Opinion

A weakened Israel should worry everyone

Eran Yashiv

Israel has been experiencing political and social turbulence on a seismic scale of late. While the world hears of a shift in Israeli politics and shrugs it off as yet another victory for the political right, millions of Israelis and Jews are watching unfolding events with great concern. One alarming scenario worth paying close attention to is whether Israel may be changing from a liberal democracy to a non-democratic weak state.

Israel's judicial system has long been under attack. The governing coalition aims to pass a sweeping set of "reforms" geared to greatly weaken it. The basic principle is to terminate the independence of the judicial branch of government, something taken straight from the modern playbook of illiberal states.

In Israel, these reforms are seen as the undoing of the "constitutional revolution" led by Supreme Court president, Aharon Barak, 30 years ago. Barak was operating within a fragile democracy in a polarised society lacking a constitution but his activist approach succeeded in putting in place judicial foundations. This structure endowed Israel with a high-quality public institution, providing essential checks on the executive and legislative branches.

While the Supreme Court has used its powers prudently and very restrictively, society has become even more polarised, public debate more abrasive and politicians ever more corrupt. A former prime minister, a former finance minister and a former interior minister have served jail time. Benjamin Netanyahu is himself a defendant in three corruption cases, being tried at the Jerusalem district court. His new government now seeks to undermine the existing judicial structures. Despite sparking mass protests, these measures are likely to pass the Knesset by April and could turn Israel into something akin to Hungary, Poland or Turkey.

There are other dangerous developments as well. Particularly worrying is a resurgence of religious forces seeking to turn Israel into a country governed by Jewish law. This agenda is being pursued by two distinct minority groups. One is the Ultra Orthodox, who now constitute 12 per cent of Israel's population and are forecast to be at least a third of it by 2065. The second is the Zionist religious group. Together they are represented by 32 Knesset members (out of 120) having won a quarter of the November 2022 parliamentary elections vote. Through population growth, their power is likely to increase.

> Netanyahu's government now seeks to undermine existing judicial structures despite mass protest

The confluence of judicial reforms and imposition of religion is mutually reinforcing. It is, of course, very difficult to forecast the consequences. If mass protests and political compromises succeed, they may thwart the danger, at least for now. If the next elections bring other parties to power, some changes may be reversed (though not all). There is however one possible scenario, in which Israel will slowly become a weak or failed state or a clerical one, in which rabbinical courts officiate.

If so, and over time, the secular, economically strong parts of the population are likely to leave. A case in point is the flourishing tech sector. With around 10 per cent of employed workers, 15 per cent of GDP and more than 50 per cent of exports, it is the linchpin of the economy and a highly mobile one. In January, one tech entrepreneur at a business valued at over $2bn announced on TV that he and the company are leaving. Once gone, taking with them a corresponding share of Israel's tax revenues, those left behind will have diminished resources. A vicious cycle might ensue.

There has been a recent response to all of this. Street demonstrations have taken place; some tech businesses are going on symbolic strikes; a leading CEO wrote to his employees hinting at an emigration scenario. Meanwhile Jacob Frenkel and Karnit Flug, two former Bank of Israel governors, issued warnings of an international bond rating downgrade for Israel and flight of private investors, while the current governor, Amir Yaron, has issued a similar warning in a private conversation with the PM. Petitions from academics, and in particular one by economists, have drawn much attention. In December the departing Finance Minister, Avigdor Lieberman, warned of a tax revolt.

But these actions may not be enough. It should be recognised that they face two formidable impediments: they require large-scale co-ordination among people and businesses, and they risk the break-up of society. The weakening of Israel as a bastion of democracy in the Middle East is not in the interests *of* the western world. The possibility that it may change from a modern, dynamic, liberal democracy to a potentially illiberal, non-democratic, religious state is a danger *to* the western world. It is not just Israelis who should be concerned.

The writer is a professor of economics at Tel Aviv University and at the London School of Economics' Centre for Macroeconomics

Colorado River battle is a warning to us all

FINANCE
Gillian Tett

This week, a nasty fight has exploded on the US political stage. This is not about congressional votes or presidential candidates. Instead, it revolves around something so mundane that it is often ignored: water.

On Tuesday, the seven states that use the Colorado River for hydration — Arizona, California, Colorado, Nevada, New Mexico, Utah and Wyoming — were supposed to agree a plan to cut their water usage. This comes after the region's driest two decades in 1,200 years.

However, the group missed the deadline, due to bitter fights. Most notably, six states have created a joint proposal for water savings, which California is trying to veto. The federal government, which wants joint cuts equivalent to a third of the average river flow, may now impose an emergency reduction plan. However, California will almost certainly contest this in court. Cue more fighting, as river levels drop.

