

Have Globalization and Liberalization “Normalized” Israel’s Political Economy?

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In his 1960 study *The Israel Economy: The First Decade*, the distinguished economist Don Patinkin complained bitterly that Israel’s political leaders acted as if they could defy the laws of economics.¹ The government consistently spent far more than it raised in taxes, just as the economy as a whole consumed more, especially in imports, than it could ever pay for. Patinkin believed that policymakers would be forced to adopt more market-conforming policies, but he was mistaken. So long as the leaders of the country could exploit Jewishness and geopolitics to mobilize loans and gifts from abroad, they did not need to heed the dictates of the market. Rationalized by its goals of building and defending the precarious new state and attracting and retaining Jewish immigrants, the government’s “profligacy” had a remarkably long life.

During roughly the first four decades of Israel’s existence there was a durable and almost wall-to-wall policy consensus among policymakers in Israel regarding the indispensability of open, organized, and subsidized Jewish immigration; the need for the state to underwrite the economic security of all Jewish citizens and to “close gaps” between different Jewish ethnic groups; the necessity to meet Israel’s defense “imperatives” irrespective of economic considerations; and the desirability of the state playing an active developmental role in the economy. Over the past 10–15 years these four consensual pillars, especially the last, have for the first time been confronted by a comprehensive and vigorously articulated alternative: the (neo) liberal view which glorifies individual acquisitiveness and views the state as an impediment to the workings of the market economy, a conviction hitherto voiced only by economists or by disaffected businessmen lacking the right connections. Both of Israel’s two major political parties are now committed to reducing the economic

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role of government, making the economy more attractive to foreign investors and other shibboleths of contemporary economic liberalism. Has the long-standing "exceptionalism" of Israel's political economy come to an end?

This paper reviews and weighs empirical evidence on the contemporary evolution of Israel's political economy which is drawn mainly from published data and documentary sources. For two reasons, this is not an easy task. First, liberalization is an ongoing drama, one in which the actors often have good reasons to engage in misinformation and camouflage. Second, we are dealing here with politically charged issues that many writers find it hard to be dispassionate about. Under these circumstances, *theory* and *comparison* (both historical and cross-national) are crucial aids to interpretation of the evidence.

The theoretical underpinnings of this paper are drawn from my book *Labour and the Political Economy in Israel*, in which the political economy was conceived as "a dynamic and potentially contradictory *gestalt* that encompasses a broad range of institutional spheres."² This perspective assumes that "state" and "economy" are always interdependent, but that the terms of this interdependence are contingent on struggles and alliances among economic classes and sectors on the one hand and the political and bureaucratic managers of the state on the other. When a lasting pattern of policy priorities becomes buttressed by institutions, coalitions, and discourses it is helpful to speak of a "policy regime." Extending the notion of policy regimes to incorporate the structure of the economy and its principal engines of growth conveys the broader notion of a political-economic regime.³ In order to understand why Israel has taken the path of liberalization, and what this might mean, the next section of the paper will attend to both the stable and the dynamic elements of its political-economic history: the inner logic characterizing the country's past and present regimes, and the tensions and conditionality built into them.

The paper also draws inspiration from a growing literature in the comparative study of political economy on the consequences of globalization for domestic policy. Scholars disagree sharply on this issue. Some have issued doomsday proclamations of the end of national sovereignty, but it is also reasonable to reverse the apparent relationship of global to domestic processes, recognizing that globalization is filtered and in part even constructed by the intentional policies of national governments.⁴ Recent comparative research vigorously asserts the relative autonomy of nation-state, finding little or no evidence for the claim that economic and social policies are bound to converge in the wake of rising openness to international trade and capital mobility. National policy distinctiveness persists, and in some critical areas retrenchment of the state's role is problematic and may even be followed by further expansion. The progress of liberalization and structural change has not been wholesale, mechanical, or uniform. The pressures

posed by globalization vary both in their objective dimensions and in the manner that they are politically constructed. Politics still appear to matter: conflicts of interest and ideology between political parties have persisting (although weakened) effects on policy, and the political costs of liberalization policies are sometimes prohibitive.⁵

Case research has an indispensable analytical role to play in clarifying the universality of the thrust to liberalize. Careful study of individual countries typically reveals that the structural features of political economies – especially those defining characteristics which are likely to enhance or impede liberalization processes – are quite distinctive, even within clusters of countries that appear to share the same political-economic regime.⁶ Accordingly, it is reasonable to assume that the particular barriers to liberalization in Israel must be sought in those features of the Israeli political economy that most distinguish it from other economically advanced capitalist democracies.

