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THE ECONOMIC IMPACT OF PEACE

Moshe Sanbar Interviewed by Manfred Gerstenfeld

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Moshe Sanbar: From Dachau to Bank Chairman

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Bank Leumi Chairman Moshe Sanbar was born in 1936 in Kecskemet, Hungary. In World War II, he was sent to several concentration camps, including Dachau. His experiences there are described in his 1961 book, *My Longest Year*, which was translated into several languages. After the war, he came to Israel.

After studying at the Hebrew University, where he earned a Masters degree in economics, statistics and sociology in 1951, Sanbar worked at the Israel Institute of Applied Social Research, eventually becoming deputy director. In 1958 he moved to the Ministry of Finance where he held a number

of top positions, including that of budget director. From 1968 to 1970 he was Chairman of the Board of the Industrial Development Bank.

In 1970, Sanbar ran the Ministry of Commerce and Industry. The following year, he was appointed Governor of the Bank of Israel, a post he held until 1976. Since then, he has held a variety of chairmanships of public companies. In 1988, he became Chairman of the Board of Directors of Bank Leumi.

Moshe Sanbar is a Fellow of the Jerusalem Center for Public Affairs and his published books include *The Local Government in Israel* as well as *Economic and Social Policy in Israel: The First Generation* (JCPA and University Press of America, 1989). His many awards include the Yad Vashem prize for Holocaust studies (1958), the Herzl prize for public service (1973), and the prize for extraordinary contributions to the development of local government in Israel (1986).

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Peace Increases Foreign Interest

Sanbar characterizes the Israeli economy today as a "stream of new momentum." He explains: "There is always something new. One impulse follows another. It started with the big aliya from the former Soviet Union and has continued with American loan guarantees, the hope for peace, peace talks, and the agreement with the Palestinians. All this leads to enlarged foreign interest in the country, and in the region as a whole."

But Sanbar does not expect any dramatic leaps in Israel's economic development as a result of peace. "Peace is very important," he says, "but not as far as structural changes in our economy are concerned. The Israeli economy has done well in recent years, and peace will act as a catalyst for a continuation of that positive trend. Peace brings a new wave of foreign interest and adds additional momentum."

Contrary to what some people want to believe, Sanbar states, "exports to countries in the Middle East cannot change Israel's development in a major way. The economic aspects of dealing with the Palestinian entity will be of a secondary nature. The same goes for economic relations with the Arab countries bordering on Israel. They all have a very low standard of living, and their import needs are not particularly well-suited to what Israel manufactures."

"Israel's economic development depends mainly on the expansion of its exports to developed countries," Sanbar says. "Peace will help that trend, but it requires additional investments, which is another reason why the process will take time." He puts the issue in perspective by using a European comparison: Holland imports more than all of Israel's Arab neighbors combined. "The Netherlands is a more advanced country, so there is greater economic logic to trying to increase Israel's exports to the Netherlands rather than to its neighbors."

Development in the Face of Worldwide Recession

Setting aside the issue of peace and its potential benefits, Sanbar focuses on an equally interesting question: Why has the Israeli economy developed strongly since 1990, while all the world has been in recession?

"Since the end of 1989, about half a million immigrants have come, mainly from the former Soviet Union. Increasing a country's population by ten percent in such a short time creates major additional demand for primary needs such as food, housing, schooling, clothing, etc. Even if the immigrants have below-average incomes, they still create additional

demand for goods and services," Sanbar says. "Industry met demand largely from excess capacity, without additional investment in new products at full price while producing at low cost. This increased profits substantially, and the economy benefitted."

"A second major factor for the economic recovery has been the monetary policy," Sanbar says. "The abundant money supply was in part due to low interest rates and inflation down which were small. This flow of additional money was used for consumption; it went to the private sector which prevented an increase in the inflation rate. In fact, a number of good things came together. The large money supply and low interest rates made it easy to invest in the stock market, and this trend was reinforced by increasing corporate profitability. "This led to a major increase in stock market turnover, this caused greater foreign interest in the stock exchange."

