

## **Karnit Flug: Important goals to achieve for the Israeli economy**

Address by Dr Karnit Flug, Governor of the Bank of Israel, for the Appointment Ceremony of the Governor of the Bank of Israel at the President's Residence, Tel Aviv, 13 November 2013.

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President Peres, Prime Minister Netanyahu, members of the Government, distinguished guests, and dear family:

I would like to thank the President of the State of Israel who accepted the Government's recommendation to appoint me as the ninth Governor of the Bank of Israel. I thank the Prime Minister and the Minister of Finance for their earlier remarks. I would also like to offer a special thank you to my predecessor in the position, Professor Stanley Fischer, who left a magnificent legacy at the Bank of Israel. It is a great honor and privilege for me to serve in this role, and I will make every effort to justify the confidence that the Government of Israel and the President of the State have placed in me, and to serve the Israeli economy to the best of my ability. I express my gratitude as well to the many people who have congratulated me and have wished me luck since my appointment to the position was announced.

I would like to open by telling you a bit about my parents – my father, Noah Flug, of blessed memory, and my mother, Dorota, may she live and be well. They were both born in 1925 in the city of Lodz, in Poland. During World War II, they joined the youth underground in the Lodz ghetto. Later on, my father was imprisoned in Auschwitz, Gross-Rosen, and Mauthausen, while my mother was in Auschwitz, Bergen-Belsen, and Salzwedel. In 1958, when I was three, we made aliyah and moved to Israel.

My father worked in the civil service for 30 years, as an economist in the Budgets Department of the Ministry of Finance, as an economic advisor to the Knesset Finance Committee, as an economic Consul in Zurich and at the Israeli Embassy in Bonn. My mother worked around the clock as a pediatrician.

After retiring from government service, my father worked to protect the rights and honor of Holocaust survivors and to perpetuate the memory of the Holocaust. To the day he died, about two years ago, he served as Chairman of the Center of Organizations of Holocaust Survivors in Israel.

Over the years, I heard my mother speak straightforwardly to her little patients. From my father, I learned to focus on a goal, to concentrate on what is truly important, but also to be pragmatic and reach agreements, because there is no need for unnecessary battles. I hope to bring these principles with me to the role of Governor of the Bank of Israel.

There are many important goals to achieve for the economy and the Bank of Israel, which is one of the most important institutions in the economy. The new law defines the Bank's objectives and functions clearly and unequivocally. The main objective of the Bank is to maintain price stability. In recent years, this goal has generally been achieved, though we must not take this for granted. We all remember very well the consequences of high inflation for Israel's economy. The Bank of Israel will continue to maintain inflation within the target, and no less importantly, the public's confidence in the Bank's commitment to price stability. The economic literature and historical experience indicate that in the long term, price stability is a necessary condition for a growing and thriving economy. Given price stability, the law defines the additional objectives of the Bank of Israel – to support the Government's economic policy and the stability of the financial system. These issues are at the forefront of our considerations when we decide the Bank of Israel's policies. Just as in recent years, the Bank of Israel will continue to support the growth of the economy, while maintaining the stability of the financial system in general, and the banking system in particular.

The Governor of the Bank of Israel is also, by law, the economic advisor to the government. Our Research Department leads the research on Israel's economy, and will continue to delineate the research basis for the public discussion in areas on the agenda of economic policy makers. There are many issues, and I will attempt to focus on the most important ones:

First and foremost, we must find the ways to increase the growth rate of productivity in the Israeli economy. There is tremendous potential lying within the Israeli worker, but GDP per employee does not match that of the most advanced economies, and as a result, the economy does not succeed in allowing citizens a standard of living in line with that of the most developed economies. We must find the way to increase the attractiveness of investment in the economy and to increase capital stock, to improve the competitive environment in which the business sector operates, and to reduce the bureaucratic burden. We must continue our efforts to increase the participation in employment of those population sectors which are still characterized by low employment. The expected demographic trends do not support a high rate of growth in the coming years, and we will need to act to offset the effects on growth of those trends in order to continue to grow at a satisfactory rate.

High growth rates are not enough; it is very important that the fruits of growth are divided more equally by all parts of the population, so that they will support the reduction of poverty and of inequality in income distribution. We want inclusive growth, which supports the cohesion between various population groups, and within the groups themselves. Social cohesion is a prerequisite for national strength, and for forming a society in which our children, as well, will want to live and raise their children. Increasing labor force participation has an important role in this regard as well.

In recent years, the cost of living has also been placed the top of the public agenda. This is partly related to the issues I already mentioned. Improvements in productivity and the rate of growth will necessarily bring with them an improvement in the purchasing power of the Israeli worker, in particular if the growth will be distributed more equally. But the cost of living is also partly related to the structure of the economy, to the level of competitiveness and the level of concentration of the economy. We must continue to strive toward an economy with a competitive environment, in which every producer can rely on its relative advantages and offer the best products and services, and in which every consumer has the access and ability to choose the cheapest and most appropriate goods and services. In recent years, we have seen important reforms in this area, and we must continue to carry out reforms which will reduce the concentration and increase competition. In the banking industry, as well, changes are occurring which increase competitiveness and the consumer's ability to compare and choose the best and cheapest service. Alongside these changes, it is important to continue the efficiency measures in the banking system, so that competitiveness will increase while maintaining the stability of the system – stability which is a necessary condition for a growing and thriving economy.

