

## Chapter IV: Israel and the Global Challenge

### Introduction

In large part, Israel's accelerated process of integrating into the global world occurred simultaneously with - and even facilitated - its recuperation from the harsh economic crisis that peaked in the mid-1980s and continued into the 1990s. As a small nation lacking in natural resources, Israel took advantage of globalization's potential, enjoying the expansion of global openness and its newly-found access to large international markets.

The relatively small size of Israel's economy does not in itself preclude the benefits of the global economy. Israel's high-value-added products, based on knowledge, technology and innovation, have indeed earned strong returns in world markets.

Two basic themes lie at the foundation of globalization's development in Israel:

Since its inception, Israel's unique **geo-political position** has isolated it from its neighbors and prevented the forming of relations with the region's countries, while creating a continuous need for maintaining international economic relations with nations outside the region. Already in the 1960s, Israel began to venture into the world economy by initiating relations with the European Economic Community, which evolved into a free trade agreement in 1975. These connections later extended to other nations, chiefly the US. Israel's unique, close relations with the US produced the free trade agreement of 1985, which positioned Israel's foreign trade in an accelerated globalization mode. In its continued efforts to participate in the global economy, Israel unilaterally reduced tariffs in 1991, in order to make the economy more accessible to foreign trade.

The 1990s saw considerable acceleration of Israel's globalization process. Israel adopted a number of measures set by the international economic community. It bound its fiscal and monetary macro-economic policy to the principles of the Maastricht Treaty and the Washington Consensus. It instituted significant foreign currency reforms in order to make the shekel a tradable currency. Capital market reforms and the abolishment of controls over foreign currency laid the necessary groundwork for attracting foreign investors. The economy's competitiveness was continuously enhanced through minor and major structural changes, privatization and the development of primarily international high-tech industries, all of which shaped the Israeli economy's global identity from the end of the 1990s into the new millennium. One of the critical events in this regard was the Israeli government's entry into the credit rating system in 1995, a move that signified a willingness to be exposed to the international capital market and to international credit rating agencies. Political agreements, first with Egypt in the late 1970s, and most significantly in the 1990s with the Palestinians and Jordan, pushed the Israeli economy forward on the international front.

As a nation dispersed throughout the world for centuries, the Jewish people have been well-served by **Jewish tradition and heritage** over the years. In recent decades, the Jewish connection has been an influential factor in the global process; the Israeli expatriate community abroad has also contributed to this process.

All of these processes are at the foundation of the Israeli economy's growing force. The global process is gradual, continuous and ongoing and will continue in this direction in the future as well.

Globalization has penetrated many realms of Israeli economy and society, creating tensions between the ethos of a global, international, open and universal society, and the reality of Israel as a mobilized society still struggling with unique existential challenges.

The particular combination of the wish to continue to enjoy the global process with Israel's unique experience will continue to be pivotal over the next twenty years. Without taking a pessimistic stance regarding the political process in the region, it appears that even if significant progress is made in the peace process, we will not attain the complete calm that could free us completely of the burden of an embattled nation in a hostile region. Survival in this part of the world cannot rely solely on well-trained military strength. It requires a strong economy and a durable society as well. In the state of Israel, a strong economy that is able to support a durable society must include a substantial global element.

At the same time, we must consider a number of undesirable social phenomena that have accompanied Israel's integration into the global economy, especially as regards the labor market and other social issues.

Globalization has substantially altered the absolute and relative returns to education. In developed countries, the wage gap between educated and uneducated workers has grown significantly. In Israel as well, the wage/income gap has increased, due in large part to globalization's impact. This impact has been intensified by migration of workers to Israel and the growth of a large market of low-cost foreign workers employed at the bottom rung of the employment ladder, in conditions inferior to those of Israelis in the same occupations. The international migration of labor has increased globalization's contribution to the broadening of Israel's income gap. Large income gaps produce social gaps, undermine social cohesion and increase alienation and despair.

Globalization also carries the threat of a "brain drain". The economic and cultural changes involved in globalization threaten the anchors that connect Israelis with their homeland. On the other hand, the developed world encourages migration of an educated, skilled and entrepreneurial work force, and compensates well for these qualifications. This product is in high demand in a global world and there is competition for such workers. Israel has a relative abundance of people whose migration would be a considerable loss of human capital for the Israeli economy and society.