Loan Guarantees and Palestinian Aid

Sanbar notes that the 1992 elections, which brought Labor to power, convinced the public abroad that the time had come for peace. The American government finally authorized loan guarantees to Israel, about which the Likud government reached agreement with the Likud government. The importance of the guarantees is not that they allow Israel to get money," Sanbar explains. "The message to the international financial community is that Israel has a significant amount of foreign currency available and is not in danger. Israel's internal discussions as to whether or not to use these guarantees do not touch on this issue. The business logic to foreign investment in the country has reserves it does not need. This gave a place to invest. This gave a push to investment, which was no longer limited to the stock markets or real estate."

"Now, more new money will flow into the world. In the framework of the \$2.5 billion made available by foreign donors to the private sector, there is talk about some very big projects. People think that if a Western company is the contractor for such a project, nothing will be done in Israel," Sanbar says. "That is a mistake. Jewish and non-Palestinian Arabs will benefit. Definitely, this money is meant for the Palestinian economy. It will be spent here in the neighborhood."

example of French contractors who may win a contract to build new roads near Nablus, saying that they will not bring many engineers and laborers from home; much of the work will go to Israeli and Palestinian sub-contractors, and local engineers — who cost less than those brought from France — will get a large piece of the pie. Furthermore, Sanbar predicts that the Palestinians will use a fair share of the money they receive in aid to buy Israeli products. "This has been the case since 1967," he says. "The French may cream a project's income and transfer its profits out of the region, but the main flow of money, that for the work done, will go to local people."

Consumption Up, Inflation Down

Despite the optimistic outlook, Sanbar warns that not all is positive. "Macro-economically, there are some negative developments," he says. "Israeli consumption is increasing, as are imports. In the past, we considered this totally bad. The country's economic history is characterized by its lack of foreign currency, which was always the sensitive point in its economic thinking. Today, we have to change our mindset, at least partly, because foreign currency is available."

"It is a basic economic rule that if demand for goods exceeds supply, the result is either inflation or an increase in imports," Sanbar says. "In the past, we preferred increased prices to increased imports. Today, the greater imports help reduce inflation to levels which are low by our standards. This policy is a luxury we now can permit ourselves."

This new policy is a direct outgrowth of one of Israel's major achievements of the past decade: reducing inflation from 20 percent per month in 1985 to about 1.5 percent, where it remained for several years. Rising imports helped bring the level down even more, to about 1 percent per month. Sanbar notes that other countries which lowered hyperinflation rates only held them down temporarily, while in Israel the levels of the early 1980s have not returned.

Achievements in Employment

Contrary to what many people believe, Sanbar insists that Israel has done quite well in the employment field. "Unemployment went up from 9 percent in 1989 to almost 12 percent," he notes. "Then it came down again to about 10 percent. This seems high, but the fact that such a major factor as the aliya caused only a limited rise in unemployment should be considered another great economic achievement. Of the 200,000 olim who came here in 1990, half entered the job

market and at least 80 percent have found work. Of the 100,000 potential workers, 40,000 had an academic background, leading Sanbar to say "This was a windfall for Israeli society, as somebody else invested in their education and training."

In Western eyes, increased unemployment usually means less people are working, Sanbar says. That stands in stark contrast to the Israeli situation, where more people work and more people are without work than a few years ago. "In view of the substantial increase in population, the latter should not surprise anybody," he says. "Israel's 10 percent unemployment rate is still lower than that of some Western European countries, and that is a major achievement." The reservoir of professional manpower is much larger than the unemployment figures indicate, and Sanbar believes that if immigrants find appropriate work, the whole country will benefit.

"This may lead to another interesting, positive development," he suggests. "It is reasonable to assume that when job opportunities increase and unemployment falls, aliya will rise again. Many Jews want to leave Eastern Europe, where the bad economic situation affects most of them," he continues. "When they see that Israel can provide employment, they will move, thereby providing still more momentum to our economy. Of course, that may cause unemployment figures to go up again, but that will be temporary."

