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**The Israeli Economy on the Eve of the Second Lockdown: A Strategic
Outline for the Future**

Shmuel Even

Israel has lost control over the spread of coronavirus, and the government has decided to impose a second nation-wide lockdown. The economic and social crisis caused by the virus affects a large group of people, especially among the middle class working in the private sector. The impact of the crisis on healthcare, the economy, and society is also affected by political instability, erratic management, and non-compliance with the regulations among some of the public. The Covid-19 virus is a natural disaster, but to a large extent the ramifications of the ensuing crises result from how this disaster is managed. This article describes the main aspects of the economic situation before the second lockdown, and presents an outline for future management of the crisis. In the current predicament, it is essential to manage the crisis with determination, efficiency, and a look ahead, with planning for accelerated economic growth, once the pandemic no longer has a decisive effect on Israel's economy and society. This approach urges approval of the 2021 state budget before the end of 2020.

The Economic Situation

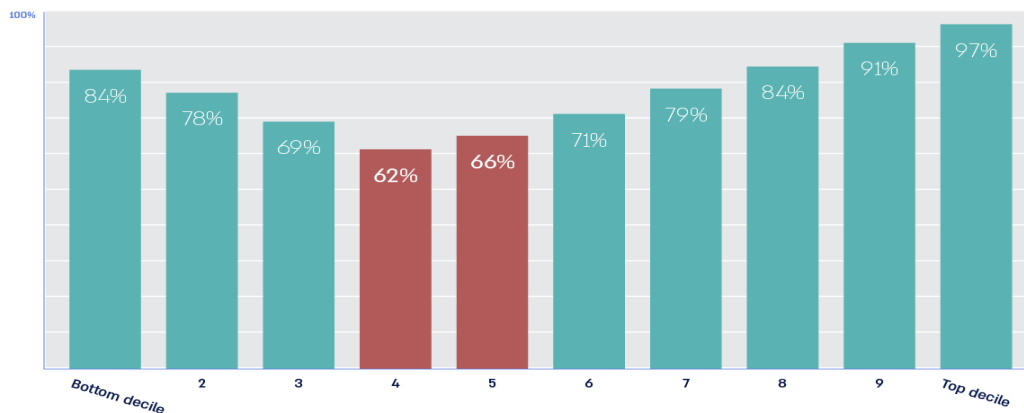
On the eve of a second nation-wide lockdown imposed by the government, the Israeli economy is in a recession. The economic consequences of the new lockdown are billions of shekels more in spending and lost GDP, as well as increased unemployment. Israel enters the upcoming lockdown in a much poorer economic state than what existed in the period before the first lockdown. From an epidemiological aspect, the prospects of the second lockdown significantly containing the spread of the coronavirus are highly uncertain, but that is beyond the scope of this article.

According to a forecast by the Bank of Israel issued on August 24, 2020, in an optimistic scenario GDP will shrink in 2020 by 4.5 percent. In a worse scenario, particularly if there is a loss of control over the infection rate – as is currently the case – GDP will shrink by 7 percent.¹ According to a forecast by the Ministry of Finance issued on August 4, GDP will shrink by 5.9 percent and 7.2 percent, respectively.² For the sake of comparison, GDP growth in 2019 was 3.4 percent.

The crisis has increased state spending, decreased revenues, and enlarged the state budget deficit and debt. Thus far, the government has promised aid plans of various types amounting to NIS 135 billion, of which NIS 65 billion has already been distributed. The government has already borrowed NIS 98 billion for this purpose.³ According to a Bank of Israel forecast, the ratio of debt to GDP is expected to reach 78 percent by the end of 2020 in the optimistic forecast and 87 percent in the pessimistic forecast, compared with 60 percent in 2019. At the same time, however, to date the shekel is holding steady against the basket of currencies, as are Israeli government bonds.

