Desert Boom

By Robert Pollock

Venture capitalists win approval for a private free-trade zone in Israel.

"TILL NOW THE WALLET COMES out—and the government takes half," declared Knesset member Raphael Eitan. He was explaining why despite a highly skilled labor force, excellent ports, and a prime location at the crossroads of Europe, Africa, and Asia, Israel's economy stagnates. Burdensome tax and regulatory policies have long made it a terrible place to do business. That is, until now. "Now" was June 20, the day the Knesset approved the creation of Israel's first free-export processing zone (FEPZ).

More than 100 companies have already expressed interest in locating in the zone, including clothing manufacturers Liz Claiborne, Phillip van Heusen, and London Fog, as well as chemical, trade, telecommunications, and pharmaceutical firms. That's because they will benefit from exemptions from tariffs, personal and corporate income taxes, and a whole host of regulations. And Israel is the only country in the world to have signed free-trade agreements with both the United States and the European Union, giving companies in the zone a competitive advantage abroad, too. In return for the hands-off treatment, Israel expects the zone to generate as many as 50,000 jobs within four years.

The FEPZ will likely cover about 500 acres located near Beersheba in the Negev desert. It will operate as a privately run, semi-autonomous laissez-faire state. In the coming months, Israel will award the rights to serve as concessionaire in the zone. The winning investors will purchase the land and be responsible for providing all infrastructure and services. In return, they will get to lease the land for a profit.

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This means roads, water, sewers, electricity, and telecommunications, as well as police and fire protection, will be privately provided—another bonus for potential tenants. Backers expect the zone to be able to offer the lowest telecommunications rates in the world. In an information economy that can mean huge savings.

The FEPZ is not unique as a concept. The first free zone started in Taiwan in the '60s. And depending on how you define them, there are now between 120 and 150 special free-market zones in 70 countries. But Israel's FEPZ is important because it may herald a coming wave of privately created, financed, and run free-market zones. It was not proposed by any politician nor planned by any government. It began as an offer from a group of Jewish-American venture capitalists that Israel quite literally couldn't afford to refuse.

ALTHOUGH IT MAY SEEM ODD THAT A LAbor government would accept such an offer, the economic situation forced a move away from government intervention, says Jerry Stoch, an Israeli consul for economic affairs. High inflation and unemployment in the '80s were followed immediately by a tidal wave of immigrants from Russia, Ethiopia, Bosnia, and elsewhere. They needed jobs. Meanwhile, thousands of Israel's own entrepreneurially inclined citizens were emigrating to the United States. And without general economic growth, the new Palestinian-administered regions promised to provide fertile ground for militant activity.

But with Israel's tax and regulatory climate, no relief was in sight. Getting government approval for a new business venture might take two years. And at the $40,000 income level, it cost an employer $3.60 to give an employee an extra dollar of after-tax income. Even at the lowest pay levels, that ratio was 2-to-1.

Reliance on foreign aid long allowed Israel to forego much-needed economic reforms. Last year, the unilateral transfers—in other words, free money—that Israel received from overseas totaled about $6.7 billion. That's more than 10 percent of its Gross Domestic Product. About $3 billion came from the U.S. government, about $3 billion more from private donors. Prominent New York real estate broker Larry Silverstein, for example, alone has raised more than $250 million annually for Israel.

But when it came to investment, even the donors said no way. Upon passage of the FEPZ bill, Member of Knesset Amir Peretz (Labor) recalled how he once said to a donor, "Stop building us buildings, we have enough; stop building clubs and recreation centers. Build us a factory. But the donor replied: 'Your bureaucracy ruins everything. Forget attracting investment and entrepreneurship.'"

Enter David Yerushalmi, a former California real estate developer and lawyer who had recently emigrated to Israel. As it happened, he was also a former student

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of Robert Loewenberg, president of the Institute for Advanced Strategic and Political Studies, the Jerusalem-based think tank where the idea for the Israeli FEPZ originated. The possibility of an FEPZ gave Yerushalmi a chance to put his business talents to work for his homeland and make a profit in return. He convinced 26 Jewish-American businessmen who had been prominent donors to Israel that they could do the same. In 1992, Yerushalmi's Israel Export Development Corporation (IEDC) offered Israeli Finance Minister Avraham Shohat a guarantee of at least $750 million in investment in return for creation of the FEPZ.