THE POLITICAL ECONOMY OF ISRAELI EXCEPTIONALISM

Any observer of Israeli society over the last decade cannot fail to be struck by the rise of the market and market culture in contemporary Israel. Adapting John G. Ruggie's well-known phrase, I find it helpful to think of Israel's previous political-economic regimes as having shared an "embedded illiberalism" with roots in the pre-state experience of colonization by Jewish settlers and their conflict with the Palestinians and the Arab world.⁷ Briefly, the conditions of Jewish settlement required that the political institutions of the Zionist movement and the Jewish community in Palestine dominate the mobilization of capital and the purchase of land. Because of their common interest in neutralizing an unfavorable labor market, the labor and Zionist movements cooperated intensely. Organized Zionism supported the workers' movement, which shielded Jewish workers from Arab competition by providing subsidized employment and social services. A wide consensus developed around the view that economic collectivism was indispensable to the success of Jewish colonization but that it could and should coexist with a capitalist market economy.⁸

The labor movement so dominated Zionist politics over so long a period, that it was tempting to identify this collectivism with socialist ideology. In fact, the world-view of labor Zionism was only secondarily socialist; its central theme was Jewish nationalism.⁹ The arrival of sovereignty reinforced the collectivist consensus. The ruling Labor Party adopted a highly interventionist economic stance but embraced neither of the innovations associated with western parliamentary socialism after the war – nationalization and the welfare state. The government was committed to assisting the private sector along with state and Histadrut-owned enterprises; in any case, the local bourgeoisie was neither able nor willing to bear principal responsibility for economic development, and private industrialists were the first to demand a controlled (protected

and subsidized) economy. In the domain of social policy, attempts to introduce a modern system of social insurance along the lines of postwar British reforms were stillborn.¹⁰

In the event, state intervention was rationalized by specifically Israeli constructions: the challenges of arming and defending the country, settling huge waves of new immigrants, bringing territory where Arabs lived or which bordered Arab countries under the control of the state, and developing an economic infrastructure that would permit immigrant absorption and eventually eliminate Israel's dependence on charity and loans. This constituted what may be thought of as the "demand side" of the interventionist state in Israel. The "supply side" was no less compelling. It rested on Israel's singular capacity to attract gift capital from foreign donors stemming partly from its active alignment with the West in the East-West struggle, but even more importantly from the Jewish character of the state which enabled it to make claims on Jewish communities abroad and obtain substantial financial compensation from Germany on behalf of world Jewry.¹¹ These "unilateral transfers," as well as a relatively favorable borrowing capacity for a struggling new entity, provided the Israeli state with the means to steer economic development and play a very active role in distributional processes. Economic growth was powered by the state's ability to mobilize money and people from abroad. Tellingly, both before and since sovereignty business cycles have been driven by waves of immigration and periodic eruptions of violence and war.¹² Under these conditions, it is not surprising that liberal arguments in favor of "free" markets and self-interested private investment enjoyed limited appeal among policymakers.

CONTINUITY AND CHANGE

Perhaps the clearest indication of the structural underpinnings of the role of the state in the Israeli economy was the continuity that became evident after the 1977 elections, when Labor's long period of uninterrupted rule was abruptly brought to a close. Despite the new Likud government's claims to be embarking on a radical program of liberalization (complete with a cameo appearance by Milton Friedman), widespread expectations of a fundamental shift in economic policy priorities proved to be premature.¹³ The enduring parameters of economic policy proved to include the following:¹⁴

1. High levels of government expenditure and employment (biased by commitments to defense and immigrant absorption), relative to the economy's level of development.
2. Extensive state control of savings, investment, and foreign currency.
3. Modest public ownership alongside a high degree of public subsidy of private and Histadrut-owned business.

4. Corporatist delegation of state functions to the Histadrut, with the state trading subsidies for policy cooperation and legitimation.

This is not to suggest that Israel's political economy has been immutable to change. Rather, changes have not necessarily been coupled with policy proclamations and they must be understood more broadly than exclusive concentration on policy allows. This is why it is more useful to think in terms of political-economic regimes, an analytical construct which abstracts the underlying "model" of political economy in a given epoch from the broad ensemble of economic, political, and institutional variables which supports it.

