

ISRAEL HIGH-TECH & INVESTMENT REPORT

A MONTHLY REPORT COVERING NEWS AND INVESTMENT OPPORTUNITIES

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From the Editor's Desk

The little country than can maintain growth

Though the economies of the United States and England are only beginning to show signs of recovery, their stock markets are hitting all-time highs. Interest rates in both countries -- as well as in West Germany and Japan -- have been set at very low levels to stimulate the economies. Predictions from various quarters look for further gains from these slow-moving industrial giants, but a new breed of investor is looking to greener pastures -- the tiny but rapidly expanding markets of the poorer nations. Most have an annual gross domestic product of under \$6,000 per capita.

Countries like Argentina, Brazil, Chile, China, Columbia, India, Indonesia, Malaysia, Mexico, South Korea, Taiwan, Thailand, Turkey and Venezuela -- at one time considered exotic markets -- are now being monitored by some of the world's largest investment banks, mutual funds and individual investors. The stock markets in these countries come under the heading of "Emerging Growth Markets." These countries, with their huge markets and low labor costs, are finally beginning to enjoy rapid economic growth. In 1992, while the west was struggling to maintain a real growth in its GNP, that of Malaysia rose 8.0%, Argentina was up by 8.7%, Chile by 10.4%, and China by 12.8%. Part of the reason for the dramatic growth in these countries is that they represent 80% of the world's population but hold only 20% of the world's assets. The trend is to desire higher standards of living, and therefore to adopt a strict work ethic. As their work-forces show higher productivity and their governments relax regulations governing foreign investment, money and technology are attracted. According to a study by J.P. Morgan, stock market returns since 1988 have been very impressive. Among the leaders are Thailand, up 120.9%; Argentina, up 343.5%; Chile, up 298.6%; Columbia, up 331.0% and Mexico, up 450.4%. But no matter how good these returns seem, these mini markets are known to be quite volatile and not as liquid as the larger market places. Of the five

countries with such sparkling investment returns, only Mexico has a formidable market capitalization -- more than \$129 billion as of June 1993.

One would expect that the price:earnings ratio of the securities of these countries would be exceedingly high -- similar to the Japanese PE of a few years ago, in the order of 60-70. However, as of August of this year, Mexico's was only 11.6, Thailand 16, and only Argentina a relatively high 39.

But do small size and fast growth be maintained? Consider Israel. Though tiny and new, it cannot be characterized as an emerging growth market. Its \$12,600 per capita gross domestic product is more than three times that of Mexico. Yet the GNP rose 6.4% in 1992, and as of June 1993 the share market capitalization stood at \$130 billion.

The growth of Israel's economy has been enhanced by a sharp increase in population, the arrival of more highly trained people than it knows what to do with, and the dividends already being realized from the peace process. The real annual yields on shares and convertibles have been substantial. In 1991, the return on investment in industrial companies was up by 52.4%, and in 1992 it rose 84.7%. In 1993, the general share index on the Tel Aviv Stock Exchange was up by a nominal 33.5% as of November 30.

A review of some of the best-performing mutual funds which specialize in shares and have aggressive growth as their investment objective reveals that the top five returned between 37.7% and 78.6% in dollar terms.

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Israel's economy is being led by its industrial exporting companies. For the first 11 months of 1993, total exports jumped by 16.4% to \$11.8 billion dollars, compared to the same period in 1992. The metal and electronic sectors, which include defense and most of the high-tech exports, rose by 33%. And economists look forward to continuing expansion in 1994.

It's little wonder that more bankers, brokers and private investors are making visits and doing their homework to learn about Israel -- The Little Country that Can Maintain Growth.

Enhanced information transfer along optical fibers

A new Weizmann Institute method for increasing the number of channels that can be carried on a single optical fiber may greatly enhance the transmission of information.

The method, based on the use of twin holograms, was described earlier this year in the journal *Optics Communications*.

