Sharon Is Destroying Israel's Broken Economy

by Dean Andromidas

While Israel Prime Minister Ariel Sharon threatens wars all over the Middle East, the Israeli economy is collapsing at his feet. While he was in Washington on June 10, convincing the White House that Palestinian President Yasser Arafat is not a partner for peace, the Israeli shekel (NIS) was plummeting to historic lows against the dollar, as Israeli investors and savers fled the currency. When it broke below the barrier of NIS 5 to the dollar on June 12, the Israel's Central Bank increased interest rates by 1.5%, setting rates at the highest level in years, in a desperate attempt to halt the capital flight. Since December 2001, the shekel has depreciated almost 20%, and economists are predicting an annual inflation rate of over 8% by the end of this year.

Many of Israel's economic woes can be attributed to the ongoing worldwide economic collapse, but Sharon's determination to use military force to deal with the Palestinians, is widely blamed within Israel. "The behavior of the public in pursuing the dollar is a sign of no-confidence. Usually, when the interest rate is raised, it changes the thrust of devaluation, but that didn't happen this week," Knesset (parliament) member Avraham Shochat, who had been Finance Minister in the Labor governments of slain Prime Minister Yitzhak Rabin and of Ehud Barak, told the Israeli daily *Ha'aretz* on May 31. Shochat said that the government has "above all, to present a political horizon [on the Palestinian front]. The economic moves will not help unless there is also a change in the political security front. . . . I was in similar situations twice as Finance Minister. In 1992, Yitzhak Rabin, who had just been elected Prime Minister, started to talk about peace with the Palestinians, a declaration of intentions that was realized a year later in the Oslo Accord, and I saw firsthand how Israel's economic situation changed dramatically: Foreign investment increased from $130 million a year to $3 billion. In the period of Barak, too, when the feeling was that peace agreements were going to be signed, the economy grew rapidly."

Peace Is the Only Name for Recovery

This is advice Sharon does not want to hear. But even the monetarist bureaucrats at the Central Bank are telling him the same thing. According to the Israeli media, these bureaucrats know, that no matter how much the budget is cut, nor how often new taxes are levied, there will never be any hope of an economic recovery unless the peace process is renewed.

On June 8, Bank of Israel Governor David Klein met with Sharon, prior to the latter's visit to the United States, and told him, that if Israel did not want to see its international credit rating reduced, it would have to cut NIS 10 billion (over $2 billion) from the budget, including NIS 3 billion from defense. (NIS 12 billion had already been cut from the 2002 budget.) Some reports say that Klein wants to cut NIS 10 billion from the defense budget alone. Such a cut is seen as politically impossible for Sharon to implement, while maintaining a war of attrition against the Palestinians.

According to the Finance Ministry, security spending instead increased by NIS 6 billion since Sharon came into office in February 2001, and is expected to increase by another NIS 2-3 billion next year. Over the last year and a half, the Israeli GDP lost over NIS 36 billion, or almost $8 billion. Sharon's government had already threatened to collapse at the end of May, when the ultra-Orthodox parties, Shas and United Torah Judaism, were temporarily thrown out, because they refused to vote for the government's austerity budget.

Since returning from Washington, Sharon has been told he has to "intervene" into economic policy, but despite highly publicized meetings with Finance Minister Silvan Shalom and Bank of Israel Governor Klein, neither the public nor the markets have been impressed.

The terror attacks by Hamas, which have always helped Sharon diplomatically, have also helped him politically: Under normal circumstances, Israelis would throw any government with such poor economic performance out on its ear, but the Hamas attacks have kept the population too unnerved to unseat him. Skepticism was expressed in a June 17 commentary in *Ha'aretz:* "If the voters are sufficiently terrified and anxious about their prospects for survival, they will back you all the way to national bankruptcy. If these tactics are properly implemented, any opposition to military spending is percieved as unpatriotic, and the military leadership is secured for the time required to rewrite history."

The Collapse Continues

All the major economic indicators are pointing "south" for Israel. Not only is the physical economy contracting, but Israel is experiencing a massive flight of capital that has devalued the currency by 20%. Governor Klein knocked up interest rates by a combined 2.5% in late May and early June, as an attempt to reverse a disastrous decision of last December, when Sharon demanded that Klein cut the interest rate by 2% in one blow, from 5.8% to 3.8%. Klein agreed only after Sharon "promised" to cut the budget by NIS 10 billion. Sharon, true to form, never kept his side of the bargain, and the shekel immediately began to slide. Billions of shekels worth of investments, particularly from foreign investors who had parked considerable sums in Israel, fled to the dollar zone.

