



# A woman's job

All Karnit Flug has to do is stabilize the currency, battle inflation and deflation, cool housing prices, and fight inequality and poverty

**THE LATE** British prime minister Margaret Thatcher, the Iron Lady, once remarked, “If you want something said, ask a man; if you want something done, ask a woman.”

Thatcher died in April. If she were still alive, she would have relished the recent Israeli comic opera that lasted 112 days. In it, bumbling men (mainly Prime Minister Benjamin Netanyahu) tried to appoint a replacement for former Bank of Israel governor Stanley Fischer, who left office at the end of June after six eventful years. Other bumbling men sought and then quit the race for the job. Meanwhile a reserved, capable person, who had served as deputy governor since July 2011 and was initially rejected as a candidate for the post, said nothing and finally won the appointment – when, at last, the men asked a woman.

First, former Bank of Israel governor Jacob Frankel, who served two terms in the post, from 1991 to 2000, dropped out of the race in July, saying that he was being “burned at the stake” over an alleged shoplifting incident at Hong Kong Airport in 2006.

Thereafter, Netanyahu and Finance Minister Yair Lapid chose a new candidate, Bank Hapoalim chief economist Prof. Leo Leiderman. The central bank's deputy governor, and temporary acting governor, Dr. Karnit Flug, then quietly announced she was resigning, even though she was reportedly highly recommended by Fischer for the job and had successfully headed the Research Department of the bank for a decade. Leiderman, however, dropped out in late Au-

gust, saying he wanted to remain a “private citizen.” There were rumors in the press about his interest in astrology.

Flug, therefore, remained on the job, making tough decisions as Netanyahu and Lapid sought a new candidate.

Netanyahu reportedly favored Mario Blejcer, who had a stormy tenure as head of Argentina's central bank and is mentioned in a class action suit filed by shareholders of Argentina's nationalized oil company, YPF. Lapid, for his part, favored Flug. Lapid won, and Flug formally took over as governor on November 13.

THE WEAK ECONOMY  
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Throughout the four-month process, Flug maintained her dignity, ran the bank's affairs, made tough decisions, and said little. A firm Bank of Israel loyalist, her laconic press release said she looked forward to working “in full cooperation with the professional and dedicated staff of the Bank of Israel, as well as with government officials, to meet [significant] challenges,” notably putting government after the bank staff.

There are strong similarities between new-

ly appointed Governor Flug and the newly nominated chair of the US Federal Reserve Board of Governors Janet Yellen, who replaces Ben Bernanke. Both are women, Jewish, and are married to top economists (Yellen is married to Nobel Laureate George Akerlof; Flug is married to Shaul Lach, head of the Economics Department at Hebrew University). Both are liberal and soft-spoken, but have tough, independent minds, with minimal egos, and both were spurned for the top central bank jobs in favor of men, who ended up withdrawing due to rumor and scandal. (Former Harvard president Larry Summers withdrew after the press revealed he had made fast millions as a Wall St. advisor.)

Yellen sounded the alarm bell early about the US housing market bubble. Flug, as interim governor, has also taken decisive action to cool Israel's housing bubble. When they meet, at the annual International Monetary Fund gatherings, Yellen and Flug will have much in common.

Why did Netanyahu oppose Flug from the outset?

Persistent rumors in the press cited a scholarly paper co-written by Flug and Michel Strawczynski some six years ago. In it, the authors examine the quality of Israel's macroeconomic policy as the country emerged from the deep 2001-3 recession. “We found that two-thirds of the transition [to strong economic growth] is explained by... the world trade and security situation and one-third is explained by policy variables, i.e. better macroeconomic perfor-

mance and the reduction of tax rates,” they wrote.

Netanyahu frequently claims 100 percent credit for the strong recovery, which he claims he facilitated as finance minister at the time. Flug demoted him to one-third. Netanyahu disliked the demotion. But has he actually read the paper? As a graduate of MIT’s Sloan School of Management, Netanyahu can clearly understand Flug’s paper, but I doubt he could find any holes in it. It’s all male ego and pique.

**AS THE** Bank of Israel’s new governor, Flug faces many tough challenges. She has already faced a major one. On September 23, the Bank of Israel announced it was cutting its base lending rate by 0.25 percent, to only 1 percent. This was a surprise. As interim governor, nobody expected Flug to take decisive action. She did so, however, because the shekel had appreciated sharply against the dollar, hurting Israel’s exports, while the US Federal Reserve continued to print money. The overvalued shekel is now trading at a rate of around 3.53 shekels per dollar, touching previous highs reached in early 2012.

“The Bank of Israel returned to a policy of leading, rather than being led,” noted an analyst after the rate cut.

Slashing interest rates will make shekel deposits less attractive. At the same time, the bank has probably reached its limit. In future, it will have to find other more creative policy tools, when the interest rate is essentially at rock bottom.

What other challenges does the new gov-



NATI SHOHAT / FLASH 90

Karnit Flug, newly appointed Governor of Bank of Israel, faces many tough challenges

ernor face? And, based on her research and publications, what is she likely to do?