For an understanding of the background to contemporary economic liberalization in Israel, two such regimes are noteworthy. The first, characterizing the period of rapid growth from the mid-1950s to the mid-1960s, rested on the synergy created by the meeting of two imported influences: German reparations and other foreign gifts, and the arrival of masses of propertyless immigrants who (among other things) expanded the markets for housing and consumer essentials and simultaneously provided a cheap labor force for their production.¹⁵ The state was positioned strategically, as the factor that directed immigration and settlement, the disposal of foreign gifts, and housing and industrial policy. It created a highly politicized and closely regulated economy with partially competing blocs of public, private, and Histadrut capital, and a high degree of labor market segmentation parallel to ethnic and national divisions in the working class. These arrangements, which I have described elsewhere as "the system of 1948," awarded both the state and the party that dominated it considerable autonomy – that is, the capacity to steer business interests and civil society rather than be steered by them.¹⁶

After a decade of rapid growth, this regime was exhausted. The shift to full employment upset power relations by reducing the dependence of ordinary workers on the state and the ruling parties. The winding down of immigration and German aid persuaded the state to cut back both the scope of its presence in the economy, and the extent of its subsidizing role. It was thought necessary to discipline both labor and capital. The instrument for exercising this discipline was a recessionary economic policy – the *mitun* or slowdown of 1966–67.¹⁷

This cooling-off period proved to be short-lived. In the aftermath of the Six Day War a new "system of 1967" came into being that fundamentally altered key elements of Israel's political-economic regime. Although senior politicians and bureaucrats developed a sudden fondness for *laissez-faire* rhetoric, and some elements of economic regulation did become less direct, there was no undermining of the state's role as the central pivot of the economy. Instead, this pivot found a new axis in the "military-industrial complex."¹⁸ The basis for this development was a potent combination of government-subsidized local

military procurement, the burgeoning world market for arms, and (from 1970) US government financing of Israel's foreign arms purchases. The occupation of the West Bank and Gaza also played an important part in reviving growth along new lines, both by extending the scope of Israel's "domestic" product market, and by providing a source of cheap labor to replace increasingly scarce Israeli manual workers, especially in construction.

During the 1970s the structure of the Israeli economy, and its labor market, became increasingly dualistic. "Big business" developed in the bureaucratic sector, nominally controlled by the state or the Histadrut, frequently linked to military requirements, and employing exclusively Jewish labor under the favorable conditions of a sheltered or "primary" labor market. The more competitive economic periphery, smaller-scale and privately owned, operated a "secondary" labor market employing a mixed (Jewish and Arab) workforce.¹⁹

As in the prewar period, the coherence of the post-1967 growth model rested on state subsidy of both capital and labor. The most compelling claims to subsidy were made by the bureaucratic sector. The key actors in this respect were the big banks and the big conglomerates under their control; the "strong" Workers' Committees in the bureaucratic sector; and the Histadrut (simultaneously representing big business and "big labor"). The state found itself increasingly indebted to these powerful interests, and unable to assert its will and extract benefits in return for the rising tide of subsidies. Under the conditions prevailing in the world economy of the post-1973 period, and given the earmarked nature of US aid, economic policy became strikingly "undisciplined." Symptomatic of this was the public sector's excessive deficit spending, frequent recourse to corrective devaluations, and government lending policies that favored borrowers at the state's expense. The result of these policies was to exacerbate Israel's immanent condition of stagflation after 1973, while paradoxically enriching its big banks and conglomerates.²⁰

This is the background to the Emergency Stabilization Plan of June 1985.²¹ In hindsight, the astonishing success of the plan in bringing the Israeli economy back from the brink of hyperinflation is of lesser importance than the structural change that it inaugurated – the contemporary liberalizing shift in Israel's political-economic regime. The most compelling interpretation of the stabilization plan is that, just like the *mitun*, it was a radical attempt by the state – led by senior economic policy mandarins and sages – to regain autonomy by strengthening market discipline.²² The plan and the structural reforms temporarily hidden in its shadow constituted a frontal attack on mechanisms that had previously protected societal interests, directly or indirectly at the expense of the state: devaluations, protectionism, wage indexation, unlinked public lending, and diffuse investment incentives.