Employment is the main sphere connecting the economy to society. The steep decline in the employment rate affects all aspects of the lives of the unemployed and their families. According to the Central Bureau of Statistics, as of July 2020, there were approximately 500,000 people out of work (unemployed, people on unpaid leave, and others), amounting to 12 percent of the labor force.⁴ Unemployment in 2019 was only 3.8 percent. Most of the jobless are in the private sector and from sectors affected by social distancing, such as tourism, the restaurant business, culture and leisure, transportation, and retailers. Hardest hit was the middle class, particularly deciles 4-6 (Figure 1). Indeed, it appears that overall the middle class has been hit particularly hard: in contrast to the lower deciles, it is ordinarily not supported by transfer payments from the state, and has much less economic resilience than the upper deciles. This situation requires that government policy be aimed at this sector.

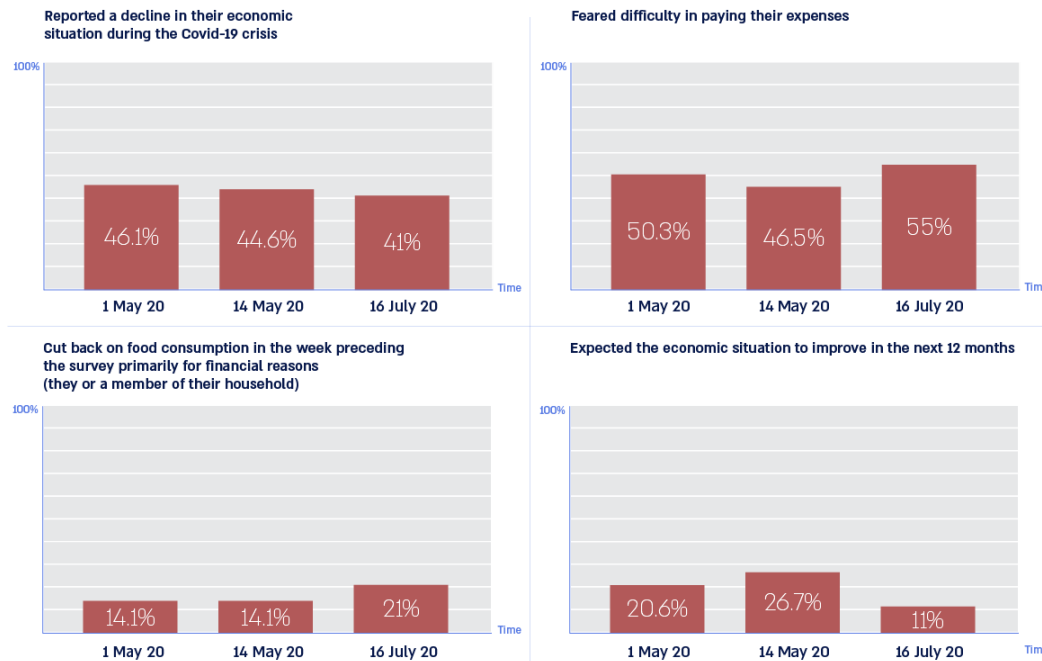
Figure 1. Employment in March-May 2020 by deciles, compared with employment in the corresponding period in 2019



Source: Labor Survey by the Central Bureau of Statistics, and analyses by the Bank of Israel⁵

The Central Bureau of Statistics monitored the population's economic situation in three surveys, conducted from early May through mid-July 2020 (Figure 2). In all three surveys, 40 percent or more of those questioned reported that the pandemic had worsened their economic situation. While the percentage of those complaining about a worsening of their situation fell (from 46 percent in early May to 41 percent in mid-July), the distress of those affected deepened. For example, the number of those reporting a reduction in food consumption, mainly for economic reasons, grew from 14 percent in mid-May 2020 to 21 percent in mid-July 2020. The proportion of those expecting improvement in their economic situation in the coming 12 months (the optimists) plummeted from 27 percent in mid-May to 11 percent in mid-July. Such trends are also prominent in the Arab society's economy, where the situation is worse, but optimism is greater (16 percent in the July survey). These and other figures indicate that the economic crisis does not affect the entire population to the same extent. Most of those affected by the crisis can be identified, and thus a focused policy for them can be implemented.

