

**ECONOMICS***Sociology*

**Erez Cohen,**  
Ariel University,  
Ariel, Israel,  
E-mail: [erez@ariel.ac.il](mailto:erez@ariel.ac.il)

## THE NATURE OF ISRAEL'S PUBLIC POLICY AIMED AT CURBING THE RISE IN PROPERTY PRICES FROM 2008-2015, AS A DERIVATIVE OF THE COUNTRY'S GOVERNANCE STRUCTURE

Cohen, E. (2016), The Nature of Israel's Public Policy Aimed at Curbing the Rise in Property Prices from 2008-2015, as a Derivative of the Country's Governance Structure, *Economics and Sociology*, Vol. 9, No 2, pp. 73-89. DOI: [10.14254/2071-789X.2016/9-2/5](https://doi.org/10.14254/2071-789X.2016/9-2/5)

*Received:* December 2015  
*1st Revision:* March, 2015  
*Accepted:* May, 2015

DOI: [10.14254/2071-789X.2016/9-2/5](https://doi.org/10.14254/2071-789X.2016/9-2/5)

**ABSTRACT.** The paper portrays public policy steps taken in order to reduce housing prices, formulated and implemented in Israel 2008-2015, and analyzes them in light of the locally prevalent economic worldview and governance structure. Analysis of the policy shows that in order to understand the justifications for its formulation it should be viewed through the positivist worldview that focuses on the subjective considerations of policy shapers that neutralize its objective-normative efficacy. The paper stresses the impact of the country's governance structure at each point in time on the type of policy chosen and determines that a democratic but weak and unstable governance structure leads to the formulation and implementation of a positivist policy reflecting politicians' narrow interests of reelection. In contrast, stable democratic rule supported by a sound majority of a single ruling party can easily sustain public policy that expresses the normative approach, reflecting social values as defined by politicians.

**JEL Classification:** H1, H7,  
E6

**Keywords:** Political Science, Public Policy, Political Economy, Israel, Real Estate, property prices, Normative approach.

### Introduction

The considerable rise in Israel's property prices from 2008 to the present<sup>1</sup> has put concerns of a developing real estate bubble on Israel's public agenda (Dovman *et al.*, 2012). Volatile property prices are not unusual and occur in all countries with a free market, similar to the price of shares and commodities. Nonetheless, a historical perspective points to the notable contribution of real estate bubbles to the development of domestic economic and social crises. Two particularly noticeable cases of extreme volatility in domestic property prices are known to have led to acute long-term local and foreign economic crises. The first is the case of Japan in the early 1990s (the property bubble crisis), which generated much research (Weinstein, 1990; Ito & Iwaisako, 1995; Stone & Ziemba, 1993; Noguchi, 1994; Cargill, Hutchison & Ito, 1996; Noguchi, 1994; Schaede, 1996; Ohmi, 2010; Saxonhouse &

<sup>1</sup> Until the third quartile of 2015.

Stem, 2002). The second is the US property crisis (the subprime crisis) in the first decade of the twenty first century, which has also been extensively studied (Kregel, 2008; Demyanyk & Van Hemert, 2011; Gjerstad & Smith, 2009; Blundell-Wignall & Atkinson, 2008; Gwinner & Sanders, 2009; Hellwig, 2009; Whalen, 2008; Arner, 2009; Brown & Davis, 2008; Serkan, 2009; Sagemann & Reese, 2011). The disastrous economic consequences of these crises served as a warning sign for Israel and its developing property bubble, resulting in policy plans for curbing and even reducing property prices. For many years Israel's real estate industry has been known as a free market industry, protected from government intervention in determining prices. Based on their concern that the end of the local property price bubble might come to resemble the US crisis in 2008, Israeli leaders have formed policy and regulatory steps aimed at intervening in free market forces.

The purpose of this paper is to follow these policy steps, analyze them, and examine them in light of the economic worldview customary in Israel as well as its governance structure. The research hypothesis claims an association between the governance structure in a given country and the nature of its public policy. Thus, a country with a stable governance structure will witness the formation of a normative public policy that seeks to promote and achieve national interests for the public good. In contrast, a country with an unstable governance structure will witness the formation of a positivist public policy aimed at promoting the interests of specific groups in society that have individual characteristics and specific interests, including those of the policy makers themselves. This hypothesis shall be explored through a case study analyzing the characteristics of the Israeli public policy endeavoring to reduce domestic housing prices during 2008-2015. The State of Israel is characterized by an unstable governance structure, and thus identifying the nature of public policy formed on this issue (as normative or positivist) may attest to the existence or nonexistence of the hypothesized association between a country's governance structure and the nature of its public policy. Before examining the existence of such an association, however, the characteristics of public policy and the justifications for its formation and implementation shall now be presented.

## **1. The nature of public policy**

The nature of public policy and its contents derive from a country's type of government, with a totalitarian country more inclined to implement a strict policy that intervenes in the life of its citizens and does not always act in their favor, while a democratic country will implement public policy that aims to serve the public, with elected officials serving as an instrument for promoting the public good. Nevertheless, in some cases democratic rule as well will use public policy as an opportunity to promote the political interests of officials and thus miss its original goal (Bertelli, 2012).<sup>2</sup> Bertelli brings an example of the public policy of a government in a democratic country in another publication that describes how democratic governments in general and the British government in particular seek to improve their chances of reelection by adapting policy to this goal (Bertelli & John, 2013). Similarly, in some situations public policy in general and allocation of the necessary funds for its implementation in particular, are determined according to the agenda of the media and following public opinion (John, 2006).

There are two approaches to the analysis of public policy. One is normative, dependent on and guided by values, and it attempts to formulate solutions for the existing state of affairs with the aim of attaining society's values. The other is positivist, dependent on interests, and it focuses on and makes do with justifying and explaining the existing state of affairs in light of the personal interests of policy shapers, and therefore does not examine the policy in light of the

---

<sup>2</sup> See: *The Political Economy of Public Sector Governance*, p. 1.

ethical and objective parameters of society in general (Torgerson, 1986; Fisher, 1998; Lynn, 1999).

Public policy can be implemented by taking regulatory steps, i.e. the collection of laws and regulations that control the exchange of commodities and services in society (Moran & Wood, 1993). The term "regulatory steps" might be misinterpreted as regularization, supervision, intervention, or standardization of a certain activity. In the government context, regulation refers to an action that regularizes activities that are within the authority of the government. Government regulation reflects the involvement of the government in a certain activity, with countries differing in the extent, design, and implementation of their regularization policy as well as its justification.

The concept of regulation originates from the economic theory, whereby a major goal of supervision is the defense of public interests (Stigler, 1971; Waters & Moore, 1990). Even the United States, which stands for the principle of market forces, saw a need in the early twentieth century to supervise the markets in order to stabilize market forces, supervise prices, and set threshold conditions for entering the markets, and initially embraced government regulation by enforcing use of administrative systems to supervise the free market. Today the goals of regulation primarily involve defending the public good, avoiding economic risk, and preventing the exploitation of weak groups in society (Sunstein, 1990).