Optical fibers are increasingly replacing electrical wires in phone lines, TV cables and a variety of other telecommunication systems. However, with present technology the number of channels that can be sent over one fiberoptic cable is limited, primarily because it is difficult to combine the signals at the transmitter end and separate them at the receiving end.

Dr. Yaakov Amitai (Dept. of Physics of Complex Systems) proposes to overcome this problem by using two arrays of identical hologram pairs, one on each end of a fiberoptic cable. One array would take uniquely colored light from different signals, trap it, and introduce it into the optical fiber, while the other would pick up the combined light and separate it back into its uniquely colored components.

The system, developed in collaboration with Amitai's colleague Asher Friesem, relies on the fact that holograms are extremely sensitive to wavelength; each diffracts only a specific wavelength of light, but is completely transparent to all others. Thus each pair of holographic elements at the receiving end will pick up only the signal sent by its twin pair at the sending end.

This method multiplies the amount of information that can be transmitted. Up to 20 different signals can be sent down the same fiber without interfering with one another, according to Amitai. He says the system is compact, simple, cheap, and suitable for mass production.

A patent application has been filed by the Institute's Yeda Research and Development Co.

Development without deficits at Weizmann

Prof. Haim Harari, who has been reelected to a second five-year term as the Weizmann Institute's president, noted last month that six scientific

departments and six research centers had been established during his tenure. Also, seven buildings had been completed and work on four others had begun. Moreover, an increased flow of contributions and research grants -- together with substantial economies on the campus and support from the Israel Government -- had enabled the Institute to operate without a deficit for the fourth year in a row.

Prof. Harari was particularly proud to announce that the Institute has absorbed 11 top scientists, world leaders in their fields. Five had come from the former Soviet Union, two from the United States, three were Israelis returning from the US, and the 11th was an Israeli from another local institution of higher learning. These newcomers and others have greatly strengthened the Institute's faculties, with Mathematics benefiting in particular from the influx of Soviet-trained researchers and students.

Magnesium: A likely new weapon against osteoporosis

Osteoporosis is one of the most common afflictions of women after menopause. One-third to one-half of postmenopausal women, and nearly half of all people over the age of 75, are affected. Bones become brittle and often ache, and there is an increased risk of fractures in the vertebrae and hip. This involves suffering for the patient and a severe drain on health care resources.

To date, no safe and effective treatment has been found. Estrogen therapy, used extensively to prevent the symptoms of menopause, also slows the bone loss and fracture risk of osteoporosis, but is not considered completely safe. For example, women with breast cancer, or with a family history of breast cancer, are advised not to take it.

The effectiveness of calcium supplements has been questioned, while that of alternative treatments has not been fully established.

Now, a safe and simple therapy may be just around the corner -- magnesium. Prof. Gustawa Stendig-Lindberg of the Department of Physiology and Pharmacology at TAU's Sackler School of Medicine led a research team that has shown magnesium to be effective in improving bone density in postmenopausal women.

Magnesium tablets were administered over a two-year period to 31 women suffering from osteoporosis. All were patients in Ichilov Hospital's Back Rehabilitation Unit, which was founded and is headed by Prof. Stendig-Lindberg. All the women had complained of back pain, most had bone pain, and their tests showed that all had lower-than-normal bone density.

Results of the research were encouraging. During the two years, no new fractures occurred. Bone density in 22 of the women (71%) actually increased from 1% to 8%. In five other patients (16%) bone density

remained unchanged. The remaining four women suffered a continuing decrease in bone density, but these patients were also suffering from endocrine diseases which hamper the metabolization of magnesium. A control group of 23 postmenopausal women were free of symptoms, in spite of lower-than-normal bone density. In 17 of these untreated women, bone density decreased by a further 1 to 3% after one year.

