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TOWARD FISCAL AND ECONOMIC RECOVERY IN ISRAEL:
SOME LESSONS FROM NEW YORK CITY'S BAIL-OUT EXPERIENCE

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THE NATURE OF THE CRISIS

Israel's economic crisis is deep and real, as threatening to her survival as any war. For Israelis the effects of triple-digit inflation are not mere theory, but are felt in their daily life. They know it means that it is impossible to plan, either in one's personal or business life. Uncertainty is a way of life, in which the currency of one's country becomes increasingly valueless.

In addition to inflation, a number of other facts are indicative of the crisis. Gross national product (GNP) growth has slowed virtually to zero. Israel's foreign exchange reserves have slipped far below acceptable levels. Foreign debt has climbed to about 75 percent of the GNP. At the same time, though, visitors to Israel—and Israelis themselves—are often puzzled by the visible signs of prosperity. How can this country be in such an economic shambles when so many individuals are able to own automobiles, televisions and VCRs? Chaim Barkai has developed a penetrating analysis as to how this apparent paradox is sustained.

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In his view, the crux of the issue is the huge and growing debt owed to the government by firms and households. This debt came about since, when the government granted development credits to firms and mortgages to households, the loans were *not linked,* or only partially linked, through the end of the decade. "The nominal interest rates that were stipulated in the loan contracts in no way reflected expectations of double-digit, not to mention triple-digit, inflation. Under these circumstances, the acceleration of inflation benefited debtors, and when inflation soared their gains reached immense proportions....Thus, a monthly repayment on a housing mortgage might initially have been 20 percent of disposable income. But, at inflation rates of 100 percent and more, the repayment shrank to 5 percent within about three years, the balance being put at the disposal of households. The Israeli consumer behaved rationally: he reallocated those funds initially designated for debt payments, to the purchase of durables and cars."[1] Thus, despite the appearance of prosperity, Israel's economy is in urgent need of a program for recovery.

FINDING A STRATEGY

Strategies for economic and fiscal recovery have various elements in common, to wit:

1. The government must restructure and reduce its debt.
2. It must balance its budget, or at least significantly reduce the gap between expenditures and income.
3. It must increase productivity, both in the public and private sectors, so as to compete more effectively for local and world markets. Related to this, it should aim to reduce imports and increase exports.

While Israel's position is unique, lessons can be learned from the economic success stories of others, be they in the free world or in bail-out programs used in industry.

THE BAILING OUT OF NEW YORK CITY

One such recovery model was the bail-out of New York City between the years 1975 and 1980. A great deal has been written on how New York City got into trouble, but relatively little on how it got out. The differences between Israel—a sovereign state, with enormous responsibilities for defense—and New York City—a municipality, governing an international business headquarters embedded in a federal system involving more powerful state and federal governments—are obvious and important. Although these differences outweigh the similarities, there are valuable lessons to be learned from New York City's fiscal recovery.

First, some of the comparisons. The budget of the New York municipal government in 1975 was $13 billion; Israel's 1984 budget was $22 billion. In 1975 New York City's debt was $12 billion; in 1984 Israel's was $23 billion. In New York City the gap between income and expenditures in the first year of the financial plan was approximately $1 billion; Israel's gap between income and expenditures is $1.2 billion. New York City's work force was 225,000; Israel's central civilian governmental work force is 250,000. In both cases, the government faced massive debts, huge annual deficits and the threat of bankruptcy. And in both cases, the political process was unable, or those who dominated it unwilling, to resolve the problem alone.

By 1980, New York City's work force had been reduced to 165,000, and the annual gap between income and expenditures virtually eliminated. The debt had been restructured so that short-term debt had been erased and long-term debt significantly reduced. How was this accomplished?

The chief factor was the development of a comprehensive, functional *partnership* of key power groups in the society, each of which had a substantial stake in keeping New York City afloat. It consisted of the leaders of private industry, of government and of labor. For the partnership to carry out its mandate, a number of elaborate, temporary institutional structures were put into operation, around the normal governmental apparatus.

The first such structure was the Emergency Financial Control Board, which included high elected officials, e.g., the governor and the mayor, but also had four representatives of private industry. Labor, while not formally on the committee, sat in on all the meetings and was extremely active in the corridors.

The second unit was the Municipal Assistance Corporation, which was crucial in restructuring the City's debt and had the legal authority to market new instruments. Again, both government and private industry were represented on the board.