## 2. Fundamental justifications of regulation

Different countries vary in the extent and intensity of their regulation versus the free market, ranging from actual preplanned intervention aimed at shaping reality to post factum involvement aimed at regularizing the reality formed by the free market. Whatever the case, regulation on all levels is based on several fundamental justifications, as follows: The first is *maintaining public interests*: The most basic foundation of regularization is the principle whereby regulation is intended to defend public interests. Public interests encompass a varied list of needs, interests, and values. Promoting competition is a major interest that regulation seeks to realize. This is an interest both of business owners, who wish to enter the market, and of consumers, who seek to enjoy the effects of competition, manifested in improvement of service availability, quality, and prices. Free competition is vital for the economy's growth and efficiency. Some contend that competition is the best guarantee for obtaining high-quality products and services and that it is even capable of lowering prices. The second is *maintaining consumer interests*: A major role of the regulator is to defend the interests of service consumers. Consumer interests require protection and enhancement, mainly due to the power differential between service providers (in our case: contractors, developers, and construction companies) and citizens. Modern countries offer much better conditions for the development of large companies that provide essential services and goods. Companies strive for profitability, and profitability stems from consumers. The interests of the company contrast with the interests of the consumer. The third is *correcting market failures*: This justification is the basic routine rationale for regulatory intervention. In analyzing the foundations of regulation it is possible to distinguish between market failure in its narrow sense and market failure in its wide sense. Market failure in the narrow sense is measured by economic parameters; for example, when the market force of a monopoly lets it operate with no considerations for the constraints of competition, regulatory intervention is necessary. Market failure in the wide sense is when a (not necessarily economic) purpose or goal, desirable for reasons of public interest, would not be achieved through free activity of players in the market in the absence of regulatory intervention.

The purpose of this paper is, as stated, to examine and analyze the regulatory processes formulated and implemented in Israel from 2008-2015 in response to the sharp rise in property prices, while examining the justifications underlying these processes. First, however, a review

will be provided of trends in the Israeli real estate industry in the period under scrutiny that led to formulation of these processes.

### 3. The rise in Israel's property prices

The continued rise in Israel's property prices since 2007, presented in Figure 1 below, shows that since 2007 and until the present there has been a clear and consistent trend consisting of an overall rise in property prices (both new and second-hand). Indeed, the Israeli property market knew periods of accelerated price rises in the past as well, mainly from the mid-1970s to the early 1990s, and this served as a research focus (Rubinstein, 1999). However, it appears that this time things are slightly different and both government leaders and many citizens are genuinely concerned that prices will spiral out of control, possibly leading the Israeli economy and society to a crisis situation similar to those of Japan and the United States.

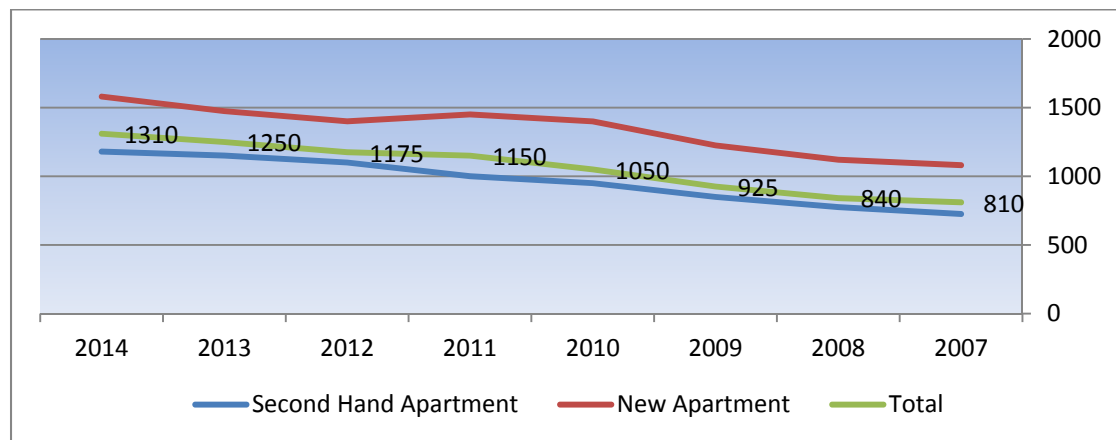


Figure 1. Housing prices in Israel, 2007-2014 (thousands of shekels)

Source: Israel CBS.

Examination of the many reasons for the continuous rise in Israel's housing prices as presented in the State Comptroller's report for 2015 (State Comptroller, 2015) indicates that many reasons appeared at one point in time. First of all, from 2002-2012 an accumulated disparity was evident between the number of households (which continued to rise consistently) and the number of construction starts (which dropped in that period). As a result, an overall shortage of residential units was formed, contributing to the rising disparity between demand and supply and to the rise in housing prices (as show in *Figure 2*).

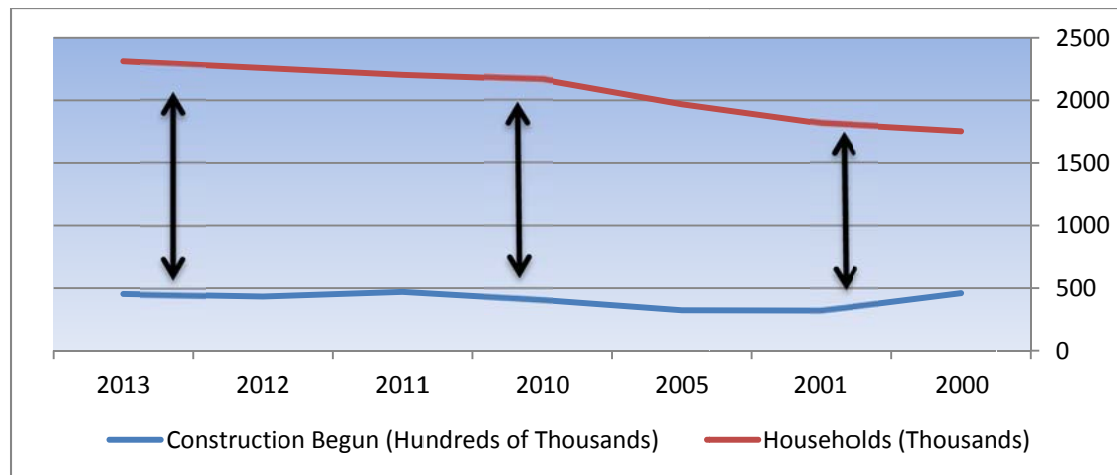


Figure 2. Israel's construction starts versus households, 2000-2013

Source: Israel CBS, Statistical Abstract of Israel 2014. Table 22.1 – Construction – selected date, and Table 5.1 – Households.