Therefore, complementary action must be taken now and in the future to decrease the risks posed by the processes of globalization, and to create the economic, social, cultural and personal conditions that will enhance Israel's appeal for its educated, skilled employees.

## International Experience

In recent decades, a number of European and Asian nations similar to Israel in size, some of which had a lower economic standard than Israel in the 1970s, have made great strides in their economic performance. In the framework of preparing this plan, these countries' successes and achievements were studied, and their experience served us in reaching a number of important conclusions. Four key issues were identified, in the following areas:

### 1. Institutions

Institutions formulate and enforce the "rules of the game". Proper functioning of public institutions is imperative for building an efficient, modern economy. Israel lags behind in this respect. Following are listed a number of Israel's areas of weakness, according to the World Economic Forum's report (the rankings are arranged by area; following are Israel's rankings out of the 131 countries that were evaluated):

**Reliability of police services - 53; public trust of politicians - 42; wastefulness of government spending - 38; organized crime - 36; diversion of public funds - 33; favoritism in decisions of government officials - 32; burden of government regulation - 31; firms' ethical conduct - 31.**

Many of the areas indicated above have to do with corruption and ethics. According to the "Transparency International" organization, Israel has declined in these areas in recent years. This constitutes an immediate, real threat. Investors steer clear of corrupt nations. We have found that the world leader in freedom from corruption is Finland, where a politician caught in a relatively minor ethical transgression is forced to resign.

### 2. Infrastructure

Israel's infrastructure standards are poor. Its land transportation density (roads and railways) is high. At Israel's ports, the cost of handling a single container is \$2000, three times the average of competitive nations. For a country whose engine of growth is exports, and which is significantly dependent upon import, the state of its ports impair economic success. Following are Israel's rankings as regards a number of its weaker infrastructure-related areas (out of 131 countries):

**Quality of port infrastructure - 37; quality of railroad infrastructure - 36; quality of roads - 30.**

### 3. Education

Israel's teachers are underpaid, underappreciated, and struggle with classes of 30-40 students (In Finland, for example, which ranks very high on competitive rankings, teachers have a Masters' degree, are held in high esteem and are well-paid. The number of students per class is twenty.). Israel's national expenditure on education does not reduce inequalities; rather, it increases gaps. The national expenditure per student is one of the lowest among developed nations. At the same time, the ratio of public expenditure for educational administration and management vs. allocation to schools and students is greater than in developed countries. The scope of expenditure per student and the structure of expenditure on education impair the effectiveness of education and teaching in Israel.

Due to the freezing of jobs offered at higher education institutions and cuts in research budgets, there is a brain drain; in a country that bases its competitive advantage on knowledge-intensive industries, this is a serious deficiency.

Following are Israel's rankings on education issues (out of 131 countries):

**Quality of primary education – 30; quality of math and science education – 31; quality of the school system – 25.**

### 4. Business Environment

**Israel is perceived as a country in which it is difficult to do business.** Taxes are high, bureaucracy is complicated, and the financial sector is backward and lacks sufficient foreign presence. Following are some of Israel's rankings in the more problematic areas pertaining to the business environment, out of 131 countries:

**Extent and effect of taxation - 68; time required to start a business - 67; total tax rate - 42; cost of firing a worker - 107; flexibility of wages - 65; rigidity of employment - 30; cooperation in labor-employer relations - 30; brain drain - 26; regulation of securities exchanges - 29; soundness of banks - 27; restriction on capital flows - 25.**

According to the World Bank's "Ease of Doing Business" indexes for 178 countries, Israel ranks only 109 in "dealing with licenses"; 87 in "ease of employing workers"; 152 in "registering property" (at the Land Registry Bureau); 69 in "ease of paying taxes"; 102 in "ease of enforcing contracts"; and 40 in "ease of closing a business". None of these defects is necessary. Singapore, for example, ranks at or near the top in all these areas. But in Israel complacency reigns, and businesses have learned to deal with impediments to efficiency, rather than attempt to change them.

**In today's global marketplace, Israel competes with some 200 other countries for capital, exports, jobs and technology. Many of these countries are small, agile, focused, and have business environments that welcome foreign capital and corporations and they are improving. If Israel fails to resolve its problems noted above, there is a real risk that it will quickly fall behind its rapidly-improving competitors.**

The World Economic Forum asked a sample of Israeli managers and businesspersons to list the most problematic factors that hinder them in doing business. A list of 14 factors was presented, and respondents were asked to select the five most problematic factors for doing business. The three issues selected as most problematic were inefficient government bureaucracy, high tax rates and political instability.

