

Israel's Unbalanced Economic Development

Executive Summary

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A. Investments in Israel

Israel is not realizing its full potential for economic growth. The public debate on this issue generally focuses on low labor force participation rates, pointing the accusing finger at ultra-Orthodox Jewish men and Arab women. The present document attempts to direct the discussion to the issue of investments, and more specifically, to the imbalance in investments between different geographic areas and different social groups in Israel.

In the background are several important facts. Firstly, Israel's present level of investments (fixed capital formation) is lower than it was in the past. In the first decade following establishment of the state, it was 29% of GDP, on average. In the 1960s, 1970s, 1980s and 1990s, it was 25%, 27%, 22%, and 19%, respectively. During the years 2000-2009, it declined further to an average of 17% of GDP.

Secondly, Israel's fixed capital formation is lower than the average of OECD countries. In 2008, the last year for which comparative figures were published, Israel's fixed capital formation was 18% of GDP, compared with the average of 20.6% for OECD countries.

Thirdly, the present level of fixed capital formation is unbalanced: over the past decade, investment in the hi-tech industries, concentrated in the center of the country, grew at an average annual rate of 8%, while investment in low-tech industries, located in peripheral areas, grew at an average rate of only 2%.

Fourthly, in the first half of the last decade, fixed capital formation declined, following the double crisis of the global hi-tech industry and the second Palestinian intifadah. In the years that followed, investments began to increase but once again declined after the global financial crisis at the end of 2008.

Israel does not publish figures on fixed capital formation by geographical area and locality. However, it is possible to approximate such figures by using the proxy of investments in non-residential construction, which are available by locality. This allowed us to examine the imbalance in investments between different geographical areas and types of locality.

In general, total investment in non-residential construction declined during most of the years 2000-2009, from NIS 16.7 billion in 2000 to NIS 12.7 billion in 2009. The decrease occurred in all three of the main constituents of non-residential construction: (1) public buildings, (2) construction for commerce and commercial services and (3) construction for manufacturing. Exceptional was an increase in the construction for manufacturing purposes in 2006-2007, apparently due to the expansion of the Intel plant in Kiryat Gat.

The report that follows examines the above-mentioned three types of non-residential construction -- by administrative district (there are seven: Tel Aviv, Central, Northern, Southern, Haifa, Jerusalem and Judea & Samaria) and by type of locality (we use five categories: all Jewish localities, all Arab localities, Jewish development towns, the group of 15 most prosperous cities in Israel, and the Israeli settlements in the Palestinian territories). In each area, the document examines the building stock that existed at the beginning of the decade (2003), and the investments in construction made during the course of the decade 2000-2009.

B. Construction of Buildings for Commerce and Commercial Services

The Situation in 2003

We used Israel Central Bureau of Statistics (CBS) figures on the number of square meters on which municipal taxes were collected in each locality as a measure of the stock of commerce and commercial service buildings. Unfortunately, such figures were not published prior to 2003.

Distribution by administrative district: In 2003, 30% of the total area of buildings used for commerce and banking were in the district of Tel Aviv. Tel Aviv also led with a per-capita area 1.7 times larger than the national average. Following close was the Haifa district, both in total area and in per-capita area – which was 1.6 times larger than the national average. Together these two districts were the site of about 50% of the total area of buildings for commerce and banking.

The Jerusalem district has a high concentration of Ultra-Orthodox Jews and of Palestinians – the latter of whom reside in East Jerusalem and constitute 31% of the total population of the Jerusalem district. It registered the smallest built-up area of all – 7.5% of the total.

Distribution by type of locality: Jewish localities were the site of 95% of the total area for commerce and commercial services, and Arab localities the site of 5%. Among the Jewish localities, cities in the "Forum of 15" were the site of 66% of the total built-up area utilized for commerce and commercial services. Measured on a per-capita basis, cities in the "Forum of 15" had an area double that of Jewish development towns and five times greater than that of Arab localities.

New investments 2000-2009

Distribution by administrative district: New investments increased the imbalance: the Tel Aviv district attracted about one-fourth of total new investment; on a per-capita basis, it

attracted investments 1.4 times larger than the national average. The neighboring Central district attracted the highest new investment – 30% of the total, and was second to Tel Aviv in terms of its per-capita investment. The Southern and Northern districts received, together, only 30% of the total new investment. The Haifa district receded in importance compared to its position regarding built-up stock in 2003. The Jerusalem district received only 5% of new investments.

Distribution by type of settlement: The figures show continuing concentration in Jewish localities and particularly in cities in the "Forum of 15": these attracted about half of all new investments; on a per-capita basis, their share was 1.9 times that of the Jewish development towns and 1.6 times that of the Arab localities. The Arab localities received 12% of new investments for commerce and commercial services – a significant improvement over the situation in 2003, when it registered only 5% of the total built-up area for such activities.

C. Construction for Manufacturing

The Situation in 2003

Here, too, we used CBS figures on the area of buildings for which municipal taxes were charged, by locality. Such figures are available only from 2003.