Ramnicanu Prize goes to Koor Industries

In what capped Israel's success story of the decade, according to TAU President Professor Yoram Dinstein, Koor Industries received this year's Hugo Ramnicanu Prize in Economics for its turnaround from near bankruptcy to profitability. Accepting the prize was Koor's Director-General, Benny Gaon, who led the dramatic recovery. Koor, which accounts for 10% of Israel's industrial capacity, is owned by the Histadrut Labor Federation. It faced a \$1.3 billion debt and losses of \$250 million in 1988. Its ranks had swelled to 32,000 employees, and of its 250 subsidiaries, 248 were in the red.

"In a company undergoing a crisis... one needs a manager who is willing to make decisions and stand behind them. That person was Benny Gaon," said Yisrael Kessar, Israel's Minister of Transportation and Secretary-General of the Histadrut at the time of Koor's reorganization. At the close of 1992, a slimmed organization of only 45 companies and 17,000 employees enjoyed net profits of \$145 million and positive equity of almost \$400 million. "We intend to grow by 20% in 1993," said Gaon, "and expect sales to reach \$2.7 billion."

Bar-Ilan scientists provide a colorful holiday

For over 2,000 years, Chanukah candles have shone with a yellow light. For all that time, even though multi-colored candles had been introduced, the flame has been the same yellowish color. This may very well change. At Prof. Gedanken's chemistry lab at Bar-Ilan one marvels at the colorful flames jumping and flashing in a spectacular kaleidoscope.

"We have developed candles made of non-wax material," Prof. Gedanken explains. "In the normal candle," he goes on, "the combustion of hydrocarbons causes the flames always to burn yellow, whereas in the Bar-Ilan chemistry lab we have found a non-wax material which burns in a variety of colors. There are no such inorganic candles anywhere in the world."

Research on the subject began as a game 14 years ago, when Prof. Gedanken and Dr. Jack Beranes were experimenting with the chemical components of candlelight. Upon receipt of a grant from the Ministry of Commerce and Industry, the two decided to begin serious development of the project.

At first, the candle flames were too small for commercial use. However, a solution that provides the desired-size flame was patented by the two scientists and has been marketed by a Hong Kong firm. Prof. Gedanken is of the opinion that with proper promotion, a favorable market presents itself for usage on such holidays as Chanukah and Christmas, in places of entertainment and for special celebrations.

Special Report: Yields and not labor costs are the key issue in the diamond industry

Diamond manufacturer Adi Legziel refers to the industry's earlier obsession with labor costs as a conceptual problem. "Let us say that the cost of labor in Israel per carat of rough diamond is between \$2 and \$3," he said. "For roughs, which average \$300-\$500 per carat, we are talking about less than 1% for labor. So even if you are able to reduce labor costs by 10-20%, you are not talking about significant differences.

"In our experience, technology provides its greatest advantage when it comes to yield. We save about 1.5% with each rough, translating into 3.3% with polished diamonds."

Zvi Shur, general manager of the Israel Diamond Manufacturers Association, agreed. "Consider the savings in terms of the entire industry. Let us say we are exporting \$3 billion a year in polished diamonds. A saving of 1% equals \$10 million, and 3% equals \$90 million. That is far in excess of what's invested in technology each year."

This is not to say that technology cannot reduce labor costs. Certain labor-intensive sizes of diamond which until recently were deemed too small to be cost effective, are once again being produced in Israel. Indeed, at a recent meeting between representatives of the local industry and the Central Selling Organization, the Israelis called on the CSO to allocate them more roughs at the lower end of the scale.

Shur is credited with having coined the term "the bucket phenomenon." Simply stated, it refers to a bucket full of rough diamonds which is emptied into one end of an as-yet-undeveloped-machine. The empty bucket is then placed at the opposite end of the machine, where it is filled with polished diamonds. To many in the industry, such a device is no longer science fiction. A diamond today typically passes through a laser machine, where it is kerfed or sawn; an automatic centering system, where it will be analyzed and aligned robotically for bruting; an automatic bruting machine where its girdle is cut; a polishing/centering system, where it is aligned for polishing; and an automatic polishing machine, where its facets are polished.