Now the Bank's discount rate stands at 7.1%, even higher than last December, when Sharon had pushed the panic button. The shekel, although it has not gone below 5 to the dollar, is trading at its all-time low. In the six months ending in April, Israelis invested NIS 98.76 billion abroad, nearly $20 billion; this compares to NIS 65.49 billion for the six months ending October 2001. These figures are only the "official" amounts, in a country notorious for its "gray market" financiers, who are the preferred channel for flight capital by many companies, private cititzens, and organized crime. According to Israeli sources, this channel accounts for a figure three or four times larger than official figures for flight capital. According to these sources, this is how Israel's triple-A credit rating is being artificially maintained. The problem was indirectly confirmed, when the Israeli authorities announced on June 5 that new and aggressive measures would be taken against gray market financiers, who have avoided paying billions in taxes.

Israel's Gross Domestic Product is expected to decrease by 1% this year, and by 3% per capita. In fact, the GDP per capita, in dollar terms, has dramatically collapsed from $18,000 in 2000 to $14,500 in 2002, primarily because of the depreciation of the shekel.

Other economic indicators are equally bad. In the first five months of the year, the country's trade deficit grew by 22%, or $4.5 billion annualized. Exports to its two largest trading partners, the United States and the European Union, fell by 6.1% and 8% respectively, despite devaluation. High-tech exports, which account for half of all Israeli exports, have dropped by 6.5% so far this year. Exports from the very important electronic components sector have dropped by 31.5%. It seems the only category of exports that has not decreased, is the $2.5 billion in military equipment.

The hardest-hit sector continues to be hotels and tourism. Hotel occupancy is below 30%. The Central Bureau of Statistics reports that between October 2000, when the "Al Aqsa Intifada" broke out, and December 2001, the hotel sector lost NIS 3 billion, and its potential profits were cut by NIS 990 million. The situation has not changed.

All this has added to the continuing increase in unemployment, officially at 10.6% (more than 270,000 people) in the first quarter, but actually much higher, since thousands who have given up looking for work, or, have exhausted their unemployment benefits, have disappeared from official statistics.

Troubled Banks

In 1983, an Israeli banking crisis started a process that led to hyperinflation, which reached 400% annually in 1985. The crisis was only reversed after the government took over all the banks and, more importantly, after the United States footed the bill for a stabilization scheme. History could be repeating itself. Although on the surface, the banking sector appears to be stable, many banks have suffered a deep downturn in their profits. Problematic loans held by the five largest banks grew by NIS 13.6 billion to NIS 50 billion, which is more than their total capital assets in 2001. In 2000, the bad loan figure was only NIS 2.8 billion. Specific write-offs for the same period increased 85%, and totalled NIS 4.1 billion, compared to NIS 2.2 billion in 2000. These write-offs slashed profits by an average of 45%. Among the banks' troubled debtors have been telecomunications, real estate (particularly hotels), agriculture, industry and commerce, and financial services. The Central Bank recently ordered banks to raise their assets-to-loans ratios, which has forced Israeli Discount Bank, one of the largest, to announce that it will not be able to make corporate loans for the rest of the year.

Recent scandals point to the fact that something very bad could be lurking in the woodwork in Israel's banks. In May, the small Trade Bank collapsed, after an account manager, Esther Alon, confessed to embezzling NIS 250 million, the bank's entire reserve capital. Alon claimed she took the money over a five-year period to pay off her brother's gambling debts, owed to "gray market" financiers. It has not been explained how the brother was able to run up gambling debts totalling almost $50 million. The government ended up paying off the bank's depositors. Then, Mizrahi Bank discovered that several of its investment managers, in an effort to cover massive stock market losses, were transferring money from the large accounts of wealthy individuals, to the accounts of the clients whose investments they had mismanaged. Similar practices were discovered at other banks as well; these Israeli dirty banking practices could be for Israel what Enron is to the United States, a mere foretaste of disaster, in a sector that has been a big player in international financial markets.

Austerity and More Austerity

In the absence of a "political horizon," the only answer Sharon has for the economic crisis is to cut the national budget. The monetarists at the Central Bank demand massive budget cuts, including NIS 10 billion from the defense budget, and 12 billion from other sectors, beyond the NIS 12 billion already cut in 2002. A cut of NIS 7 billion from government salaries is also being demanded. But the crafty fascist Sharon has only agreed to an additional NIS 2 billion this year, "promising" NIS 12 billion more from the 2003 budget.

But this promise, Sharon has given the devil. Before announcing it on June 17, he met with former Bank of Israel Governor Jacob Frenkel, currently chairman of the international division of Merrill Lynch and Co. Frenkel warned Sharon, that if Israel does not meet its budget deficit targets of 3.9% of GDP in 2002 and 3% in 2003 ("mission impossible," given collapsing tax revenues), the international credit agencies will lower Israel's sovereign credit rating.