Why had it taken the state so long to develop a coherent policy

response to the problems of economic stagnation and hyperinflation? While most observers have emphasized the role of public opinion and the leadership finally shown by the government, the state's drive to reinstate its autonomy accounts more effectively for the timing of its stabilization initiative. By 1985 the economic crisis posed tangible threats to the state itself – its fundamental legitimacy and, no less importantly, its economic viability. While critics cast doubt on the plan's macro-economic effectiveness,²³ its consequences for the viability and autonomy of the state were very substantial indeed. Talk of the need for a "strong leader" (an ominous threat to the political regime) disappeared; state extraction of economic resources through taxation was restored to effectiveness; it was possible to set in motion a long-overdue flattening of military expenditure; and a worrying hole in Israel's foreign reserves was filled, in large part by virtue of enlarged United States aid.

This is not to argue that the acute crisis which economic instability posed to core state interests was the only relevant factor. As is often the case when history turns at a major crossroads, multiple causal forces converged in mid-1985. First, many of Israel's largest corporations and investors began to believe that there were limits to the profitability of military-based demand and inflationary subsidies, and that the time was ripe for a new and more outward-looking economic strategy.²⁴ Second, the political conjuncture in mid-1985 was especially favorable to radical policy initiatives.²⁵ There was little scope for profiting from party rivalry under the National Unity government which was then in its early stages. And the leadership of the Histadrut, the most vocal potential opposition to the stabilization plan given that it was expected to slash real wages, was politically indebted to the government for its aid in a recent election. All of these circumstances together offered exceptional leeway to the professional economists in state agencies and university economics departments who prepared and lobbied for the stabilization plan. The architects of the plan cannily grasped the opportunity to go beyond crisis management and engineer a strategic reorientation of economic policy.²⁶ Have they succeeded in liberalizing the Israeli economy?

INDICATORS OF LIBERALIZATION

The term liberalization is typically applied to reforms of countries' trade policies (removing barriers to imports and ending preferential treatment of exports) and their foreign currency regimes (eliminating restrictions on inward and outward flows of foreign currency and letting exchange rates float more freely). From a broader perspective, the principal goal of liberalizing economic reforms in Israel and elsewhere has been state contraction, a fundamental alteration of the division of labor between markets and the state by means that include privatization, expenditure, and tax cuts, sectoral "deregulation," etc. To the extent that this aim is

achieved, the state's ownership, regulatory, and distributional roles are diminished in favor of the market and the private sector. The conventional wisdom assumes that combining state contraction with increased exposure to international competition causes markets to become both more important and more competitive.

Internationalization

In 1996 Israel's "internationalization" was ranked 18 out of 46 countries – including all of the OECD and the rapidly growing NICs – by the *World Competitiveness Yearbook*.²⁷ Liberalization in the sense of opening up to the global economy should be evidenced at the macro level by buying more from the outside world and selling more to it, and at the micro level by the elimination of import restrictions and export incentives. The scope and regulation of trade can only tell part of the story, however, especially in Israel where politicization has been the most salient feature of external economic relations. In the Israeli context liberalization would also imply a change in the character of capital inflow, from state to market-sponsored and from gifts to loans or investments.

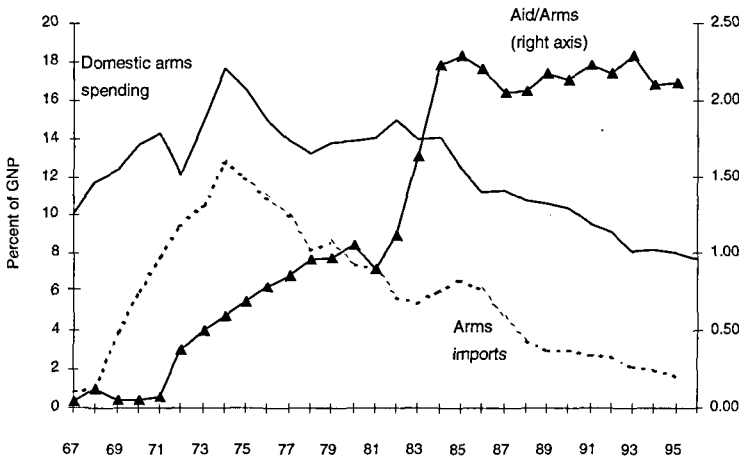
Has the economy become more involved in trade? Since its establishment as a state and in fact well before that, Israel has been chronically dependent on imported goods and services yet unable to pay for them from export revenues alone. The total value of trade (imports + exports) relative to national product has always been exceptionally high compared to other countries, three-quarters or more of GNP. Setting aside fluctuations, it is evident that this ratio experienced a *declining trend* between the late 1970s and the early 1990s. The seeming absence of a tendency toward increasing openness is again unusual from a comparative perspective.²⁸