Third was the Management Advisory Board, composed of chief executives of banks, insurance companies, and the like. While the Board's official mandate was to advise the city how to improve the efficiency of day-to-day operations, its underlying and far more important agenda was to develop a climate of confidence in the city government. Business leadership needed to be shown that the city indeed meant to get its operations under control, and that the capacity either existed or could be created to govern the city and to manage it effectively.

The fourth unit was a Productivity Council which brought together the leaders of labor and government, to work jointly in improving operations.

Each of the partners had a say in the direction to be taken. Each could blame the other for actions which negatively affected their own constituency. The frequent, often daily, contact between leaders from the various sectors formed a basis for trust and communication which enabled them to reach joint solutions.

In addition to the aspect of partnership, a second reason reason for New York's success was the systematic, intensive effort to restructure the government. Within four years government employment was reduced by over 60,000, most of it accomplished without layoffs. Rather, vacant positions were not filled, and early retirement encouraged. True, there were some reductions in service, but these reductions were not as great as the reductions in employment. In other words, productivity was increased and elaborate systems of fiscal management control were put into operation. A four-year financial plan was agreed upon by all partners; a formal system of management planning and control was also implemented, and a new (expensive and badly needed) financial management system built.

A third element in New York City's recovery was the willingness to reduce or eliminate various subsidies, including many "sacred cows." In 1974, the possibity of ending free tuition to the city university could not even be mentioned in public debate; by 1976 tuition was a *fait accompli*. Entire agencies were either combined or eliminated.

Finally, specific attention was given to economic development. Of course, the city was fortunate in having a strong economy; during this period substantial foreign investment fueled the continuing growth and development of midtown Manhattan. And there was extensive outside help, such as from the government. But no external aid would have been forthcoming had the city itself not initiated actions. The municipal government moved to freeze property taxes for a five-year period, thereby signaling a positive climate for private investment.

RELEVANCE OF THE NEW YORK EXPERIENCE FOR ISRAEL

While both the specifics and the governmental context are different, some aspects of the New York experience are strikingly parallel to the current situation in Israel. For one thing, many people in Israel who ought to know better do not take the crisis seriously enough. In New York City, too, there was a blind spot toward the many signs of impending economic doom. I recall lunching with a senior budget official in the spring of 1975. "We are in terrible trouble," he said, to which I responded, "you always say that." "You don't understand," he insisted, "this time it's serious." I answered, "You are just sabre rattling. The mayor will make a series of hysterical pronouncements as a way to generate more federal and state aid." By September 1975, the city was virtually bankrupt.

In early October of that year, I met with a high city official who was playing a key role in attempting to combat the crisis. He commented, "Don't worry, it will all blow over. We'll move the money from here to there; we'll issue some new debt instruments and make a few personnel reductions. Washington and Albany will pitch in, and the problem will be resolved." Two months later, he was out of a job and a serious program was implemented. In Israel, many government officials believe that the crisis will "blow over." They feel that the United States government and the Jewish community in the diaspora will "not allow" Israel to collapse, and that therefore there is nothing to worry about.

Secondly, again parallel to the New York City experience, those in the know are dealing with numbers and problems so vast as to appear insoluble. I recall sitting in a room filled with other "crisis-fighters," and looking at projections showing anticipated budget gaps of close to a billion dollars. We did not have the vaguest idea as to how that gap could be closed. Yet gradually, with careful planning, concerted effort, some outside help and good fortune, the gap was closed. By the spring of 1985, Israel could be facing a problem of the magnitude of five to seven billion dollars. Even if United States aid to Israel, already at an all-time high, were again to be increased, it is out of the question that such increases would be large enough to even approach a gap of this size.

Thirdly, it is extremely difficult for the political apparatus in Israel, as it was in New York, to respond on its own, without a carefully orchestrated program of "carrots and sticks." Israel's short-term objective is to forestall immediate economic disaster, i.e., depression and/or governmental bankruptcy. The country needs emergency mechanisms such as New York's Emergency Financial Control Board.

EMERGENCY SYSTEMS: FISCAL CONTROL AND RESTRUCTURING OF THE ECONOMY

Two types of mechanisms are crucial:

1. The immediate creation of an emergency control system to manage and limit the fiscal crisis.

2. The creation of a planning mechanism to restructure the Israel economy, similarly on an emergency basis.

A system to manage and limit the fiscal crisis might include three types of entities in Israel: (1) an entity to restructure and manage the debt; (2) another to balance the budget; and (3) a third to increase productivity in the private and public sectors.

