BANK OF ISRAEL
Office of the Spokesperson and Economic Information

Address by the Governor to the Executive Committee of the Manufacturers Association of Israel

December 30, 2007

I would like to speak today about three interrelated matters: the continuation of economic growth, the fact that this growth is affecting, although not to the same extent, all levels of the population—including the weak—and the obstacles that according to international surveys are preventing the Israeli economy from becoming a magnet for investment, on the route to long-term growth.

a. Continuation of economic growth

The main goal of Israel's macroeconomic policy is the attainment of rapid long-term growth that will benefit the entire population. Long-term growth is crucial for the future of Israel's economy, its society, and the state itself.

Why? Because it creates the sources that are needed to cope with our main problems in education, defense, and social services, to name only a few. It also creates an additional source of attraction for immigrants, furthers the population's well-being, and improves the standard of living of all population groups—including the weaker ones.

The goal can be attained by maintaining budget discipline, applying an interest policy that strives to maintain price stability and support financial stability, and continued reform in growth-supportive fields—especially education, which is important not only in economic terms, as a pro-growth factor, but also in social terms, as a factor that allows every member of Israeli society to fulfill his or her potential.

By means of this macroeconomic policy, the government creates the framework for rapid long-term growth. In turn, it is the business sector that creates the growth by operating in this economic environment.

This macroeconomic policy, coupled with the tailwind that global growth has provided thus far, has brought the economy to its auspicious situation today. We are all familiar with the achievements:

The economy has been growing at more than 5 percent per year, and is expected to grow by 5.5 percent in 2007.

The government debt burden has fallen from 102 percent of GDP at the end of 2003 to 82 percent today.

The government's interest expenditure has fallen by more than 1 percent of GDP since 2003.

Government expenditure has fallen from 52 percent of GDP to less than 45 percent.

Exports have expanded rapidly, to more than 44 percent of GDP. The surplus on current account of the balance of payments has climbed to 4 percent of GDP. The unemployment rate has fallen from 11 percent to 7.3 percent since 2003. The poverty rate has begun to decline. Financial and economic stability has been maintained. Admittedly, the inflation rate today is slightly above the upper bound of the target range, but it is expected to return to target by the middle of next year. The Bank of Israel, for its part, will do everything it can make sure that this happens.

As for the U.S. dollar exchange rate, as we know, the dollar has lost ground against all currencies and its depreciation against the shekel is not exceptional in its intensity. This is because only one-third of Israel's exports go to the U.S. The rest are divided between the eurozone and the rest of the world. The exchange rate of the shekel against a weighted average of the currencies of Israel's trading partners is only slightly lower than one of the most depreciated levels ever.

The results of the economic achievements are:

Israel's risk premiums have fallen.

Our country rating has been upgraded.

Investment is continuing to flow in, albeit more slowly than last year, at more than 8 percent of GDP in 2007.

The OECD, the organization of developed countries, has invited Israel to begin the process of joining.

This is an enormous success. We must preserve it by continuing to apply the macroeconomic policy, especially at the present time, when there are expectations of a growth slowdown in the United States and around the world, against the background of the credit crisis in the U.S. and Europe.

Are the benefits of our economic growth reaching all levels of the population?

b The growth is indeed reaching all levels of the population

Israel's growth since 2003 has improved the standard of living of all population groups, including the weak ones. This is evidenced in several ways:

a. *The poverty rate has fallen:* the poverty rate stopped climbing in 2006, according to the relative measure of income gaps. Furthermore, by the absolute measure of the ability to buy a basic basket of goods, the poverty rate actually declined steadily in 2005 and 2006.

b. *The unemployment rate is falling:* the decline since 2003 has embraced all levels of schooling, including those with low levels of education.

c. *Labor-force participation is rising:* the labor-force participation rate is moving upward in all parts of the country, both center and periphery (the Northern and Southern districts).

d. *Employment is on the increase*: the employment rates of Israelis are climbing in all industries, including traditional ones such as construction, agriculture, hospitality and food services, and electricity and water.

e. *Real wages are rising:* real average wages are rising in all industries, including the traditional ones.

Obviously, then, the more we persevere in staying on the path of rapid long-term growth, the more people will find work and the more the standard of living will rise of among all population groups.

However, the existence of large social disparities in our country is plainly unacceptable. These disparities demand special treatment: incentives for those who are able to work, support for those who are unable to work, and training and education for the current generation and the generations to come.

c. How can the Israeli economy become a magnet for investment?

As a central feature of the path to rapid long-term growth, it is important to make the Israeli economy an attractive place for domestic and foreign investors. In the 1990s we opened the economy to the world; today there are no more restrictions on capital inflows and outflows, including investments. By means of these reforms, and others that were carried out, we managed to establish a strong basis for growth. However, further action is still necessary. In the main, the domestic economic environment must be changed so that the economy can become a magnet for domestic and foreign investment.

To illustrate this point, I will cite two important reports that were recently published: the Davos "Global Competitiveness Report" of the World Economic Forum, and the "Doing Business Report" of the World Bank.

The "Global Competitiveness Report," which ranks 131 countries on the basis of a comprehensive survey among each country's business community, ranks Israel in seventeenth place, definitely not bad and actually quite good. However, if we fine-tune the picture, we find something interesting: it turns out that the most problematic factor in doing business in Israel is inefficiency and government bureaucracy.

I am sure that no one here is surprised by this.

By the way, another troubling thing that arises from this report is its emphasis on education and labor-force quality as a very positive factor in the Israeli economy. The fact that the report places such strong emphasis on this topic, which has become an issue of crisis in Israel, only substantiates the need to treat it promptly.

The second report, the “Doing Business Report,” ranks 170 countries by parameters that represent the ease (or the difficulty) of doing business in each country. This report ranks Israel in 2007 in twenty-ninth place—less rosy, but still not bad. Here, too, however, if we examine the parameters of the index closely, we find that Israel scored well in some respects and rather badly in others.

The two parameters in which Israel’s situation is really good, according to the survey, are shareholders’ ability to defend themselves against misuse of company assets by executives, and the legal rights of borrowers and lenders and the availability of relevant information for the issue and obtaining of credit.

In contrast, the two parameters in which Israel ranks most poorly are the process that a business has to follow in order to obtain permits to build a warehouse, and the process related to the transfer of title of land and buildings to a business. In other words, this report, too, gives Israel’s bureaucracy special attention—in its negative context—this time mainly in regard to real estate and building.

Again, we are not surprised, and you as manufacturers are surely not surprised, to hear that Israeli bureaucracy is a problematic factor that interferes with doing business.

The government and the private sector are familiar with these problems. The bureaucratic shackles must be unlocked, especially in respect of land. The government has to deal with these matters, no matter how hard it is to tackle such issues.

Such action would make an additional and very important contribution to rapid long-term growth.

And as I said that the beginning of my remarks, rapid long-term growth that benefits the entire population is critical for the future of Israel’s economy, society, and the state itself.