

Israel has three main objectives: 1) to strengthen security and move toward peace; 2) to achieve prosperity and increase economic growth; and 3) to cure social ills (by narrowing the gaps between the country's center and its periphery; eliminating the pockets of poverty, distress and crime; improving the education system; and providing all members of the younger generation with equal opportunities for acquiring a college education that meets 21st century needs).

The test for leadership lies in its ability to advance Israel toward all three objectives simultaneously. Not toward one objective at the expense of the others. Not toward neglect of society in the name of security or economic interests, nor vice-versa. This requires leadership that strikes a balance between the needs, and acts with moderate, thorough discretion, devoid of empty slogans, media spins, sparks or fireworks.

Both as IDF Chief of Staff and the Minister of Defence, I have advocated the necessity to develop a young, educated social leadership that will bring about a long-lasting quiet revolution throughout Israel's social structure.

To that end, I worked with several partners to conceive the Atidim program.

Atidim has been operating for the past five years. The basic idea is to search the social fringes for talented young people with

potential, and place them on a track of knowledge enrichment and higher education. The program has been a huge success. The average academic achievements of the male and female Atidim participants are significantly higher than those of their well-to-do peers. The Atidim graduates receive placements in professional and command positions in the IDF, and integrate smoothly into the top hi-tech fields and public administration. They constitute a leadership reserve that will produce a welcome turnaround in Israeli society.

Each graduating class is another group of young leaders who serve as role models and broaden Atidim's sphere of influence. They are highly motivated individuals who strive to improve Israeli society by narrowing gaps and providing equal opportunities to each and every teenager.

I am certain that from among the Atidim graduates, who are endowed with leadership qualities and excellence, we will see the emergence of a group that will play a key role in leading Israel in the next generation.

Leadership is not a career. It is a purpose and a mission involving tremendous responsibility.

Israel needs genuine leadership. I believe our citizens are fully aware of it, and I believe we will all be intelligent enough to make the proper distinction.

Free Market Reform –

Dependant on the Peace Process

“When I look at the history of Israel’s economy, I see a considerable success story” declared Prof. Stanley Fisher in his address upon being appointed Governor of the Bank of Israel in May 2005.

And indeed, a glance back over the 57 years since the establishment of the State of Israel reveals an average 6.5% annual growth, an impressive 11.4% per annum increase in exports and current per capita income of \$17,000 – rated 24th worldwide.

Another noteworthy achievement is the series of comprehensive reforms that the economy has undergone over the past 20 years. Realistically this refers to the import-exposure plan introduced in 1991, canceling import restrictions from Asia, Latin America and Eastern Europe. This resulted in an influx of inexpensive goods forcing Israeli industry to streamline and switch to more sophisticated and feasible industries. In the past, savings accounts had to be cashed in to buy a TV or T-shirt ... but thanks to today’s cheap imports, prices in Israel are low, raising the standard of living for the general population.

The fiscal market has also undergone far-reaching reform. Until 1985, the government controlled the financial market without

restraint, deciding who qualifies for credit facilities and at what price. Those closest to the leadership were granted a lot while those further away received nothing. The banks acted only as the government’s executive arm.

However, during the 1990’s the Bank of Israel “privatized” credit. In other words,

the Bank of Israel transferred the authority to the banks to decide who would be granted credit facilities and at what price – based on business figures and without any governmental interference. This move introduced new blood into the economy, allowing development and growth.

Later, in December 2001, foreign currency controls were abolished entirely. Today, Israeli citizens may hold any amount of foreign currency and invest as much as they wish abroad – and the outcome: inflow of dollars and not outflow as was feared by many.

The budgetary process was also reformed. After many years during which there was no budgetary discipline, the government adheres to a low deficit and gradual cost reduction regime. At the



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same time the Bank of Israel fought inflation and succeeded in leading the economy to price stability.