Sharon brought back from the United States a promise by the Congress for an additional $200 million in military aid. But this will, no doubt, be used to build the "Great Fence of Israel" project inaugurated on June 15, which will add at least another $130 million to the government's expenses. The rest will go to finance the war on the Palestinians and defense of the settlements in occupied territory.

The Israeli population is beginning to suffer economically as they have not done for decades, particularly the weakest sectors. The government had instituted an across-the-board cut of 10% in national insurance payments, Israel's social security system. Hardest hit will be the Israeli Arab community, which has the highest unemployment rate. The government has cut child allowances to any family whose members don't serve in the military. While this hits the ultra-Orthodox, who do everything to avoid military service, Israeli Arab citizens are forbidden from serving.

While claiming it won't increase taxes, the government has already increased the value added tax, one of the world's highest, from 17% to 18%. Educational cuts have forced schools to announce that the school day will be cut by one hour. Teachers have already struck over this issue. Other such cuts are already being felt in all the public sectors, particularly the health sector.

Historic Water Crisis

In midst of all this, Israel faces the worst water crisis in its history. The Sea of Galilee, its primary source of water, is at record lows, as are the coastal and mountain aquifers. Israel is dependent on water resources in the West Bank as well, which it freely exploits, while greatly restricting Palestinian use. Although Israel has commissioned its first water desalination plants, construction has yet to start. Each plant costs NIS 400 million or more, with the government expecting private investors to take the initiative. In a war zone, progress is not likely to occur.

Ironically, solving the water crisis is key to reviving the economy and establishing peace in the region, given the reality that the majority of the existing water resources are located in a watershed that links Israel, the West Bank, Jordan, Syria, and Lebanon. Its exploitation and expansion can be most effectively accomplished through regional cooperation. This is the core of Lyndon LaRouche's well-known Oasis Plan for Middle East peace.

Yet Sharon's policy continues to be to expand the Jewish settlements in Palestine, using Israeli military might. He has refused to touch the tremendous subsidies and tax breaks the settlements receive. Money continues to be allocated to build bypass roads from West Bank settlements to Israel and connect new settlements to the electricty grid, among other types of infrastructure there. In fact, Sharon's war is to keep the settlements. *Ha'aretz* commentator Davhna Levit on June 17 identified their central role in the crisis: "The real costs of the settlements to our economy are prohibitive, although incalculable. . . . They have cost billions in lost opportunities and misdirected expenditures. . . . The most horrendous thought of all is not only that our leadership has no way out of this accelerating descent into Third World or worse status; it actively encourages it. Why else would it continue to speak of peace and provoke war, promise security and encourage violence, pay for a fence and continue to build outside of it?"

Ranks of Wall Street's 'Misfortune 500' Grow

by Arthur Ticknor

Reading the business pages of any major U.S. newspaper has become like reading a police blotter, with allegations of rampant corporate crime and corruption, even surpassing that of the 1980s "Decade of Greed" typified by the savings-and-loan scandal. Among the new items on the docket since May, are criminal investigations of former executives at ImClone Systems and Tyco International, and a pre-criminal investigation of the Glaxo pharmaceuticals giant; while the conclusion of the trial of the Arthur Andersen accounting firm showed just how fed up Americans—as represented by the "12 angry people" of the jury—have become with the Wall Street and other financial superstars who fooled them on their now-disappearing 401(k) pension accounts.

The police-blotter firms are still just a growing minority of the much broader "Misfortune 500"—America's corporate leaders of the 1990s "New Economy boom" who are now the grim denizens of economic depression.

A new sign of their contagious misery, reported in June, is the use by hundreds of companies, of the sad tactic of "forced vacations" for their employees, in order to cut costs during this breakdown Summer. Some, such as Sun Microsystems, Hewlett-Packard, and VeriSign, while laying some employees off, are giving others paid vacations, and closing down to save operating costs. But there are those, like Manugistics of Rockville, Maryland, which is forcing all 1,200 of its employees to take *unpaid* vacations. And others are doing both, like Peregrine Systems, which is laying off half of its 3,000 workers and closing its offices on the others. Remember this trend when you read the next official U.S. unemployment statistics.

Telecom Alley

It is becoming so hard to find a telecommunications firm which is not choking on its own debt and/or management corruption, that such rare exceptions now make "human interest" stories for the business pages. The telecom firms added to the Misfortune 500 in June were led by XO Communications, which on June 17 made the second-largest bankruptcy filing yet by a telecom. The Reston, Virginia-based phone and Web service provider owes about $4.4 billion to bondholders (led by Carl Icahn), and another $1 billion to banks. XO has not yet agreed on a restructuring plan with its bondholders and its largest investor, Theodore Forstmann, who has already written off $1.5 billion invested in XO. Forstman asked on