Milken Institute

Israel Center News

Volume 2 - Fall 2007

Shana Tova,

We have good news to report to welcome the New Year at the Milken Institute Israel Center.

Our long-time partner, the Koret Foundation, has directed a $1 million grant to the Milken Institute Israel Center for our northern Israel recovery and development project. Half of the funds will support the Milken Institute's efforts to establish a regional bond authority, and half will serve as the first funds into a credit enhancement pool that will back the bonds. This kind of mission-related investing and philanthropic giving not only makes a difference in people's lives but is leveraged to make an exponential impact. A special thank you to the Rosalinde and Arthur Gilbert Foundation for providing the planning grant to pursue this important project.

As another example of targeted giving, the Koret Israel Economic Development Funds (KIEDF) have successfully leveraged the small-business loan program recommended in the Milken Institute's *Financial Innovations for Economic Recovery and Development in Northern Israel* report into $25 million dollars in loans for that purpose.

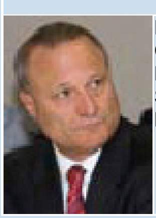
As you will see as you read on, we are working on a variety of projects that seek to reform and expand Israel's capital markets, catalyze economic development and increase the knowledge and skills of Israel's students and leaders. We are also in the process of expanding our partnership by formalizing the Koret–Milken Institute Fellows Program, which will enable us to continue to inform and implement capital market reforms and financial innovations.

Fall is a busy time for us and will include a conference where we plan to present policy recommendations on critical economic issues, including: foreign workers in Israel, pollution reduction, tax reform, increasing Haredi workforce participation, joint Arab–Jewish industrial parks and a workshop to determine the top-priority projects for northern Israel's bond authority based on implementation costs and projected revenues.

We wish you the best in the New Year and invite your continued engagement and support.

Warm regards,

David and Glenn



David Pollock
Chairman
Milken Institute Israel Center
Senior Managing Director
Bear Stearns & Co. Inc.

Glenn Yago, Ph.D.
Director
Milken Institute Israel Center
Director, Capital Studies
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Below

Upcoming Activities & Events

Koret–Milken Institute Fellows Advanced Seminar on Financial Innovations
Monday–Wednesday, November 5–7, and November 12–14, 2007
Jerusalem Center for Public Affairs, Beit Milken, Jerusalem

Glenn Yago, Director of Capital Studies, Milken Institute, and Senior Fellow, Koret–Milken Institute Fellows Program, will provide the first six sessions of an advanced economics training program for the new 2007–2008 Koret–Milken Institute Fellows.

Northern Israel Bond Authority Conference
Thursday, November 8, 2007
Carmiel, Israel

A result of the Financial Innovations Lab "Financial Innovations for Economic Recovery and Development in Northern Israel," conducted by the Milken Institute. This conference will convene in order to examine potential regional projects in northern Israel. Conclusions for future project implementation will follow according to ease of implementation and economic impact.

Koret–Milken Institute Fellows Research Conference
Thursday, November 15, 2007
Interdisciplinary Center (IDC), Herzliya, Israel

This conference will feature the findings of the independent research projects done by the 2006–2007 Koret–Milken Institute Fellows during their fellowships.

Beyond Bachar: Next Steps in Israeli Financial Reform

Architects of the historical Bachar financial reforms passed by the Knesset in 2005 met at the Jerusalem Center for Public Affairs, located at Beit Milken, on July 3 for a meeting sponsored by the Koret–Milken Institute Fellows Program.

The purpose of the session was to assess the progress of the Bachar reforms implementation and to discuss recommendations put forth by Koret–Milken Institute fellows that will regain Israel's momentum to a global, competitive capital market.

Dr. Joseph Bachar, until recently both Chairman of the Israel Tax Authority and Director General of the Ministry of Finance, responded to a detailed report, "Beyond Bachar: Next Steps for Financial Reform," presented by Koret–Milken Institute Fellows Shahar Shlush, Diana Zaks and Amit Goldwasser. The fellows have written what is to date the only review of the implementation of these historic reforms.

Also present were representatives from the banking industry (which has been forced by the reforms to divest most of their mutual funds and other monopoly powers in financial services), the Israel Securities Authority, the Bank of Israel, economists and representatives of financial services firms from Israel and abroad.

Dr. Joseph Bachar addressed a group convened to discuss Israeli economic reforms at the Jerusalem Center for Public Affairs on July 3, 2007.

Undisputed achievements of the Bachar reforms include: (1) an increase in overall market capitalization of the private sector as a portion of GDP from 83 percent to 101 percent; (2) the emergence of a small but growing corporate bond market that has grown from 12 percent to 21 percent of GDP, enabling firms to diversify their capital structures; and (3) an increase of non-bank credit by over 7 percent.

Still, the fellows' research found that the positive results of the Bachar Committee reforms made for a glass half empty. They demonstrated that the failure to implement more than half of the reforms called for in the 2005 legislation were accompanied by an actual increase in the very banking concentration the legislation was intended to redress. Banking concentration in the financial services sector rose by 4.23 percent in the past two years.

