Comparative Overview

Public Sector Puts Brakes on Top 15 Agenda

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Executive Summary

- The TOP 15 Vision requires an episode of significant improvement in Israel's Quality of Life.
- This document identifies the potential engines of growth for Israel's Quality of Life by analyzing the World Economic Forum's (WEF) 2005-2006 Global Competitiveness Index (GCI). This Index is instrumental in singling-out the brakes and the engines of growth that can bring about a significant improvement in the Quality of Life in Israel.
- The GCI ranking of Israel as 15th in the overall competitiveness index belies imbalances between the poor competitiveness of Israel's public sphere and its efficient and innovative private sector.
- Furthermore, the size of Israel's public sector amplifies its economy's exposure to inefficiencies in this sector. Ranking 25 countries according to the combined effect of size of public sector and its level of competitiveness, Israel drops to the bottom of the list.
- The conclusion of this analysis is that the potential for a significant socio-economic leap lies in improving the performance of the public sector, or by reducing its size.

Introduction

1. The concept 'Top 15 Vision' ('Top 15') is comprised of the issues and actions involved in achieving a significant socioeconomic advancement ('leapfrog' or 'catch-up episode') that would place Israel among the 15 leading countries in terms of quality of life.
2. The Top 15 Agenda includes the following: A rich and textured vision of Israel when it becomes one of the Top 15 countries, identification of engines of growth in quality of life, dealing with Israel's idiosyncrasies such as the security burden or its association with the Jewish world, outlining the required structural changes, designing specific policy, identification of relevant indices, and initiation of public discourse.
3. In this paper, Reut identifies the most powerful agents - public or private - that drive or hinder the Top 15 Vision.

Approach

4. **Global Competitiveness Index** – The basis for this document is the 2005-2006 Global Competitiveness Index (GCI) published in the 2005-2006 Global Competitiveness Report ('Competitiveness Report') of the World Economic Forum (WEF). The paper aims to identify the strengths and weaknesses of the Israeli economy and its potential engines of growth based on the analysis of the GCI.
5. **Competitiveness and *not* Quality of Life** – The GCI measures competitiveness, which is defined as the set of factors, policies and institutions that determine the level of productivity of a country.[1]

[1] See the Global Competitiveness Report published by the World Economic Forum, p. 3.

Competitiveness should not be confused with Quality of Life. It does not include considerations of social or environmental sustainability, demography or income inequality.

For the purposes of this document, 'Quality of Life' is defined as a weighted appreciation of factors that determine human satisfaction like income, leisure, personal safety, health, job security, etc. The OECD Quality of Life Index ('the OECD Index') and the Economist Life Satisfaction Survey ('the Economist Index') are accepted measures.

Nevertheless, economic growth and income per capita are key factors in these indices.[2]

6. **GCI as a tool for identifying engines of growth –** The Reut Institute assumes that the GCI is useful for understanding Israel's prospects for experiencing an episode of substantial socioeconomic growth ('leapfrog' or 'catch-up episode') in Quality of Life.

7. The GCI is based on three 'sub-indices', which attempt to measure competitiveness in the private, private-public and public spheres.

8. Each sub-index is derived from several of the following 'pillars': institutions, infrastructure, macro-economy, health and primary education, higher education and training, market efficiency, technological readiness, business sophistication, and innovation.

9. The pillars themselves are comprised of 90 'variables' relevant to competitiveness. Variables included in the macroeconomy pillar are: government surplus/deficit, national savings rate, inflation, and government debt.

10. An analysis of the GCI sub-indices and the 9 pillars is the basis for this paper.[3]

Brief Introduction to GCI

11. The sub-indices identified by the GCI as engines of development are: [4]

- **'Basic Requirements' –** This sub-index combines the pillars of 'stable macroeconomic framework', 'well-functioning public and private institutions', 'appropriate infrastructure' and 'health and primary education'.[5] These pillars are largely dominated by the public sector.

  GCI identifies 'Basic Requirements' as key for development of countries with GDP Per Capita (PPP) of less than $2,000. Its relative importance diminishes as the country develops.

- **'Efficiency Enhancers' –** This sub-index combines the pillars of 'higher education and training', 'market efficiency' (goods, labor and financial) and the ability to harness benefits of existing technologies ('technological readiness').[6]

  GCI identifies 'Efficiency Enhancers' as key for development of countries with GDP Per

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2 The understanding that economic growth plays a role in determining the quality of life is supported by the findings of the Economist Life Satisfaction Survey in which material well being (defined as GDP/capita (PPP)) explains over 50% of the variation in Life Satisfaction among countries. See The Economist Intelligence Unit's quality-of-life index, p3.

3 As part of this paper, Reut categorized 90 variables according to whether they fall under the public, private or public-private spheres.

4 Countries with PPP per-capita-income between $2,000-$3,000 and $9,000-$17,000 are considered in transition. A hybrid policy combining recommendations from the old and new stages of development is appropriate for the these countries.

5 See CGI p. 11.

6 Efficiency in these markets reduces transaction costs, interference and distortions in the economy.

Capita (PPP) between $3,000 and $9,000.

