



Speaking truth to power

ONE OF the key foundations of democracy is under assault, in Israel and the US. It is the ability of experts to speak truth to power and the willingness of political leaders to listen to what they say.

In the US, President Donald Trump appointed Larry Kudlow as head of his National Economic Council. Kudlow thus becomes a key architect of US economic policy.

According to *The New York Times*, Kudlow said, “The president likes me as a media communicator, so I will be happy to oblige.”

Kudlow’s zeal “had led him to issue some predictions that...were wildly wrong,” noted *The Times*, and he denied two recessions that were already well under way during the administration of former president George W. Bush. Kudlow will “speak power to truth” – aligning truth with whatever his boss says and believes, just as Trump does. Trump regularly labels truth as “fake news.”

Similarly, in Israel, as Bank of Israel Governor Karnit Flug issues the bank’s 2018 annual report with mild criticism of Finance Minister Moshe Kahlon’s housing policy, Kahlon threatens to replace her this November.

Dr. Flug has headed the Bank of Israel since November 2013, prior to heading Bank of Israel research. She has proved quiet, effective and steady in the job guiding monetary policy and interest rates that made Israel’s economy perform better than its OECD counterparts.

Her deputy Dr. Nadine Baudot-Trajtenberg, appointed by Flug in March 2014, has been equally effective, especially in battling the strong shekel-dollar exchange rate, and building and managing Israel’s foreign exchange reserves. These two women do their jobs without the bloated egos that afflict men in similar positions. Yet, few Israelis recognize the name Baudot-Trajtenberg except in the context of her noted husband, Prof. Manuel Trajtenberg.

Kahlon’s search committee may well end up firing both Flug and, as a consequence, Baudot-Trajtenberg. According to the daily



BRENDAN MCDERMID / REUTERS

Economic analyst Larry Kudlow appears on CNBC at the New York Stock Exchange on March 7, 2018

Haaretz, “Unofficial Treasury sources were telling the media that Kahlon would not be asking Flug to stay on when her current five-year term ends.”

In Israel and the US today, “speaking truth to power” will likely cost you your job.

“Kahlon vs. Flug” (see *The Jerusalem Report*, April 18, 2016) is not new. I wrote about the conflict between these two people two years ago. At the time, Flug strongly supported bank stability (i.e. profitability), while Kahlon wanted more banking competition. I felt truth, at the time, favored Kahlon.

Now, the key issue is Kahlon’s program to subsidize the cost of new apartments for those in need. Like a roulette player, Kahlon has gambled all his chips on this program. Meanwhile, from September to Decem-

ber 2017, housing prices did fall by 2.1%. Kahlon thinks this fragile short-term fall vindicates his program, even though overall, housing prices rose by 1.2% in 2017.

Bank of Israel experts say the program will actually cause the price of apartments to rise. Why? Simple – all prices are determined by supply and demand. If you boost demand, without boosting supply, by paying a subsidy, you get higher prices. And the number of new housing starts (supply) actually declined sharply in 2017, to under 50,000.

This is the basic truth Flug is now speaking to power. And she is mandated by law to do it. The 2010 Bank of Israel Law requires the bank to give impartial economic policy advice to the government. But Kahlon won’t listen.

I can understand, and even sympathize with Kahlon's frustration. He has been finance minister for more than three years. He has been pretty good at the job. He has tried to help middle- and low-income groups with his Net Family program and tax cuts, costing the state budget some 12 billion shekels (\$3.4b).

Yet polls show his Kulanu party will lose heavily in the next election. Meanwhile, Yair Lapid's Yesh Atid party is soaring in the polls, rivalling the Likud as the second biggest party, even though Lapid, as Kahlon's predecessor in the Finance Ministry, was a disaster. Go figure! No wonder Kahlon is riled.

Here is a brief summary of the key points in the Bank of Israel Annual Report, issued on Wednesday March 28, just before Passover.

High marks for Kahlon: As editor of the business daily TheMarker, Sami Peretz observed that in many cases Kahlon gets high marks in the report for his policies.