Taxes and bureaucracy ranked high, and both are relatively straightforward to solve. Estonia, for instance, implemented a flat-tax system: 22 % on income, without exemptions or deductions, and zero percent on corporate profits, as long as they are retained in the business. Can Israel adopt and adapt solutions to problems developed in small, wealthy, competitive countries, by adapting solutions to its own needs and situation? Such solutions are possible **if a global benchmarking mindset is cultivated, at the policy decision-making level. Israel accepts waste, inefficiency, bureaucracy, corruption and delays as facts of life, rather than as challenges that can be successfully addressed.**

The chapters of this plan address each of the abovementioned areas, and make recommendations for policy change, in order to bring about significant improvements in the economy's and society's performance and to enhance social cohesion.

## Vision and Strategy

We envision an Israeli economy that ranks among the 10-15 leading countries of the world, ten rankings higher than its current standing. This is not a simple or easy objective, but one that will necessitate proactive Israeli policy in all economic, social, cultural and governmental areas, in order for Israel to become well-integrated in the global realm, while taking into consideration the small size of Israel's domestic market and its limited ability to participate in the regional economy. Increasing Israel's GDP per capita to over \$50,000 (in 2007 terms), as compared with about \$23,000 in 2007, necessitates proactive policy to integrate Israel into the global process.

Israel's participation in the global process requires providing skills to more people, businesses and organizations in Israel in order to adapt to and contend with the global world. In this complex reality, Israel must adopt a comprehensive strategy of excellence, in order to enable it strong survival ability and success in a competitive world. Excellence requires adopting standards of quality in various realms, and employing innovation in varied realms, not exclusively in

technological or knowledge-based industries. It must be broad and comprehensive, and include government and the entire business sector. Knowledge-based industries are the driving force of the economic world. Israel must continue strengthening this element in its economy in all interfacing fields: education, higher education, academic research, research and development and technology. The required conditions for realizing this comprehensive strategy are the existence of a quality competitive business system, quality government and public administration, social equality, modern infrastructures, satisfactory governability and an economic environment that supports initiative.

## Principles of Policy for Integrating into the Global World

This plan has identified a number of basic principles for policy, based on international experience as well as Israel's experience over the past twenty years. These principles are necessary for participation in globalization and producing the benefits of the global process, and are common to all successful nations that have reaped the full returns of globalization:

1. A strong capacity for **economic competitiveness** that relies on high productivity. A high level of competitiveness is key for maintaining a strong, functional economy. The Israeli economy must be highly competitive in foreign as well as **domestic** markets. Israeli products must compete in world markets while maintaining competitiveness vis-à-vis international competitors in domestic markets. Maintaining competitiveness is of vital importance to the economy, comparable to maintaining deterrence capability and military capacity.
2. Implementing stable **macro-economic policy** that requires maintaining the central macro-economic parameters: price stability, exchange rate stability, keeping a balanced or near-balanced budget, and reducing public **debt** to a low level. Fiscal and monetary responsibility is a basic condition for maintaining a functioning economy under globalization.
3. Maintaining a **high level of governability**. The global world gives high marks to effective, non-corrupt governments. An effective government is a transparent government with clear, non-arbitrary regulations; effective public services run in a consumer-friendly manner; a reliable legal system that strictly safeguards the rules of private property; a complete range of economic and social rights; and an egalitarian law enforcement system that stands for reward and punishment.
4. Maintaining **reliable, accessible physical national infrastructures**. Transportation systems must be highly efficient and reliable; the infrastructure system must be modern; infrastructure services connecting the Israeli economy to the world such as sea and air ports must be open and accessible; communication services (telephone, internet, cellular, etc.) must be effective and consistent with the acceptable standards of the most developed nations; basic infrastructure systems of electricity, water, energy and gas must be reliable and accessible to all consumers.

## Recommendations

The globalization process lends itself to ongoing benchmarking between nations of the world. This comparative process has been employed continuously and intensively in various fields for a number of years. It is difficult to compare Israel with another, seemingly similar economy, just as there will almost always be differences between Israel's fundamental political and cultural situation and that of other countries. Nonetheless, the comparative process is a very established, even central, practice as regards globalization, and Israel must continually and comprehensively engage in benchmarking. The various measures published by international groups such as the International Economic Forum and the IMD, or international institutions such as the International Monetary Fund and the World Bank, allow Israel to be ranked in the various categories, and particularly call the attention of Israeli policy-makers to the weaker points of Israeli economy, government or society. If, for example, various measures indicate a decrease in Israel's visibility in the realm of quality of government, rule of law, government stability and the fight against corruption, Israel's image suffers vis-à-vis foreign investors and financial markets.