THE ROAD TO APPROVAL WAS NOT EASY. Two committees appointed by Shohat to study the proposed FEPZ rejected the idea, as did the chamber of commerce. Labor groups, academics, and many in the media invoked the images of primitive sweatshops, suggesting that Israel would be turned into a "banana republic." One Israeli journal claimed that the zone amounted to a free license to import or distribute drugs. In fact, the zone will be subject to most of Israeli law. As Yerushalmi pointed out, it is unlikely that close to a billion dollars would be invested without significant assurances of the zone's security and responsibility.

Yerushalmi persuaded six U.S. senators and 13 representatives to send letters to Prime Minister Rabin backing the zone. Several mayors in the economically depressed Negev wrote the Ministry of Finance pleading for the creation of an FEPZ. And the IEDC provided numerous studies to address the arguments of opponents. In the end, Shohat and Rabin ignored the committees' findings, and the FEPZ emerged from the Knesset virtually unchanged from the original proposal. The legislation passed with unanimous support from both the Labor and Likud parties. All three votes against were cast by the communist Hadash party.

Even statist politicians could not ignore the evidence rolling in from the Far East. When just Hong Kong was free and prosperous, it could have been a fluke. But when China's special-processing zones gave it the world's fastest-growing economy, the evidence was just too strong to ignore. Even tiny Portugal at the far end of the Mediterranean employed FEPZs as part of a strategy that gave it Europe's fastest growth rate.

The rapidly increasing number of free-market zones worldwide bears witness to the birth of the quicksilver capital theory in action. Because technology has increased the mobility of capital, governments must shape up before business ships out. This means government policy will increasingly be dictated by economic reality, not vice versa. In the case of the Israeli FEPZ, not only did capital actively seek out a business-friendly environment, it actively worked to create one.

Israel's free-export processing zone is important because it was not planned by any government. Not only did capitalists seek out a business-friendly environment, they actively worked to create one.

The emerging reality is not lost on the Israeli government. Amid the orgy of praise for free markets following the bill's passage, MK Michael Eitan (Likud) observed, "Those afraid of the law are not afraid of its failure, because private money, not taxpayers' money, is at risk. Rather, they are afraid it will succeed and that the bureaucrats will lose their power. I say to these reactionaries: The world is changing. The time has come to change your economics textbooks." MK Gedalya Gal (Labor) added, "If it succeeds, if there is growth and new jobs, then we can consider widening the FEPZ to include the entire country."

Indeed, it now seems impossible for the Israeli government to stop economic liberalization from spreading to the whole country. The clamor to join an FEPZ will come from anyone who could benefit from deregulation, no taxes, and no customs. That means just about everybody doing business in Israel.

BUT NOT JUST IN ISRAEL. LATE LAST YEAR, Gateway Ventures, also headed by Yerushalmi, signed an agreement with the autonomous Russian republic of Chuvashia, an industrial area on the Volga River, to develop and manage the first free-trade zone ever in the former Soviet Union. Yerushalmi plans to locate Israeli and U.S. high-tech companies in the zone, and estimates the project will cost about $2 billion. The prime minister of Georgia invited Gateway to tour his country as well, suggesting they set up an information technology center in a free-trade zone to be located there. And Gateway is also working on setting up free-trade zones in Hungary, Dubai, the Baltic states, other former Soviet republics, and countries in the Far East.

For now, Yerushalmi's energies are focused on winning concession rights in Israel's FEPZ. As the zone's original backer, IEDC seems favored to get the job. It has already pre-leased 50 percent of the space, has Merrill Lynch and Salomon Bros. ready to underwrite the first phase of construction, and will be ready to break ground early next year if it wins.