Secondly, this period saw a clear drop in the construction of small dwellings (three rooms or less), reducing the supply of inexpensive housing, with a negative impact on the necessary compatibility between the needs of a not inconsiderable proportion of households and the supply of suitable housing, hence unnecessarily overburdening these households. The drop in the construction of small dwellings in Israel and the rise in the number of large dwellings (four rooms or more) constructed from 2001-2013 are shown in *Figure 3*.

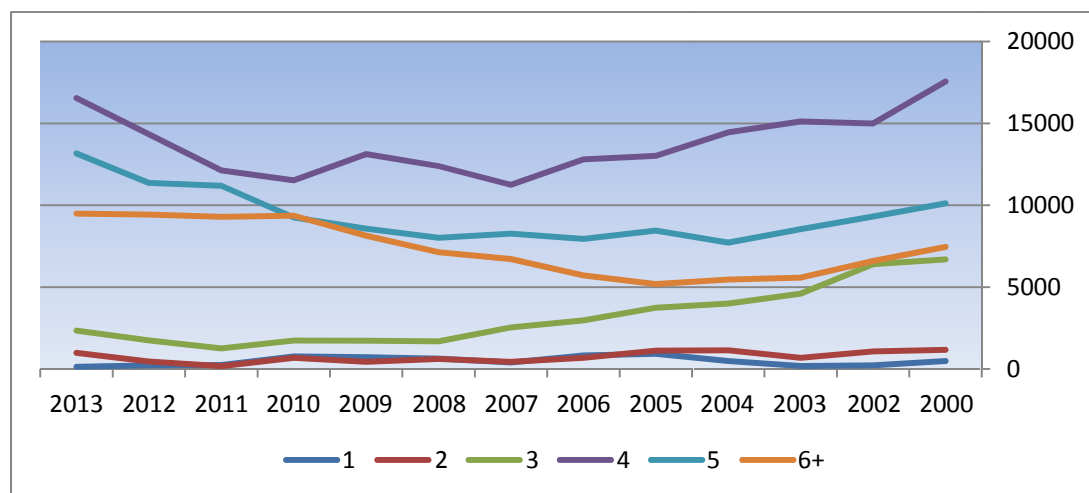


Figure 3. Israel's dwellings, by number of rooms, 2000-2013 (construction completed)

Source: Israel CBS, Statistical Abstract of Israel 2014. Table 22.9 – Dwellings, by number of rooms.

Third, in the period under scrutiny there was a conspicuous increase in the demand for housing in Israel, which contributed significantly to the rise of housing prices, in addition to the supply limitations presented above. The increase in the demand for housing is particularly evident from the extent of mortgages taken out by the Israeli public during this period (as shown in *Figure 4*).

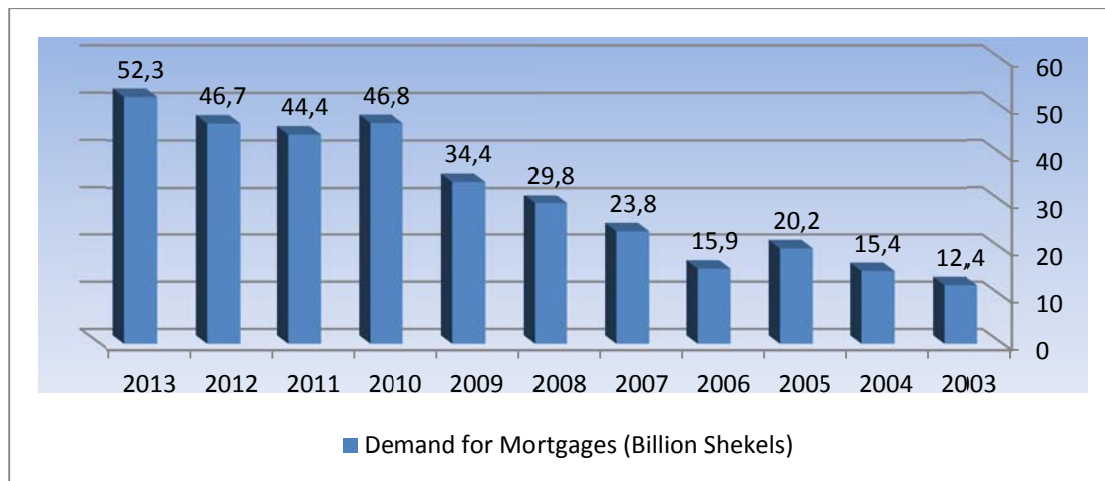


Figure 4. Demand for mortgages in Israel (in billion shekels), 2003-2013  
*Source:* Israel CBS.

One of the prominent reasons for the rise in mortgages taken out in Israel in the investigated period is the particularly low interest environment in Israel and all over the world as a result of the global recession. A low interest environment contributes to a rise in demand for mortgages in two concurrent directions: First of all, it constitutes an investment opportunity for those who otherwise would not have the necessary funds to purchase an apartment. A reality of near zero interest rates encourages them to commit to comfortable mortgages, purchase their first apartment for residential purposes, and provide themselves with socioeconomic leverage. Furthermore, the low interest environment reduces the attractiveness of conservative savings and investment channels and increases the tendency of investors to divert their investments from financial channels to real estate in an attempt to earn significant returns. This state of affairs is perceived by investors as a unique opportunity to take out a mortgage with favorable conditions in order to purchase high-yield property for investment. The returns are anticipated both in the form of future rental fees and due to expectations that property prices will continue to rise, raise the value of the property purchased, and produce yields higher than those possible in any other investment channel. Data published by the Taub Center of Social Policy Studies in Israel<sup>3</sup> indicate a fourfold rise in the number of Israelis who owned two or more homes, i.e., who invested in real estate, from 2006 to 2012.<sup>4</sup> Although a rise in investment in home ownership is evident in all income groups, the most affluent (ranked in the top quintile) set the tone (as evident from *Figure 5*).

<sup>3</sup> The Taub Center of Social Policy Studies in Israel (2015), *Picture of the Nation, Ownership of two or more homes*, p. 11.<sup>3</sup>

<sup>4</sup> From 2.1% to 8.1%.

