THE JERUSALEM POST
BREAKING NEWS 24 HOURS A DAY

Lapid: Cut taxes and freeze spending

By: Aaron Katsman – May 23, 2013

"Every time in this century we've lowered the tax rates across the board, on employment, on saving, investment and risk-taking in this economy, revenues went up, not down."
– Jack Kemp

It's no secret that Finance Minister Yair Lapid has been raked over the coals for his budget, but we haven't seen much in the way of an alternative to solve Israel's economic challenges. Aside from the usual calls for more government spending, which is what got us into this situation to begin with and what his budget proposes (as a reminder, his cut's are really a 7 percent increase in spending over 2012), most pundits have been critical without providing much in the way of help for the struggling new finance minister. Here is an easy-to-use three-point plan that will get the Israeli economy firing on all cylinders and help the average citizen move up the socioeconomic ladder.

In previous columns I have spoken about the need to rein in spending, so due to space limitations I will skip over that step.

Respect capital

Each year the Milken Institute publishes its Global Opportunity Index, in which it ranks countries according to their attractiveness to foreign investors. Based on the results, governments can initiate policies that will help them be a magnet to attract foreign investment.

Much to my chagrin, Israel is ranked No. 33, behind the likes of Portugal and Cyprus. While Israel places very high in the category of Rule of Law (No. 6), its ranking of No. 79 and No. 63, respectively, in regulatory barriers and ease of doing business is an embarrassment.

In a world where capital flows to countries that encourage it, Israel is on the wrong track. If you don't respect capital, you lose it. Plain and simple. The recent populism to go after Intel and Google, "to pay their fair share," as if their employment of thousands of Israelis is a bad thing, is going to backfire. We've seen Intel open new centers in Ireland as a result of a sweet tax package, and there is no reason to believe that if they can get a better deal somewhere else they won't "follow the money."

New MK Stav Shaffir (Labor) just proposed raising corporate taxes on "wealthy companies" to a whopping 35%. She defines "wealthy companies" as those who make a staggering NIS 3 million a year. That will certainly encourage new business creation – not really.

Well maybe, but not in Israel! I wonder why? Analysts, as well as the head of the Tel Aviv Stock Exchange, have been at a loss to explain why trading volumes have dried up over

the last year and a half.

They now are talking about expanding trading hours to be more in line with European and US markets, as if that's the problem. It wasn't a problem a few years ago when volumes were setting records. The real reason is due to the tax increase on capital gains that went into effect January 1, 2012 – coincidentally the time that trading volumes started to decline. In today's global economy, when you increase tax on foreign investment, it finds a new home.

Cut taxes

Instead of local policy makers trying to reinvent the wheel, why not try and emulate a system that has proven to be extremely successful? The country that always is at or near the top in various economic rankings is Hong Kong. Interestingly Hong Kong has a very similar population and GDP as Israel, so it makes for an interesting comparison.

Hong Kong has a 16.5% corporate-tax rate and an equally low income-tax rate, with the highest bracket approximately 17%. There is no VAT, and as Alan Reynolds of the CATO institute says: "Hong Kong does allow charitable deductions up to 25 percent of salary income and a mortgage interest deduction up to about $13,000 (in US dollars). Other deductions are allowed for adult education, care of elderly relatives and retirement savings plans."

I am sure local politicians will cry that such drastic tax cuts in Israel will never work and the budget deficit will explode as revenues will plummet. Keep in mind that Israel now sports more than NIS 660 billion of debt and pays over NIS 30b. a year in interest.

Michael Littlewood writes in Forbes: "Most strikingly, the burden of taxation in Hong Kong is exceptionally light, and yet the government has generally operated at a substantial surplus. As a result, it has accumulated enormous reserves, often standing at more than 12 months' total government spending. This, in turn, has meant that the interest which the government receives on its reserves is itself an important source of revenue."

And for those, such as Labor chairwoman Shelly Yacimovich, who cry for the rich to pay more, Littlewood continues: "The key to this success seems to be that small and medium incomes are hardly taxed at all and that almost the whole of the burden has always been borne by the relatively affluent."

It's time for Israel to follow the lead of Hong Kong.

Encourage foreign investment and cut taxes.

aaron@lighthousecapital.co.il Aaron Katsman is a licensed financial adviser in Israel and the United States who helps people with US investment accounts.