The plan makes several key recommendations for Israel on the basis of analyses of the cumulative knowledge of countries with economies somewhat similar to that of Israel. These economies – including Ireland, Finland, Denmark, Sweden, Singapore, Estonia and Taiwan - have shown rapid growth over time and sound global integration. The analysis included numerous parameters that extended beyond the narrow economic perspective, to include administration, education, culture, law, etc., certain primary conclusions were reached that should be adopted in Israel.

The major conclusion is that some of the successful nations of the last two decades have adopted strategic plans that define a complete, appropriate, and comprehensive strategy for each country, which integrates objectives, takes into account countries' limitations, and incorporates far-reaching and comprehensive economic and social policies in many realms, while building the appropriate institutional systems through which to implement them.

Establishing institutions is an essential step that is based on political partnerships between the economy's various players, primarily the government, the business sector and workers, and the development of the professional capabilities required for the global process. The building of institutions and processes appropriate for the needs of the future requires a great effort, as it involves both building for the future and changing past practices.

Following is a summary of the key recommendations for successful integration into the world economy. The first three recommendations relate to the institutional structures required for realizing globalization and the other objectives recommended by the task force (see also Chapter V).

1. As strong domestic and foreign competitiveness capability is critical for global success, an appropriate institutional system must be established to ensure the maintenance of this advantage over time. It is recommended to establish a **National Council for Competitiveness**

**and Globalization** adjacent to the Ministry of Industry, Trade and Labor, which will release an annual report on the state of competitiveness, to be debated in government at least once a year. The Council must comprise both a professional tier and a public tier, and include economic and business representatives. The government must be represented by professional employees and ministers.

2. The **National Council on Economy and Society** located in the Prime Minister's office must be the focal point for assessing Israel's progress in the various economic areas (growth, unemployment, investments, and balance of payments) as well as social areas (income disparities and the standard of public services). One of the Council's main responsibilities is to lead the necessary reforms, along with the Finance Ministry, aimed at attaining a reasonable level of flexibility in the Israeli economy, as well as to closely follow the progress of the economy and society in achieving the objectives set by the government.
3. A **National Science and Technology Council** is to be established, to assess science/technology and higher education policies on an ongoing basis, as regards "supply" aspects of educated and skilled manpower for Israel for the long term, employing a systemic view at the levels of government and business. It will evaluate and recommend specific priority areas requiring attention (see Chapter VI). The Chief Scientist in the Ministry of Industry, Trade and Labor will continue in the future to serve as the agent for implementing and developing policy on a day-to-day basis and advancing knowledge-based industries using the assistance tools at his disposal.
4. The abovementioned Councils are distinct yet complementary. Their work will be **coordinated** by the Prime Minister's Office. Coordination meetings of the Councils' heads and bodies involved in policy and implementation, such as the Budget Department in the Finance Ministry, should be held once monthly. As implementing bodies, the Investment Center and the Foreign Trade Administration in the Ministry of Industry, Trade and Labor, must adapt to the policies and objectives set by the National Council for Competitiveness and Globalization, the National Council on Economy and Society and the National Science and Technology Council.
5. The **Bank of Israel** must maintain its **independent status** in its traditional monetary roles as regards the maintenance of price stability. The existence of a well-functioning central bank is an important consideration for foreign investors. The central bank must, however, also be attentive to the market's needs in the areas of growth and employment.
6. The state's physical **national infrastructures** mentioned above, as an essential condition for successful integration into globalization, must be coordinated through a functional government planning system with respect to all physical infrastructures (see recommendations in Chapter XI).