Attractions for Foreign Companies

All of these positive factors will get several boosts from the progressing peace process, Sanbar believes. In addition to the factors already mentioned, he says that large foreign companies which have ignored Israel in the past, in part because of the Arab boycott, may now decide to establish regional headquarters of offices here. "We have a very big advantage over our neighbors in the professional services we can supply," he says. "These big foreign companies will come here for regional business, not just Israeli business. They will explore ways to participate in some of the projects which will start in our neighborhood. They will send people to Israel, and these people will gradually become familiar with what goes on in the country. One of the first things they will realize is that Israel has highly qualified manpower which is cheap by their standards, especially in high-tech fields. Many immigrants are not yet employed in their professions; they do less qualified work, and they represent significant manpower available for new projects."

One area that has been touted in the context of

peace projections is financial services, but Sanbar does not show great enthusiasm. "One has to differentiate between becoming a financial service center and a financial center," he says. "We will be the first, but are unlikely to be the second. We will be able to provide financial services to those multinational companies operating in the region, and may be able to draw more private financial deposits than we have today. Yet Israel will not become a financial center, as we will not be able to attract large amounts of capital. We will not be able to compete with London or Singapore. The only real money in this neighborhood is that of the Gulf states, and they are not about to invest heavily in or through Israel."

He stresses that the barrier is not due to lack of technical ability; Israel, he says, is capable of providing the services of a financial center, but the rich countries of the region already get good service in the West. "If they will come here at all, it will be for a small part of their money, and it will take a long time until they are convinced that peace is really stable," Sanbar predicts. "Then it may be in their interest to diversify and also operate through Israel. If this happens, there will be ferocious competition because this money will have to be withdrawn from elsewhere."

Independence vs. Interdependence

Returning to the peace process, Sanbar lists several developments which he believes should occur. Some concern Israeli government policy, while others depend on the approach of the international bodies which will allocate funds for regional development projects. "President Clinton has succeeded in mobilizing significant funds for the Palestinians, who will receive about \$500 million in each of the coming five years," he notes. "Of this sum, the American have pledged \$600 million." This international aid is earmarked for development projects. The Palestinians have set as a priority projects that lessen their political and economic dependence on Israel, but Sanbar maintains that peace and economic independence are contradictory.

"Peace must mean interdependence between people," he says. "We saw that clearly after World War II. When Germany put up a power station near the French border, France did not put up a competing power station on the other side. Today, many European power stations feed into a common network. Common networks link multiple European countries for supply of resources ranging from natural gas to such specialized products as ethylene." Sanbar notes that economic interdependence is a cornerstone of the EEC

model. It was, he recalls, the very basis for the discussions about European institutions, and it is what eventually became the single European market which will lead to a single currency.

Against this frame of reference, Sanbar is understandably not pleased with the Palestinian concept of economic independence. "They want to erect an electric power station in the Gaza region," he says. "There is already an Israel power station 20 kilometers to the north, in Ashkelon. The Ashkelon station supplies electricity to Gaza, and steps already have been taken to double its capacity. If the Palestinians want to build their own power plant rather than use power from Ashkelon, then the West should tell them, 'We will give you money to accelerate the peace process. Projects which have the opposite effect should not be financed by our money,'" Sanbar suggests. "The donor countries should give a clear message that such independence projects contradict the spirit in which the money was pledged."

Although he believes it is in Israel's interest, too, to foster economic interdependence, Sanbar does not think that Israel should raise the issue in the context of aid to the Palestinians. The countries that are giving the money should set the rules; the reason is based at least in part on self-interest. "The small part of European taxpayers' money sent to this region has been made available to let peace progress," he says. "From an economic viewpoint, the independence projects are a waste. If that is how the aid money will be spent, then the Palestinian standard of living will go up more than it otherwise could, and the donors can rest assured that they will be called upon to give more very soon."