Figure 2. Economic situation according to CBS Surveys



Source: Central Bureau of Statistics⁶

The Israeli government's economic policy is short term, unorganized, and affected by political pressure. For example, the state budget for 2020 has not been approved, and the country is run under a continuation budget from 2019 (approved in March 2018), which was recently extended and increased by NIS 11 billion for the purpose of regular operations. A large proportion of government spending on the crisis is funded by "out-of-

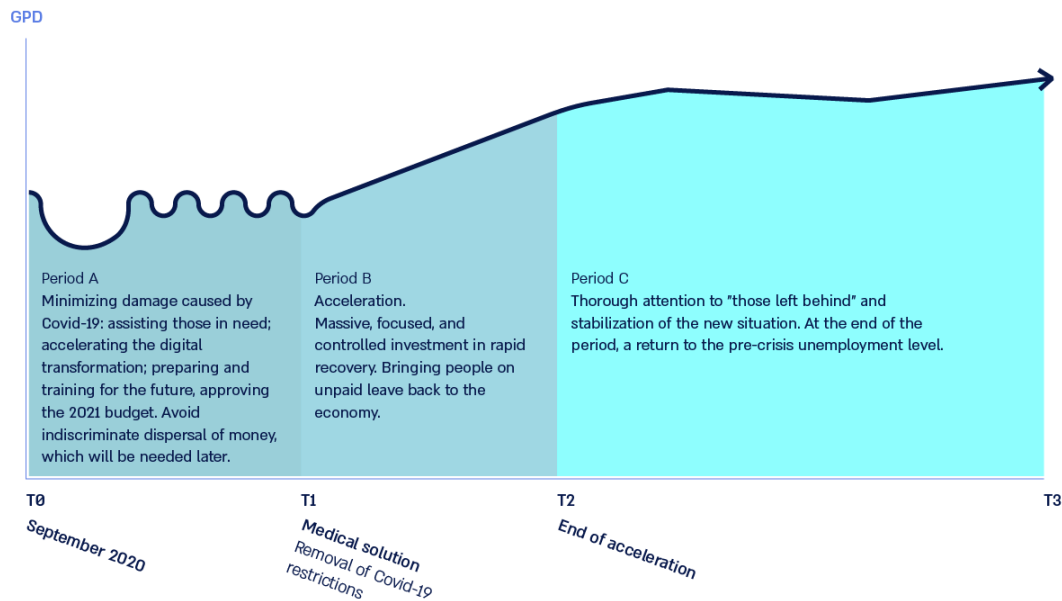
budget boxes" (a method of evading the spending ceiling stipulated in the Budget Law). Furthermore, no proposal for the 2021 state budget has been formulated, and spillover of the continuation budget into 2021 is liable to have a negative impact on the performance of the government and the subordinate organizations.⁷ Monetary assistance was handed out indiscriminately (every Israeli citizen received a NIS 750 grant), but effective aid should be differential and focused on those affected by the crisis. The unpaid leave model is also criticized for not including incentives to encourage those out of work to the return to the labor market.

A Strategic Outline for Later Management of the Crisis

The economic management of the crisis is subject to factors external to the economy, especially morbidity on the one hand and the unstable political situation on the other. The Covid-19 virus is a natural disaster, but to a large extent the ramifications of the ensuing crises result from how this disaster is managed according to various time intervals.

The challenge currently facing Israel is to minimize the damage, and then gradually restore several of the economy's main parameters (unemployment, growth, debt-GDP ratio) to their pre-crisis levels. This, however, is not enough. Even before the crisis, Israel had several alarming fundamental problems, among them a relatively low rate of participation in the labor force and low productivity among a considerable percentage of the population. This is true mainly of the ultra-Orthodox and Arab sectors. It will also be necessary to adapt to a new reality and even participate encourage it in various ways, for example, a leap forward in the digital transformation, a new labor market, acceleration of competition in the global economy and new consumer behavior. The additional challenge is therefore to take advantage of the process of emerging from the crisis in order to shape a stronger economy and society.

Figure 3 presents a schematic multiyear outline for managing the COVID-19 crisis. The underlying assumption is that on a certain date (T1), the coronavirus will cease to be an influential element in the population's healthcare situation, and consequently the economic and social situation. The uncertainty about this date requires economic agencies, such as the Bank of Israel and the Ministry of Finance, to present and update various scenarios for economic recovery, which are a function of the possible T1 dates. Note that according to the intermediate scenarios of these agencies, strong growth will take place in 2021, as opposed to late 2020. From a managerial perspective, uncertainty regarding T1 has economic significance that should be considered, for example the scope of available resources and the time necessary to keep afloat businesses and individuals seriously affected by the ongoing and future social distancing measures until the pandemic is eradicated, or at least weakened.

