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Kramer's Corner

Israel Faces Challenges Beyond the War

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By Hilary Kramer

FOX NEWS

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ADVERTISEMENT With general elections scheduled for January 28, Israelis mostly think about their national survival. If the Jewish State is to be more than a country under siege, Israel's economy must again thrive in the century to come. And that's the Achilles Heel of the two dominant parties, Likud and Labor.

Prime Minister Ariel Sharon's Likud has never lived up to its promise to de-socialize the economy, and now it is under investigation in the wake of allegations of corruption and bribery stemming from its December 2002 internal party elections. The Labor Party, led by Amram Mitzna, has never embraced de-socialization and continues to lose appeal among young Israeli voters.

Only Shinui, a relatively minor party -- until recently -- stands ready to fill the vacuum of economic leadership; while it has no prospect of winning next year, it could still push Israel in a new direction. With a decidedly secular and free-market bent, Shinui -- the word means "change" in Hebrew -- has become a force on the political landscape, a magnet for those looking for economic improvement as well as a negotiated settlement with the Palestinians.

Since the September 2001 declaration of the new Intifada, Israel has been plagued with economic woes. Surrounded by foreign enemies, Israel is also besieged by a 10.4 percent unemployment rate, 7 percent inflation, a highly weakened currency, and a contracting economy. Not surprisingly, its budget is out of whack, too; rapidly rising defense costs and welfare spending have helped balloon this year's deficit to an expected 3.5 percent to 3.9 percent of GDP.

No wonder the Tel Aviv Stock Exchange (TASE), founded in 1953, has lost more than 34 percent of its value since the failure of the Camp David Summit in 2000. In the past year alone, the stock market is down close to 20 percent. Foreign investment dropped in the first half of 2002 to \$3.5 billion from a record \$11.1 billion for all of 2000. Venture capital investments in Israeli companies -- the life blood of the entrepreneurial high tech economy -- was down 47 percent in the first half of the year at \$515 million.

According to Goldman Sachs economist Kent Hargis, Israel is suffering with a -1.1 percent GDP growth in 2002 and is projected to experience -- at best -- moderate growth of 2.3 percent in 2003. Not since 1953, when the economy shrank 1.6 percent, has the situation been so dire. At first glance, the 2.3 percent projection for 2003 doesn't seem so bad, but it is very low in comparison to Goldman Sachs' 4.2 percent average 2003 growth projection among the global emerging market countries (excluding China). For example, even with their own recessionary pressures and political challenges, Goldman Sachs projects 4 percent growth for Russia and 4.5 percent for South Korea. Furthermore, there are some economists predicting that Israel's economy will continue to contract in 2003.

Israeli Foreign Minister Benjamin Netanyahu -- a man with a solid grounding in free market ideas, even if he didn't always adhere to them when he was prime minister from 1996 to 1999 -- attempted to topple Sharon in the November 2002 Likud

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primary, promising to revitalize the stagnant economy. But he was defeated, according to former Netanyahu aide, Ron Dermer of the *Jerusalem Post*, because "a vote for Netanyahu was seen as a rejection of an incumbent prime minister, a step that Likud voters were loath to take." So, loyalty to the incumbent Likud prime minister trumped the promises and economic initiatives of an ambitious challenger.

Israel's Labor party has been similarly unsuccessful in turning Israel's economic woes into an issue. According to the latest polls, Labor stands to lose as many as seven seats in the 120-member Knesset, down from the 28 it currently holds.

While the United States and Israel may employ similar tactics in combating terror, their respective approaches to handling the current global economic downturn could not be more divergent. For example, in 2001, when the bear market and rising unemployment were only in their early stages, President Bush was able to successfully push through a \$1.3 trillion tax cut. And in his upcoming State of the Union Speech, he will likely propose some or all of the following: ending the double-taxation of dividends, speeding up the 2001 tax cuts, abolishing the Alternative Minimum Tax, and accelerating the phasing-out of the Estate Tax.

By contrast, Sharon's Israeli government raised taxes in the middle of a protracted recession, with little outcry from the public.

This divergence of economic policy is rooted not only in the different political realities that both administrations face, but also the historic and cultural differences unique to the two nations. One of the driving factors leading to the revolution of the colonists in the United States was the abhorrence of taxation without representation. The Stamp Act, Townshend Duties, and the Tea Tax -- which culminated in the Boston Tea Party -- were a turning point in the colonial relationship with the Crown. The young republic's post-revolutionary experiences with the Shay's Rebellion and the Whiskey Rebellion only solidified this anti-tax cultural mindset; the Constitution barred the imposition of a federal income tax until the ratification of the Sixteenth Amendment in 1913.

Israel may share with the United States an early hostility toward, and desire for independence from, British colonialism, but the true sources of its current domestic and economic policies lie elsewhere. The Jewish state's fundamental attitudes and beliefs are rooted firmly in the Bible, a history of collective nationalist yearnings, deeply held socialist idealism, messianic dreams, and the rise, fall, and terrible consequences of the Third Reich.