Israel Diamonds & Precious Stones no.133

(Cont'd on page 6)

New Product

Myriad Ultrasound Systems Ltd. unveils a new diagnostic product using advanced technology

Sound waves measure bone fragility

Osteoporosis refers to the fragility brought about by the decrease in bone density and mass which often accompanies old age -- particularly in post-menopausal women. In the United States alone, osteoporosis affects 15-20 million people and is responsible for 1.3 million fractures and 50,000 deaths annually. Direct and indirect costs to the American health system are estimated at \$10 billion a year, including the cost of diagnosis -- a set of diagnostic tests is priced at up to \$450 -- lost work days and medication. The equipment used to diagnose the disease -- whether X-ray or dual spectrum photometry -- is often limited by its inability to distinguish between bone and surrounding soft tissue, and may expose patients to unnecessary radiation.

"Any new, accurate test would be a welcome development," says Prof. Stern, a specialist in endocrinology and thyroid problems.

A young Israeli company is offering a major step forward. Myriad (formerly Medicano) Ultrasound Systems' diagnostic system, Soundscan 2000, includes a patent pending ultrasonic probe with transducer sensors, unique algorithms and proprietary software, as well as a state-of-the-art processing platform. It measures sound velocity within a bone itself, with no contribution from surrounding soft tissue -- a major source of error in bone fragility measurements. Elimination of the soft-tissue error enables the Myriad system to attain 99.7% precision. The system, with patents pending, is claimed to be the first and only one of its kind capable of assessing the fragility of the cortical layer of bone -- a crucial indicator of bone strength. With clinical tests at Beilinson, Ichilov and Kaplan hospitals continuously confirming the system's advantages, Myriad is preparing to introduce its first major product to hospitals and private physicians.

"The market's acceptance is only a matter of time," says Alex Rapoport, Myriad's 31-year-old founder. Managing a staff of 20, including nine researchers, this graduate of Ben Gurion University's School of Engineering points out that the patient, the physician and the health system

are all winners. The patient benefits from the accuracy of a friendly, accurate, radiation-free diagnosis. The physician is presented with a picture ten times more accurate than has been possible before. The health system gains due to the system's efficiency and \$50,000 price tag -- about half the cost of existing equipment.

Dr. U. Lieberman, professor of physiology and department head at Beilinson Hospital, describes the system as highly promising. Professor Lieberman serves as scientific advisor to Myriad, and coordinates the results of clinical tests in Israel, the USA and Europe.

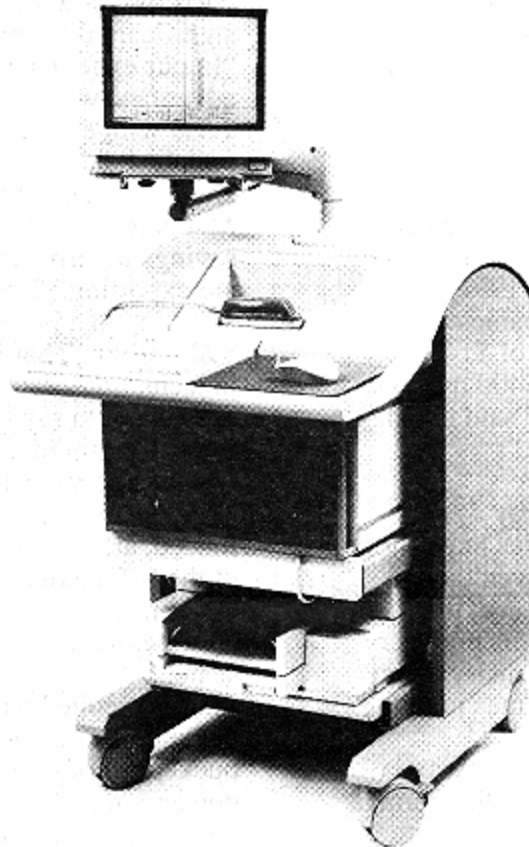
"The technology is an improvement on existing equipment. It allows for many bones to be diagnosed accurately. Some of the currently used equipment is limited to only one or two bones in the body because soft tissue interferes in obtaining meaningful readings. This problem has been solved with the new technology. Its other major advantage is its ability to evaluate bone quality accurately," says Professor Lieberman.

