

THE ELMER WINTER ...

# “YOU OUGHT TO KNOW GAZETTE”

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Dear Friends:

Do you often wonder ... I'm sure that you pause from time to time and ask yourself ...

## “What’s ahead for Israel five years from now?”

Well, let me share with you a well thought out “five years from now” analysis provided by Stu Eizenstat, a major speaker at the conference convened by Shimon Peres in Jerusalem in June, 2008, to discuss “Facing Tomorrow”.

Stu is a long time friend of mine. He wrote and presented a brilliant 41-page report where he answered many of your questions about Israel's future. I would like to excerpt portions of Stu's analysis for your attention and interest. I believe that you will find Stu's forecast to be of considerable interest to you and your business friends.

By way of introduction, “Stuart E. Eizenstat is the head of the international trade and finance practice at Covington & Burling, LLP, in Washington, D.C. He was President Jimmy Carter’s Chief Domestic Policy Adviser and Executive Director of the White House Domestic Policy Staff (1977-81). In the Clinton Administration, he served as U.S. Ambassador to the European Union.”

Stu was called upon to present his forecast to a group of 200 political leaders, senior economists, scientists, philosophers and business managers. The theme of the meeting was “Facing Tomorrow”.

Let me start by quoting portions of Stu's report as he provides his analysis of Israel's future ... five years from now.

Stu started by stating:

“Jews have accomplished something no other people in recorded history has achieved: the return after two millennia of exile from our land to a new sovereign Jewish State, the Third Jewish Commonwealth, one which has embodied the Prophetic vision of the ingathering of the dispersed from the four corners of the world.”

“And yet, in the first decade of the 21<sup>st</sup> century and over the next five years, world Jewry and Israel face an unparalleled set of challenges, from Global Mega-Trends. *Surmounting these challenges will require the same vision, leadership, courage, and strength as the Jewish people have summoned to meet past challenges.*”

Stu finds these first five Mega-Trends with which World Jewry and the State of Israel must cope:

- I. The Dramatic Shift of Economic, Political, and Military Power from the West to the East and South, Moving from a Unipolar World Dominated by the United States and Its Allies to a Multipolar World;
- II. The Impact of Globalization and Its Effect on a Possible “War of Civilizations”;
- III. The Rise of Islamic Extremism and Terrorism, the Rise of Violent Non-State Actors, and the Challenges these Pose to Moderate Arab states, the United States, Israel, and World Jewry;
- IV. The Rise of Non-Traditional Security Risks: Nuclear Proliferation; Global Warming; and Demography; and,
- V. The Rise of a New Form of Anti-Semitism and Anti-Israeli Sentiment.

According to Stu:

“For Israel, these Mega-Trends could form a ‘perfect storm’ of economic, geo-strategic, and environmental factors all potentially impacting the state. But all of these Mega-Trends, with proper foresight, leadership, and diplomacy, can be not only managed, but surmounted, with Israel emerging stronger for having faced them.”

Stu Points out:

“All in all, Israel is facing a significant set of risks in the near term. But in this great global shift of power, Israel is not without assets.”

“Israel makes up just 0.3 percent of global GDP and consequently there may be seemingly little that Israel can do to influence wider economic forces. That may be true, and Israel will certainly be buffeted by the global financial changes under way, perhaps most importantly by the slow, relative decline of U.S. power. In this, however, there are several variables that, depending upon how both the U.S. and Israel manage their economic, diplomatic, and military relations, may soften the landing.”

What about Israel's assets? Stu points out that Israel:

“boasts one of the highest levels per capita of exports of any nation in the world; has a GDP per capita above the level of several Member States of the European Union; is a world leader in science, and high technology; has a world-class university system; and receives a substantial amount of foreign direct investment from leading multinational firms around the world. Israel has one of the five strongest militaries in the world. And, in 2006, with a steadily growing population, it became the largest Jewish community in the world, surpassing the United States.”

“Meanwhile, trade with China represents perhaps the biggest prize, but brings with it a firewall of which Israel should be wary. Israel-China trade is accelerating remarkably, climbing 30 percent between 2005 and 2006 to \$3.8 billion, and exceeding \$5 billion in 2007. China is now Israel's second largest trading partner, after the U.S.”

“However, in balancing its relationships, Israel must be very careful in its dealing with China, because of American concerns, expressed particularly by those in the Pentagon who see China as a potential military opponent, and consequently strongly oppose transfers of technology to China which could aid its military and missile capacity.”