Part of the puzzle is resolved by recognizing that Israel's relatively strong growth rates in the 1990s hide a major increase in the absolute volume of trade. Since stabilization the dollar value of both imports and exports has surged upwards, even taking account of rapid population growth. In addition, two elements of Israel's trade that arguably warrant separate consideration – the diamond-processing industry and arms imports – have been contracting. The Bank of Israel estimates that setting these elements aside, during the 1990s the scope of trade increased from roughly 50 percent to 70 percent of national product.²⁹ No less significant than the quantitative trend, foreign sales have altered qualitatively – more high-tech yet less military-centered; less dependent on the European market and more on "emerging" markets in eastern Europe and, especially, Asia.³⁰ Nevertheless, during the present decade exports have failed to keep pace with rapidly rising imports as trade barriers came down and cheap imports became a *de facto* mainstay of Israel's anti-inflationary policy. Consequently, the civilian "import

surplus" (excess of imports over exports, again net of diamonds) has risen to a staggering 15 percent of national product – far above OECD standards.³¹

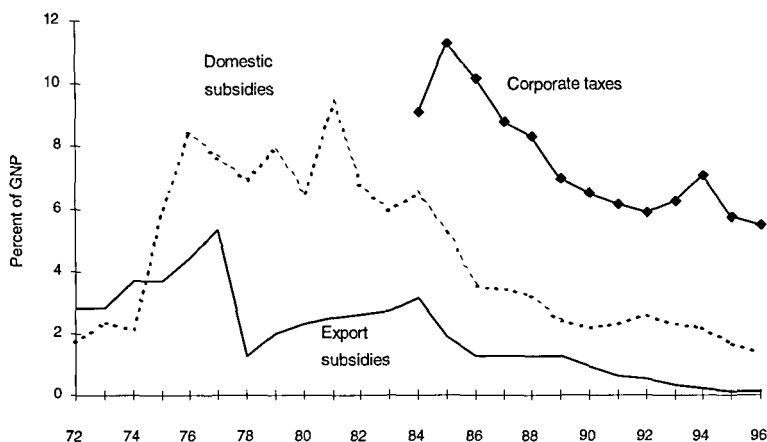
Theoretically, opening up to trade should have important microeconomic effects, obliging domestic producers to feel the whip of foreign competition and encouraging exports to be driven by comparative advantage in world markets. The first of these variables, exposure to competition from import substitutes, has increased significantly since stabilization. Between 1985 and 1990 there was a 30 percent increase in the penetration of domestic markets for manufactured goods.³² Still, the impact of greater openness to imports on competition has been weakened by monopolistic tendencies among importers. Moreover, while after much foot-dragging Israel honored its free trade agreements with the EU (1975) and the United States (1985), defenses against competing imports from other countries (mostly NICs) were actually fortified for a time. However, during the 1990s these barriers have gradually come down.³³ On the other side of the trade ledger, export subsidies – at least those for which statistics are available – have been phased out (see *State Expenditure*, below, and Figure 2). At their peak in the period 1970-84 these subsidies averaged 3 percent of GNP, but by 1990 they had been virtually eliminated.³⁴

FIGURE 1
MILITARY SPENDING AND FOREIGN AID



Note: Military spending as a percent of GNP, using the SNA system from 1980 (old series linked to new at 1980). "Domestic" is net domestic defense consumption; "imports" is direct defense imports, including advance payments. The "aid to arms" ratio is intergovernmental transfers divided by defense imports. To dampen their volatility, imports and aid are three-year moving averages (BOI-96, Appendix Table Hay-1a,1b).

FIGURE 2
THE STATE AND BUSINESS



Note: Subsidies on exports and domestic production combine direct supports and credit subsidies. (BOI-96, Appendix Table Hay-7). Revenues from corporate taxes combine two series. First, corporate income tax data published by the State Revenues Administration (annual report for 1996, Table *Chet-1* and parallel data from earlier reports). Second, CBS data on social security contributions and payroll taxes (Abstract-97, Table 6.13 and earlier years).