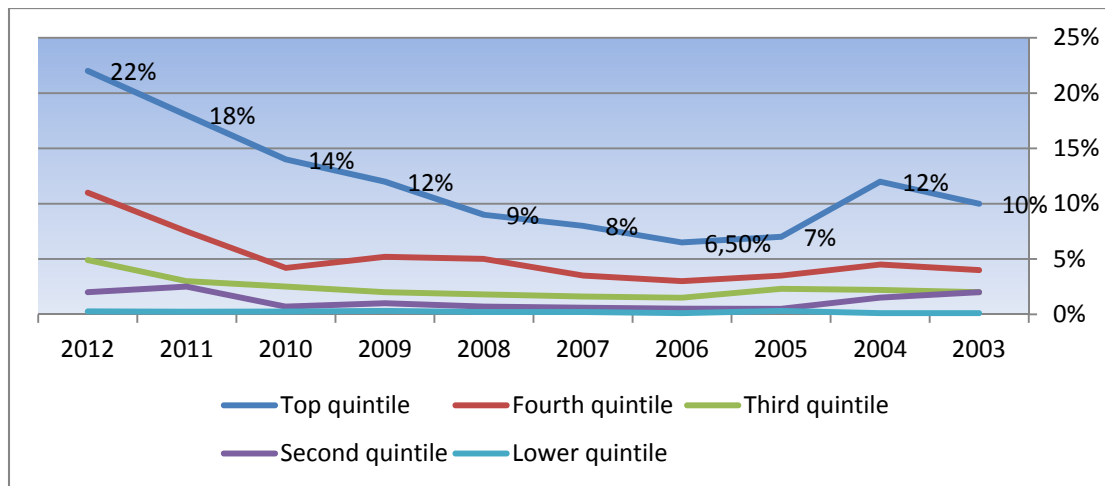


Figure 5. Ownership of two or more apartments (by income group), 2003-2012 (%)  
 Source: Taub Center for Social Policy Studies in Israel, (2015). *Picture of the Nation 2015*, p. 11.

Shapers of Israel's public policy are aware of the trends presented above, and of the concerns of their destructive economic and social implications, and have tried time after time to halt the rise in property prices and even to lower them. These attempts are the basis of the current study, which follows policy steps taken during the tenure of the two last Israeli governments (under Benjamin Netanyahu).<sup>5</sup> Public policy steps implemented in Israel's real estate industry shall next be analysed and explored.

#### 4. Regulatory processes implemented in Israel's real estate industry from 2008-2015

The research literature is replete with publications on public policy and possible ways of preventing bubbles in property markets. For example, Żróbek and Gross presented and compared public policy in the real estate field in various countries (Żróbek & Gross, 2015). Conefrey and John examined the public policy of Spain and Ireland in attempting to prevent and deal with their property bubbles in the beginning of the decade, and show the efficacy of fiscal policy in such an endeavor (Conefrey & John, 2010). Crowe *et al.* as well presented the disastrous economic consequences of the various property bubbles that emerged in different countries and listed among other things three possible manners of intervention and regulation available to the leadership. First of all, implementing a monetary policy that curbs the demand for mortgages, such as raising interest rates. Second, operating fiscal policy tools to reduce demand for housing, such as imposition of transaction taxes, property taxes, and mortgage interest tax. Third, operating macro prudential regulation aimed at moderating demand for housing and reducing risk to the financial system, for instance, instituting higher capital requirements for mortgage applicants and limits on loan-to-value and debt-to-income ratios, according to the client's income and financial state (Crowe *et al.*, 2013).

Similarly, public policy shapers in Israel formulated a long list of actions aimed at curbing and even lowering property prices. These steps may be classified as belonging to three categories: actions taken to reduce the demand for housing, actions taken to increase the supply of dwellings, and actions taken to lower property prices.

<sup>5</sup> The 33<sup>rd</sup> government of Israel, which served from 2013-2015, and the 34<sup>th</sup> government inaugurated in May 2015.

## 5. Actions taken to lower the demand for housing

From 2010 to 2015, various regulatory actions were taken in Israel, aimed primarily at lowering the demand for investment properties, and some of these even contributed to the financial stability of Israeli banks. Attempts to lower demands for housing may be divided into two: legislative actions, and regulation and stabilization of the banks.

Legislative actions:

In February 2011 (and subsequently also in June 2015) a decision was reached to raise the purchase tax on investment properties. The purpose of this action was to modify the demand for investment properties, however in practice the market responded by increasing demands for housing in the weeks prior to implementation of the resolution, which had the effect of further raising their prices. In August 2013 a decision was made to toughen the conditions for tax benefits awarded to foreign residents. This action was taken with the intention of moderating the demand for housing by foreign residents who purchase dwellings in Israel for investment purposes, but its effect on the demand was later proven to be negligible. Similarly, legislative actions enforced in January 2014 with the aim of changing and reducing exemptions from capital gains tax on real estate for the sale of residential apartments had a low degree of efficacy and had no impact on demands for housing.

### 5.1. Regulation and stabilization of the banks

In October 2010 the Bank of Israel instructed the banks to reserve capital against mortgages considered risky and that equal a high proportion of the original capital cost. As a result, these mortgages became more expensive and their interest rates rose. Thus the Bank of Israel achieved two things at once: increased stability of the banks and reducing the attractiveness of these mortgages for clients. In November 2012 the Bank of Israel decided to restrict the financing provided by the banks for purchasing housing, and as a result, apartment purchasers had to increase their equity capital in order to cover the total sum necessary to purchase a dwelling. This action, however, did not curb the demand for mortgages and housing as the Israeli public simply began taking out supplementary loans at higher interest rates in order to obtain the purchase sum. A similar action was enforced in August 2013, when the Bank of Israel instructed that mortgages given by the banks be limited by a criterion of monthly repayments as a proportion of the client's free income. However this action too was not efficient as many citizens proceeded to take out loans jointly with their children and thus presented the banks with a higher repayment capacity. In September 2014 the Bank of Israel once again instructed the banks to raise the bank's capital against the mortgage portfolio (change of the reserve ratio) in order to increase the bank's stability in case of non-payment.

### 5.2. Actions taken to increase the supply of dwellings

Concurrent with attempts presented above to lower the demand for housing in general and for investment properties in particular, many attempts were also made to increase the supply of residential housing. In July 2007 the Israeli government decided to relocate several IDF bases from central Israel to the southern Negev, with the aim of clearing considerable land for construction in central Israel. It later became evident that this decision contributed to a rise in housing prices in the Negev while not lowering housing prices in central Israel. Two years later, in May 2009, the government declared a reform in the Israel Lands Administration,<sup>6</sup> including changes in authority and setting a target of marketing 35,000 residential units a year. Once again,

---

<sup>6</sup> The main government agency in charge of government owned lands. Now called the Israel Lands Authority.



this action did not contribute to lowering housing prices, as the Israel Lands Administration did not meet the target.

In 2011 several additional attempts were made to increase the supply of dwellings, and in June of that year an overall plan was publicized for specifically increasing the supply in areas in demand. As part of this overall plan, 70 programs were formulated for construction of 60 thousand residential units (by order of priority). About two months later, a decision was reached to establish residential committees for rapid planning of residential complexes offering attainable housing. In practice, several such complexes were indeed established, but only a small proportion of the dwellings were allocated for attainable housing purposes, thus not contributing to the lowering of housing prices. A month later, in September of that year, a decision was reached to promote plans for municipal renewal (evaluation and construction, fortification and renewal of old buildings), as well as acceleration of marketing and increasing government aid for public housing. However, once again, the targets set were not achieved, mostly due to lack of response by related factors. These were, on the one hand, contractors who did not find these construction projects sufficiently profitable. On the other, heads of local municipalities responsible for providing permits for municipal renewal plans were reluctant to give their approval due to concerns of an uncontrollable rise in the number of residents in renewed neighborhoods, making it hard to provide necessary public services (e.g., education, parking, public institutions, etc.). Similarly, the evacuation and construction plan for municipal renewal slated to be carried out by the state, declared in November 2013, was also not implemented.