Backing for the three-year-old company has come from Athena Venture Partners, and Anglo-American Ventures, managed by Veritas, whose directors are Yadin Kaufmann and Gideon Tolkowsky. The initial investment group was joined by Rosebud -- a healthcare investment fund which is part of the Evergreen Group and managed by Yaacov Burak.

Myriad is now moving into the marketing phase, with Soundscan 2000 being offered simultaneously in Europe, South America and Israel in January 1994. Marketing in the United States is scheduled for a later stage. Additional area for production has been leased.

Since it is produced by a small company with limited means, the new product will require time to penetrate the European and North American markets. Nonetheless, the prospects for Myriad's commercial success appear very bright. Its three-year goal is to gain a 10-20% share of the \$100 million diagnostics market.

Myriad is located in the Kiryat Weizmann Science Based Industrial Park.



SOUNDSCAN 2000

The Capital Market

An update on the performance of mutual funds

With the start of the New Year we come back to the original thesis of investing. If you are invested in the best-performing funds you will obtain the best investment results. With that in mind you can compare the results you are getting from the mutual funds which you own with those that are the "best performing"

Israeli mutual funds are divided into categories which include:

•Share Funds, of which there are two basic categories.

One has an investment objective of growth and a management policy of investing in a diversified and flexible style. The other group seeks aggressive growth

by investing either in the leading shares that make up the TASE Index or the Maof Index or in specific areas such as real estate, oil or peace-related companies.

Generally speaking, investors who seek conservative growth are likely to forego the possibly large returns which have characterized the share market in recent years.

They consider the risk of investing in the share market as being too great. They invest in mutual funds which invest in either government or non-government bonds, the main feature of which is that they are linked to the cost-of-living index.

•The other conservative approach is to invest in funds which invest in bonds that are linked to foreign currency.

•The last remaining category of funds are those known as "mixed." The management objective is conservative growth through investment in index-linked bonds and shares.

Interpreting the data in the Table of Yields and Major Investments, a number of comments can be made

regarding which categories of mutual funds have provided above-average results.

The conservative investor who chose mutual funds specializing in government bonds linked to the C-O-L index in 1993 saw no \$ gain on his investments.

Investors in bonds linked to the US dollar or denominated in US\$ lost nearly 3% in dollar terms.

Bank of Israel notes, the equivalent of US Treasury notes, yielded 2.8% in dollar terms.

The return on investment in mutual funds that invest in shares (see the above Table) clearly indicates that these have produced the best results after 11 months

of 1993. The General Share Index in US dollar terms returned +32.8% and the Index for Variable for shares traded in the Variables Group yielded +14.3% in US dollar terms, while the Index of Low-capitalization Shares yielded 55%.

The difference between yields realized from bond and share investments points to what investors have learned in other markets, namely that investing in ordinary shares of companies -- whether industrial or service -- results in better returns than does investing in debt securities. Moreover, investing in best-performing share funds has provided above-average returns. In the first 11 months of 1993, the General Index of Mutual Funds advanced by 17.9%, or just less than 10% in US dollar terms. The three best-performing mutual funds in the 11 months were:

Ahrayut Oil	+ 71% in dollar terms
General Flexible	+ 48% in dollar terms
Ahrayut Real Estate	+ 48% in dollar terms

Yields on Major Investments

	Nov. 93	Jan.-Nov. 93
General Share Index	+ 1.3	+35.3
General Bond Index linked to C-O-L	+ 2.5	+ 7.9
Devaluation of NIS against the US \$	+ 2.3	+ 4.0
Bank of Israel notes	+ 0.7	+10.5
Variable Share Index	- 0.1	+22.9
Index of low-capitalization shares	+ 4.6	+66.2

Share Funds

Category: Diversified and Flexible Share Funds

Investment Objective: Growth

Management Policy: Manager invests in equities with mix of investments adjusted to market conditions.

