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Israel Charges Toward a More Competitive, Less Monopolistic Economy

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The Israeli economy is in the midst of a profound restructuring, reminiscent of Teddy Roosevelt's early 20th century trust-busting in the United States. Beginning in 2013, the Israeli government enacted sweeping reforms that opened the economy for consumers and investors by breaking up monopolies and increasing competition. The divestment of the country's two biggest credit card businesses in early 2019 is the latest sign of these fundamental economic changes.

Until this spring, Israel's two largest banks – Bank Hapoalim and Bank Leumi – oversaw the country's most popular credit cards. Bank Hapoalim's Isracard is the largest credit card brand in Israel, with 5 million cards issued that account for 50% of Israeli credit card transaction volume. Leumi Card and the ICC-Cal card (controlled by Bank Discount, Israel's third-largest bank) evenly split the remaining 50% of the credit card market. According to the Israeli business newspaper, Globes, credit card transactions totaled 300 billion shekels ($84 billion) in 2017 and grew by 7% over the prior year.

In 2017, the Israeli government passed "The Law for Increasing Competition and Reducing Concentration in the Israeli Banking Market". The law ordered Bank Hapoalim and Bank Leumi to divest their credit card businesses. To meet the requirements, Bank Leumi sold Leumi Card to the U.S. private equity firm Warburg Pincus in March 2019. Bank Hapoalim opted instead for an initial public offering (IPO) of its Isracard subsidiary on the Tel-Aviv Stock Exchange (TASE). Bank Hapoalim sold 65% of Isracard shares in May and will sell most of its remaining stake by the end of this year to fulfill its lawful obligations.

Credit Card Competition Should Boost Consumption Spending in Israel

Regulators hope intensified competition will expand Israel's consumer credit market. Most cards in Israel are charge cards, rather than the revolving lines of credit familiar to Americans. Fees can be high and charge limits tight, with banks requiring payment in full each month. Loan options are available, but credit limits are low and typically restricted to customers with decent credit histories.

Many options resemble installment payment plans, rather than bank credit. Perhaps more importantly, cards in Israel offer meager fraud or theft protection compared to protection offered to American consumers. Better protections would reduce transaction risks for many consumers and could boost personal consumption expenditures above 56% of GDP (in comparison, personal consumption expenditures are 67% of GDP in the United States).

Increased competition should improve credit availability and services for Israeli consumers. For example, following the passage of the credit card competition law, Bank of Jerusalem – one of the smaller banks in Israel – announced it will launch its own credit card business focused on customers previously denied credit. New entrants, like Bank of Jerusalem, will benefit from another aspect of the law – the larger banks must work with more than one credit card company after they are allowed to re-enter the credit card business.

Oligarchs on the Run

The changes to the credit card business are an important part of the much broader "Law for the Promotion of Competition and Reduction of Concentration" passed in December 2013. This law mandated separate ownership of financial and nonfinancial companies. With a deadline of December 2019, the tycoons controlling monopolistic business empires through preferential access to capital have had to sell off important segments of their enterprises.

With the deadline looming, Israeli tycoons are engaged in a flurry of deal-making. Shari Arison, who controlled both Bank Hapoalim and Israel's largest construction firm, Shikun v'Binui, sold a portion of her Bank Hapoalim shares in a secondary offering on the TASE last November. She will continue selling shares until her stake is reduced to less than 5%, at which time Bank Hapoalim will be entirely publicly traded. She also sold her controlling interest in Shikun v'Binui to a U.S. based real estate company, putting these previously intertwined entities completely at arm's length.

Other examples abound. Delek Group, a conglomerate controlled by billionaire Yitzhak Tshuvah that owns Israel's offshore natural gas fields, vast real estate holdings and a major insurer, signed a deal to sell its stake in Phoenix Insurance to U.S. private equity funds in May. IDB Group once controlled Israel's third-largest bank, one of its largest insurance companies, and significant non-financial holdings. Over the past six years, regulators dismantled this empire, and its former billionaire owner, Nochi Dankner – the poster child for the excesses of the monopolist moguls – is now serving a three-year jail term for fraud.

What Remains to Be Done

In addition to the reforms outlined above, the Israeli government expanded competition in the cellular telephony market. Predictably, monthly charges for consumers plummeted over the past several years. Last summer, the Knesset passed a law to end Israel Electric Corporation's (IEC) near-monopoly over electricity production in Israel. Over the next five years, IEC will divest several plants, reduce bloated headcount, allow new entrants into the market, and moderate prices for consumers.

Most of the reforms to date affect Israel's largest companies and business groups. Even so, a host of anti-competitive business practices remain common throughout the Israeli economy (with the notable exception of the technology sector). To address pervasive monopoly power, the Israeli government passed another landmark piece of legislation in January 2019. The Israel Antitrust Authority will be renamed the "Competition Authority", with a broader mandate to act if it finds that companies or industries exercise and abuse "significant market power".

At Israel Investment Advisors, LLC, we have issued many reports over the years outlining the privatization of Israel's state-owned socialist economy into the hands of the monopolist tycoons. Now, Israel is in rapid transition toward a free-market economy, more characterized by competition than privilege, connections or political influence. This restructuring will sustain Israel's long-term economic growth, benefit Israeli consumers, and offer greater opportunities to stock market investors like us.

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