- 7. Flexible employment policy** is essential in order to attain social and economic achievements. This policy will be led by the Ministry of Labor in its new format, which will replace the Ministry of Industry, Trade and Labor, in coordination with the National Council on Economy and Society. The labor market, regarding which recommendations are made in Chapter IX, is of great importance under extensive globalization, as rapid changes affect many of the economy's workers and their ability to integrate properly into the labor market. In this realm, special attention should be directed to two groups that are not adequately integrated in the labor market – Arab women and ultra-Orthodox men. The labor market is an important, central framework that facilitates the participation of the general citizenry in economic and social objectives.
- 8.** Success in the international arena depends upon sound, efficient utilization of manpower in economy and society, and upon the existence of an education system that provides broad education and prepares its students for the higher tiers of the labor market. In order to achieve this essential goal, we must define shared **core studies** for all schools in Israel, in which students will learn Hebrew, math, social studies, English and sciences. The basic curriculum is essential for creating a shared social/national basis and providing skills that facilitate integration into the labor market.
- 9.** Long-term forecasts must be constructed to **map the skills** required for the future, in order to update curricula at relevant levels of education accordingly, to ensure the existence of appropriate future manpower for economic and social needs, in view of the extended training and adjustment periods.
- 10. Openness to the world and close cooperation with world players** are important conditions for adapting to the global process. Israel's higher education will profit if Israel brings in students from around the world to study in Israel; doctoral students who come to study in Israel will greatly benefit higher education and the culture of openness so crucial for globalization. Economic and social openness is also exemplified by consulting with executives and experts from abroad.
- 11.** Israel's **tax policy** must adapt to the trends in the tax systems of nations competing with Israel in the international capital market, especially as regards corporate taxes. Lower corporate taxes are preferable to special tax benefits given to favored sectors. Tax policy is measured not only by its tax rates, but also by its simplicity and efficiency.
- 12.** We must adopt a permanent strategy of a **balance of payments surplus**. This is customary strategy in small countries that rely on a well-developed, competitive export sector. Thus the Israeli economy will be better protected from fluctuations in the international capital market, and fiscal stability along with economic stability will be better maintained.

13. Israel's success in the field of knowledge-based industries and technology requires the continued creation of large, export oriented **Israeli global companies** (see more below). Thus high added economic value will be created, as will employment opportunities for a broader range of employees, over a longer time period.

## Developments in World Markets

For nearly twenty years, the global economic world has been undergoing significant changes. The growth of new economies in Asia is becoming a significant economic event, affecting Israel's economy as well. In terms of historical processes, globalization is relatively rapid. As a small market in the world arena, Israel must adapt to world developments and set a policy of worldwide risk-dispersal. Nevertheless, because of its relatively small size in world trade, Israel can choose in which markets to specialize, as each market in itself can serve as a base for growth. The Israeli economy currently makes up 0.4% of the world product. Even if we improve our performance we will still be at the level of 0.5-0.6% of the world product, allowing us adequate flexibility to integrate into the large economies. This presupposes that the Israeli economy maintains a high competitiveness capability in the coming years. Business choices at both the national and the business levels must be informed by a good understanding of world economic developments, which are based not only on the ability to predict macro-economic trends indicating the rise of countries such as China and India, but also on a grasp of countries' or blocs' sectoral processes and national strategies, as well as international trends.

The relatively rapid changes occurring at international centers of gravity are creating a chain reaction in additional circles of the global world. The rapid growth, especially in Asia, has created a growing demand for raw materials and natural resources. It also apparently impacts indirectly upon global warming. Climate change has far-reaching economic implications. Among other things, global warming causes a rise in the cost of food staples, which is already being evidenced. The expected outcome for the coming years is a trend of increased cost for raw materials, food and energy, which will impact upon Israel's economy by making these components of foreign trade more expensive. To compensate for the worsening in trade conditions, greater efforts will have to be made to export high-value-added products. While Israel can tolerate this burden, it needs to prepare by adopting an economizing policy and by finding inexpensive alternatives, from alternative energy sources through energy-efficient production methods (for more on infrastructure and the environment, see Chapters X and XI).

In twenty years, Asia will have over 40% of the world product, as compared with under 20% today. The relative growth in Asia's economic activity is not merely quantitative but also involves qualitative production aspects. Understanding these processes is important. The potential risks posed by globalization may be considerable, including the entry of new players, but also offer new opportunities for the Israeli economy.

The architecture of the world economy is poised for change as regards economic power centers, changes in social norms and the reshaping of relations between countries, markets, companies and consumers. Globalization produces great benefits to the citizens of poor, developing countries by facilitating growth and increasing income. However, the opponents of globalization are the poor and even some of the middle-class in the developed world, who see this process as threatening their status. These changes will produce shifts in the world order as India, China, Brazil and Russia become more significant. Despite the high economic growth of Asian countries, the West will apparently maintain its economic hegemony over the next two decades. During this time period, the emerging economies' high growth rates will not afford them the economic maturity needed to become international economic leaders. Such leadership requires well-developed capital markets, high-standard legal systems and governability, and sufficient control over raw material and energy markets. These developments are likely to occur in subsequent years. Nonetheless, the US and Europe cannot ignore the new challenges they face, particularly in the financial realm. Nor can Israel remain unprepared.

