Chapter 22
Stabilization and Liberalization in the Israeli Economy

Paul Rivlin
Tel Aviv University, Israel

ABSTRACT

This chapter examines the stabilization programs of 1985, 2003, other changes in fiscal policy and the liberalization of the Israeli economy. These programs have had dramatic effects in terms of reducing inflation, encouraging growth and improving the balance of payments and the structure of the economy. At the same time, they have reduced the role of the state and have been accompanied by growing inequality and an increase in relative poverty that resulted in an increase in transfers to households and a squeeze on other public spending.

INTRODUCTION

The achievements of the Israeli economy over the last three decades have been impressive despite severe problems, especially in the 1980s. The population increased from 3.9 million in 1980 to 8.1 million in 2013 while GDP rose from $73 billion to $291 billion in 2013 (in 2013 prices and exchange rates). As a result, GDP per capita almost doubled from $18,000 to $35,925.

Table 1 shows that since the early 1980s the Israeli economy has also experienced major structural change. Between 1981 and 2013, the share of public spending in GDP fell by 33 percent while public sector revenues fell by just over twenty percent. As a result, the public sector balance moved from an average annual deficit of 9.8 percent of GDP in 1981-85 to 3.7 percent in 2009-2013. The ratio of domestic debt to GDP more than halved from almost 149 percent in 1983 to just under 62 percent in 2013

The decline in the size of the public sector was very large and resulted from a number of factors including stabilization policy, a secular fall in defense spending as well as demographic changes. Underlying all of these were ideological changes that manifest themselves in the political system and the economy.

Liberalization of the economy goes back at least to the 1960s when a trade agreement was signed with the European Common Market that opened Israel's markets to European imports. The

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Table 1. The budget and the debt, 1980-2013 percent of GDP

Year	Total Receipts	Total Expenditure	Total Deficit	Total Net Domestic Debt, Year End
1980	59.0		-11.5	
1981	56.7	72.8	-16.1	
1982	57.5	69.5	-11.9	
1983	58.5	64.4	-5.9	148.8
1984	53.6	68.8	-15.3	135.4
1985	64.5	64.5	0.0	144.5
1986	62.5	59.7	2.7	133.8
1987	56.8	57.3	-0.6	121.9
1988	53.1	56.3	-3.2	121.2
1989	49.5	55.6	-6.1	126.3
1990	49.2	54.8	-5.7	114.4
1991	49.1	53.4	-4.3	99.6
1992	48.7	54.3	-5.6	100.5
1993	48.7	53.5	-4.8	94.2
1994	47.8	51.3	-3.4	84.8
1995	44.5	49.1	-4.6	78.2
1996	43.8	49.3	-5.5	75.2
1997	44.7	48.9	-4.2	77.0
1998	43.7	47.8	-4.0	74.6
1999	43.4	46.9	-3.5	73.5
2000	43.6	45.1	-1.4	67.6
2001	43.5	47.5	-4.0	76.6
2002	43.5	48.4	-4.9	81.6
2003	42.1	47.9	-5.8	85.9
2004	41.2	45.3	-4.1	83.9
2005	40.9	43.4	-2.5	79.0
2006	42.1	43.1	-0.9	71.9
2007	41.3	41.5	-0.3	64.0
2008	38.6	40.7	-2.1	64.6
2009	35.7	41.0	-5.3	66.3
2010	36.5	40.1	-3.6	63.4
2011	36.7	39.4	-2.7	62.2
2012	35.4	39.2	-3.9	61.7
2013	36.2	39.4	-3.2	61.9

Source: Bank of Israel Annual Report (2013) and author's calculations.

multiple exchange rate system was abolished and in the early 1970s restrictions on interest rates were reduced. These moves, that had been formulated in the government and the Bank of Israel (the central bank), were overshadowed by the Yom Kippur War that led to a surge in government spending and therefore to an increase in de facto state intervention in the economy (Michaely, 1975).