Projects which foster peace will cause Palestinian income to rise faster than it otherwise could, and such a rise would mean that the Palestinians will be likely to come back to the Europeans and Americans looking for more aid money. "Many Palestinian leaders cannot believe that \$2.5 billion is all the aid they will receive," Sanbar says. If they begin to spend on the assumption that more money will be forthcoming, he warns, then the international body overseeing the allocations will need to assess Palestinian development projects with an eye to their contribution to advancing peace.

Sanbar stresses that he does not oppose a Palestinian power station, per se. If the Palestinians were to establish a major power station for regional use, and if neighboring countries were to agree to buy electricity from it, he would back the plan wholeheartedly. If such a plant also met Israeli demand, he says, it would

create economic interdependence and thus make a contribution to peace. And, he sums up, if Israel and the Palestinians both benefit from such a development project, then the project will give a boost to peace. "If there will be no peace," he points out, "then Israel can hardly be expected to purchase electricity from a Palestinian station. If, on the other hand, the Palestinians cut off the supply," Sanbar notes, "they too will suffer, as their own cost of electricity will increase."

Israel and Its Arab Neighbors

Sanbar believes that, in the spirit of peace, Israel should be permitted to participate in the execution of development projects in neighboring countries, just like any other country. "One might even say that in order to promote peace Israelis and Arabs should get a certain priority," he suggests. "The donor countries may be shortsighted enough to want the money they give to create work for their own companies. It would be a very bad omen if there were no equal terms for Israelis."

Yet another condition for real peace lies in the end of the Arab boycott. Sanbar notes that the boycott began when the Palestinians asked the Arab states to create it, and says that they must now ask them to end it, given that they have achieved peace. Without such a step, he says, there will not be real peace. Genuine peace requires open trade between Israel and Arab countries. Israeli companies must be permitted to sell their goods in Arab countries, initially in Jordan and North Africa, and eventually in Syria, Saudi Arabia, and the Gulf states. Demand will not be great, Sanbar acknowledges, but the political importance exceeds the economic value.

He maintains that Israeli politicians who have lobbied mainly for the abolition of the secondary boycott, that of Europeans who refuse to work with Israel, have erred. Perhaps, he allows, industrialists who were hurt by the secondary boycott could have spearheaded such a campaign, but Israeli politicians must insist on seeing Israeli products appear in Arab markets. "Some Israeli companies may even establish plants in Arab countries. The Israeli textile firm Delta is already setting up a plant in Egypt, with plans to export its production to Europe. This is a good alternative to investing in Eastern Europe. Before such investments can be made, obviously, the Arab boycott must be abolished."

Sanbar believes that the potential for Israeli exports to Arab countries will be limited to those goods which those countries already import. "We have to realize

that Israeli products will never be able to compete in Arab markets with products the Arabs can make themselves," he says. "Their labor costs are much lower than ours." Israel will need to compete with other countries that vie for Arab market share, and Israeli companies should understand that their market share will never be large. The political significance of such trade is crucial, he says, despite the fact that Israel's economic future will not be determined by it.

Autonomy and Open Borders

Another important factor in the implementation of true peace has to do with open borders between Israel and the Palestinian entity. Sanbar stresses that "open borders" means free travel for goods, capital, and manpower. "This means that even if a Palestinian factory which competes with an Israeli plant is built, we will not protect our products. From a macro-economic point of view, our economy is strong enough to meet the competition of Palestine, or even Palestine and Jordan together. Such a policy may pose a problem for Israeli company owners who will face competition, but these things have to happen."

"If Israel has open borders with the autonomy, then third-party imports through the autonomy's outer borders will become a problem," Sanbar warns. If Israel and the Palestinians reach a long-term agreement delineating similar customs duties and quality control, the problem could be minimized, at least in theory.

