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### Strengthening Israel's Economy

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## *Strengthening Israel's Economy*

Murray Weidenbaum

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## Strengthening Israel's Economy

By Murray Weidenbaum

It is a great honor for me to receive the Albert Einstein award this evening. I say that for a very special reason. Many years ago, when I was a graduate student at Princeton, Albert Einstein was in residence. No, I did not study astrophysics under the great man. But merely to see him walk the campus in his baggy pants and oversized sweater was an inspiration. Especially so was his occasional smile and wave.

It is also a pleasure to acknowledge the fine relationship between Washington University and Technion. I have in mind specifically the cooperative program with the Olin School of Business.

I have been asked to talk tonight about the Israeli economy. Let me give you a bit of a preface. This has not been an easy speech to prepare. When an economist looks at an economy, it's something like a physician examining a patient. It is very serious business. A good doctor doesn't tell you what you want to hear. When your doctor says that your appendix has to come out, he or she is making a medical diagnosis. The doctor is not passing a moral judgment on the patient.

When, as an economist, I examine the Israeli economy, I find lots of big pluses. Especially notable are very high levels of literacy, education, and training — what economists call investments in human capital. I also find substantial investments in agriculture and industry, the more traditional types of physical capital. These two forms of capital — rare in the Middle East — are the basic ingredients for a strong and growing economy.

However, I do not find as healthy an economy as I would have expected. For the past two decades, the Israeli economy has been characterized by slow growth and high inflation —

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as well as heavy dependence on foreign aid and declining domestic capital formation. A low rate of capital formation means that old production equipment is not being replaced and that increased economic capacity is growing very slowly.

No, I am not pointing my finger at the large expenditures for defense. Frankly, there are some economic pluses (as well as minuses) from a modern high-tech military establishment. The design and production of weapon systems generate the demand for well-trained people and for high-tech industry. In any event, we must acknowledge the need for giving national security a high priority.

Nevertheless, the numbers show that Israel is a very civilian-oriented society. Total military spending is about 12 percent of its economy. In the United States, the military share was up to 15 percent during the Korean conflict and we had no problem in maintaining a private enterprise society.

The basic shortcoming in Israel's economy cannot be blamed on high levels of military spending. The problem is far more internal. It arises from discretionary decisions that the government has made over the years. Let me get to the heart of the matter: compared to the other advanced industrialized societies, the Israeli economy is far more socialized and far more heavily regulated. This is a time when most of the rest of the world is moving away from socialism and communism. Eastern Europe and Western Europe alike are reducing the role of government and depending more heavily on the private marketplace.

Now, please remember, you invited an economist to talk about the Israeli economy. It is my unpleasant task to report that Israel is operating counter to the trend in the rest of the world. The government still owns over 90 percent of all the land. With less than 10 percent of the land available for private ownership, land prices are very high, far beyond the reach of ordinary Israelis. As a result, housing prices are also very high.

Moreover, the government subsidizes a very inefficient agricultural sector. At a time when most advanced industrialized nations are emphasizing industry, trade, and services, Israel

still is preoccupied with the very expensive dream of creating a large class of farmers. It is an expensive luxury.

In contrast, the development of new small business is hampered by the government. A tremendous array of government regulations makes it very difficult to start a small business, much less for it to grow and prosper. For example, it is against the law to set up a pharmacy within 500 meters of an existing pharmacy. The result is what you would expect: government-sanctioned local monopolies.

To get the permits and licenses required for a new building takes, on average, 120 man days of lawyer and accountant charges. Not many small companies can afford that. When you consider the success of Jewish people around the world as entrepreneurs, it is sad to report that, compared to other industrialized nations, there are very few small businesses in Israel. Remember, most of the job growth in the United States takes place, not in large enterprises, but in small businesses.

Let us turn to the subject of labor relations. The Israeli government tolerates what must be labeled — and economists call it that — a virtual national labor monopoly. Calling it Histadruth does not help any. Unlike the AFL-CIO in the United States, Histadruth uses its members' money to own a lot of inefficient, money-losing businesses. That is a very expensive way of creating jobs.

I think you're beginning to get the idea. People all over the world are abandoning socialism — not for any grand philosophical reason, but simply because it doesn't work. Israel is behind the times.