Distribution by administrative district: In 2003, the leading district was the Central one, with 24% of the total; but on a per-capita basis, it was only the fourth largest. It was followed by the Northern, Southern and Haifa districts. The three districts with smallest built-up industrial establishments were Tel Aviv, its major city being a leading center of commerce and finances; the Jerusalem district, whose major city is home to governmental services, and the district of the Israeli settlements in Palestinian territories, most of whose residents make their living inside the Green Line, although they do have industrial parks. It is noteworthy that when calculated per 1,000 residents, the built-up area in the settlements was two times larger than that of the Jerusalem district.

Distribution by type of settlement: The Arab localities had only 3% of the built-up area for manufacturing in Israel in 2003. Thus it can be said that they were effectively excluded from Israel's industrial economy. In comparison, the Jewish development towns, whose combined population was only 80% that of the Arab localities, had built-up manufacturing areas seven times larger than the Arab localities. Calculated per 1,000 residents, the Arab localities had built-up manufacturing areas nine times smaller than the Jewish development towns, 6.5 times smaller than cities in the "Forum of 15," and four times smaller than the settlements.

New investments 2000-2009

Distribution by administrative district: The new investments increased the geographical concentration of industrial buildings, with the Central district receiving 34% of new investments – on a per-capita basis, 1.4 times more than the national average. The Southern district received a particularly high amount – probably due to the expansion of the Intel

plant in Kiryat Gat. The Haifa district came in fifth, both in size of investment and on a per-capita basis - a sign of decreasing importance. The Jerusalem district, with 12% of the population of Israel, received only 4% of the new investments. On a per-capita basis, this investment was 3.2 times smaller than the national average (The Jerusalem district was still 2.2 times lower than the national average even after we discounted the Palestinian population of East Jerusalem). In this sense, we can say what we said about the Arab localities, that is, that the Jerusalem district is not really part of the industrial economy of Israel.

Distribution of new investments by type of locality: The Jewish development towns received 32% of the new investments; on a per-capita basis, their new investments were 2.5 times larger than the investments in the "Forum of 15" and 8 times larger than the investments in the Arab localities - one of the reasons being – again -- the large investment in the Intel plant in the development town of Kiryat Gat. The Arab localities received 4% of new investments, keeping them outside of Israel's manufacturing economy.

D. Construction of Public Buildings

The Situation in 2003

We used CBS figures on land use, published by locality, to examine the distribution of the capital stock of public buildings at the start of the decade. Unfortunately, the only year for which such figures were published was 2002. Another limitation of the data was that the area referred to included the area of only the ground floor of the buildings in question rather than that of all floors.

In 2002, the cities in the "Forum of 15" stood out for having the largest land area devoted to public buildings. Jewish development towns were far behind them and Arab localities were even further behind. The area devoted to public buildings in Jewish development towns, whose population in 2003 was 80% of the Arab localities, was 2.8 times greater than that of Arab localities in the field of education, 1.5 times greater in the field of health and social welfare, and 2.2 times higher in the field of public services. Looking at the area per 1,000 residents, the smallest area devoted to public buildings was still to be found in Arab localities; thus, for example, the area per 1,000 residents in the settlements was 2.3 larger than that of Arab localities in the field of education, 1.3 times larger in the fields of health and social welfare and 1.3 times larger in the field of public services.

New construction 2000-2009

The present decade was marked by a decline in the construction of public buildings, from 855 thousand square meters in 2000 to 574 thousand square meters in 2009. One of the reasons for the decline was the cutbacks in the investment budgets of the ministries of education and health.

The construction of health facilities was concentrated in the cities of the "Forum of 15": they received about half of new hospitals and buildings classified as "other health facilities" and two-thirds of new health clinics and hospital rooms. We can say that over the last decade, the position of the cities in the "Forum of 15" as centers of health services was reinforced.

Regarding educational structures, the Arab localities received 22% of the new construction, evidence of increasing public investment designed to narrow existing gaps. Most of the new buildings in Arab localities were for kindergartens, elementary schools and high schools. New construction for higher education was negligible.

Examining the construction area per 1,000 residents, an even sharper picture of imbalance emerges. The most outstanding figure has to do with the exceptional extent of construction of educational structures in the settlements. In 2000-2009, such construction amounted to 789 square meters per 1,000 residents, a figure 2.6 times that of the average in Jewish localities. Especially salient is the extent of construction of kindergartens, day care facilities, elementary schools, high schools and yeshivas.

The Arab localities also registered considerable construction activity for educational purposes per 1,000 residents, including kindergartens, day care facilities, elementary and high schools. In contrast, the figure for institutes of higher learning was negligible.

Cities in the "Forum of 15" showed the highest investment figures per 1,000 residents when it came to construction for higher education.

Finally, it is worth noting that in Arab localities, in which local resources are minimal, three-fourths of the construction of public buildings was the result of public initiative. In contrast, in the cities of the "Forum of 15," three-fourths of the construction of public buildings was the result of private initiative.

E. Conclusion

In view of the huge geographical and social imbalance that characterizes investments in the construction of buildings for commerce and industry, it appears that any attempt to redress the imbalance will have to depend heavily on state intervention. This is especially true with regard to the two most critical foci of imbalance: the Jerusalem district, which has large concentrations of Ultra-Orthodox Jews and of Palestinians; and Arab localities within the Green Line. If left to business initiatives, and to them alone, economic hegemony will continue to be concentrated in the Tel Aviv and Central districts of Israel, and Arab residents and Ultra-Orthodox Jews will remain outside of the sphere of commercial and manufacturing development.