## Israel in a Global World

The central question facing Israel's economy will be, "What are Israel's comparative advantages in a rapidly-developing and changing world?" In recent years, Asia has established a business structure in which leading countries specialize in leading sectoral focal points: Japan specializes in consumer goods, Taiwan in device production, China in assembly and India in outsourcing of various technical services. There is no doubt that these specializations will change over the next twenty years. In any case, Israel will not be able to compete with any of these specializations. Israel has limited manpower and cannot compete with Asia's large populated countries: China, India, Pakistan, Japan, Bangladesh, and Indonesia make up about half of the world's population. Israel's policy needs to be to maintain an economic foothold and cooperate with all the large developing economic blocs. **Israel should strengthen its Asian connections, particularly with the two large growth economies -- India and China.** China, whose rapidly-growing economy is a significant market for Israeli products, aspires to attain leading economic and political status in the world, and is an important economic target for Israel. Despite cultural and language barriers and other challenges, the efforts that have begun should be intensified to create close cooperation with this country. Economic relations should also be strengthened with India, a rapidly-growing economy in which Israel has already established an impressive presence. The current potential for continued development of economic relations with India is based on that country's relative affinity to the democratic tradition, its large middle-class of 300 million people, its spoken English and the stability and clarity of its economic system.

**The recommended policy for strengthening Israel's economic ties with the Asian continent will not compromise the nurturing of the close relations Israel has created over the years**

**with the US and Europe.** The Western nations' (US and Europe) maturity and achievements continue to give them a considerable advantage in world competition. Relations with Europe and the US are an important asset of Israel's economy, and are currently the basis for globalization's rise in Israel. The economically-united Europe is a relatively close market geographically. Israel's close relationship with the European Union's institutions must continue. Israel's economic relations with the US are very advanced and offer many economic as well as political and cultural advantages. The US will probably remain the leading economic force over the next twenty years, despite the growth of countries in Asia and elsewhere. Israel's continued economic development of knowledge- and technology-based industries will provide a basis for future cooperation with the US economy. For many years, the US has shown outstanding resiliency under changing circumstances, allowing it to maintain economic dominance in the world economy. It can be assumed that this capacity will continue to serve the US in the future, and therefore the very close economic relations between both economies will benefit Israeli growth and development. Developing relations with the US and Europe requires close emulation of the high standards they will create, in order to **avoid lagging behind in implementing these standards** given the Israeli conditions, as the global process requires.

One of the dangers of the global process is that of counter-reaction ("economic protectionism") by developed countries that are concerned about the competition posed by developing countries' inexpensive products and services. It is in Israel's great interest to maintain open international trade. It must oppose protectionist policies restricting world trade, as they do not serve the Israeli interest, which is based on good accessibility of all world markets. Israeli policymakers **must not retreat from the Israeli market's current openness**, regardless of short-term considerations.

Israel must **specialize and focus on innovative and creative activity**, which should include creating intellectual properties on the one hand, and innovative and creative business models for services and traditional industries on the other. Cooperation with the large new economic forces will be an important source of growth and high added value for the economy. In the future, we must strengthen the overall systemic impact of the research stage, and combine it with development, aiming to expand the base of Israel's economy.

The rapid growth of emerging economies alongside the growth of established economies and acceleration of the global process carry with them the dangerous phenomenon of global warming. According to the 4<sup>th</sup> report of the Intergovernmental Panel on Climate Change, solid scientific analysis projects that this development will continue over the coming years, primarily as a result of greenhouse gas emissions caused by humans. Like the rest of the world's countries, Israel will be negatively affected by global warming, and as part of the global world, Israel must join the international efforts to address these worrisome developments. Israel's ability to join international

organizations will depend on its ability to meet stringent conditions, such as those required by the OECD. These requirements involve an increased public and private economic burden (see Chapter X); nonetheless, Israel can leverage this field for economic and technological growth, by taking advantage as in the past Israeli research and development and knowledge that may create productive business activity.