The report warned that loss of momentum in completing the reform recommendations would limit the opening of new distribution channels for credit and capital access. Debate ensued among those present as to how best to proceed with reform implementation and deregulation, and what Israel should do to best ensure sound economic growth and global competitiveness.

For more information on the report "Beyond Bachar: Next Steps for Financial Reform," see:
http://www.milkeninstitute.org/publications/publications.taf?function=detail&ID=38801007&cat=PBriefs

Food and Poverty: Policy Solutions for Israel

On September 5, 2007, a Knesset leadership delegation met in Washington, D.C., with members of Congress, nonprofits, and business and philanthropic leaders to explore solutions to hunger issues in Israel that are resulting in social gaps and threatening the country's economic security.

Sponsored by Mazon: A Jewish Response to Hunger, the Israel Religious Action Center of Reform Judaism and the Israel Forum on Food Insecurity and Poverty, the Knesset team was charged with identifying best practices and policy innovations that could be transferred into Israeli reality. A highlight of their visit was a session based on the work of Koret–Milken Institute Fellow Sharon Ouziely, a Ph.D. candidate at the Faculty of Agricultural, Food and Environmental Quality Sciences at Hebrew University. With support from the Rosalinde and Arthur Gilbert

Foundation, Ouziely, who begins her third-year fellowship this fall, researched inefficient agricultural policies in Israel that create waste and contribute to hunger.

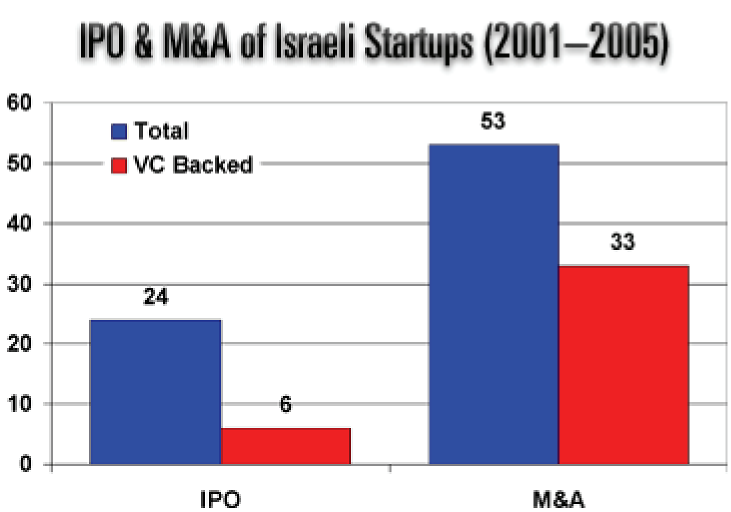
Ouziely concluded that public policy and market failures were to blame for the insecurity and poverty resulting from a paradoxical creation and destruction of agricultural surpluses. The Knesset delegation agreed with her findings. A number of solutions were identified to (1) redeploy food surpluses to food banks in order to help bridge nutritional needs for poor Israelis while (2) increasing efficiency in agricultural production.

Like so many market and policy failures, this one originated in the best of intentions, Ouziely found. Surpluses emerged in order to protect farmers' incomes when the government set minimum prices for agricultural produce at higher-than-market levels.

The resulting unharvested and unsold surpluses were found to represent an untapped resource to cross-subsidize food support programs for school lunches and poverty-assistance programs through a system of nonprofit food banks. The Knesset members held a working session on an existing legislative proposal that had emerged from Ouziely's research. The proposal would channel the surpluses designated for destruction to food contractors and the needy, especially to under-funded school lunch programs.

Such innovations would prevent the government paying twice—first, through payments to farmers for destroyed surpluses of eggs, vegetables and fruit, and second, for school lunch procurement—for the surpluses. The government would simultaneously avoid the ongoing violation of Jewish law that prohibits destruction of food. Jewish, Arab, left, center and right-wing MKs (Members of the Knesset) agreed on these points and resolved to address the issue in the next session of the Knesset. To access Ouziely's full report, "Food Surpluses and Food Insecurity," see http://www.milkeninstitute.org/publications/publications.taf?function=detail&ID=38801012&cat=PBriefs

Is Israel Becoming a High-Tech Banana Republic?



Source: Central Bureau of Statistics (2006), Israel Association of Electronics Industry (2006), Israel Venture Center (2006) and Office of the Chief Scientist (2006).