Likud is the direct descendant of Menachem Begin's Irgun and Yitzhak Shamir's Stern Gang. Unlike the Republican party of the United States, taxation is not foremost in the minds of the Likud. Rather, its ideology is influenced by the dominant ethic of the Yishuv -- also known as Palestine. That is, Ben Gurion-led socialist-Zionists -- who idealized the collectivist kibbutz.

The first kibbutz, a unique Israeli phenomenon, was founded in 1909, and as a primarily agrarian collective unit where the work and production of the Kibbutz is shared equally by all. The assumption, of course, is that all have done their own fair share of tasks. This kibbutz mentality, some think, has degraded into an uneasy acceptance by the Likud -- and its political allies -- of the urban, easy-living welfare infrastructure for the right wing Ultra-orthodox. These Israelis -- also known as the "haredim" -- are the loudest to proclaim that Israel should defend itself to the last man, woman, and child, are exempt from mandatory military service.

For his part, Sharon, an ex-Laborite, has always been more comfortable with Labor's Shimon Peres than with many of his Likud compatriots; indeed, Sharon would prefer to lead a Likud-Labor coalition government again rather than a narrowly focused government of the Right. Though neither party is averse to crony-capitalism, Likud's most recent selection of Knesset candidates has been mired in charges of vote-buying.

With elections around the corner, Labor was quick to capitalize on the scandal of the criminal investigation brought forth by the Israeli Attorney General. Labor Party Secretary-General Ophir Pines-Paz proclaimed that:

"The new testimony about extortion and attempted bribery in the Likud raises questions about the vulnerability of democratic rule in Israel. The danger of criminals slipping representatives into the Knesset...requires enacting immediate far-reaching laws."

This scandal may have far-reaching consequences for Likud. According to Amnon Barzilai of the Israeli newspaper *Ha'aretz*, Likud has publicly indicated that they expect to lose three to four seats "due to the corruption scandal that broke out over vote-buying allegations." However, no Likudnik is too worried; as the projection still stands that the party could double its strength in the Knesset.

The core constituency of Likud is blue collar, downscale populist, and heavily favors social spending and the welfare state -- and is not unsympathetic to -- the ultra-orthodox who gain the most for doing the least. Attacks on the Israeli welfare-state regularly draw protests from Likud stalwarts. Its members in the

Knesset oppose regularly, without hesitation, any threatened cuts to non-defense, non-security budget components, since they are as assured of losing their seats at the next election for failing to defend the subsidies that the ultra-orthodox and populist constituencies enjoys.

The Labor party has problems of its own. Labor's constituency is primarily composed of the well-educated and affluent. In a country where ethnicity roughly correlates to income, over 60 percent of Labor's candidates are Ashkenazic, in contrast to the much more ethnically diverse Likud, which includes Jews with roots from Sweden to Yemen. The Labor Party has long viewed itself as the Mediterranean cousin of the social democrats of Western Europe. Ben Gurion protégé Shimon Peres takes great and public pride in his participation in the Socialist Internationale. In fact, there have been two recent defections by prominent members of Labor to the Meretz party, an ultra-left party which demographically is the polar opposite of the ultra right-wing Shas Party.

Emerging from this economic and political tumult, Shinui was founded in 1974. After decades of waiting in the wings, it is knocking on the chamber door of the Knesset. Independent, moderate, secular, and free-market oriented, Shinui has gone from holding only one seat until the elections in 1999, when it won six seats in the Knesset. Projections indicate a possible 10-13 seat win in the January elections.

Previously seen as a one-issue party, that of secularization, Shinui has created a cogent and coherent platform around which the under-30 crowd have gathered. It proudly calls itself "a democratic, secular, Liberal, Zionist, peace-seeking party". Rallying around the banners of secularism and free-marketeteering they demand complete equality for all Israelis, meaning primarily that the ultra-orthodox lose their exempt status from military service and their preferred status for government largesse. Economically, they want to remove the impediment of heavy government involvement and accelerate the process of privatization in the science and technology industries, both of which are the shining stars of, and keys to, the recovery of the Israeli economy.

On education and law, taxes and military service, Shinui is a radical departure from the standard Likud/Shas and Labor/Meretz lines in nearly every way. Their originality, dedication to less government, and the high-visibility of their members -- one of their representatives in the Knesset, Yosef "Tommy" Lapid, is a noted television personality—has given them, in the past five years, a substantial swelling of ranks by young (and some not-so-young) voters, tired of the status quo of daily life and inequity in Israel between the secular and religious.

So, does Shinui have Labor and Likud shaking in their collective statist boots? Not yet -- but the future is showing a changing force within Israeli politics. While the two political juggernauts are in combat with each other, this smaller party now stands to become a force to be reckoned with. The hope for Israel's economy is that Shinui will be able to continue gaining momentum enough to shape policy. But the question remains: will the security situation and the economy be too far gone for the Shinui to enact their forward-looking policies? With the young and industrious starting to migrate towards the Shinui party -- or otherwise, perhaps, out of the country altogether -- this may be the best hope for a revival of Israeli prosperity.

Hilary Kramer serves as a business news contributor at FOX News Channel. She joined the network as a regular guest on **Cashin' In** in May 2001. Currently, Kramer is the senior strategist and adviser at Montgomery Asset Management.

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