The time for blunt talk has arrived. Socialism hasn't worked in Great Britain and it's been abandoned. Socialism hasn't worked in France and it's being abandoned. The same is true in Portugal, Spain, Mexico, Argentina, etc., etc. Even communist China is privatizing large areas of its economy. No amount of American *subsidy* for socialism in Israel is going to save the day. Of course, there is a very important role for foreign *investment* in Israel and I'm going to come to that in a little while.

How does any country attract large amounts of voluntary private capital? First, a favorable climate for private enterprise must be created. Anyone who has gone through the regulatory maze imposed by any country knows the opportunity for change. Improvement won't come by itself. As a former government bureaucrat, I know that each official sincerely believes in the agency's mission and that more of what they are doing is always better than less. In no country does the reform of the bureaucracy come from within. The needed streamlining of bureaucracy must come from the will of the people themselves and must be carried out by the national leadership.

Secondly, the government's monopoly over resources should end. Yes, sell some of the land to private people. There is no good reason why the government should own over 90 percent of all the land. And the people of Israel should brace themselves for the inevitable: somebody will make a profit. I have to repeat the same economic ABCs that we're teaching the people in Eastern Europe: you can't have capitalism without private capital and without capitalists.

That also means privatizing the many government-owned businesses. It is good to acknowledge that some progress has been made in recent years, although the effort is behind schedule. Haifa Chemicals Ltd. was privatized. So was Industrial Building Corporation and several others. In a few cases, some large government-owned businesses have been partially privatized. For example, Bezeq, the telephone company, sold one quarter of its shares to the public. Service has improved and costs have been reduced. Five-year waits for a new phone have been cut to a few weeks.

Thirdly, give economic development a higher priority than social programs. I understood that even now thousands of housing units are vacant because they have not been built where people want to live. The priority should go the other way: scarce investment capital should be invested in productive, economically viable business ventures that will create new jobs and bring in income.

Given the high education and training levels of the Russian immigrants, it would make



far more sense to invest in high-tech enterprises which will need their special skills than to build housing for them. If the people have income, the demand for housing will arise on its own and builders will respond.

Perhaps I'm being too circumspect. If you followed me closely, I'm criticizing the idea of giving housing top priority in the case of the immigrants from Russia. For a moment, let us reflect on an alternative: instead of the billions of dollars that have gone into new settlements in the West Bank, consider the benefits that would have resulted if the same amount of money had been invested in setting up new high-tech industries in Israel. That would have used the powerful talents of the many scientists, engineers, and skilled craftsmen who migrated from the different parts of the former Soviet Union.

Under the status quo, there are buildings for the new people to live in, but so many of them are unhappy holding down menial jobs. (In fact, the flow of migration has slowed down.) Consider the reverse of the policy that has been pursued. Building a center for technological progress in the Middle East would have created new products and new industrial processes — and also new jobs for both Jews and Arabs in the Holy Land. I find that an attractive and very positive approach.

People with good paying jobs will generate a demand for housing and other necessities. The difference is that they will be able to pay for these items. Productive enterprise, when it is successful, also generates the income to pay the interest on the initial loans and ultimately to repay the principal. That is very different from trying to repay housing loans from rent from people with low paying jobs or none at all.

Of course, I'm looking at all this as an economist, not as a politician. But, please remember, a weak economy cannot support heavy expenditures for military or social programs. A strong economy can.

By the way, if you have any question that a favorable investment climate plus a trained workforce will attract private investment capital, just look at the experiences around the world, in such different places as Western Europe and East Asia. Many of those economies were very

poor a decade ago — Spain and Singapore, Portugal and Malaysia, northern Italy and Indonesia. Following a capitalistic approach, they are now booming.

In fact, let me draw a useful parallel. Several of those countries also took in large numbers of destitute immigrants and they did not receive significant amounts of foreign aid. The large amounts of foreign capital that those countries did succeed in attracting are voluntary private business investments.

It is heartening to note that, despite all of the governmental barriers, quite a few large and medium size businesses have established subsidiaries in Israel. Often that has required special subsidies. Some of these well-known companies include GTE, Loral, Zenith, Intel, Digital Equipment, and National Semiconductors.

The moral of the tale is simple but powerful: the response of free people to economic incentives is far more effective than large amounts of well-intended governmental direction, control, and aid. The sooner that the people and the government of Israel apply that important economic lesson, the sooner we will see the rapid economic development that that country so badly needs.

Thank you for the honor you have bestowed on me and for the opportunity to share my thoughts with you.



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