In a series of provocative lectures that received intense coverage in the Israeli business press in July, Glenn Yago, Director of Capital Studies at the Milken Institute, presented findings from a recent Institute report, "Financing Ideas: The Role of Capital Markets and R&D in Bridging Israel's Growth Gap." Yago addressed two conferences: the "The National High Tech Policy Conference" in Ra'anana and a "Forum on Research and Development Policy" hosted by the Merage Foundation for U.S.–Israel Trade

Israel's greatest success, its high-tech sector, is highly vulnerable, Yago warned. Over the past decade, the sector grew from 5 percent to 16.8 percent of GDP, and from 14 percent to 57 percent of exports. Yet sector employment only grew from 3 percent to 7 percent over the same period, reflecting lower productivity growth related to education and R&D spending, both of which are lagging relative to global competitors.

Despite the obvious benefits of direct foreign investment by Intel, Oracle, Microsoft and venture capitalists from around the world, Israeli tax and investment incentives have disproportionately benefited those companies' shareholders rather than create economic growth and wealth in Israel.

Israel's high-tech success is vulnerable because multinational corporations control most of Israel's high-tech productive capacity, the lion's share of Israel's intellectual property (through patent ownership) and a growing share of the country high-tech revenues and profits. The key challenge? Israel had adopted the U.S emphasis on R&D model but has not built a related capacity to establish global corporations and capital markets. The country places an emphasis on R&D centers, but not on manufacturing, and has an undeveloped initial public offering (IPO) market, not to mention growing competition from Taiwan, Ireland, India and China. In short, Israel must find the means to become a global competitor and not devolve into an "intellectual banana republic," Yago said. Since 2000, most Israeli high-tech entrepreneurs have shifted from IPO exits (and retaining control of high-tech companies) to premature exits through acquisitions by foreign corporations.

By 2006, for example, 76 high-tech companies were sold off to foreign owners, while only 20 companies raised funds for expansion through the IPO market, mostly abroad as well.

Yago's presentations in Israel were sponsored by the Israel Venture Capital Association and the Merage Foundation for U.S.–Israel Trade.

Koret–Milken Institute Fellow Profile: Noa Yehezkel

Noa Yehezkel, a 26-year-old first-year Koret–Milken Institute Fellow, chose the topic "Must Getting Older Condemn Israelis to Unemployment?" for her yearlong policy study. The paper is a groundbreaking assessment of Israeli laws and economic policies that prevent individuals over age 65 from obtaining employment. If implemented, her recommendations for reform, which are based on international comparisons, would make life easier for tens of thousands of Israelis. But the title is what best expresses Noa's approach to the issue: neither dry nor academic, it expresses her dismay at economic folly and personal degradation. Koret–Milken Institute Fellowship Program directors had no trouble awarding Noa a second-year fellowship.

The fellowship program, established by the Koret Foundation, provides annual fellowships to exemplary students to complete independent economic research on issues impeding small-business development, employment expansion and private-sector economic growth in Israel. The program is financed mainly by a grant from the Koret Foundation with additional assistance from the Milken Family Foundation, the Rosalinde and Arthur Gilbert Foundation and the Jewish Community Foundation of Los Angeles.

During the first year of her fellowship, Noa was posted in the office of MK Eliahu Gabai, a member of the Knesset's Economics Committee. She researched such topics as the implications of a negative income tax; the bureaucratic and budgetary savings that would result if small villages merged with cities; and the transportation infrastructure necessary to rebuild Israel's northern region. MK Gabai turned her data and analyses into policy initiatives, and her op-eds—for example, "The Importance of Small Businesses to the Economy" and "Issuing Municipal Bonds Instead of Pouring Money Down the Municipal Drain"—were published in Israeli dailies and Internet news sites.

In addition to researching her policy paper on employment for the elderly, which will be published in November, Noa was part of a team of fellows researching municipal bonds and innovative means of financing regional projects. She is taking an active role in the development of a bond bank for northern Israel that will seek to fund regional and municipal industrial, environment, transportation and tourism projects. Her enthusiasm and the data she gathered led to her being attached to a team of Milken Institute researchers headed by Professor Glenn Yago, and including members of Israel's ministries of industry and finance, and the Bank of Israel, which is seeking to encourage financial innovations.

Noa received a bachelor's degree with honors in business and economics at Haifa University in 2006 and begins her MBA this year at Hebrew University in Jerusalem. During her upcoming fellowship, she will be posted to the Finance Ministry, where she expects to work on municipal bond issues. "I want to be given a lot of work," she said before accepting the second-year fellowship, "and expect to work hard."

About the Israel Center

The Israel Center accelerates and supports Israel's path toward economic independence and broad-based prosperity through capital-market development, financial innovation and job creation.

About the Milken Institute

The Milken Institute is a publicly supported, nonpartisan, independent economic think tank whose work makes a difference in the lives of people worldwide by helping create a more democratic and efficient global economy. We do this by using capital-market principles and financial innovations to address some of our biggest social and economic challenges.

For more information, visit www.milkeninstitute.org.

For more information on the Jerusalem Center for Public Affairs publications on economic policy innovations go to: http://www.jcpa.org/jcprg7.htm

To join our efforts, please contact Mindy Silverstein at msilverstein@milkeninstitute.org or (310) 570-4634.