Funds in Category: 45

Top Five Performers

Fund	Manager	% gain
General Flexible	General	+51.7
Ramco Flexible	Ramco	+44.7
Panther	Central Trade	+44.6
Psagot 50	Psagot	+41.6
Sivan	Amban	+37.3

Category: General, Maof and Specialized

Investment Objective: Aggressive Growth

Management Policy: Manager invests in the 70 leading shares making up the TASE Share index or in the 25 leading shares which make up the Maof Index

Funds in Category: 73

Top Five Performers

Fund	Manager	% gain
Afikim	Afikim	42.5
Magic	Moritz & Tuchler	36.2
Epsilon Shares	Epsilon	34.9
Analist Shares	Analist	34.8
Zmicha Shares	Zmicha	32.6

(percentages represent gain in value in U.S. dollar terms for 12 months ending Nov. 30, 1993)

Comverse Technology maintains rapid growth

This company is mentioned by leading American publications as one of the fastest-growing small firms in the communications field. In the first nine months of 1993, its profits nearly tripled to \$9 million. For that period, sales exceeded \$50 million -- more than double the figure in the comparable period of 1992.

Bankers' Trust recommends investments on TASE

Now that the peace process is underway, Bankers' Trust has published a research report pointing to the Tel Aviv Stock Exchange as an attractive place to invest. Areas chosen for special consideration include infrastructure, industries, telecommunications; export industries, electronics and communications, biotechnology, hardware and software. Bankers' Trust projects a rising market in 1994, and 6% growth in the GNP.

Laser burns brighter as earnings could top \$2 million

Based on expectations of a strong fourth quarter, Laser's annual earnings could exceed \$2 million, and as much as \$0.36 cents a share.

Medax 1993 - the 9th International Exhibition of Medical Technology

The Medax Exhibition was one of the largest of its kind in Israel. The 200 exhibitors represented 1,000 companies and agencies. Among the 18,000 visitors were groups from Nigeria, Poland, Panama and Italy. Many representatives of the 11 hospitals serving the Arab population in East Jerusalem and across the Green Line were also present. Among the innovative Israeli products shown were a children's thermometer that comes as part of a diaper; a kit to help women determine the time of ovulation; and a blood testing device which eliminates the need to pierce the skin.

Pharmos adjuvant improves delivery of HIV vaccine

Last month, Colonel George Lowell of the Walter Reed Army Institute of Research in Washington presented the results of studies on a novel formulation of HIV gp 160 vaccine at the Conference on Advances in AIDS Vaccine Development in Alexandria, Virginia. Included in these studies was Pharmos Corporation's (NASDAQ: PARSD) formulation -- an adjuvant derived from the company's proprietary SubMicron Emulsion technology.

The studies compared several formulations of the vaccine, including MicroGeneSys' alum formulation and Pharmos' formulation. The results suggest that the Pharmos technology may increase the effectiveness of HIV vaccines.

Furthermore, the Pharmos version showed enhanced total immune response compared to the alum product.

Pharmos Corporation is engaged in the development of novel pharmaceuticals based on innovative drug delivery technologies.

EXECUTIVE SUMMARY: A report on securing peace in the Middle East

Peace in the Middle East will be secured only when it takes root in the everyday lives of the people in the region. In addition to securing the appropriate political agreements, securing peace, therefore, requires establishing an hospitable environment for economic development.

Working with a team of economists from Harvard and the Massachusetts Institute of Technology (MIT), Palestinian, Israeli and Jordanian economists present here a policy plan for trade and development among these three parties - a plan for the start of a new economic era in the Middle East.