## The Need to Create Global Companies in Israel

The international economic system encourages the creation of large companies whose arena is the entire world, or even relatively small companies that are established from the outset as global companies. Israel's economic strategy for the next twenty years must place an emphasis on the need to create large and medium-sized companies that can succeed globally, in the 21<sup>st</sup> century's arena of world competition. The Jewish Diaspora and the increased presence of Israelis in the world's large corporations may help create connections for building global Israeli companies.

Creating large global companies whose management headquarters are based in Israel is important, because of the diversity of the jobs they can offer in Israel, extending beyond the technological occupations. Offering a wide range of quality jobs is important because it can provide employment for the entire range of abilities and desires of Israeli workers. The job supply will extend beyond employment in the global company itself, to all the services and products the company purchases in Israel. This is in fact a complete model of a post-industrial society that maintains a high per capita income level. It characterizes all the developed countries that were industrial nations up until 20-30 years ago and whose economies were eventually driven by the high-value-added services sector.

The recruitment capabilities of large Israeli companies wishing to integrate into the global economy are concentrated in the capital market – the most global market, the market of all markets, and a major driving force in the world's global process. Competition over international capital will certainly require that companies be of high quality and meet high international standards, as well as the existence of a quality governmental system that earns the trust of the financial markets.

Some 15 Israeli industrial companies currently operate whose sales exceed over \$1 billion a year; these companies have prominent global characteristics. Another some 15 services companies also have the potential to integrate into the global corporate world (especially in the fields of communications, transport and energy), with sales exceeding \$1 billion per year. Only one Israeli company (Teva) has global sales of over \$5 billion (in fact, Teva is currently approaching \$10 billion in sales); it also fulfills global criteria. This plan presents the economy with an ambitious but crucial goal for integration into the global process: the creation of at least one new company

a year with sales of over \$1 billion, and the creation of three global companies every ten years with sales exceeding \$2.5 billion, whose business headquarters are based in Israel. Ultimately, the aim is to create, over the next twenty years, at least three Israeli companies whose business center is in Israel and whose sales exceed \$5 billion a year, one of which will reach \$10 billion. The global Israeli companies will not necessarily be from the advanced knowledge industry; they may come from a wide variety of sectors. World-wide, even companies with sales of a few billion dollars are not considered to be large global companies, but for Israel, the absence of a group of large companies will render Israel's participation inadequate, even imperceptible, in international markets. Creation of global Israeli companies will bring Israel closer to the objective of successful integration in the global process and its positioning among the top 10-15 economies in the world.

Business models for global integration are not based on one single route. We envision three primary routes for firms' global integration:

- Growth of an Israeli company which controls international operational systems that has its business center, central functions and management headquarters are in Israel.
- Integration of an Israeli company into global companies while continuing to carry out focused, defined activity, first and foremost management in Israel.
- Purchasing of advanced global-standard knowledge in the field of products or services by an Israeli company that sells to both foreign and domestic markets.

These are feasible and acceptable models for global companies, drawn from international business experience. Each route involves the "upward pull" of productivity and competitiveness that enable the growth of such companies, as necessitated by process of integration of Israeli companies into the global business landscape.

## Potential and Objectives for Creating Global Companies

Beyond the 15 industrial companies that are already integrating in the global process to various degrees of success, about 75 others have been identified that have current sales of over \$100 million a year, a large export component and the foundations for a global management outlook. Twenty-five of them already have sales in excess of \$250 million. This reservoir of companies lays the foundations for Israel's future global companies. Of course, over the next twenty years, companies may develop from outside of the reservoir of currently-existing large companies.

Over the past twenty years, Israel has shown an impressive ability to create knowledge- and technology-based companies that are the product of original Israeli research and development. Only a few have established a broad industrial base with Israeli business headquarters whose aim is to create an international global company. In Israel's economic conditions of the past

twenty years, the strategy of selling companies abroad made sense, in view of the absence of management and marketing experience and the lack of convenient funding arrangements. Selling companies in their early stages was an important phase in the development of the Israeli economy, bringing in considerable sums of foreign currency, which substantially improved Israel's balance of payments over the last decade.