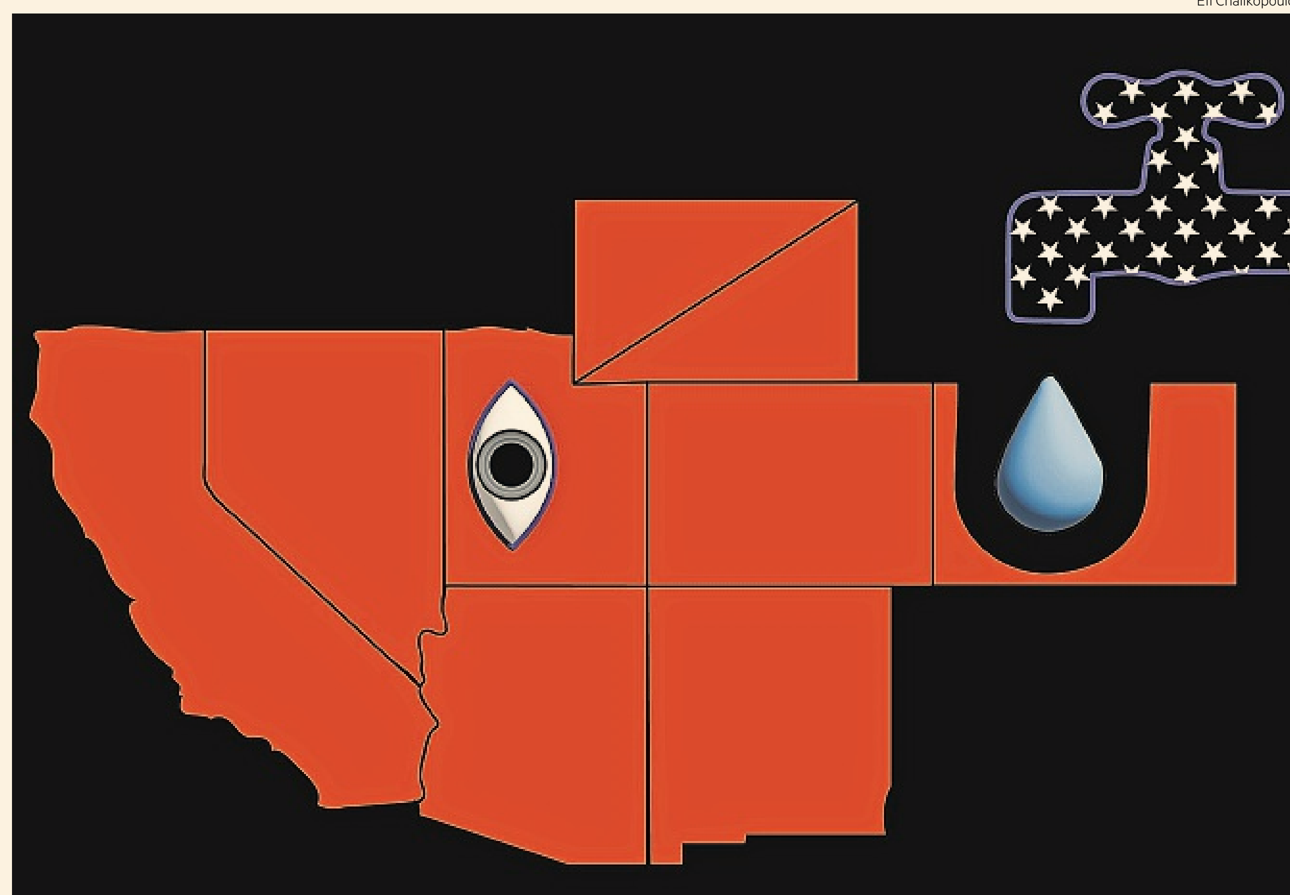
Investors should take note. In recent years, it has become painfully clear that shortages of key commodities, such as oil, lithium or corn, damage business. Unsurprisingly, investor interest in the pricing and supply of these commodities has soared.

By comparison, the question of water is oddly neglected. That is partly because the sector is less financialised (in other words, readily traded and hedged) than other commodities. Although the Chicago Mercantile Exchange launched water derivatives nearly three years ago, the market for these products is small.

The lack of attention also reflects a presumption in the west that water could and should always be readily available. Thus while the corporate world has scrambled to create accounting systems for carbon usage in recent years (via the Task Force on Climate-Related Financial Disclosures), it has only recently started developing ways to price water in corporate accounts.

However, this must — and will — change. After all, as the UN points out, "water scarcity is an increasing problem on every continent", due to population growth and climate change. Or as Kamala Harris, the US vice-president, noted pithily in 2021: "For years there were wars fought over oil. In a short time there will be wars fought over water."