Each of these mechanisms should include a board or committee comprising significant power blocs in the society, e.g., the state government, the Histadrut, and private sector leadership. Diaspora leadership should be involved only as observers, if at all. It is only through the creation of apolitical, extra-governmental apparatuses that it will be possible for political leaders to impose the necessary Draconian measures on their own constituencies. Thus the need for partnership; only in such a context can each participant blame the other for painful decisions taken.

These mechanisms, which appear to threaten democratic institutions, paradoxically have the opposite effect. By temporarily removing unpleasant decisions from the political arena, they insure that responsible democratic parties are "held harmless" and are not abandoned by angry constituencies in favor of extremist parties promising easy solutions. In the long run, such temporary mechanisms can strengthen rather than weaken responsible political parties in Israel, and strengthen democratic government.

Besides an emergency system to manage and limit the fiscal crisis, the second instrument of note is a planning mechanism to restructure the Israeli economy. Accepting the concept of a mixed public-private economy for the foreseeable future, Israel needs to open more opportunities for investment in the private sector. Unless substantial changes are made in the regulatory environment affecting private business, it will be impossible to attract the kind of private investment that Israel needs so badly. Of the American Jewish businessmen come to Israel to explore the possibility of investing here, many leave with the view that "it is impossible to do business in Israel." Even discounting the tendency of private entrepreneurs to blame red-tape for every problem in every society, a kernel of truth undoubtedly remains.

In addition to changing the regulatory environment, the scope of Israel's welfare system needs to be re-examined. As with the economies in many countries in Europe, Israel subsidizes a relatively high level of individual welfare benefits. Private risk-taking is discouraged by this, and even more so by the high unemployment benefits paid by employers and the impossibility of firing nonproductive workers. No one would argue for the elimination of central economic planning; even in the United States—which views itself as a free enterprise society—national institutions, such as the Federal Reserve Board, have a powerful impact on individual economic decisions, through control of the supply of money and interest rates.

Setting national economic goals, and manipulating such economic environmental variables as money supply and interest rates to achieve these goals, though, is not at all the same thing as the kind of interference in individual economic enterprise characteristic of Israel. The point is not an ideological but a pragmatic one. Israelis have argued an urgent need for private investment; but they will not see this investment without substantial changes in the rules affecting private economic activity.

Beyond the issue of regulatory controls, there are attributes endemic to the Israeli economy that discourage private investment. The amount of public land ownership (97 percent of the land is owned by the government) and the extent to which the state owns economic enterprise need to be thoroughly reassessed. Whereas in most Western societies the government accounts for 30 percent of GNP, in Israel governmental activity has been estimated at 120 percent.[2] The Histadrut alone controls over 500 factories, in addition to enterprises controlled by the Jewish Agency and the government itself. Approaches to the development of non-wasteful competition are feasible and practical.

One crucial issue to be confronted is how much weight to give economic planning, as opposed to free enterprise. This question could be a source of conflict, as well, in Israel-diaspora relations. Diaspora Jewish leadership from the free world tends to advocate a free market, while Israeli leadership tends to see the need for even greater government control of the economy in the face of greater stress. There is a middle ground, but it needs to be developed. In the context of an overall plan, with growth targets and investment priorities, it is possible to deregulate economic activity, gradually eliminate subsidies, and foster competition for available resources.

CAN AMERICAN JEWRY HELP?

Is there a role for the organized Jewish community in the United States in response to the immediate fiscal crisis and the long-term economic crisis that threatens Israel? In the short run, American Jewish leadership should recommend an extra-governmental emergency entity to increase private and public productivity, to restructure the debt and balance the budget; and an entity to restructure the economy. The organized Jewish community can also help the economy.

Beyond investment in factories, Israel urgently needs investment in economic and managerial infrastructure. This suggests that American Jewish philanthropy should focus over the next few years on developing a Productivity Fund, to support economic and managerial improvement projects. Projects would be approved by an Israeli Economic and Management Development Board based on the recommendations of a counterpart United States Advisory Committee. The fund would make grants for: factory modernization; training (technical and managerial); marketing assistance; large-scale management systems; and infrastructure, such as roads. The objective would be to gradually decrease the amount of aid as Israel increases its self-sufficiency. Elmer Winter has argued that the Israeli economy can become self-sufficient by 1990; while this may be slightly optimistic, his overall thrust seems feasible.

Project Renewal, with its focus on specific and visible projects, has been relatively successful. This endeavor can be transplanted from the arena of local neighborhood housing and facilities into that of economic development (not necessarily in the same neighborhood). Projects would be evaluated on the basis of the projected ratio of costs to benefits. Benefits in this context would be defined as: increases in exports, decreases in imports, reductions in government expenditure (efficiency), improvement in public services (effectiveness), and increases in revenue. Projects would involve, not only capital investment, but also funds to hire experts to solve such problems as reduction in government "red tape." Each project coming up for review would have to be justified in terms of its contribution to the overall standard of Israel's economic and managerial quality.