Figure 3. Strategic outline for management of the crisis

The outline covers three periods: Period A, in which damages caused by living with Covid-19 are to be minimized (between now and T1); Period B – economic resurgence, after the influence of the pandemic ceases (T1 until T2); and Period C, attending to those left behind and growth stabilizes in the new situation (T2 until T3). The duration of the first period depends on the medical situation, but the degree of economic and social damage also depends on how the crisis is managed. The duration of the other periods depends on how the crisis is managed in that specific period and in the preceding period. The third period (T2 to T3) is liable to be lengthy, after which the level of unemployment is likely to revert to its pre-crisis level. Some parameters, however, such as the ratio of debt to GDP, which will require many years to return to the previous situation.

The recommended efforts in each of the three periods described in the model are as follows:

From T0 (now) until T1: The Struggle against the Pandemic

Currently the pandemic continues to intensify, and the government has ordered a second lockdown. Experience since March 2020 shows that before a comprehensive medical solution to the pandemic is found, the economy is liable to suffer from extreme volatility caused by changes in morbidity and government measures to bring the infection rate under control. The damage to various individuals, businesses, and sectors will continue to be selective and affect differentially civil resilience and the ability of various sectors to

recover. It is clear that if the economic crisis escalates, there are liable to be severe system-wide consequences for the entire economy and society.

There are two main challenges in this period. One is to balance the needs of combating the pandemic against the needs of the economy and society, in other words, to manage simultaneously the medical, economic, and social curves. The social distancing measures introduced for medical purposes are not anti-economic, because if contagion accelerates, it will have severe economic and social consequences. The difficulty is to find the equilibrium point, for example, when medical experts are divided about the effectiveness of measures such as a lockdown, or when political pressures are exerted on decision makers.

Coping with this challenge in the T0-T1 period requires addressing three timespans: managing the campaign at the daily and weekly level, management 2-3 months ahead, and managing the remainder of the period until T1. The optimal policy includes expanding the capabilities of the healthcare system for the struggle against Covid-19 (the capacity of this system affects the ability to make decisions having economic consequences); providing systematic and reliable explanations for gaining public trust; minimizing the damage and preventing the crisis from expanding, for example, in the financial sphere (e.g., avoiding steps that jeopardize Israel's credit rating); providing focused and controlled assistance for those affected. It is best to reduce indiscriminate aid, and to keep resources in reserve that will make it possible to move to the next stages. Focused assistance depends to a large extent on accurate information about the population's situation.

The second challenge is to plan and implement practical measures leading to the next stages. This involves professional training on a large scale and expediting digital transformation processes that will contribute to economic and social activity in both this period and thereafter. For example, improving communications infrastructure and subsidizing computer equipment will facilitate remote work and learning. Plans should therefore already be made for the following periods, including targets, indices, control, forces, tasks, and budgets.

From T1 until T2: Rapid Growth

After the Covid-19 constraints wane, a large proportion of the population still on unpaid leave can go back to work. The challenge during this period is rapid growth and a steep drop in unemployment. The preparations made in the preceding period will affect both the ability to manage the crisis during that period and success in the following period. It is therefore recommended to be as well prepared as possible for this period.

From T2 until T3: Attention to those “Left Behind” and a Return to Stability

This period is divided into two. In the first part, the emphasis should be on close attention to those "left behind" and full use of what was achieved in the preceding stage. Later, the emphasis will be on a transition to balanced growth based on the new situation. One of the main efforts will be generating jobs for employees on unpaid leave who did not return to their jobs and other unemployed people. The goal is to increase labor productivity, i.e., transfer employees to technologically advanced sectors and promote employment among the ultra-Orthodox and Arab populations.