It turns out that Marx was right about the power of capital. But happily it's governments, not workers, being pushed around. Technology has made this a smaller world, and the resulting increase in mobility has made capital a force capable of liberating peoples worldwide from the grip of controlling states. As Likud MK Raphael Eitan declared after the bill's passage, "We have reached a time when we must put an end to government interference in trade and the economy. We must free ourselves from the government centralization of the past and bestow freedom, especially the freedom to make money." ®

Robert Pollock is REASON*'s 1994 Burton C. Gray Memorial intern.*

Crime Time

By Martin Morse Wooster

The age of "Kojak liberals"

CRIME HAS BECOME THE most hotly contested social policy issue of the 1990s, but the debate is decidedly overheated. Statistics issued by the Federal Bureau of Investigation and the Justice Department suggest that if you live in an area that isn't infested by drug dealers (and, of course, if you don't happen to *be* a drug dealer), your odds of being a victim of violent crime are about the same as they were 10 years ago.

How has crime fighting become such a prominent issue without a growing group of victims of crime? The most important reason is a gradual change in the attitudes of the Democratic Party. Until 1985, it was easy to tell the difference between Democrats and Republicans on crime issues. Democrats were the namby-pamby, goo-goo eggheads who thought hardened criminals could become good citizens with plenty of Prozac, hugs, and herb tea. The Republicans were the tough-as-nails types who delighted in tossing people in jail and throwing away the key, even if the jails didn't have keys.

But in the early '90s many Democrats became what *Washington Post* columnist E.J. Dionne called "Kojak liberals," trying to show that they were as tough on crime as their Republican rivals. As a result, far too many campaigns hinge on how eager the candidates are to send people to jail.

As president, Bill Clinton continues the effort he began as governor of Arkansas to be a no-nonsense crime fighter. This concern is due in part to his other failures. Ruth Shalit reports in the July 18 *New Republic* that high-ranking Clinton staffers were convinced that, if other administration proposals failed, the crime bill could be, in the words of a senior Justice Department aide, "the major domestic accomplishment of Clinton's first term....If health care doesn't work, if welfare reform doesn't work, this [crime bill] is going to be the thing."

While one branch of the government says it's fighting crime, other government agencies are turning previously law-abiding citizens into "criminals" by creating more punitive regulations. As James V. DeLong observes in the March *American Enterprise*, many activities that were not illegal 10 years ago now are. Landlords can have their buildings seized if tenants are found using drugs. People who don't properly fill out forms required under the Clean Air Act can go to jail. Employees of corporations can be considered criminals if they can't tell the courts what a petty cash fund was used for, or why a particular investment doesn't appear on company books.

DeLong observes that what he calls "the New Criminalization" has both economic and spiritual consequences. Corporations have to spend countless hours gathering permits and obeying bureaucrats, and even then they may unwittingly commit crimes; two-thirds of corporate lawyers surveyed by the *National Law Journal* in 1993 said their companies, due to the uncertainty and complexity of the law, had violated an environmental statute. (See "Crimes Against Nature," December 1993.) The result is an erosion of our sense of what is right and what is wrong. "Under the New Criminalization," DeLong observes, "with its technical complexity and often arbitrary provisions, no one can rely on an internal moral compass or on common sense as protection. The 'reasonable person' standard is obviated."

EVEN AS PEOPLE ARE SENT TO JAIL FOR minor crimes, high-profile defendants appear to be set free due to technicalities in the law or to variants of the insanity defense. The average American, flooded with reports about the Menendez brothers, the Bobbitts, the trials resulting from the Los Angeles riots, as well as the guests on salacious talk shows, might well conclude that anyone can finagle his or her way to freedom with a sad story and slick attorneys.

That analysis is only partially true, reports Stephanie B. Goldberg in the June *ABA Journal*. Not many defendants use variations of the insanity defense, and three states have abolished insanity defenses entirely. Some "victimization" defenses, most notably battered woman's syndrome, are grudgingly accepted by the courts. But the requirement that battered women prove that they were in imminent danger of harm before they maimed or killed their husbands limits this defense. State University of New York at Buffalo law professor Charles P. Ewing says jurors are often skeptical about this defense

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