In her opening letter, Flug recounts: "This year [2017], GDP grew by 3.4%... and presented a more balanced composition as the growth rate of exports accelerated. ... the unemployment rate continued to decline, reaching its lowest level in decades... [2017] was the first year since 2014 that the rate [of inflation] was positive, 0.4%... The Numerator Law [a financial accountability law, which says any new program will have to be offset through cuts elsewhere or new taxes], was put into effect for the first time this year [2017] and contributes to transparency in terms of the government's future obligations."

The report notes that during 2017, public debt as a fraction of GDP declined, owing to one-time tax receipts (mainly an amnesty for tax evaders). "The incidence of poverty declined in recent years to the level seen at the end of the 1990s, thanks to the... measures taken by the government to increase employment, though the incidence of poverty and inequality in net income remains higher than in most OECD countries."

Moreover, increased competition and openness contributed to an increase in productivity in industries geared to the domestic market. Export activity has been diverted from manufacturing to advanced service industries.

The Bank of Israel pats itself on the back,

noting that inflation remains low because the "Bank of Israel decided to avoid unconventional monetary accommodation measures such as a negative interest rate [as adopted in the European Union]."

Housing supply: The section in the report that miffed Kahlon relates to his Buyer's Price (subsidy) program: "The increase in home prices... is a result of the limits on the supply of homes caused by the marketing of land, the approvals process for plans, and the process of construction itself. Supply cannot adjust rapidly enough... The Buyer's Price program encourages demand on the part of young couples but does not provide an immediate response to that demand..."

Shekel-dollar: "In 2017, the Bank of Israel purchased about \$6.5b. (\$1.5b. of which was to offset the effects of natural gas production)." Sale of natural gas creates a supply of dollars, which causes the shekel to appreciate.

Online purchases: "The volume of online purchases by households has increased, which is intensifying competition in the economy [and causing] sharper price declines..."

Investment: "Institutional investors in Israel, who manage close to half the economy's total financial portfolio, invest very little resources in venture capital, compared with similar financial institutions abroad, partly because of Israel's unique financial regulation."

Labor income: "Like other OECD countries, the share of labor in national income has declined since the 1990s. Unlike most other countries, the share of labor income has continued to fall even after the recovery from the 2008 financial crisis... The tight labor market, though, has brought a sharp rise in labor's share of income in 2017."

Budget deficit: "The government budget deficit in 2017 was 2% of GDP, lower than in 2016, while the ratio of public debt to GDP fell to 60.8%, lower than the OECD average."

Net Family Program: "The Net Family Program... improved the situation of working families in all income quintiles and has reduced poverty."

Higher education: "Israel's comparative advantage is based on human capital and higher education. This places a heavy responsibility on the government to improve

public higher education, to improve student achievement at all levels of education, and to train academics in science and engineering... The shortage of graduates (in engineering and science), though, is growing and limits the growth potential of the economy."

Social policy: "In January 2018, the government approved a reform in public long-term care for the elderly, at a cost of 1.8b. shekels. This will improve public services for the elderly and reduce the economic burden on families."

When I work with managers, I try to persuade them that speaking truth to power is not only good ethics, it is primarily good business. Yet frequently, senior management, just like our political leaders, does not want to hear the truth.

"Kill the messenger" is a phrase used to describe the act of blaming the bearer of bad news, even if true. Bigots often regard those who speak truth as disloyal – a sin far worse than lying. This is why Trump has fired a record number of his appointees; 37 administration officials have been fired or have quit in the past year or so.

The time has come to fight back. As the voices of objective journalists, scholars and experts are drowned out by the cacophony of biased news, as the Netanyahu family faces possible indictment for seeking to corrupt news media in their favor, those who know the truth are obliged to speak it, forcefully and often.

Klug must be reappointed. She merits it. Her team of first-rate Bank of Israel economists must not, cannot, be ignored.

According to *Bamidbar Rabba* (a part of the *Midrash*, an ancient commentary on Scriptures), a key principle of Torah study is "the Torah has 70 faces," meaning that there are 70 interpretations to everything. So does economic truth.

Vigorous debate over economic policy is a hallmark of strong democratic systems. Those who see only one "face" – the one favorable to their ideas and policies – do immense damage to their nation and its democratic health. Let's hope Kahlon faces reality and listens to those who speak truth. ■

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