Has the nature of capital inflow changed? “Unilateral transfers” from foreign sympathizers and governments have always been crucial both for meeting Israel’s external obligations and for financing the role of the state in the economy. One variety of gift capital, that which emanates from Diaspora Jewry, has gradually declined in importance.³⁵ Since the beginning of the 1970s the United States government has become the pre-eminent source. By the late 1970s the import of American arms had plateaued at around 8 percent of GNP, and American aid was effectively paying for them in full (Figure 1). In 1984 and 1985 Israel’s foreign economic relations took a dramatic new turn. A wide gap emerged in Israel’s favor between what it receives from the US government and its purchases of US arms. In the first half of the 1990s net US aid averaged over 3 billion dollars a year, up by a billion dollars from a decade before. At the same time Israel’s purchases of imported arms were declining, especially in relation to the rapidly growing national product. As the combined result of these two trends, for more than a decade the ratio of aid to arms has been at least 2:1.

Not only has the pure gift element in US aid increased substantially

since the mid-1980s, but following the transition to a Labor government after the 1992 elections Israel was able to obtain official US guarantees for \$10 billion worth of future commercial loans. Like the peace process which was also inaugurated following the 1992 elections, the loan guarantees have helped raise Israel's commercial credit-worthiness abroad.³⁶ So far, in most years of the 1990s this has helped give the state the resources and flexibility to maintain or increase non-defense spending while actually reducing the budget deficit and the public debt and accumulating very high levels of foreign reserves.

The political-economic implication of these changes is multi-dimensional. The increase in the gift component of US aid and the addition of the loan guarantees has enhanced the scope and autonomy of the state in the economic arena. At the same time, by helping relieve the budget deficit and the shortage of hard currency that reached crisis proportions prior to stabilization, American aid created necessary (although not of course sufficient) conditions for liberalization of the capital market and the foreign exchange regime, which in turn opened up new possibilities for capital inflows and outflows through the market.

Foreign direct investment (FDI) has been the most novel and noticed element of Israel's contemporary integration into the world economy.³⁷ Net FDI was insignificant until the early 1990s and only at mid-decade did it reach substantial levels (1.5–2.0 billion dollars a year).³⁸ In the past the Israeli economy was too small and resource-poor to interest most foreign investors, and many big financial and corporate interests also stayed away because of the chronic state of war or their fear of losing Arab markets. The little FDI that did enter Israel typically involved Jewish businessmen with connections to Zionist philanthropy and the Israeli political establishment, who were induced to invest by a combination of generous subsidies and patriotic appeals.³⁹ Investments in Israel by Volkswagen, Nestles, Macdonalds, and numerous other well-known transnational enterprises indicate a substantial departure from this tradition, although not its elimination. The recent acquisitions, led by Charles Bronfman and Ted Arison respectively, of controlling interests in Koor and Bank Hapoalim – arguably the two most important corporate entities in Israel – are eloquent testimony to the continuing role of well-connected Jewish magnates.⁴⁰

There are additional reasons why the features of the new foreign investment warrant careful scrutiny. The effective scope of the capital inflow accompanying FDI is far more modest than the imagery conveyed by government and business discourse suggests. The largest deals (including those just mentioned) have been financed almost entirely by Israeli banks.⁴¹ The mushrooming of franchise operations in consumer markets also takes place, by definition, with a minimal financial commitment on the part of the foreign investor. Another significant limitation of FDI is that the state continues to generously subsidize showcase foreign investments. Intel's decision to open a major

production facility in Israel was conditional on a government subsidy so large (\$600 million) that the Investment Incentive Law had to be amended to make it legally possible.⁴²

FDI is not, of course, the only means by which overseas investors channel capital to Israel. Indeed, it has been complemented by an equal or larger stream of foreign purchases of shares issued by Israeli firms. Both, in turn, are overshadowed by the liquid capital (much of it “hot money” originating in Israeli companies) which has been attracted simply by high interest rates and convenient opportunities for “laundering.”⁴³

It is still too early to assess the scope or durability of Israel’s new status as a target for foreign investment, but there is no gainsaying the growing international orientation of Israeli business (mainly big business, but also smaller hi-tech firms), which in the last few years have become much more committed to raising capital via foreign banks and stock markets, undertaking joint ventures with foreign firms, and in some cases even setting up branch plants abroad. Reports of such activities fill the business-oriented media in Israel, although it is hard to gauge their scope with any precision. Aggregate data confirm, however, that like incoming FDI, outward direct investment has risen far above previous levels. For instance, in the period 1994–96 alone, industrial firms in Israel purchased one billion dollars worth of equity in foreign concerns.⁴⁴