The essential understandings in this report are:

- 1) that the formal peace treaties will grant the Palestinians economic sovereignty over an economy dominated by the private sector and one in which markets are the principal guide to the allocation of resources;
- 2) that the three economies will move towards free trade - with free trade between Israel and the Occupied Territories being largely attainable within a few months after the initial accords;
- and 3) that this is a fundamental transformation in existing economic relations, one that will be undergirded by regional projects integrating and benefiting the three economies.

The economics of peace should be comprehensive. The free trade arrangements could and should be widened to include as soon as possible Egypt, Lebanon and Syria. In time, they could be extended further into an all-embracing Middle East Economic Community.

Regional Trade in Agriculture, Industry and Services

We recommend that there be a steady movement towards free trade and the free flow of capital among the three economies, with the goal of eventually achieving among them a free trade area in goods, services, capital and technology. Free trade between Israel and the Occupied Territories can be reached very soon; between the Occupied Territories and Jordan more gradually; and between Israel and Jordan over a longer period. Special attention will have to be given to the early lifting of Israeli restrictions on Palestinian agricultural exports. We recommend that working parties of experts should be appointed to develop regional projects in the following areas: tourist services; airport facilities;

road and bridge facilities (including the need for road transportation within the Occupied Territories); and electric power.

While the World Bank has an important role to play, particularly in the next few years, we also recommend that a new regional bank be set up. This bank, the Middle Eastern Bank for Cooperation and Development (MEBCD), would have as its initial goal, the development of regional projects involving the Palestinian, Jordanian and Israeli economies. It could also be a vehicle for the financing of projects within the Occupied Territories. We believe strongly in functional cooperation and regard the MEBCD as an effective means of creating such cooperation.

Labor Policies

The short run priority is to promote job creation in the private sector in the Occupied Territories. We emphasize the important for the labor market of all growth enhancing policies - increased investment, deregulation and appropriate fiscal and monetary policies.

Even under the most optimistic scenarios, however, full employment requires that substantial numbers of Palestinians - at least 100,000 - will need to continue to work in Israel. We therefore recommend the resumption of Palestinian access to the Israeli labor markets on the basis of agreed regulations and benefits.

We recommend consideration by the Palestinians of establishing a Palestinian "provident fund" as exists, for example, in Singapore. Under this system, which provides social insurance, individuals receive benefits that are related to their contributions. The provident fund could invest in private sector enterprises and projects. Such a scheme would need to be supplemented by social assistance funds.

To compensate Palestinians who work in Israel, and who pay social insurance taxes, but do not receive commensurate social insurance benefits, we offer two options: either to recompense workers directly, or to use these funds to support economic development in the Occupied Territories.

For the future, the moneys currently paid by employers could be paid into a Palestinian social insurance fund, whether that is a provident fund or some other mechanism that is established.

Economic Authority

We assume and recommend that within the framework of the negotiated agreement, the interim self-government authority should be accorded effective legislative power regarding domestic economic matters. This should include not only power to issue new laws and regulations, but also authority to amend and abrogate laws inherited from previous authorities.

Our most important recommendation in the area of economic management is that the Palestinians should initially simply assume leadership of and utilize the existing institutions of Israel's Civil Administration for the West Bank and Gaza. Palestinians should replace Israeli military officers at the helm of the agencies, but existing bureaucracies and procedures should be left intact to provide an organized point of departure. From there on, the Palestinians obviously will develop their institutions of economic management in the directions they regard as most likely to promote economic development.

We recommend a new structure with four major economic management departments: Finance, Industry, Economic Development and Human Resources. In addition to these four departments, we envisage a number of independent agencies, including the Central Bureau of Statistics and the Civil Service Administration. The Palestinian Interim Monetary and Financial Authority (PIMFA), responsible for the financial system, would likewise be run separately.

Fiscal Policy

The Palestinians appear now to be paying about 18% of GDP in taxes, half of which accrues to the Civil Administration. This is below, but not very much so, the average for an economy at this level of development. If arrangements are made for the Palestinians to recapture revenues (VAT and excise taxes) received by the Israeli government, the current tax apparatus could serve to generate revenues for the self-governing authority for a few years.