Stu points out:

“Consequently, Israel must be wary of the particular ways in which it becomes close with Beijing. Israel's recent, alleged military cooperation with China (via Israel Aircraft Industries and others), led to tensions in U.S.-Israel relations. It required an MOU between the U.S. and Israel to confirm that Israel would not supply military-related items to China, but the scars remain, and there have been clear impacts outside the defense cooperation relationship with greater scrutiny being paid by U.S. regulators on Israeli acquisition plans for U.S. assets in the high-tech sector.”

What about Israel's internal economic policies? Stu points out:

"Israel's policy moves internally are arguably as important as her decisions to further relations externally. And, in this regard, the best scenario for Israel is to continue down the path it set in the 1980s – towards further and faster economic liberalization and promotion of high technology – and to limit any slide in the areas that have made the country so successful. Signs in this regard are also hopeful."

"Israel's 'Silicon Wadi' remains the envy of much of the world, and IBM, Motorola, Microsoft, and dozens of other multinational high technology companies have benefited greatly from their positioning in Israel."

"The wider Israeli economy is attractive enough to have coaxed U.S. investment bellwether, Berkshire Hathaway, out of its American shell and choose Israel as the location for its first ever international investment (in 2006 paying \$4 billion for 80 percent of Iscar Metalworking). Meanwhile, technology firm Cisco has made nine high-tech acquisitions in Israel and is aiming for more. Such investments are only a part of Israeli foreign direct investment, which reached \$9.5 billion in 2007, a number that puts it in rare company – FDI is more than 5 percent of the country's GDP. This is reflected in the size of Israel's economy, especially when compared with its oil rich neighbors; GDP per capita in Israel is \$28,800; average GDP per capita in OPEC states is more than 25 percent less, only \$21,250."

Stu points out:

"... almost one Israeli in 10 works in the high-tech sector; thousands of start-ups are created every year; and, outside U.S.-based firms, more companies from Israel are listed on the NASDAQ than from any other state."

What about Israel's risks? Stu stresses:

"On the economic front, the risks for Israel come from its strengths. As Cisco CEO John Chambers noted, the reason his company has been disproportionately interested in Israel, rather than, for example, China was because though China boasted greater manpower, the attraction of Israel is that 'innovation was Israel's strong point'."

"Unfortunately, there are some signs that Israel's role as a font of innovation has slowed; education has been subjected to budget cuts in recent years, and a recent poll of potential high-tech investors conducted by consultants at Deloitte found that 30 percent intended to invest in Chinese companies while 25 percent said they planned in investing in India – Israel was not on the list."

How is globalization affecting Israel? Stu warns:

“... despite mounting inequality and threats from those leveraging globalization’s tools to do Israel harm, the Jewish state becoming a net loser in globalization is only one potential outcome. In fact, I believe strongly it is the least likely outcome. Another, more likely eventuality, would see Israel leveraging the economic, technical, and entrepreneurial talents of its citizens and taking advantage of globalization. And, again, the state is well positioned to do so.”

Is Israel globally aware? Stu points out:

“Israel boasts the highest number of engineers per capita (135 per 10,000 people, compared with 85 per 10,000 in the U.S.), the highest number of cell phones per capita; three-quarters of Israelis use the internet, 1.25 million households are online – 95 percent of whom have broadband connections – and Israel stands in second place in the world for the amount of time its citizens spend online.”

“With a third of the population born outside the country, and more than half of the population making at least one international trip a year, Israel is more ‘plugged in’, and globally aware, than nearly any other state.”

“The more Israel can encourage other states to become similarly bound up in its success and stability, the better the outcome for Israel in an era of globalization.”

“This suggests that Israel must make itself more central to the economies of as many countries as possible. This includes, eventually with the Arab states, when they make peace with Israel, as Israel has begun to do in a limited fashion with Egypt and Jordan.”

What about Israel's bureaucracy? Stu warns:

“... despite the potential for Israel, there is a concerning scenario in which Israeli bureaucracy, alternatively described by some Israeli entrepreneurs and manufacturers as sclerotic or simply backwards, impedes the ability of the state to take advantage. To some, it is bureaucracy and an antiquated tax code that helps produce the inequality in Israeli incomes – a 2006 study suggested that Israelis earning NIS 12-13 thousand paid the world’s highest taxes.”