State Expenditure

The decline since the mid-1980s in the share of national resources distributed by the state is quite remarkable. Total public expenditure had been equivalent to at least three-quarters of the national product since the “Yom Kippur War” in 1973. But two years after stabilization the figure fell to 62 percent and by 1994 it had troughed at only 54 percent. Almost all of the decline in government spending since the early eighties can be traced to defense (a drop of over 10 points of GNP), capital subsidies (down 8 points) and debt service (down nearly 5 points).⁴⁵

*The welfare state for business.*⁴⁶ The decline in capital subsidies is especially significant, given that much of the increase in transfer payments during the 1970s – which was the major factor behind the fiscal crisis of the early 1980s – consisted of payments and benefits to business.⁴⁷ One element in the cutback, already noted, has been the termination of subsidies specifically targeted to exporters. Subsidies on production for the domestic market have also been sharply reduced. As shown in Figure 2, during Israel’s initial inflationary spurt in the mid-1970s, the burden of these subsidies jumped fourfold to 8 percent of GNP, remaining at this level through the early 1980s. Phased reductions over the next decade brought their share back down to 2 percent.⁴⁸

Because of their indirect effects on the business sector, the implications of the other principal budget cuts – in debt service and

defense – have been no less portentous. Servicing the government's debt became a major source of profitability for Israel's biggest banks, especially during the 1983–88 period when it preempted an average of nearly a fifth of GDP.⁴⁹ Reductions since stabilization in the domestic defense budget, which had showered lucrative cost-plus contracts on large-scale local suppliers,⁵⁰ may also be assumed to have indirectly eroded the profitability of big business. From 1985 the domestic military procurement budget failed to increase in real terms, so that its share of Israel's growing GNP fell substantially (Figure 1).⁵¹

All of the data reviewed thus far appear to signify massive retrenchment of the "welfare state for business." But a fuller assessment of this issue also requires us to consider whether the apparent harshness of post-1985 policy toward business has not been mitigated by two developments that would not necessarily show up in these data: compensatory "tax expenditures," or the replacement of old subsidies by new ones.

Regarding taxation, as Swank has recently noted in a comparative study of OECD economies, despite the pressures exerted by mobile global capital on state managers, they continue to "defend the treasury." Accordingly, while governments have found it necessary to cut taxes on business the primacy of markets has also been invoked to justify the withdrawal of investment incentives.⁵² The same is true in Israel, where the other side of the equation is also evident: in aggregate, as can be seen in Figure 2, massive cuts in subsidies have been offset by tax cuts of similar magnitude. One of the immediate effects of stabilization was to revive the state's capacity to extract revenues from the business sector – a capacity which had been badly undermined by rapid inflation. Revenues from corporate income and payroll taxes rose sharply relative to national product immediately following stabilization, but since then taxes and subsidies have been declining more or less in tandem. A major reform in the mid-1980s and gradual additional cuts since then have brought the tax rate on undistributed profits down from an internationally high level of 61 percent in 1984 to the rich-country norm (only 36 percent) in 1996.⁵³ In addition, employer contributions to the social security system and other payroll taxes have been either reduced or taken over by the Treasury in order to help employers lower their labor costs.⁵⁴

Finally, while automatic and indirect capital subsidies have been dramatically cut, targeted incentives are more generous than ever. This has already been noted with respect to foreign investment, in the specific case of Intel's enlarged presence in Israel. It is also true of direct investment grants issued by the Ministry of Industry and Commerce, especially assistance to startup companies in high technology fields which was three times higher in real terms in 1992–94 than in 1985–87.⁵⁵

The welfare state for households. There is no evidence that aggregate social spending in Israel has fallen during the contemporary era of liberalization – an irony that holds for other countries as well.⁵⁶ Following a period of budget cutting in the 1980s, in the first half of the 1990s spending on the major categories of social services – health and education – rose, returning to approximately the same share of GNP as a decade earlier.⁵⁷ Expenditure on housing and immigrant absorption (important components of Israel's generosity toward Jewish newcomers) increased by well over 3 points of GNP, in response to the wave of immigration from the former Soviet Union. Transfer payments to households also grew, by about one and a half points of GNP.

