



Israel's Path to Economic and Social Prosperity

Kohelet Economic Forum's Fifth Chartbook

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This chartbook is the fifth in a series published by Kohelet Economic Forum (the first was published in September 2015). The chartbooks' aim is to offer a broad picture of the Israeli economy through thematic highlights, emphasizing several foundational issues and attempting to challenge accepted doctrines.

This chartbook includes five chapters on subjects that are at the heart of the social-economic discourse among policy makers, senior bureaucrats, cabinet ministries, academic and scholarly economists, the media and the general public in Israel.

The **first chapter**, written in collaboration with Kohelet Forum's regulation department, examines **Israel's trade policy and its implications for the cost of living and the rate of market competition**, two issues looming large in the public discourse in recent years. We raise the question of economic fate versus deliberate policy.

The data covered shows that importation of goods and services to Israel is low, both in comparison to OECD countries and to countries with a similar population size, and much less efficient (in terms of time and costs). Most of the restrictions on importation originate from the Ministries of Health, Agriculture and Transportation and the number and volume of official standards, legislative measures and internal directives restricting importation have increased significantly in the past two decades. These restrictions are also amongst the most stringent in the OECD, as are the restrictions on the entry of short term, high-skilled foreign workers. Israel (along with Turkey and Mexico) leads the OECD countries in lack of regulatory transparency, and is also negatively prominent in preferring local suppliers and discriminating against foreign suppliers in its procurement markets, and in its high barriers to competition.

Protectionist policies manifest in excessive trade barriers that lead to high prices and low labor productivity.

While significant steps to reduce trade restrictions have been taken in recent years, Israel, unfortunately, still stands out for the worse in trade restrictions internationally. Haifa Port, for instance, shows marked improvement following an increase in port

competition, but Ashdod is amongst the bottom 15% in port efficiency on a global scale.

The **second chapter** compares **districts in Israel**, and presents various aspects of the differing demographic trends, human capital and labor markets.

Israel's major population shifts occurred in the first forty years after the State was established; change since then has consisted mostly of growth in the Central districts and in Judea and Samaria, and reduction in the Tel Aviv District.

Other data shows that the Tel Aviv and Central districts are more prominent in terms of income, employment rate, academic education and excess demand for labor. This seems to be a result, in part, of the fact that density, characterized by high demand for skilled labor and a better capability of creating and transmitting information, allows for better use of agglomeration. Large, dense cities typically feature high labor productivity and higher salaries and attract young people with high human capital. On average, the proportion of workers with higher than average salaries and tertiary education is higher than in other districts. The Tel Aviv and Central Districts also surpass the others in excess demand for workers, income from work and employment rates. The Tel Aviv metropolitan area's obvious advantage in employment appears to play an important role in choice of residence; commuters from the Tel Aviv and Central districts tend to remain within their own or neighboring districts.

Recent years have also seen a rise in academic employees working outside their place of residence. A possible explanation is the expansion of working from home options, particularly in fields with high labor productivity.

The **third chapter** deals with the **Israeli labor market** in recent years, **following the covid-19 crisis**.

In the period following the covid-19 crisis, the Israeli labor market was in fine shape: high demand for workers, high supply of labor and a rise in salaries. The Israeli labor market's performance in recent years is not abnormal in terms of OECD averages: the 25-64 cohort's rates of employment and participation are only slightly lower than the OECD average, and the rate of unemployment for all age groups is lower. Israel's labor market still faces some challenges: the participation rates of young people was lower in 2022 than in 2019; the disparity in employment rates for Haredi men and Arab women is high; and long term unemployment is also high compared to 2019. The rise in participation in recent years is slow compared to the OECD average, due in part to low rates among Haredi men and Arab women.

The **fourth chapter** presents data on the **Palestinian economy and Palestinian workers in Israel** on the eve of the 'Swords of Iron' war, as well as initial data on the economic implications of the war. In the decade preceding it, Israel had significantly increased entry of Palestinian workers into Israel, mostly from Judea and Samaria. This entry was virtually halted following the horrific October 7 massacre and the escalating military situation.

Before the war, the labor market in Judea and Samaria showed better performance (less unemployment and more participation) than in Gaza for both men and women, although Palestinian women in general are mostly absent from the work force – women's unemployment in Gaza is greater than 50%. These disparities have been growing since the 2005 Israeli withdrawal and Hamas' subsequent rise to power, and Gaza's GDP has been decreasing since then as well.

Before the war, approximately 170,000 Palestinian workers worked in Israel, around 22% of them without permits. Close to 98% of them arrived from Judea and Samaria. Nearly a quarter of employed Palestinians worked in Israel, mostly in construction. At the same time, the number of Arab Israelis working in this industry decreased, so that there may be a measure of substitution between Palestinian and Arab Israeli workers. Increasing access to employment in Israel may disrupt incentives in the Palestinian economy, since half of the uneducated population earned more than the educated, thus creating disincentives for investing in human capital.

Initial data points to The "Swords of Iron" war's negative impact on the Palestinian economy, particularly in the Gaza Strip, as more severe than in prior military conflicts. One reason for this is the drastic reduction in the number of Palestinians working in Israel.

The **fifth and final chapter** is an **economic analysis of child tax credits points for parents**. Child tax credit points are discriminatory towards non-parents in income tax payments and have been expanded in recent years, with 2024 seeing an addition of two more tax credit points for children up to the age of three and one for children aged twelve to eighteen. The budgetary cost of this tax benefit has soared– while in 2018 the tax benefit relative to GDP stood at 0.2%, it is expected to stand at 0.7% (about NIS 14 billion) in 2024, translating to potentially thousands of shekels per month for individuals. Parents of a single child in the preschool age group with an average income from employment will be almost completely exempt from income tax in 2024. Data shows that the intended 2024 additional credit points will be more significant to fathers in the upper half of the income distribution and to mothers in the top two

deciles. The benefit to fathers tends to be higher than that of mothers, since fathers' incomes are higher than mothers', and women's tax threshold is higher (because they are entitled to half a point more than men). Compared to mothers, the budgetary cost of the benefit to fathers is more concentrated in the preschool age group. Distribution of the child tax credits seems inefficient in terms of employment incentives; concentrating the tax credits on mothers of preschool children at the expense of mothers of older children or fathers, may increase these incentives.

Credit points have a significant advantage over allowances in that realizing the benefit is tied to employment and salary. However, it is not clear that the policy of increasing tax credits for children is best, given its high cost and the available alternatives such as a reduction in income tax rates in general or an increase in tax credits for all residents, regardless of the number of their children.

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