In September 2013 agreements were signed between the Israel Lands Authority, the planning authorities, and local authorities, to accelerate the construction process. This course of action indeed helped increase the number of dwellings by creating gigantic neighborhoods on city outskirts, but then again it led to the neglect of city center development. A month later a decision was made to redeem agricultural land and change its designation for purposes of construction. The plan was not implemented at the time, due to conflicts with the farmers, but in 2015 it appeared once again on the government agenda as part of the overall plan of the current Finance Minister, Moshe Kachlon, to reduce housing prices. In November of that year, a resolution was declared to implement a national construction project encompassing 150,000 housing units in a decade. The first tenders were issued before the elections in 2015. The last significant act carried out in Israel (as of now) to increase the supply of dwellings was in July 2014, when a decision was reached to market plots for large construction projects, of which 30% of the housing units would be slated for long-term rental. These projects were indeed carried out, although only to a fairly limited extent.

### ***5.3. Actions taken to reduce housing prices in practice***

Once the government's attempts to indirectly urge free market forces (demand and supply) to reduce housing prices did not succeed, in 2014 the government began formulating plans to directly influence prices. In March 2014 Finance Minister Yair Lapid declared a zero Value Added Tax plan (henceforth: zero VAT) on new dwellings purchased by those eligible according to specified criteria. The purpose of this plan was to reduce the total taxation on new dwellings and thus also their overall price. Disagreements within the government delayed implementation of the plan and led to de facto paralysis of the entire construction industry, as potential purchasers put their plans on hold in expectation of further developments. Moreover, when it became clear that the plan would not take root, followed by a decision to dissolve the government and initiate new elections – an irregular demand for housing emerged, leading to a further hike in prices. In December of that year the "target price" plan was presented, enabling the sale of dwellings to those eligible at a 20% reduction from the market price. This plan was indeed carried out, but its dimensions were too small to have had any real effect on Israel's

housing prices. After the elections held in 2015, and with the establishment of the new government, Moshe Kachlon, elected Minister of Finance, established a committee to attempt to reduce Israel's housing prices. The committee led to the August 2015 resolution to expand the government plan called "price for residents", enabling discounts for young couples according to predetermined criteria.

## 6. Analysis of public policy

The regulatory steps presented above reflect a clear declared public policy by Israeli leadership attempting to influence (whether directly or indirectly) the results of the free market in Israeli real estate. Therefore, the question is whether this policy reflects Israel's economic worldview during these years. Israel, established on the foundations of the socio-democratic worldview as a legacy of the former British rule, changed its economic outlook in 1977 with the political transition that occurred in the elections in that year, leading to the ascension to power of the Likud party, which advocated a free market and liberalization. From then until the present Israel has followed a neoliberal worldview combining principles of a free market, private entrepreneurship, liberalization, and globalization, while also upholding a welfare state supported by the necessary regulatory processes.

At the same time, since its establishment and unrelated to the economic worldview of the government in the various periods, Israel has maintained a declared aim of spreading its population throughout the country, based on a Zionist ideology supporting settlement of the various parts of the country with no consideration for efficiency or economic justifications. It seems that, thanks to unrestrained free market powers leading to a rise in Israel's housing prices, particularly in central areas of high demand, the present time provides good conditions for realizing the attempts of the young state to distribute the local population in general and new immigrants in particular throughout various parts of the country rather than only in central Israel. Giving these unrestrained powers freedom of action could be assumed to raise housing prices in the center even further and compel citizens seeking a roof over their head to turn to less developed parts of the country and settle there with no government interference and fully congruent with the foundations of Zionist ideology seeking to settle the country, an ideology formulated with the establishment of the state and declared by those currently in power as well.<sup>7</sup> Therefore, the endeavors of Israel's rulers to reduce housing prices, among other things in the center, appear puzzling. If so, what is the justification or justifications underlying this government activity? If reducing housing prices has no ideological significance for the geographic distribution of the population, as presented above, it must have some other greater national significance, for instance economic significance.

A look at the state's revenues from taxes during 2012-2015<sup>8</sup> shows that collection of direct property taxes<sup>9</sup> alone earns the state coffers a sum of over 7 billion shekels. This further stresses the question of whether reducing Israel's housing prices has a positive effect on the country's economy. Reducing housing prices will necessarily lead to a drop in direct and indirect<sup>10</sup> property taxes collected and will have a detrimental effect on the government's revenues, which might increase the budget deficit. Moreover, a drop in real estate prices might have a bad financial effect on other factors in the Israeli economy, such as contractors, banks, and many citizens, as plummeting prices will affect the income of building contractors and might

---

<sup>7</sup> The Office for Development of the Negev and the Galilee is responsible for promoting the settlement and development of peripheral parts of the country.

<sup>8</sup> From the summary of the state budget for 2015, p. 215. Table 12: The state's revenues from taxes for 2012-2015.

<sup>9</sup> Including capital gains tax, property tax, and purchasing tax.

<sup>10</sup> Value Added Tax.

detract from their ability to repay bank loans and even lead to bankruptcy. The banks too, which in recent years approved many mortgages with property serving as collateral, might be gravely harmed by a decrease in the value of mortgaged properties, as occurred in the United States during the sub-prime crisis. No less affected will be the 68%<sup>11</sup> of Israel's households that own residential properties (more than 40% of these are mortgaged), as reduced prices will mean heavy losses for them as well.

Thus, it appears that the country has no economic incentive to reduce housing prices, as such a course of action will have a detrimental effect on the state coffers, building companies and contractors, and financial institutions, and last and not least – a large majority of the citizens. Therefore, it may be concluded that the Israeli public policy of reducing housing prices should not be perceived in normative terms, i.e. in light of justifications related to public interests and according to the country's objective values. Rather, this policy must be examined and evaluated according to the positivist approach linked, as stated, to narrow personal interests of the country's leaders.

Accordingly, it appears that what underlies the public policy of reducing housing prices is politicians' desire to attain political and personal benefits as a result of the formation and implementation of this policy. Unlike the past<sup>12</sup>, when the economic worldview implemented in Israel was clear and well-defined, acting in the public good and in the interests of the state, at present Israel's public economic policy is based on short-term transient populist considerations aimed at satisfying the voters, sometimes at the expense of economic efficiency and of the public good. Politicians depend on public support and therefore strive to maximize the public good, namely politicians focus on maximizing their chances of being chosen for another term and for this purpose they act (even if only for the sake of appearances) to promote the public good. This claim is supported by many other cases in Israeli politics in the past and present<sup>13</sup> in which Israeli politicians changed their opinions or acted against their own free will on crucial economic issues due to their wish to satisfy the sectorial voter audience with which they are associated. This conduct is compatible with the median voter model (Downs, 1957), which claims that the attitudes of politicians seeking election and the policy of elected governments tend to express the wishes of the median voter whose attitudes and political inclinations are in the center of the political map and are therefore perceived as representing the attitudes of the majority of voters.

