration on labor markets and public spending are relatively small.
- On the other hand, the **long term positive effects on growth are more important.**

→ I think the balance is in favor of long-term benefits

Assaf said immigrants have more social mobility than the rest of the population. If it seems to be true in the case of Jews from the Soviet Union, it proves wrong in many other cases.

About technology

Several factors explain the growth in FDI and R&D:

- In the 1980's the US military aid turned from cash to in-kind, **the Israeli military industry had to find his own markets**
- **Strong links with the Silicon Valley:** during the Israeli economic slowdown in the 1980's, many high-skill Israeli workers went to the Silicon Valley.
- Cheap and abundant human capital

About inflation and sound macroeconomic policies

1980's: stabilization plan (reducing inflation)

1990's: deregulation, liberalization

2000's: macroeconomic resilience through the crisis

I think in his account of these successful policies, Assaf might be forgetting – out of modesty - a very important factor: the quality of Israeli economists. Indeed:

France has good economists who have no say
Greece has bad economists who have their say
Israel has good economists who have their say

Conclusion

- There is no anti-globalization in Israel, but we are not immune to populism.

- Israel should learn from France about population policy. The French fertility rate increased and France has now one of the highest fertility rate in Europe. To do so, the middle class was moved from 2 to 3 child, through fiscal incentives and subsidizing. **The Israeli policy is to move ultra-orthodox families from 5 to 8 children, which could be catastrophic in the long run.**
- On the inequality side, Israel moved from one of the lowest inequality country among the OECD to one of the highest. This could be a threat to Israel as inequality are likely to foster even more conflicts within the society.
- About “the elephant in the room”. The occupation of the Palestinian territories has an economic cost in the short term, but it also has one in the longer term as it will worsen some current diplomatic and political issues.

Q&A

What about the lack of infrastructures in Israel?

Assaf Razin: We're actually lagging behind in terms of roads and infrastructures in general. You could appreciate it by seeing how congested Tel Aviv is. This lack of infrastructures tends to increase the prices on the real estate market, as many people who work in Tel Aviv have to live there too because of congestion.

What about the integration of the Israeli economy in the world?

Assaf Razin: The importance of FDI to Israel shows how integrated is the country. FDI don't necessarily come from the US or Europe, but now also from China. Israel emerged as a high-tech economy through FDI under the specific form of “venture capital”, which is the riskiest form of FDI. Many other countries couldn't do so as they were not targeted by FDI under this form.

To what extent could the Israeli economy be threatened by the boycott campaign?

Assaf Razin: Theoretically, the high level of integration of the Israeli economy makes it dependent on the rest of the world and thus sensitive to this kind of campaign. However, the BDS campaign is still a fringe movement that doesn't look threatening at all yet.

The Israeli economy could be threatened if the EU decided to boycott Israel. For now, the EU only boycotts products from the West Bank. This is no big deal for now as the Israeli economy is essentially located outside the West Bank and people from the West Bank move out to get employed. But who knows the importance this fringe movement might get in the coming years, especially in the current context, made of uncertainty (Trump, but also the conflicts in the Middle East)?

About the relations between Israel and its partners

Assaf Razin: It's striking to see that whereas Turkey is officially very hostile to Israel, our trade relations are as strong as ever, maybe because the Turkish economy is not doing so well (with inflation, depreciation, etc.)

Austria, Romania and Hungary are taking anti-Semitic decisions, as kicking George Soros outside the country (Hungary). It's a very ironical story as George Soros actually financed Viktor Orban higher education. Yet, these countries are not considered as diplomatically decisive to Israel.

Saudi Arabia might appear as an ally in front of Iran. This context could theoretically help reach a compromise with the Palestinians, but my view is that we don't have a leader in Israel who can positively exploit this context.

Why did the Jews from the former Soviet Union adapt so well and quickly to the new Israeli technology environment?

Assaf Razin: One key element might be the importance given to education in these Jewish communities. Moreover, women were not housewives but workers, which helped these households' economic integration.