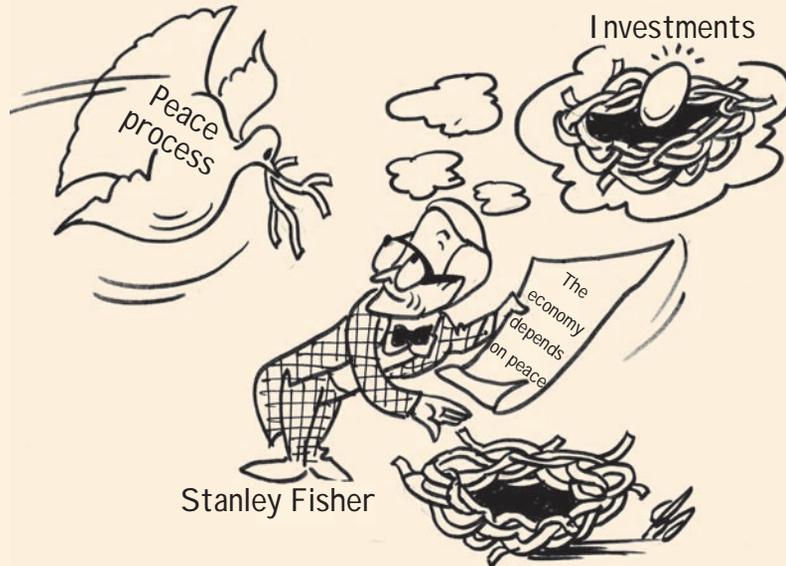
Subsequently, after 57 years of independence, the current Israeli economy is open, competitive, modern and financially stable. However, despite this, it has not managed to achieve its full growth potential or to reduce poverty.

Why?

The driving force behind lowering taxes

Ariel Sharon won the elections in January 2003 and unexpectedly appointed Benjamin Netanyahu as Finance Minister. It seemed that this was the opportunity Netanyahu had been waiting for all his life.

He entered the Ministry with new tidings: free market economy.



Netanyahu presented an economic policy built on three components. The first, to impose a strict diet on the “fat man” while offering massive incentives for the “thin man”. The “fat man” is the government, so cutting government spending is aimed at setting aside maximum resources for the private sector, the “thin man”, the only one able to generate new jobs. As soon as government expenditure dropped, Netanyahu cut taxes (income tax and company tax) to spur economic activity.

The second component of Netanyahu’s policy was the transition from welfare to work. On the one hand Netanyahu cut income support benefits and child allowances, while on the other he reduced income-tax payments to make working more worthwhile.

This strategy resulted in a shift from a welfare culture to a work one.

The third part of Netanyahu’s policy was to open up economic

bottlenecks to stimulate competition. This could be achieved through reform and privatization, such as the reform of the ports system and the privatization of Israel Discount Bank and Bezeq.

Impressive results

The outcome of these various steps was impressive. In 2002 the economy was in severe crisis. It was impossible to obtain a loan of even one single dollar abroad, interest rates were sky-high and the stock market hit rock bottom. There were even fears that a large bank in Israel might collapse, dragging the entire economy into the abyss with it.

But, following Netanyahu’s presentation of his policy, immediate changes began to take place. Interest rates dropped, the stock market climbed, and the economy began to move out of the slump with growth reaching 4.3% in 2004 after three years of recession.

Apparently, reducing government spending, which allows tax reduction, is the right thing to do. Privatization of government companies also proved to be the right thing because the government simply does not know how to manage business. Furthermore it was proven that reform which accelerates competition and lowers prices is also a smart move.

It turns out that Israelis are also prepared to go back to work. Some 150,000 Israelis re-entered the workforce over the past two years, not only in high-tech, but also in commerce, services, tourism and housekeeping.

The social problem

Despite these achievements, growth has not been uniform on all social strata. It is almost not felt in outlying areas and has also not reached the building industry.

The upper classes benefit most from the growth, and the grave outcome of this is increased poverty and widening social gaps.

We could claim that the growth and reduced taxes will also reach the lower social-economic groups.

The fact is that 80% of newcomers in the workforce come from lower social-economic groups, but this is not sufficient. We need to do a lot more than this.