“... Israel may have the highest number of engineers per capita of any state, but it still only has less than 100,000 engineers. China is thought to be producing as many as 600,000 new engineers every year, with India minting 350,000 annually. Clearly Israel needs to differentiate its engineering product, based on quality and ingenuity, to avoid being shut out by the growing weight of Chinese and Indian expertise. Israel’s comparative advantage will maintain, and Israeli

talent will remain sought after, so long as Israel continues to focus on ensuring that its engineers are also 'world beaters'."

What about the importance of peace possibilities with the Palestinians? Stu points out:

"However, in order for any of the true benefits of globalization to come about, peace with the Palestinians, and eventually with the wider Arab world, is an important pre-condition. Evidence for this comes from the positive economic fallout of the 1993 Oslo Accords, which directly 'triggered a warmer global embrace' and resulted in even more multinational corporations being attracted to Israel."

Can status quo be maintained? Stu warns:

"The alternate scenarios in this regard are well known but worthy of repeating. In short, the status quo can be maintained, with a focus primarily on the short-term security situation. Unfortunately it appears that such a focus will produce poverty-ridden, violence prone entities next door to Israel – a clear medium and long-term threat to the state."

"The other alternative to provide some needed breathing space for Palestinians, at least moderate Palestinians. Finance Minister Benjamin Netanyahu's plans for an economic peace between the Palestinians and Israel, borrowing much from the successful Qualified Industrial Zones projects between Israel and Jordan, and between Israel and the Territories, is a potential tool in this arsenal."

"In January Netanyahu said that '[e]conomic peace is the corridor to political peace' .... [which can be established through the creation of] ... bases of hope, instead of bases of Islamic radicalism."

What are Stu's thoughts on Israel-Palestinian interdependence? He stresses:

"Israel must create an economic interdependence with the West Bank and Gaza, as it did successfully before the Second Intifada in late 2000, and help integrate the Territories with the wider, global economy, as had been done with the opening of the Gaza airport and construction of the seaport. Clearly there is a security imperative, but there is also a security imperative in having the Territories cut off from both the Israeli and wider global economy that is even more compelling."

Stu suggests:

"Israel would do well to follow Rabin's wise counsel of fighting terror as if there were negotiations, but simultaneously to negotiate as if there were no terror. The

continued expansion of settlements and the failure to reduce checkpoints undercuts the moderates and give Hamas and the radicals the argument that only violence will succeed.”

“When it takes several hours to get to jobs, schools, and hospitals, it can only build up anger and frustration. Obviously, this always must be balanced against the threat of terrorism. But this was the purpose of the security fence.”

“Some of the improvements in facilitating passage of Palestinians through the checkpoints could be made by simply using all of the lanes at some key checkpoints, which now have only one lane operating. Israel must not let this happen.”

(Note: You many not agree with Stu’s position.)

Stu points out:

“During the Clinton Administration, I was responsible for the economic dimension of the peace process. With the cooperation of both then Prime Minister Netanyahu and later Prime Minister Ehud Barak, up to the time of the Second Intifada in September, 2000, with U.S. encouragement, Israel was allowing some 100,000 Palestinian workers into Israel daily; some 20,000 VIP passes to Palestinian businessmen were granted, who had access to Israel by car; the airport was opened; the seaport was being constructed: the Gaza Industrial Estate, which I visited in July, 2000, created pursuant to legislation passed by Congress as a Qualifying Industrial Zone (QIZ), had some 30 companies from Israel and all over the world employing 1,200 Gazans, with a second phase planned to take advantage of the duty free treatment of products back to the U.S. if they had a requisite percentage of Israeli content.”

“The result was that from 1997-2000, there was over 5 percent GDP growth in the Territories, with unemployment down to 8 percent in the West Bank and 14 percent in Gaza. All of this was brought to a halt by Yassir Arafat’s leadership of a Second Intifada, following his rejection of the Camp David Summit package in 2000. But it is the model to seek now.”

“If that scenario – peace in the Territories and the region – manages to come to pass, Israel will be far better positioned to address each of the challenges it faces and to more freely choose its most propitious course.”

Stu stresses:

“This scenario calls for Israel to cooperate with its U.S. and European partners to begin preparing the region for true economic and political reforms, by slowly showing the region’s constituencies that there is another way, and that the

movement towards violent Islamization if not outright political jihadism is a return to the past rather than a way to the future.”

“Such movement must occur quickly. The current cycle of violence is creating a dangerous polarization.”

What about the threat to Israel from Iran? Stu points out:

“Clearly, Iran is the greatest medium-term threat to Israel. It is Iran that funds and supports the major terrorist groups that prey on Israel. It is Iran that attempts to scuttle any Palestinian movement toward peace with Israel. And, it is Iran that marries a radical ideology, a professed determination to eliminate Israel, with an increasing capacity to do so.”