Indeed it is already sparking cross-border strife. One oft-ignored detail about Russia's invasion of Ukraine is the bitter dispute about the supply of water to Crimea from Ukrainian canals. "Water stress", as the UN calls it, is also fuelling conflict within countries, particularly since many of them have water governance frameworks that are desperately outdated, if they exist at all.


Efi Chalikopoulou

The Colorado River is a case in point. The main regulations on water usage come via a treaty created in 1922. However, this was developed in an era when farmers were the main consumers of water, and makes no provisions at all for sprawling suburbs.

Moreover, since local land ownership generally comes with unlimited water usage rights, the current system is prone to arbitrage and abuse. As Nate Halverson, an investigative journalist, explains in a new documentary, *The Grab*, Middle Eastern investors have recently acquired land in places such as Arizona for water-intensive agriculture — which has sucked the wells of local farmers dry.

> A fight is looming about who should control water, the most precious and life-saving of commodities

Wall Street investment groups, spotting an opportunity, are now also racing to buy land and access to water rights, thus benefiting from a resource which is rising rapidly in value.

Take the New York-based hedge fund Water Asset Management: its investor pitch notes that "scarce clean water is the resource defining this century, much like plentiful oil defined the last" — and argues that "water investing has historically acted as an effective hedge against inflation" because prices are set to keep rising.

The arrival of financial investors is not necessarily a bad thing. It could make the pricing of water more rational, if it starts to reflect the real level of supplies. It might also attract more capital for investment in innovation, such as desalination technologies or measures to reduce leakage and waste. This is badly needed since there has hitherto been far less investment in water-linked innovations than in renewable energy.

But, as the sorry story of California's energy utilities show, financialisation can also come at a cost, in the form of price gouging and infrastructure cuts. And there are already signs of a rising political backlash against private investment in the region, with some officials in Colorado decrying the hedge funds as "vultures".

What could make these issues doubly contentious, Halverson tells me, is that some of America's national security officials suspect the US will eventually need to control the export of water-dense products — such as agricultural commodities — to reflect rising scarcity. Liquid protectionism looms.

To put it another way, what the Colorado River dispute shows is that a fight is looming about who should control this most precious and life-saving of commodities. Should it be private investors, the federal government or states? And what happens if they disagree?

Right now the answers are alarmingly unclear. Which is precisely why investors need to wake up and watch this fight. If nothing else, it is the first cloud in a much larger political storm.

gillian.tett@ft.com

The EU will struggle to de-risk its trade with China

EUROPE
Alan Beattie

De-risk, don't decouple, from the Chinese economy — this was the economic philosophy for the EU articulated by European Commission president Ursula von der Leyen at Davos last month. As organising principles go, it's not a bad one, certainly better than Brussels' nebulous "strategic autonomy" or the US's disingenuous "worker-centred trade policy".

The EU has for years been attempting to attain and hold a middle ground. On the one side is the US political predilection for using its federal powers to decouple its economy from China's. (It should be noted that it's unclear how far this will work: overall US-China goods trade probably hit an all-time record last year.) On the other is the EU's history of mainly letting commerce with China flow. But despite EU member states increasingly turning against Beijing, Brussels is struggling to construct tools to reduce a perceived dangerous reliance on Chinese trade.

Europe's ability to use policy is particularly weak in sensitive technologies with military and security applications. The EU has its own collective mechanisms for designing export controls. When there's an obvious threat, the EU can act swiftly, with unity and in co-ordination with Washington: the two trading powers rapidly imposed a broad range of export controls on Russia after the invasion of Ukraine, from semiconductors to submarine engines.

But when a policy is more contentious and particularly affects one member state, EU processes are generally pushed aside in favour of national competence. The details of the reported US-Netherlands-Japan agreement further restricting the sales of chips and chip-making kit to China remain to be seen. But it was the Dutch, with their comparative lack of economic and diplomatic heft, in the negotiating room with the US, not the EU collectively. The process was confidential and ad hoc, exactly the kind of environment in which Washington is particularly able to throw its weight about.

Another obvious weakness for collective EU action is the lack of a strategy on de-risking China trade more generally. Europe would like security of supply, and where feasible a domestic industry, in sectors it considers of strategic importance, particularly green goods. But the EU is far from achieving that.

> Brussels' ability to use policy is poor in sensitive technologies with military and security applications

One obvious example is that Europe, not helped by complacent sluggishness in its car industry, is lagging well behind China (and increasingly the US) in electric vehicles. The EU is poring over its underpowered and scattered subsidy toolkit to see if it can hope to match US spending on this, let alone China's.