The additional taxes collected as a result of the accelerated growth should finance additional support for those in need, such as the elderly who do not have additional income, and sick, disabled and other people who are unable to work.

At the same time, we have to offer incentives for going out to work, such as child-care subsidies for single mothers, transport subsidies, more spending on education, professional training and the Wisconsin plan, because work is the true answer to poverty.

Tenth in the world

In April 2005 Netanyahu presented his financial vision for the coming years: “to be one of the top ten developed countries in standard of living and per capita income within ten years”.

However, in order to raise the standard of living, reduce social gaps and lower unemployment, the economy has to grow at an annual rate of 6% for each of the next ten years – and that is a very difficult mission. In order to achieve such growth it is necessary to increase investment and entice large global corporations to Israel.

When the Israeli economy grew at the rapid annual rate of 7% during the mid 1990’s, investments increased by 10-15% year after year. Figures like these are not yet evident on the horizon. Furthermore, tourists are not yet returning in their masses, not to mention international conventions. For this to happen we need to create an atmosphere of peace, quiet and stability.

A look to the future

In his inaugural address as Governor of the Bank of Israel in May 2005, Prof. Stanley Fisher said “to achieve our full potential, a realistic prospect of peace is needed”. Fisher always and

obviously links economic growth to the political situation. He relates that when he told his friends in New York that he was about to make aliyah, they were aghast, assuming that he would need an entire company of bodyguards accompanying him at all times. Yes, that is the impression New Yorkers have of Israel, so you can just imagine what the rest of the world thinks.

Obviously, as we all know, not one of them wants to invest in a country constantly in fear of war and terror. Therefore, to achieve our full economic potential, to reach 6% annual growth, and to be number ten in Europe, the economy has to be linked to politics – peace and stability are essential and this can only be attained through a peace process.

Therefore it is all well and good that the Minister of Finance takes important steps in the direction of a free market economy, but if we wish to be ranked as one of the top ten most developed countries in the world, we need to act through a political channel.

If the Gaza disengagement is to be a prelude to a peace process, this would be the Prime Minister’s greatest contribution towards attaining rapid growth, lowering unemployment and fighting poverty. Never before have economy and society depended more on political processes.

The Trade And Services Sector

as a Lever for Encouraging Economic Growth and Employment in Israel

As surprising as this may be, until today many decision-makers in the Israeli economy as well as media personalities considered the Israeli economy to be divided into two principal segments: a productive segment and a non-productive segment. The productive segment consists of heavy industry, light industry, manufacturing and construction, whereas the non-productive segment includes mainly the trade and services sector.

This quaint anachronistic notion is one of the principle factors of economic development in Israel. For years, the decision-makers were under the erroneous assumption that all efforts must be aimed at encouraging industrial growth, and that the rest of the sectors would take care of themselves. They maintained that in order to encourage the industry, it is essential to change the Encouragement of Capital Investments Law and define the amount of grants, which tax breaks will be given for how long, and the rating of benefits according to the geographic zone. According to this approach, heavy taxes are imposed on everything; high income tax, high employers’ tax, high corporate tax, and subsequently tax breaks, exemptions and benefits are granted to specific economic sectors.

What our decision-makers forgot is that apart from industry, there is a huge and thriving private, entrepreneurial and independent business sector with an enormous potential for economic development and for creating jobs. Instead of contemplating how to stimulate growth throughout the business sector, the question addressed was how to boost industry.

In all developed western countries, the trade and services sector accounts for some 65-70 percent of the GDP. This is also the sector creating the majority of the jobs. 2004 marked an increase of 38,000 salaried positions in the trade and services sectors as opposed to a mere 5,000 new positions in industry. The trade and services sectors employ about 44 percent of all jobs in the marketplace, including the public sector, sharply juxtaposed with only 14 percent in industry. In effect, in the last five years the number of jobs in the industrial sector shrunk by 19,000, compared to 120,000 new jobs in the trade and services sector. Last March alone the trade and services sectors generated 16,100



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