- **'Innovation and Sophistication'** – This sub-index combines the pillars of 'Business Sophistication and Innovation'.

  GCI identifies 'Innovation and Sophistication' as key for development of countries with GDP Per Capita (PPP) greater than $17,000.

Israel's Ranking in a Competitive Perspective

12. Israel enjoys a GDP Per Capita (PPP) of over $23,000. Thus, according to the GCI, it is in the category of countries that should rely on 'Innovation and Sophistication' to fuel their development.

13. In Israel, the pillars that fall under 'Basic Requirements' are overwhelmingly dominated by the public sector.

    Conversely, the pillars that are included in 'Innovation and Sophistication' are overwhelmingly in the private sphere.

    Public-private collaboration is present in the pillars contained in the sub-index of 'Efficiency Enhancers', and in the areas in which the public sector is active in 'Innovation and Sophistication'.[7]

14. **Fifteenth in the World?** – According to the GCI, Israel is ranked 15th in overall competitiveness. However, this relative success should not be viewed as an across the board success.

    GCI’s three sub-indices indicate that Israel suffers from imbalances between the lack of competitiveness of its public sphere, on the one hand, and an efficient and innovative private sector, on the other hand, as follows:

    - Ranking of **8** in **'Innovation and Sophistication'**;
    - Ranking of **12** in **'Efficiency Enhancers'**; and
    - Ranking of **29** in its **'Basic Requirements'**.

15. **Fruits of past policy harvested in 2006 –** Israel's current rank at 15 represents a significant improvement compared to last year, largely due to a reform in capital markets.[8] In order to remain competitive Israel will have to continue in this vein of improving its public sector.

    However, 2006 has been a year of elections and military conflict. Therefore, it offers little hope for a similar advancement in next year's GCI.

16. **GCI Does not reveal specific characteristics –** Like most cross-country comparisons, GCI does *not* reveal many particular characteristics of the countries that are ranked. However, development policies and processes are designed according to economic characteristic of each economy.

17. **Sequential rankings mislead –** Although sequential ranking are by definition good indicators of competitiveness, they ignore magnitudes of absolute differences between countries.

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7 Government effect on innovation and technology through the army is sometimes double-counted and sometimes underestimated.

8 GCI, p.40.

Israel's Public Sector Inadequate

18. Reut's analysis of the top 25 nations in terms of their competitiveness recognizes three categories of countries based on the balance between their competitiveness in 'Basic Requirements' and 'Innovation and Sophistication' (see Annex A):

- **Category 1 – Balance between competitiveness of sectors –** In this category countries have relative balance in the competitiveness of their 'Basic Requirements' as compared with 'Innovation and Sophistication'. For instance, the top 4 countries in the GCI – Switzerland, Sweden, Denmark and Finland – are in this category.

  For countries in this category, comparison of sub-indices gives no clear indication of catalysts or hindering agents.

- **Category 2 – Private sector *less* competitive than public sector –** Countries in Category 2 demonstrate significantly greater competitiveness in the 'Basic Requirements' than in 'Innovation and Sophistication'. Category 2 includes countries such as Norway, Hong Kong, Luxemburg and Singapore.

- **Category 3 – Private sector *more* competitive than public sector -** Countries in this category demonstrate significantly greater competitiveness in 'Innovation and Sophistication' than in 'Basic Requirements'. As inferred, **this category includes Israel**, along with the Taiwan, the United States and Japan.

19. Furthermore, it is **mostly the private sector that creates efficiency –** According to the GCI, Israel is 12th in the sub-index of 'Efficiency Enhancers'.

The private sector is the main source of Israel's strong standing in this sub-index.[9] This sub-index is comprised of 37 variables. 16 variables are shaped by the public sector, some are shaped by the private sector, and others are shaped jointly by both sectors. Among the 16 variables included in 'Efficiency Enhancers'[10] which are shaped mainly by the public sector, Israel is only ranked in the top 15 for one variable.[11]

20. **Hindering agents dominated by public sector –** The GCI indicates major hindering agents (variables in which Israel's ranking is 36 and lower) that compromise Israel's competitiveness. Most of them are dominated by the public sector. They are:

- Business Costs of Terrorism, in which Israel is ranked 121st;[12]
- Reliability of Police services, in which Israel is ranked 42nd;[13]
- Government Deficit, in which Israel is ranked 71st;
- Flexibility of wage determination, in which Israel is ranked 65th;[14]

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9 Private: Local availability of specialized research and training (10)VC Availability (2).

10 Joint Public and Private: Quality of management schools (14) , Financial Market Sophistication (15), Technological Readiness (4), Cell Phones (6), Personal Computers (4), Nature of Competitive Advantage (12).

11 Israel is ranked #10 in "Number of Procedures Required to Start Business", compared with # 50 in "Number of Days to Start a Business".