Later in the period, it will be necessary to reduce the budget deficit and the ratio of debt to GDP, i.e., to return to frameworks that were acceptable before the crisis and are suitable for long term management. The process of restoring certain parameters to their pre-crisis values, such as a 60 percent debt-to-GDP ratio, is likely to take many years.

General Significance

Activity for all three of the periods outlined should be planned both separately and together, and the planning should be updated as time passes. The crisis should be managed with efficiency and should be forward looking, inter alia in order to reserve resources for growth acceleration when the coronavirus is no longer a factor shaping the economy and society. An expansionary and careful policy is now necessary and recommended in order to focus on the severely afflicted and in preparations for the next stages, but an excessively expansionary (non-differential) policy is liable to generate long term damage and shortage of resources for the upcoming stages. For example, if the Israeli government now disperses money indiscriminately, at the cost of increasing debt, it will experience difficulty in accelerating the economy when the coronavirus has passed, and in bringing people without jobs back to the economy. Debt and interest payments in the state budget will increase, thereby lengthening the recovery period.

A forward-looking approach supports approval of the 2021 state budget by the end of 2020. Preparing the budget is a difficult challenge in conditions of the current healthcare, economic, and political uncertainty, but it can define all of the government's activities systematically and in an organized manner, with a view toward the future. An up-to-date budget is a critical management tool, and the lack of a budget has a detrimental effect on management of the crisis. There is clearly no connection between T1 (the date of the turnaround in the health situation) and the beginning of the fiscal year in January 2021, which complicates preparation of a budget for the fiscal year. Nevertheless, when T1 is known, the state budget can be revised.

It is best to examine opportunities at every stage and to plan to use those most suitable for the outline. The crisis can provide an opportunity to change the economy, which is very difficult to accomplish in ordinary times, such as by streamlining the public sector.⁸ It is

important to make the investments fit the needs of coping with the crisis according to priorities. For example, there is clearly a need to improve communications infrastructure in Israel in order to facilitate remote work and learning, which also contributes to reduce the burden on transportation. Given the situation, it is doubtful whether government spending on investments in road infrastructure should now be increased. These investments are essential, as they were before the crisis, but their huge cost is known, and they are not a top budget priority. Such investments can be accomplished using the build-operate-transfer (BOT) franchising method.

Israel should maintain its competitive capabilities in the global economy (Israeli exports constituted 29 percent of GDP in 2019). The intense competition in the global economy should be considered, because afflicted countries are taking steps to increase their manufacturing and employment by increasing exports. Israel should take into account that the way it manages its economy in the crisis is not only subject to internal public criticism, but is also monitored by foreign countries, international agencies, and credit rating companies. Economic management regarded as irresponsible or unprofessional is liable to prove costly to the economy for many years ahead.

¹ Bank of Israel, press release, August, 24, 2020, <https://www.boi.org.il/en/NewsAndPublications/PressReleases/Pages/24-8-2020a.aspx>.

² Ministry of Finance, "Update of Macroeconomic Forecasts," August 4, 2020 [Hebrew].

³ Shaul Amsterdamski, "Pocket Games," Kan 11, September 10, 2020 [Hebrew].

⁴ Central Bureau of Statistics, media release, August 24, 2020, https://old.cbs.gov.il/reader/newhodaot/hodaa_template_eng.html?hodaa=202020263.

⁵ Sivan Klingbail, "One of Three Has No Livelihood: The Class Hit Hardest by COVID-19," TheMarker, July 30, 2020.

⁶ Central Bureau of Statistics, "Civil Resilience During the Coronavirus Crisis, Findings from a Follow-Up Survey," media release, July 26, 2020, <https://www.cbs.gov.il/en/mediarelease/Pages/2020/Civil-Resilience-During-the-Coronavirus-Crisis-Findings-from-Follow-Up-Survey.aspx>.

⁷ Bank of Israel, "Remarks by the Bank of Israel Governor at the Cabinet Meeting, September 9, 2020," press release, September 10, 2020.

⁸ See Amir Levi, Yoram Tietz, and Mor Yahalom, "Economic Opportunities," in *The Coronavirus Crisis: Recommendations for Israel*, team of experts led by Lt. Gen. (ret.) Gadi Eisenkot, Institute for National Security Studies, 2020 [Hebrew].