While such an agenda would not lend itself to mass fundraising appeals, major contributors are likely to be attracted by the tangible results of such efforts.

THE LONG-TERM VIEW: ISRAEL-AMERICAN JEWISH RELATIONS

The organized American Jewish community is ready to reassess fundamental relationships between Israel and the diaspora. The opportunity to develop a healthier Israel-diaspora relationship may well be the silver lining in the current cloud of economic and fiscal stress. Over the long term it is in Israel's interest as a society, a culture and a government, to reduce its dependency on the diaspora, to achieve self-sufficiency and a sense of independence. The number and variety of Israeli officials who have articulated this goal, speaking both in Israel and in the United States, has increased remarkably during the last twelve months. *The Jerusalem Post* in a blunt editorial, "Feeding Our Habit" (31 October 1984), sharply criticized the government for requesting that aid from the United Jewish Appeal and Israel bonds be doubled in response to the fiscal crisis. "The judgement to ask for more charity is ours," wrote the *Post*, "and it is indecent...a nation with self-respect and with such a mess to clean up, would seek to first put its own house in order, before asking for more hand-outs. If we need a package deal to rescue us at home, it is time that package also included a sense of honor."

How can this transition from dependence to independence in regard to outside aid be achieved? The philanthropic relationship of the diaspora with Israel has been a cornerstone of interactions on an individual and community-wide basis. Thus, whether Israel needs the aid or not, *sudden* elimination of UJA aid to Israel could be quite destructive. As a gradual process, however, it is feasible and necessary for Israel to increase its responsibility for local human services needs. Many have argued for the development of a UJA in Israel.

A more appropriate model might be the development a local United Way and/or federation structure in Israel. There is no question that there is now sufficient private wealth to make such an enterprise feasible. It is ironic that Israel has imported everything from America, from VCRs to the Young Israel movement, but has not imported the most successful American Jewish social model–the local federation. The raising of funds abroad for Israel has sometimes had a demeaning quality. In one radio advertisement American contributors were asked to pay for crutches for Israeli disabled children. Knowing of Israel's modern social welfare system, it is hard for the intelligent donor to understand such an appeal.

In the diaspora, competition between domestic and overseas needs is also of concern. In a tour conducted in New York City for Israeli consular officials and their families, the visitors were surprised at how much was needed in the local Jewish community, ranging from Jewish education to Jewish poverty. With national UJA/federation contributions relatively constant (except for added spurts during wars), and with the continuing cutbacks in the human services arena in the United States, the competition between domestic human services and Israel's needs will place a growing strain on Israel-diaspora relations, at least in the United States.

The other major source of United States support for Israel is the Israel Bonds organization. The infusion of capital has made an enormous positive difference to Israel, but the future must be reassessed. Bonds are a relatively small but symbolic increment to Israel's national debt, one of Israel's most fundamental problems.

The immediate disengagement of the United States Jewish community from philanthropic involvement in Israel would be a terrible mistake for all concerned, but the form of this involvement can and should be dramatically reshaped. Obviously, diaspora Jews should stand ready to help Israel with extraordinary and emergency requirements stemming from immigration and resettlement. Israel alone cannot and should not have to cope with the resettlement of substantial numbers of Ethiopian or Russian immigrants.

Aside from emergency resettlement, American Jewish philanthropy in Israel should be gradually phased out. Israel-diaspora relations in the future could focus on cultural and educational enrichment programs. Hopefully, one would also see a continuing flow of individual capital being invested (rewarding both for the investor and for Israel), as well as substanial individual Jewish involvement in trade between Israel and the West.

CONCLUSION

For the first time in its history, Israel has the luxury, as well as the necessity, of focusing on its economic life in addition to preserving life itself. While the external threats to Israel's security have not disappeared, for the first time they also do not appear overwhelming. With vigorous and effective cooperation between Israel and diaspora Jews, as well as with the United States government, this crisis can be turned into an opportunity to create a viable Israeli economy and governmental structure, over the long term, one that will enhance and support the quality of independent Jewish life in the ancient homeland.

Notes

1. *Jerusalem Quarterly* 32 (Summer 1984), 10-11.

2. Daniel Doron, Director of the Israel Center for Economic and Social Progress, has extensively documented the case for "privatizing" the Israeli economy.

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