Spending in the public sector in the Occupied Territories, and especially infrastructure spending, is well below the normal levels, and should expand as the Palestinians take over their economy.

Partial, though not complete harmonization of the VAT and excise taxes and tariffs, will be needed, especially between the Occupied Territories and Israel.

In each area, tax rates can differ somewhat, but not very much. Tariff harmonization would be easier if the Occupied Territories and Israel form a customs union. This would be facilitated by tariff rate reductions on the part of Israel.

Differences in corporate and personal income tax rates can be accommodated by agreements on taxation by country of residence of individuals and corporations.

Monetary and Financial Arrangements

We recommend that the dinar become legal tender in Gaza, and take it for granted that the extent of financial intermediation has to be expanded. During the transition period, it would be desirable for Israel to reduce capital controls further, at least to the point

where they are no more restrictive than those of Jordan. All three economies would benefit from the free flow of capital.

The primary mission of the PIMFA will be to help improve the financial system in the Territories, and thereby contribute to their economic development. A separate agency is needed both because some of the tasks, such as bank supervision, require specialized knowledge; and to ensure that a single institution is charged with this important responsibility PIMFA's functions include:

- * Chartering, supervision and regulation of new banks, as well as supervision and regulation of existing commercial banks.
- * Chartering and supervision of existing non-bank financial intermediaries, such as insurance companies and pension funds;
- * Collection and publication of data on the financial system; and advising the self-governing authority on macro-economic policy; and
- * Shared responsibility for the creation and operation of needed public sector financial institutions and intermediaries (if any)

The Management of Foreign Aid

The role of foreign aid will be large and diverse, particularly in the early years while a public sector structure is being created and the private sector is being revitalized. Several different types of aid will be needed:

- * **Project Aid:** Aid designated to support specific projects will be a major feature of assistance to the Occupied Territories for the indefinite future.
- * **Program Aid:** This is general non-project financing, to fund the government budget and for balance of payments support.
- * **Regional Projects:** Foreign aid can play an essential role in the development of regional projects that involve several countries in the region.

The self-government authority should set up an aid coordination agency, located in the Department of Finance, to coordinate, prepare requests for, and manage the implementation of foreign aid.

During the transition period, and probably for several years thereafter, the self-governing authority is unlikely to have all the experience and skills required for the tasks it faces. Some of this experience gap can be filled by technical assistance. Also needed for the Territories is an institution which will:

- ❖ make an appropriate assessment for the donors, and in conjunction, with the Palestinian aid coordination agency, of the development needs and priorities within the Occupied Territories;
- ❖ set up a framework to coordinate donor assistance, in conjunction with the Palestinian aid agency
- ❖ help manage general and project aid to the Occupied Territories;

- ❖ provide technical assistance to the self-governing authority.

The leading international financial institution, the World Bank, is the natural an appropriate institution to take on these responsibilities initially. These responsibilities could gradually be taken over by the proposed regional development bank, the MEBCD. There is also a role for a think-tank with experts from both inside and outside the Occupied Territories to provide counsel in the development of the economic plans for the area in general and the Territories in particular. This think-tank would complement, not compete with, the more regional perspective of analysts in the proposed regional bank.

(From "Securing Peace in the Middle East", The Institute for Social and Economic Policy in the Middle East, the John F. Kennedy School of Government, Harvard University - June 1993)

More on mutual funds

- ❖ One of Canada's leading mutual fund managers Toronto based Jerry Javarski, on a recent visit to Israel, was impressed with the investment potential of Israeli companies. The Toronto based manager met with members of the Israeli financial community.
- ❖ The number of share mutual funds has grown sharply in recent months. In November alone, not counting flexible funds, nine new funds were launched. This month PIA has published a prospectus in Hebrew and in English for a new mutual fund for non-residents. It is available from branches of Bank Leumi or from PIA.

ISRAEL HIGH-TECH & INVESTMENT REPORT NEWS AND INVESTMENT OPPORTUNITIES

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