This raises the question of what affects policy shapers when formulating a positivist policy rather than a normative policy? This conduct of politicians in general and of Israeli politicians in particular assumedly derives from the customary structure of governance, which allows (or even compels) the prime minister to put together a weak coalition based on a (mostly small) majority comprised of several political parties that do not see eye to eye on all issues (political, social, and economic). As a result, the prime minister is subjected to political and budgetary extortion by the heads of those parties, eventually leading to the less than optimal appointment of senior ministers who are often unfamiliar with the field they are responsible for and even give priority to the goals and aims of their party and its voters. Moreover, such a weak coalition structure, as in Israel, might easily lead to the disengagement of one of the partners due to some crisis and drag the country to frequent recurring elections, as in Israeli politics. This reality reminds Israeli politicians that their time in office is short and measured and therefore they must do what they can to take advantage of their temporary power position to obtain benefits for the public in general and for their voters in particular, so that they will be able to cite

---

<sup>11</sup> Source: Ministry of Building – Division of Economic Analysis, May 18 2015.

<sup>12</sup> Since the first days of the state and until the mid-1980s (when a National Unity government was established).

<sup>13</sup> A conspicuous example is the varying attitudes / approaches of several ministers with regard to the natural gas plan currently on the government's agenda (2015), which involves considerable economic as well as social aspects, following changes in their jobs and/or authority and corresponding with the wishes of their potential voters and/or supervisors.

these achievements in future elections. Thus, the state budget becomes a political tool rather than an economic tool.

It would indeed not be right to generalize and apply this portrayal to all Israeli politicians, however this concept is clearly quite common among many Israeli politicians today who perceive their success as a zero sum game, i.e., their success is the failure of other politicians, and vice versa. This understanding of the dynamics of Israel's politics may help illuminate the aggressive and massive race to formulate regulatory processes aimed at reducing housing prices, evident in Israel in the years studied, and hint at the explicit and implicit justifications of these processes by the politicians involved in them.

Accordingly, it seems that the Israeli public policy of reducing housing prices is also affected by these political-personal considerations. Politicians in general and party leaders in particular are involved in a race to carry out this policy, with the assumption that it has significant political benefits in the form of the support of young citizens who cannot afford to purchase a residence and therefore have a clear interest in reduced housing prices. Past experience shows that older Israelis vote according to deep-rooted traditional security-oriented political views and not according to economic whims. This understanding urges politicians to come to the aid of younger citizens whose political and security views have not yet been completely formalized and therefore their personal interests in general and their economic interests in particular head their order of priorities. The widespread social protest that emerged in Israel in the summer of 2011, led by a group of young people who drew after them hundreds of thousands to protest against Israel's cost of living in general and high property prices, in tent cities erected on city boulevards and in public parks ("the tents protest"), further clarified that members of this young generation would determine the results of the coming election campaigns. Therefore, Israeli politicians choose (even if only for the sake of appearances) to act in favor of this interest group, which is expected (as they see it) to maximally contribute to their chances of election, even if this activity is at the expense of society in general, in accordance with the Theory of Public Choice proposed by James Buchanan and Robert Tollison (Buchanan & Tollison, 1972).

The successful policy steps led in 2012 by then Minister of Communications (and current Finance Minister) Moshe Kachlon, who managed to reduce cellular service costs, constitute a model for Israeli politicians. Kachlon brought about the dissolution of the triopoly that controlled Israel's cellular market,<sup>14</sup> producing a real revolution in cellular service costs, and in return won wide public support. Furthermore, Moshe Kachlon's success in implementing the cellular reform and the considerable political benefits he reaped encouraged him to leave the ruling party (Likud) and establish his own independent party (Kulanu)<sup>15</sup> which ran in the recent elections of 2015 against his original party. This act emphasizes the "zero sum" game of Israeli politicians, whereby the success of one minister is a threat to the others and to the status of the prime minister. According to this concept, it makes sense for every minister to seek credit for reducing property prices and to renounce the contribution of other ministers to promoting this policy. In order to demonstrate this claim, it is sufficient to mention the plan of the previous Finance Minister, Yair Lapid, to reduce property prices by introducing zero VAT for those eligible, which aroused such objection by the prime minister that it eventually led to dismissal of the minister and bringing forward the date of the next national elections.

All this shows that public policy aimed at reducing Israel's property prices is affected by foreign-positivist considerations (both political and personal) that neutralize its objective-normative efficiency. If the government had indeed wished to reduce prices it could have activated more significant regulatory principles such as reducing the price of publicly owned lands, as well as extensive subsidies for purchasing housing not only as part of the "price for

---

<sup>14</sup> Consisting of the cellular companies: Pelephone, Partner, and Cellcom.

<sup>15</sup> Received ten Knesset seats and joined the coalition as a senior partner.

residents" or "target price" programs. Alternately, it could have determined by law both compulsory construction standards and a supervised price range. If the government had perceived housing as a vital necessary commodity similar to other supervised basic commodities (such as standard bread, milk, and water) it could have applied the same policy tools used for these products (subsidies, setting legally approved price ceilings, etc.).

Thus, it seems that although Israel's public policy for reducing property prices encompasses many varied steps, it is incapable of bringing about a real change in a field based on free market forces and affected mainly by sellers' independent desire to finalize sales deals at their requested price. In order to effect a real change in the level of housing prices, the government will have to relinquish reforms that seek to affect free market forces with the aim of guiding them to a lower point of equilibrium. Rather, it must act to neutralize or at least to reduce the effect of free market forces and implement, as stated, an interventionist and aggressive public policy that sets the very rules of the game, including price levels of the Israeli housing market.

Such a strategic governmental plan, aimed at obtaining housing rather than necessarily at reducing housing prices, can include a declaration of the establishment of two new development centers for residential and industrial purposes in various parts of the country (one in the northern and the other in the southern extremity). In these centers beneficial policies will be introduced with regard to several issues, such as attractive tax benefits for companies and individuals, intended to attract companies to these areas in order to increase the supply of jobs as well as to encourage people to move to these areas. Migration will stem from the high chance of finding jobs and the positive tax benefits that will enable a higher standard of living than in the dense and expensive central area. In addition, the government must allocate development budgets for introducing advanced means of transportation to these areas (paving highways, laying train tracks, etc.), additional budgets for the development and advancement of education in the new areas to be established, and so on. Such a strategic course can encourage the spread of the population throughout the country and provide people who choose to move to these areas with affordable housing and a standard of living that equals that possible in the center. Funding such a strategic plan offering affordable housing for citizens will be facilitated both by more efficient allocation of the government budget (of which an unnecessarily high proportion is used for sectorial purposes, as a result of the Israeli political system that enables and even encourages political and budgetary extortion) and by a steady percentage of Israel's future profits from natural gas.