12 Defined as the burden of costs on the business due to threat of terrorism in the country.

13 Defined as the extent to which the police can be relied upon to protect business from criminals.

14 Defined as the mechanism by which wages are determined: centralized bargaining process or individual company level.

- Favoritism in government officials' decisions where Israel is ranked 38th.
- Time for starting a business, in which Israel is ranked 50th;
- Government debt, in which Israel is ranked 99th;
- Organized crime, in which Israel is ranked 38th;[15]
- Business cost of crime and violence, in which Israel is ranked 36th.[16]

21. **Public sector underperforms in other areas as well –** As mentioned, the GCI does not include indicators that are critical for a sustainable, high quality of life, such as the environment, corruption, labor force composition and rate of participation.

    These indicators are dominated by the public sphere as well. Here too, Israel underperforms.[17]

22. **Israel's large public sector amplifies the imbalance –** Israel's public sector expenditure stands at about 50% of the economy compared to about 37% in the United States, 23% in Taiwan, 38% in Japan.[18]

    Therefore, Israel's 'exposure' to the relative lack of competitiveness of its public sphere is much larger than Japan, Taiwan, and the United States. Similarly, gains from Israel's competitive private sector that occupies a smaller portion of the economy, are diluted.

    Annex B lists the top 25 countries in terms of their competitiveness according to an approximation of the combined effect of the size of the public sector and the gap between 'Basic Requirements' and 'Innovation and Sophistication' sub-indices.

    When the size of the public sector is combined with the identified imbalance between the competitiveness of the public and private sector, Israel sinks to the bottom of the table.[19]

End.

Defined as the extent to which mafia-oriented racketeering, extortion etc. impose costs on businesses.

Defined as the incidence of common crime and violence (e.g. street muggings, firms being looted etc).

17 According to the Environmental Sustainability Index Israel is ranked 62. 2005 Environmental Sustainability Index Report, Yale Center for environmental Law and Policy, Yale University. Labor force participation rate (LFPR) in Israel in 2005 was 55.2%. In 2004 LFPR in Israel stood at 54.9 compared with 65.1 for OECD countries. Sources: Bank of Israel Annual Report, 2005, Ch5, the Labor Market; OECD Countries, 1990 to 2004 - Employment, Share of Working Age Population in Employment.

18 2005 data for Israel, Japan and the United States. 2004 data for Taiwan. Size of public sector defined as General Public Expenditure as a percentage of GDP. Sources: OECD Countries 1988-2007 % of GDP (OECD Economic Outlook Annex Table 25). Bank of Israel, Principal Components of General Government Expenditure, 1980 – 2005. Statistical Yearbook of the Republic of China.

19 Although the manipulation of rankings is by no means scientific, the above table merely hints at the extent to which size of public sector amplifies the gap when the public sector is most active in those pillars in which Israel is least competitive.

Annex A

Table of top 25 nations in competitiveness according to the imbalance between 'Basic Requirements' and 'Innovation and Sophistication' Rankings

Country Name	Ranking according to World Economic Forum's Global Competitive Index	'Basic Requirements' Rank	'Innovation and Sophistication' Rank	The Gap Between Competitiveness in 'Innovation and Sophistication' and in 'Basic Requirements'	
New Zealand	23	16	25	-9	Category 1
Denmark	4	1	7	-6	
Iceland	14	12	17	-5	
Finland	2	3	6	-3	
Netherlands	9	8	11	-3	
Canada	16	13	16	-3	
Spain	28	25	30	-5	
Estonia	25	30	32	-2	
Korea	24	22	20	2	
France	18	15	13	2	
Sweden	3	7	5	2	
Switzerland	1	5	2	3	
Belgium	20	17	14	3	
Ireland	21	23	19	4	
United Kingdom	10	14	10	4	
Germany	8	9	3	6	
Austria	17	18	12	6	
Norway	12	6	21	-15	Category 2
Hong Kong SAR	11	4	18	-14	
Luxemburg	22	10	23	-13	
Australia	19	11	24	-13	
Singapore	5	2	15	-13	
Taiwan, China	13	21	9	12	Category 3
Japan	7	19	1	18	
Israel	15	29	8	21	
United States	6	27	4	23	

Category 1: Balanced Drivers.

Category 2: Imbalance – Public sector more competitive than private sector.

Category 3: Imbalance – Private sector more competitive than public sector.

Annex B

Ranking of Countries According to Combined Effect of Size of Public Sector and its Level of Competitiveness[20]

Country Name	Ranking of Countries According to the Combined Effect of Size of Public Sector and its Level of Competitiveness	Ranking according to World Economic Forum's Global Competitive Index
Norway	1	12
Hong Kong	2	11
Luxemburg	3	22
Australia	4	19
Denmark	5	4
New Zealand	6	23
Iceland	7	14
Spain	8	28
Finland	9	2
Netherlands	10	9
Canada	11	16
Korea	12	24
Switzerland	13	1
France	14	18
Sweden	15	3
Ireland	16	21
Belgium	17	20
United Kingdom	18	10
Germany	19	8
Austria	20	17
Czech Republic	21	29
Japan	22	7
United States	23	6
Israel	24	15
Singapore	NA	5
Taiwan, China	NA	13
Estonia	NA	25

20 Size of public sector measured by general public expenditure as a percentage of GDP. Size of public sector data not available ("na") for Estonia, Singapore and Taiwan