First, deflation: Israel’s inflation rate is only about one percent. This is a problem, because it implies deflation, rising unemployment and stagnating economic growth. The Bank of Israel has recently lowered its growth projections for 2013 to 3.6 percent and to 3.4 percent in 2014. According

to the Central Bureau of Statistics, Gross Domestic Product grew only 2.2 percent in July-September, down from 4.6 percent in the second quarter. The main cause was slowing export growth. With the world economy remaining weak, Israel’s export-driven hi-tech sector will find life tough.

Second, the housing bubble: The housing



Finance Minister Yair Lapid, Prime Minister Benjamin Netanyahu and President Shimon Peres attend Governor Flug's inauguration ceremony at the President's Residence in Jerusalem, November 13

## ISRAEL RANKS 30TH IN INEQUALITY OF INCOME DISTRIBUTION AMONG THE 34 OECD NATIONS, AND INEQUALITY HAS RISEN STEEPLY SINCE 1990

cost index rose 57 percent between January 2009 and August 2013. A controversial study by Golan Benita and Ziv Naor, of the Bank's Research Department, notes that during this same period, average household income rose by only 20 percent. Can those buying apartments through mortgages really afford to make the increasingly heavy monthly payments?

The authors discuss three possible future scenarios. In the first, it's business as usual, with no major changes; in other words,

"borrowers' risk in the mortgage market will continue to increase" because anticipated increases in interest rates will "raise the monthly payments on floating rate mortgages."

This is precisely what happened in the US. When former Federal Reserve chairman Alan Greenspan sharply raised interest rates from one to six percent in 2005-6, many Americans defaulted on mortgage payments that became unbearably heavy, leading to the global, subprime mortgage crisis.

But Benita and Golan also examine two other scenarios – one, a sharp rise in interest rates, as occurred in the US; and two, a recession. Under both scenarios, mortgage default rates increase sharply, as higher unemployment makes it tough for families to meet payments. Israelis already face a far-heavier mortgage payment burden than homeowners abroad; on average, Israelis pay nearly a third of their monthly income in mortgage payments, compared with 22 percent in

Europe and only 17 percent in the US.

The problem Flug faces is this: The weak economy requires low interest rates, while cooling the housing bubble in Israel requires high rates. So far, the Bank of Israel has preferred to keep rates low, while stiffening the terms through which borrowers can get mortgages.

Supervisor of Banks David Zaken tightened restrictions on mortgages in September, the seventh such tightening in 42 months, specifically limiting mortgages whose monthly payments exceed half the borrower's monthly income. But with demand for housing outstripping supply, housing prices will continue to rise, and the Bank of Israel will find it hard to cool the market before the bubble bursts with disastrous consequences. Finance Minister Lapid recently floated a plan to boost rental housing, but it seems to have flopped.

The third problem Flug faces will revolve around her role as chief economic advisor

to the government of Netanyahu and Lapid. Novice Lapid has lost eight senior Finance Ministry officials recently.

In a paper she wrote with Stanley Fischer in 2007, Flug observes that governments have frequently broken their own fiscal rules in the preceding 15 years, resulting in a loss of credibility. She will need to rein in public spending and deficits, using mainly a bully pulpit without the bully, working with a finance minister who neither understands his own ministry nor knows any economics.

**IN OCTOBER,** the Finance Ministry reported that the government overspent by 4.6 billion shekels (\$1.3 billion), though the budget deficit over the past year is 3.3 percent of GDP, well below the 4.65 percent target for 2013. I recall that former Fed chairman Arthur Burns was very effective in teaching president Richard Nixon the basics of economics, after Nixon was elected in 1968, and opposed Nixon's failed wage and price controls. Flug may need to do the same with Lapid.

But perhaps Flug's major challenge lies in her main area of expertise, economic inequality. She served on the Trajtenberg Committee that drafted sweeping recommendations in the wake of the social protest movement, and has written several strong studies on the subject. Israel ranks 30th in inequality of income distribution among the 34 OECD nations and inequality has risen steeply since 1990. Facing a largely right-wing, pro-rich government, Flug will need to work hard to foster policies for the "99 percent," despite Lapid's lip-service embrace of the middle-class.

In a 2003 research paper, Flug found that non-employment of the head of the household was the main determinant of poverty in Israel. Those who receive large monetary allocations from the government, she found, tend not to work. Hence, she concluded, the "correct mix of allocations and incentives to work" holds the key to dealing with poverty.

As the government gears up to restore the so-called Wisconsin Plan, once known as From the Heart, a Hebrew acronym for From Welfare to Work, which privatizes

social services, a "blame the victim" mentality seems to be making a comeback. (The resurrected plan is now called Going Out to Work.) Flug will need to work hard to counsel the government on how to effectively deal with poverty, with evidence-based policies.

In 45 years of teaching and working with managers, it has been my experience that women in power function far more collaboratively than men, have far less ego, and are thus more effective. The reason is evolution. For 50,000 years, we men evolved to kill animals and defeat rivals. Women evolved to communicate, cooperate and work together.

Happily, albeit belatedly, the government has chosen a woman to do what it first thought was solely a man's job – stabilize the currency, battle inflation and deflation, cool housing prices, fight inequality and poverty, counsel the ministers and prime minister and offer wise, professional advice. She will yet prove Margaret Thatcher right. ■

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