“The actual production of a bomb that could be fabricated and used on a delivery system against Israel or parts of Europe is anywhere from 3 to 10 years away.”

“This is a grave danger to the security of Israel and the West. Iran involves a dangerous brew: a radical ideology, a president pledged to wipe Israel from the face of the world, and who rejects the Holocaust as a historical fact, and a medium range missile capacity with Shabab-3 missiles that can already reach Israel, and will soon be able to reach to eastern boundaries of the European Union.”

“Iran’s moves toward nuclear weapons will also spur other Arab states, who fear Iranian hegemony in the Middle East, like Egypt and Saudi Arabia, as well as Turkey and Algeria, all of whom have indicated an interest in civilian nuclear power, to pursue their own programs. We could be perilously close to a Second Nuclear Age.”

Stu points out: “Israel, however, is not defenseless.”

“First, Israel has a capacity for massive retaliation that Iran must know could do grave damage to their country, plus an increasingly sophisticated anti-missile system, with U.S. partnership ... Israel would do well to maintain its course of hoping for the best and preparing for the worst. This involves increasing the sophistication and ability of its Arrow, Patriot, ‘David’s Sling’, and Iron Dome missile defense, as well as perfecting an adequate, robust second-strike capability.”

“Israel is well on its way in both regards, with recent additional funding from the U.S. to work on missile defense, and the continued procurement of German Dolphin-class submarines providing a second-strike platform that would make any state think twice before launching against Israel.”

Stu points out:

“... even if Israeli jets made it to Iran there is no guarantee that a successful strike would dissuade Iran from developing nuclear weapons.”

“According to some, a successful strike would simply lead Iran to redouble its subsequent development efforts, hide and secure their facilities even more comprehensively, or, in a truly nightmarish scenario decide that actually mastering the nuclear fuel cycle was uneconomical when it could just use its excess petrodollars to buy a ready made, even if crude, weapon from a cash poor, nuclear state like North Korea or Pakistan.”

What about Israel's production of electric cars? Stu points out:

“... the Israeli government has even announced a seemingly audacious plan to install the world's first network of electric cars within three years. The endeavor will be a joint venture with Project Better Place – owned by Israeli-American entrepreneur Shai Agassi – providing lithium-ion batteries and the infrastructure to refresh or replace them, while Renault and Nissan will build the cars.”

What about Israel's demographic challenge? Stu predicts:

“Israel also faces a demographic challenge, because while the Jewish population of Israel is increasing, the population of Arab Israelis and Palestinians in the Territories is increasing at a far greater rate. Between the Mediterranean and the Jordan Sea, there may be a majority of Palestinians by mid-century. Time is not on Israel's side. Even within Israel, let alone the Territories, Jewish birthrates are far surpassed by every other major group other than Christian Israelis.”

Stu suggests:

“I continue to believe that the majority of Palestinians are prepared to live peacefully with Israel as a Jewish state. But, the weakness of the Abu Mazen government, despite the genuinely first-class Prime Minister, Salam Fayyad, and the inability to control violent groups in the West Bank, let alone Hamas in Gaza, means that progress in the peace process will be slow. But, the peace process must continue, not because it is a gift to the Palestinians, but because Israel needs to have permanent, secure, internationally recognized borders that will keep it as a Jewish democratic state.”

(Note: Again, you may not agree with Stu on this assertion.)

What about support by American Jews of Israel? Stu points out:

“... for the majority of U.S. Jews, Israel is hardly the focus of their attention. In fact, some surveys indicate that roughly one-quarter of American Jewry feels little attachment to Israel, less than 40 percent feel a ‘lot’ of attachment to Israel, and only a third feel that being Jewish involves supporting Israel. A majority of Jews in some major cities have never been to Israel.”

“More fundamentally, U.S. support for Israel comes because the American people broadly support and sympathize with Israel because it is a democratic state in a sea of dictatorships; because it is pro-American and embodies Western values – which, indeed were at their outset Jewish values, and because for many it is the Holy Land they revere from a religious standpoint. Without this bedrock support, no amount of lobbying would be successful.”

### Conclusion

I trust that you found Stu’s comments and predictions of Israel to be of interest and to provide thoughts for the future of Israel.

You may not agree with all of Stu’s hoped-for solutions, but they are worth considering.

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P.S.: The underlining and excerpting is mine.