The great challenge for the coming years will be creating a formula for the creation of companies, instead of selling them abroad. Maturation of the Israeli economy, various reforms and overall growth have all improved conditions for the development of Israeli companies based on entrepreneurship, knowledge and technology, whose center of activity is in Israel and which will be capable of adopting one or more of the existing business models for establishing a global Israeli company. The success of companies that transferred their business centers abroad indicates the soundness of their business models. Assuming that improvements will be made in background conditions and Israeli business culture, it will be possible to realize this potential in Israel as well. All factors involved in past successes must now be integrated and applied in Israel. The shift to building larger companies will require changes in venture capital fund policy, as well as additional mechanisms for later-stage funding. As Israel's management tradition is developing slowly, it may be wise to consider taking on skilled executives from abroad to help improve management. Maturation of the technology industry and venture capital policy may produce more experienced executives, who will help to establish the growth of large global companies. Appropriate incentives should be put in place to encourage this course of development.

The future global companies and the Israeli government will have to contend with a number of challenges in order to assure these companies' successful growth to Israel's greatest advantage:

1. As stated, these new growth companies must be based in Israel. Their products or services must have excellent competitiveness capability that will "capture the world" by virtue of an excellent business model. These companies may emulate and seek the assistance of companies that have already done this.
2. In some cases, **mergers** between Israeli companies involved in related fields may create a critical mass in the areas of management, production, marketing and funding and bring the firms into the global international market. This route may create large companies (in security industries or water-related agricultural equipment industries, for example). It will be necessary to assess antitrust aspects in the global economic context, and to make arrangements that take into consideration the merger's overall contribution to the Israeli economy, on a case by case basis.
3. Israeli companies entering the global markets in the future must be **prepared for tough, even cruel, competition** vis-à-vis global companies that operate in these markets. We

must build appropriate capabilities in order to contend appropriately and successfully. Part of the success of future companies will depend upon the **conditions of the economic environment** serving as the business sector's "economic home front". Israeli infrastructure must be of a high standard as regards all its components beyond physical infrastructures, including the capital market, a quality banking system, a high level of business services and quality manpower.

4. Due to the small size of Israel's economy and domestic market, the success of Israeli companies **cannot be founded on a large, developed domestic market** that serves as a protected "home port" and provides companies with a competitive advantage before they venture into international markets. We must, however, take advantage of domestic markets such as the security and medical markets, whose sophisticated local clients make them a worthy base for creating a competitive advantage.
5. With the exception of Israel Chemicals, Israel does not have the option of growing large companies based on economic returns from natural resources. **The future global companies will all be based on knowledge, technology and innovation.**
6. Companies whose growth may place them in the global arena will be based on one of the following three basic processes: business **innovation** based on technology/engineering; international **leadership** in specific products or services; creation and distribution of a **new business model**. These strategies involve abundant sophisticated and skilled management, and integrate clear business discipline and boldness.
  - 6.1. In the past, the strategy of **business innovation** based on technology/engineering generated considerable business enterprise activity, especially at the stage of research and development, on the basis of leadership in a world category. Conditions should be created in the future that support business development and the creation of large companies that are based on manufacturing and marketing for export as well.
  - 6.2. The strategy of **world leadership** in a products or services category requires focusing on government support, which will set business objectives for the company: attaining high ranking in its field within a given number of years. This will involve presentation of a clear business model and a controlled, milestone-driven strategy, upon which assistance and encouragement will be based.
  - 6.3. The strategy of creating a **new business model** and distributing it to a number of target countries simultaneously requires business development, complex transaction management, integrating forces in regional enterprises in multiple countries, and marketing capabilities.

7. Global companies require good executives who understand how to operate in global markets. **Executive Education** of the required standard may be attained via a number of routes: gradual maturation in the Israeli business world; growth of Israeli managers in international corporations; or studying in management schools in Israel and abroad. When training executives in Israel, programs should integrate international content and English language in the curriculum.

At this stage, we must locate companies that are candidates for rapid growth and identify an appropriate **strategic model** for each, after assessing external benefits to the economy and in certain cases, evaluating a designated support track.

Successful establishment of global companies during the initial years of the plan's implementation will in turn increase the number of companies that are developed, expanding the reservoir of companies with global potential. If there are currently about 75 potentially global companies, we may assume a doubling of this figure within 5-7 years. The reservoir of companies will produce a natural pyramid, which will fulfill the objective of creating at least one global company per year with sales exceeding \$1 billion, three every decade with sales exceeding \$2.5 billion and at least three over a period of 20 years with sales over \$5 billion, including one with sales of at least \$10 billion. Creating global companies has already become a regular feature of the "small" economies of Ireland, Finland, Singapore, Sweden, and Taiwan and has enabled them to maintain high growth and a high standard of living for their residents.