However since there is, as stated, no real economic justification for reducing property prices, the government has avoided enacting such interventionist policy and prefers to continue its useless regulatory steps that let it "eat the cake and keep it whole", i.e., both avoid harm to homeowners who object to price reductions and satisfy citizens who do not own homes as well as the young population, even if only for the sake of appearances.

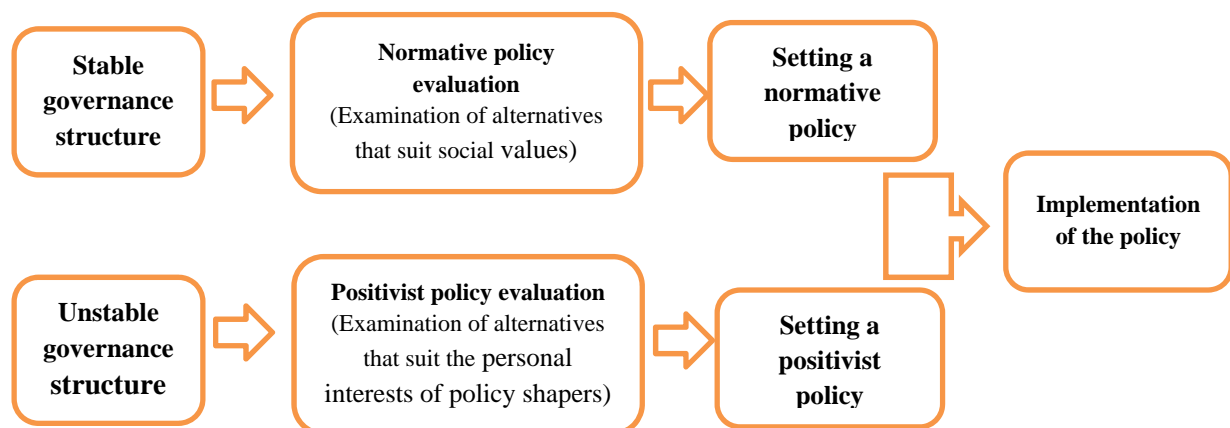
Another alternative available to Israel's policy shapers, which does not involve reducing property prices (and thus avoids financial harm to homeowners) and that will also raise the chances of those who do not own homes to purchase housing, is a reform in the structure of pay. A reform that will raise pay levels in the Israeli economy would be capable of reducing the number of monthly paychecks necessary to purchase an apartment. In this way, politicians could help weak sectors of society with no harm to the more established socioeconomic groups. As stated, however, the regulatory processes formed in Israel in the years under investigation have not taken this direction and aim for a goal that is not necessarily beneficial and appropriate for the Israeli economy but has visible potential political benefits.

The Bank of Israel report for 2015<sup>16</sup> is an objective benchmark for judging the efficacy of the government's policy aimed at reducing housing prices. This report strongly criticizes the government's inefficient conduct with regard to its policy aimed at reducing housing prices. According to this criticism the government's operations are inefficient and incapable of achieving the declared goal of lowering Israel's housing prices. One example is the statement that the "price for residents" program currently (2016) implemented by the Minister of Finance, Moshe Kachlon, far from contributing to a reduction of housing prices in the wider housing market is in fact leading to a rise in demand for housing in those areas in which it is being implemented, thus causing an additional rise in housing prices instead of the reverse.

## Conclusions

The above analysis of policies aiming to reduce Israel's property prices is based on the positivist approach, which unlike the normative approach that, as stated, examines the current state of affairs and policy according to objective values (i.e., what is right and fitting for society) focuses on examination and analysis of the current policy while identifying subjective underlying considerations. According to this approach the current policy reflects the personal interests of policy shapers. It contends that in order to understand the reality formed by public policy designers we must first try and identify the interests that motivate them, interests that are at base personal and do not necessarily suit the objective values of the general public. This raises the question of which factor determines or at least affects the choice of public policy pattern utilized. When is there a greater chance that a normative public policy will be formulated and that politicians will strive for a value set shared by society and act to apply a policy that will reflect these values? Then again, when is there a greater chance that a positivist public policy will be formulated and that politicians will choose an alternative that serves their own interests, even at the cost of clashing with the values of society?

Examination of the public policy for reducing Israel's property prices as presented in this paper indicates a possible relationship between the country's governance structure and the policy pattern implemented, as presented in the following figure:



Thus, the contribution of the current paper is evident in its emphasis on the influence of the current governance structure on the type of policy utilized (normative versus positivist). A

<sup>16</sup> The report was published in April 2016. Chapter 9. See link: <http://www.boi.org.il/he/NewsAndPublications/RegularPublications/DocLib3/BankIsraelAnnualReport/%d7%93%d7%95%d7%97%20%d7%91%d7%a0%d7%a7%20%d7%99%d7%a9%d7%a8%d7%90%d7%9c%202015/c-hap-9%282%29.pdf>

democratic but weak and unstable governance structure (similar to Israel's in the last two decades) will encourage the formation and implementation of a positivist policy, one that reflects the narrow interest of politicians to increase their chances of reelection. In contrast, a stable democratic government based on a sound majority of a single ruling party (similar to Israel's since its establishment and until the mid-1980s) can easily sustain public policy that expresses the normative approach, reflecting social values as defined by politicians.

The story of Israel's political involvement reinforces and supports the above insight, as from the establishment of the state in 1948 until the political transition in 1977 Israel was governed by a social-democratic party (Mapay) with a centralist economic agenda that acted to achieve objective values linked to sustaining a welfare state, controlling productive elements of the economy, dispersal of the population throughout the country, and more, and public policy in those days was formulated accordingly. Since the political transition in 1977 and until the rotation government in 1984, Israel was governed by the Likud party that espouses a liberal economic worldview and formulated the socioeconomic policy accordingly, supporting liberalization, cancellation of subsidies, a free market and competition, and more.

Namely, during these four decades in which Israel's political map consisted of two large stable parties capable of maintaining a relatively stable government not dependent on small parties with sectorial interests, Israel's public policy was characterized by the normative approach. However, since the end of the rotation government<sup>17</sup> in the late 1980s and until the present, Israel's political map has been characterized by a plethora of narrow niche parties that undermine the stability of the government and compel the victorious party to form a coalition consisting of several interdependent parties. Undermining the stability of the government encourages, on one hand, incidents of budgetary extortion by coalition parties whereby their support of the state budget and indirectly of the acting government is contingent on fulfillment of sectorial budgetary demands,<sup>18</sup> and on the other increases politicians' concern for their job and increases their motivation to act to promote their personal interests with the aim of strengthening their public and political position. Hence, in these years Israel has seen the gradual formation of a public policy characterized by a positivist approach. This approach is evident in Israel's public policy of reducing housing prices from 2008-2015, as shown in the current paper.