Housing prices have increased in recent years at an accelerated pace, and have also been a significant component in the rise in the cost of living. The Bank of Israel, in the framework of its economic advice to the government, assists with diagnosing the barriers and recommending the policy required to increase the supply of housing at a rate which can meet demand. Within the framework of setting monetary policy, and its responsibility for financial stability and banking system stability, the Bank of Israel deals with the consequences of a low interest rate environment, which is derived to a great extent from the monetary policy adopted in major economies worldwide. The regulatory steps taken by the Bank of Israel helped to reduce the risk to which both borrowers and the banking system are exposed. Ultimately, the solution will need to come from bringing the supply of homes in line with the basic demand for housing services, and we must hope that the steps being taken by the Government in this area will bear fruit.

Israel's agenda also includes the discussion about the size and the role of the public sector in the economy, and the structure of the tax system. After several years of reducing the share of government expenditure in GDP and reducing the tax burden, voices are heard calling for expanding the scope of services that the government provides for its citizens. The optimal size of the government cannot be calculated by one economic model or another – an economy with a small government and low tax burden can grow and thrive, as can an economy in which there is a larger government and greater tax burden. The size of government expenditure, ultimately, is the result of society's preferences. However, we must remember that the size of government and the tax burden go hand in hand. If we choose a large government which will provide public services with high quality and quantity, will invest in infrastructure, and will be actively involved in supporting engines of growth, we will have to bear a higher tax burden. It is not a simple choice, primarily because we will not be able to allow ourselves large deficits and a growing public debt – those will endanger the financial stability of the economy, and negatively impact growth and quality of life in the long term.

The global economic crisis taught us another lesson about the importance of the stability of the financial system. We learned that we must map out and understand the connections between various financial institutions, and locate possible points of failure which may influence the financial system's stability. Supervision of the financial system in Israel is dispersed among several entities. This situation is liable to lead to cracks in the supervisory systems, and to lead to a situation in which risks which are protected against adequately in one part of the financial system are growing in another. The various regulators cooperate with each other and work professionally and collaboratively. With that, we must institutionalize the collaboration and information sharing through a Financial Stability Committee with the participation of the Ministry of Finance, the Bank of Israel, and the Israel Securities Authority. Such a committee will help to significantly reduce the probability of a threat to financial stability in Israel's economy in the future.

Dealing successfully with all these challenges requires the continued effective and productive cooperation that the Bank of Israel has with the relevant government ministries, particularly the Ministry of Finance.

Alongside setting monetary policy and providing economic advice to the government, the Governor of the Bank of Israel is also charged with the responsibility of managing the Bank. I am proud that the corporate governance regime at the Bank of Israel has undergone a real revolution in the past two years. Policy decisions are not made by the Governor alone, but within the framework of the Monetary Committee. The Supervisory Council oversees important administrative decisions. Nonetheless, there are also internal challenges facing the Bank of Israel over the coming years. First and foremost, we will need to find a way to maintain the attractiveness of the Bank of Israel as a workplace which the very best will want to join. The Bank's main asset when it comes to serve the Israeli economy is the human resource which lies within its employees. We must ensure that this resource does not erode. Bank of Israel employees come to work each day in order to serve the economy and the citizens – whether it is an employee in the Currency Department, which is charged with the regular supply of banknotes and coins to the economy, or the economist in the Market Operations Department, which carries out, in actuality, monetary policy and is charged with managing the foreign exchange reserves which are the Israeli economy's insurance policy, or the staff of the Banking Supervision Department, whose dedication and professionalism are the guarantee that Israeli citizens' funds which are deposited with banks are in sure hands. We all take it as a given that the check that we deposit, or the funds transfer which we carry out, always reach their destination, but this would not happen if not for the control of the Accounting, Payment and Settlement Systems Department at the Bank, and there is no substitute for the analytical talents and policy recommendations of the Research Department economists, who work constantly to try to provide answers, to both the urgent policy questions and the longer term issues in the Israeli economy. All these, with the help of the people in Statistics, IT, and various administrative units, are the human resource that the

Bank of Israel places at the service of the Israeli economy. I have no doubt that the staff of the Bank of Israel will continue to serve Israel's economy with professionalism and dedication in the coming years, and I will be proud to lead them in this effort.

I would like to conclude my remarks by expressing my gratitude to my spouse, Shaul, and to my children Maya and Michael, without whose support over many years, despite their shunning of public exposure, it is doubtful I would be standing here today and taking on myself the position of Governor of the Bank of Israel.

Thank you very much.