"Copying European common market concepts would be an error. The EEC reached this advanced stage only when the individual countries were more or less on an equal economic footing, and the countries' interests were broadly similar. They certainly did not start after World War II, when the German economy was totally destroyed." Clearly this is not the case in the Middle East. "The gap between the Israeli and Palestinian economies is very wide. If the Palestinians were to apply existing external Israeli customs duties, they may not have adequate customs protection for their own products. Furthermore, their population may have to pay higher prices for some products to protect Israeli interests."

By adopting Israeli customs levels, he notes, the Palestinians could indeed generate some income from imports, but he notes that customs and duties do not exist solely to raise money. If the autonomy and Israel sign a customs union, he says, there will be a very real risk that Palestinian border controls will not be sufficiently strict. "One cannot send Israeli customs officials to check, as Palestine will be an autonomous

entity," he notes. "Even if the Palestinian authorities would like them to adhere to the joint rules, who says that their officials will want to do so?"

There are so many potential problems, Sanbar predicts, that customs controls will have to be erected between Israel and the Palestinian entity, regardless of what agreement is reached at the outset. "We do not like to confront this issue, because it means we have to ask where the border is," he notes, adding, "A transition state will be necessary to get from today's situation to the final one, as in the fields of security and defense."

"The autonomy process proceeds in stages, so we can try the customs arrangements initially in the Gaza region," he suggests. "It would be a mistake to commit ourselves to abandon customs controls immediately. We can assume that we want to give freedom of customs duties to all Palestinian and Jordanian products. Then we still will need to check carefully whether the product is indeed made there and has not been imported from elsewhere. Thus, we will have to define what are genuine Palestinian and Jordanian products."

"We should apply the same concepts which rule Israel's exports to the United States under the Free Trade Agreement," Sanbar suggests. "The Americans check each product to determine whether or not it can be considered Israeli. They require a 35 percent added value in Israel, as well as substantial transformation. This rule is designed to prevent us from exporting goods that have been assembled from imported components to the U.S. without customs."

There will be problems, to be sure. He points immediately to the field of agriculture. "We have to decide how much we are willing to sacrifice, and at what speed," he says. "We need a transitional agreement in this field, and we need to consider our macro-economic picture, but there is no doubt that Israel must make sacrifices regarding agriculture."

"Transition arrangements will also be necessary in the field of transport," Sanbar predicts. "Israeli operators will face major competition from Arab trucks and tour buses. Already, many tour buses operate in eastern Jerusalem. The difference in taxes actually paid will create competitive advantages for Arab operators.

If the macro-economic considerations of promoting peace are important, then we have to make sacrifices here, too, as long as there is fair competition."

Predicting a Boom in Tourism

Not every sector will be threatened by peace. Sanbar points to tourism as a field which is likely to boom. He predicts that tourism between Israel and her neighbors will not be major, but that Westerners will flow to the country in the era of peace. If quiet is maintained, he says, religious tourism will accelerate, and he notes that Jerusalem is the natural focal point of such tours. Likewise, he says, business tourism will grow, as conventions will take place in Israel in far greater numbers than happened in the past. "Many of these conventions did not come to Israel for two reasons," Sanbar explains. "First, because many organizations have Arab members, and they opposed Israel as a venue. Secondly, dates for large conventions are fixed a few years in advance, and organizers rarely wanted to run the risk of political or military unrest, so they usually avoided Israel altogether." He predicts a flood of conventions coming to Israel now. "Israel is an interesting country," he says. "The weather is nice. There is a good tourism and communications infrastructure. People here speak many languages. New tourist facilities will be built."

The picture is not all rosy, but neither is it all gray. Sanbar sums up by saying, "We will have to make sacrifices for peace, not only in the political field, but also in the economic field. These sacrifices make sense if the other side also makes some." Sanbar foresees a bright future for both the Israeli economy and its society. "I see the possibility of continuous progress in the coming years, but all of this could change if the peace process does not progress or if it suffers a major setback."

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