The main weakness of the current study is related to the fact that it does not present comparative case studies examining policies aimed at reducing housing prices, as implemented in democratic countries with a stable governance structure, which could have reinforced the research conclusions and the association between a country's governance structure and the nature of its public policy. The reason for this deficiency is that countries that have experienced a rapid rise in domestic housing prices and that also have a stable governance structure (such as the United States and Japan) formed no policy of intervention in market prices aimed at lowering them until experiencing a bursting housing bubble and the emergence of an economic crisis (the property bubble crisis in Japan and the subprime crisis in the United States). Thus, it was not possible to compare the Israeli policy on this topic to the public policy of these countries before the bursting of the domestic property bubbles.

## References

- Arner, W. D. (2009), The global credit crisis of 2008: Causes and consequences, *The International Lawyer*, 43(1), pp. 91-13.
- Blundell-Wignall, A. and Atkinson, E. P. (2008), The subprime crisis: Causal distortions and regulatory reform, *The Financial Turmoil of 2008*, pp. 55-102.

---

<sup>17</sup> In the 1984 elections neither the liberal Likud party nor the socialist Labor party (that evolved from the Mapay party) prevailed, and therefore a rotation government was formed and remained in power until 1988.

<sup>18</sup> As was indeed evident in the process of approving Israel's budget for the year of 2016.

- Buchanan, J. M. and Tollison, R. D. (1972), *The Theory of Public Choice – II*, Ann Arbor: University of Michigan Press.
- Brown, C. and Davis, K. (2008), The sub-prime crisis down under, *Journal of Applied Finance*, 18, pp. 16-28.
- Cargill, F. T., Hutchison, M. and Ito, T. (1996), Deposit guarantees and the burst of the Japanese bubble economy, *Contemporary Economic Policy*, 14(3), pp. 41-52.
- Conefrey, T. and John, F. G. (2010), Managing housing bubbles in regional economies under EMU: Ireland and Spain, *National Institute Economic Review*, 211(1), pp. 211-299.
- Crowe, C. et al. (2013), How to deal with real estate booms: lessons from country experiences, *Journal of Financial Stability*, 9(3), pp. 300-319.
- Demyanyk, Y. and Van Hemert, O. (2011), Understanding the subprime mortgage crisis, *Oxford University Press on Behalf of the Society for Financial Studies*, 24(6), pp. 1848-1880.
- Dovman, P., Ribon, S. and Yakhin, Y. (2012), The housing market in Israel 2008-2010: Are house prices a bubble, *Israel Economic Review*, 10(1).
- Downs, A. (1957), *An Economic Theory of Democracy*, New York: Harper & Row.
- Fisher, F. (1998), Beyond empiricism: Policy inquiry in post positivist perspective, *Policy Studies Journal*, 26(1), pp. 129-146.
- Gjerstad, S. and Smith, V. (2009), Monetary policy, credit extension, and housing bubbles: 2008 and 1929, *A Journal of Politics and Society*, 21(2-3), p. 272.
- Gwinner, B. W. and Sanders, A. (2009), The subprime crisis: Implications for emerging markets, *Housing Finance International*, 23(4), p. 6.
- Hellwig, F. M. (2009), Systemic risk in the financial sector: An analysis of the subprime-mortgage financial crisis, *De Economist*, 157(2), pp. 129-207.
- Ito, T. and Iwaisako, T. (1995), Explaining asset bubbles in Japan, Bank of Japan, Monetary and Economic Studies National Bureau of Economic Research, 14, pp. 143-193, *NBER Working Paper No. 5358*, November 1995.
- John, P. (2006), Opinion and political violence on urban budgets in England, *Journal of European Public Policy*, 13:7, pp. 1053-1068.
- Kregel, J. (2008), Changes in the U.S. financial system and the subprime crisis, The Levi economic institute, *Working Paper No. 530*, Retrieved April 2008.
- Lynn, L. E. (1999), A place at the table: Policy analysis, its postpositive critics, and future of practice, *Journal of Policy Analysis and Management*, 18(3), pp. 411-425.
- Moran, M. and Wood, B. (1993), *State, Regulation and the Medica*, Philadelphia: Open University Press.
- Noguchi, Y. (1994), The "bubble" and economic policies in the 1980s, *Journal of Japanese Studies*, 20(2), p. 10.
- Ohmi, N. (2010), The Japanese economic crisis of the 1990s, *International Journal of Labor Research*, 2(1), pp. 61-77.
- Rubinstein, Y. (1999), Housing prices in Israel in 1974-1996 – A financial bubble? In: Leiderman, L. (ed.), *Inflation and Disinflation in Israel*, Bank of Israel.
- Sagemann, B. and Reese, P. (2011), The great subprime credit crisis and its impact on Eastern Europe, *Financial Crisis In Eastern Europe*, 44, pp. 21-63.
- Saxonhouse, R. G. and Stem, M. R. (2002), Japan's lost decade: Origins, consequences, and prospects for recovery, *Research Seminar in International Economics*, Discussion Paper No. 485.
- Schaede, U. (1996), The 1995 financial crisis in Japan, *Berkeley Roundtable on the International Economy UC Berkeley*, Working Paper No. 85.
- Serkan, C. (2009), Behavioral approach to subprime mortgage crisis: A European perspective, *The Business Review*, 12(1), p. 190.



- State Comptroller (2015), *A Special Criticism Report: The Housing Crisis* (Hebrew).
- Stigler, G. J. (1971), The Theory of Economic Regulation, *The Bell Journal of Economics and Management Science*, 2, pp. 3-21.
- Stone, D. and Ziemba, W. (1993), Land and stock prices in Japan, *The Journal of Economic Perspectives*, 7(3), pp. 150-151.
- Sunstein, C. R. (1990), *After the Rights Revolution: Reconceiving the Regulatory State*, Cambridge, Mass.: Harvard University Press.
- Taub Center for Social Policy Studies in Israel (2015), *Picture of the Nation 2015*.
- Torgerson, D. (1986), Between knowledge and politics: There fasces of policy analysis, *Policy Sciences*, 19(1), pp. 33-59.
- Waters, M. and Moore, W. J. (1990), The Theory of Economic Regulation and Public Choice and the determinants of public sector bargaining legislation, *Public Choice*, 66: pp. 161-175.
- Weinstein, E. D. (1999), Historical, structural, and macroeconomic perspectives on the Japanese economic crisis, *Center on Japanese Economy and Business Columbia Business School*.
- Whalen, R. C. (2008), The subprime crisis – cause, effect and consequences, *Networks Financial Institute at Indiana State University*, 17(3), pp. 219-235.
- Zrobek, R. and Gross, M. (2015), Good governance in some public real estate management systems, *Land Use Policy*, 49, pp. 352-364.