In the meantime, in line with the EU's habit of relying on rules (of which it has plenty) rather than cash (of which it has relatively little), the bloc's most enthusiastic China de-riskers (France in particular) have high hopes of the EU's new foreign subsidies regulation. After years of debate, the new instrument comes into force in July. It enables the Commission to prevent state-subsidised companies from China or elsewhere producing in Europe or bidding for public procurement contracts there, essentially extending the EU's tough state aid constraints to foreign governments.

The question, though, is how it gets used. After all, the EU has long had the ability to use trade defence instruments (TDI) to impose anti-subsidy and anti-dumping duties on imports. But it has not employed those instruments to their full extent, certainly not enough to constitute a determined industrial policy in green or other high-tech goods.

A decade ago, in the face of opposition from member states, the Commission was forced to back down from its plan to impose hefty across-the-board anti-dumping and anti-subsidy duties on imports of solar cells from China, in effect ceding control of the EU solar market to Chinese companies.

Peering through the opacity of the complex Chinese subsidy regime to produce an estimate of competition-distorting handouts that might survive challenge at the World Trade Organization, which the EU quaintly seems still to care about, is not an easy task.

The anti-foreign subsidy tool, along with traditional TDI, is unlikely to achieve a carefully calibrated degree of distance between the EU and Chinese economies. It also risks being used too broadly, reflecting domestic lobbying rather than a well-judged strategy of competitiveness.

De-risking rather than an all-or-nothing approach to decoupling from China is a good way of framing the issue. But the EU isn't very well set up to do it. Brussels and the member states need to work hard to acquire and use precision-focused tools if they are to turn the slogan into more than elegant rhetoric.

alan.beattie@ft.com

OK boomer, you're more generous than we thought

BRITAIN
Chris Giles

In his first speech to the Conservative party conference as prime minister in 1991, Sir John Major pledged to create a future Britain with wealth cascading down the generations. "We do not see each generation starting out anew, with the past cut off and the future ignored," he said. More than 30 years later, Major can take some satisfaction from his success.

In the latest work on generational wealth accounts, professor James Sefton of Imperial College London estimates that £100bn a year flows down the generations in the form of bequests. That is more than 4 per cent of national income. At least another £11bn a year comes from lifetime gifts from parents to children. Sefton estimates the net present value of these transfers is equivalent to the entire value of the UK's housing stock.

Some older Brits might well be insensitive to the difficulties many younger people have with the high cost of housing and other expenses, earning themselves an "OK boomer" put-down. But as a generation, they are not frittering away their wealth on fast cars and cruises. Sefton says the data shows, "The older generations do care and they are passing down a significant amount".

Private intergenerational redistribution does not stop there. Unpaid childcare is worth £132bn a year. And although official estimates are a little dated, they suggest that unpaid social care of sick or elderly adults is worth £57bn a year. In total, this "private welfare" of nearly £300bn a year is more than the public welfare bill for pensions and other social security of £261bn in 2022-23. No one should think of the state as the only provider of a social safety net in Britain or anywhere else.

> An estimated £100bn a year flows down the generations in the form of bequests

Society would be much worse off without private welfare, although it has a bad reputation, with connotations of paying for privilege and undermining equal opportunities. And there is no doubt that there are elements of truth in these accusations. But just imagine how much more pressure there would be on public services without families caring for each other, helping the education system and providing financial lifelines.

Private welfare is also hugely popular, so much so that well-meaning suggestions of taxing wealth and inheritance much more heavily to increase equality of opportunity fall flat with the public. In a detailed examination of public attitudes, professor Ben Ansell of Oxford university finds wealth and inheritance taxes extremely unpopular among voters across the political spectrum.

People see wealth as largely earned from taxed income by virtuous savers. They do not think it should be taxed twice. "There is a moral logic to retaining wealth that is deeply embedded in the way people think about the world," Ansell says. With such firmly entrenched public attitudes, anything more than tweaking wealth and inheritance taxes is not an attractive option for politicians seeking electoral success.

That means we should stop looking at the rise in private wealth as a magical source of revenue to solve society's problems and instead focus on what else we can do to attack the lack of social mobility — the main downside of wealth cascading down the generations. This would mean, for example, governments redoubling efforts to increase the supply of housing to limit rental costs for those without access to the bank of Mum and Dad. Universities must continue successful programmes to increase access for more disadvantaged students. And it gives a justification for workplace diversity schemes that increase opportunities for people from different backgrounds.

Public policy is messier than textbooks suggest. Private welfare is large, generally virtuous and popular. Unpopular wealth and inheritance taxes raise little. So, when we want to find ways to improve the lot of younger generations, we should stop looking at boomer wealth as a magic tax pot and find more practical and popular policies instead.

chris.giles@ft.com