The record of annual fluctuations in real social expenditure over the last 15 years shows that in addition to immigrant absorption, increased commitments have come about for a variety of reasons. The cost of the key income maintenance branches has grown mainly because of automatic benefit adjustments and demographic shifts (a larger and older population). In other instances, specific programs have experienced innovations that caused sudden steps in expenditure. The most notable example is the national health insurance law adopted in 1994 (see *The Labor Market*, below). There have also been a few cases where spending rose when liberal demands for equality coincided with increased political clout, leading to a broadening of the universal basis of social security.⁵⁸ Finally, one of the social services – a very expensive one, education – actually expanded during the 1990s. The Labor government elected in 1992 restored per capita spending to the level that prevailed before cuts were instituted in the 1980s.⁵⁹ This momentum has, however, stalled in several recent years.

None of this necessarily means that there has been no rollback of the welfare state, broadly-conceived. At least one significant form of social protection has been all but eliminated since the stabilization plan – consumer subsidies on food and public transportation, which at their peak in 1984 amounted to \$1.4 billion.⁶⁰ The Treasury has also sought and sometimes succeeded to erode entitlements (child allowances have been a favorite) or stymie the implementation of costly political promises (such as extension of the school day). As in most other countries, eligibility rules for unemployment insurance have become more restrictive, although this has not prevented rising take-up.⁶¹

In addition, it has been widely observed in Israel that private expenditure on social services has increased in the last decade to compensate for inadequate public provision.⁶² The public school system both requires and encourages parents to pay a range of fees and subsidies in public education. In the health field supplementary insurance schemes have recently proliferated, and the Treasury is expected to try to cut the cost of national health insurance by creating additional membership fees and service charges.

Critics see these signs of privatization of welfare as part of a broader

project of undermining the generosity and universality of the welfare state.⁶³ No less important but less noticed so far are the implications of the ascendancy of market-oriented criteria in relation to public sector employment and government policy toward outlying Jewish areas. So long as the "bureaucratic sector" sheltered key parts of the defense industries and other key industrial sectors that exclusively employed Jewish citizens, it was a haven for government-subsidized occupational welfare.⁶⁴ The retrenchment of both the scope and conditions of blue-collar employment that tends to follow privatization seriously threatens this system of welfare. Regional development incentives constituted a second element of the state's traditional role in supporting the living standards of Jewish citizens. The claim that these incentives are inefficient and no longer justified by security considerations has generated ongoing policy changes that threaten to substantially erode direct and indirect subsidies to housing, employment and public services in peripheral "development towns."

Competition and the Structure of Capital

The industrialization of Israel was both directed and financed by the state, working through the managers of the private, public and Histadrut sectors.⁶⁵ This *dirigisme* was practiced in a fashion which strongly encouraged the monopolistic tendencies that characterize capitalism in general, and small-country capitalism in particular.⁶⁶ Since the late 1960s a very substantial and quite integrated sector of big business has emerged in Israel. At the apex are only a handful of "business groups" constituted by very large conglomerates and banks. These two wings – the financial and non-financial – are moreover closely connected by virtue of bank ownership or simply as a result of the banks' multiple roles as investors, creditors and stockbrokers. The two biggest banks account for a majority of the country's highly diversified banking business, while conglomerates and other large firms have typically dominated the branches in which they operate.⁶⁷

The period between the Yom Kippur War and the stabilization plan furnished hothouse conditions for growth in the profitability and power of the big business groups.⁶⁸ Direct incentives and capital subsidies, cost-plus procurement contracts, and windfall profits from the government's practice of lending unlinked money and borrowing linked money all contributed to an impressive increase in capital accumulation at the apex of the business sector, despite the dampening effect of economic stagnation on profitability as a whole. The changing profile of state expenditure since stabilization which has already been discussed undoubtedly hurt the profitability of the large banks and conglomerates.⁶⁹

No less important, the government's nominal ownership of the largest banks – the result of the bailout which followed the stock market collapse of 1983 – offered the reformers an opportunity to force the big

banks to divest their controlling interests in industrial and service enterprises. This demand is part of a wider recent tendency for Treasury officials to place the issues of monopoly power and ownership concentration on the public policy agenda and to advocate tighter regulatory inhibitions on big business.⁷⁰ Together with the inflow of competing imports discussed in an earlier section, the result has been a decline in the monopolistic character of the market for manufactured goods.⁷¹

The recent “trust-busting” activities of the state, so alien to its traditional role of fostering concentration, should not, however, be overdramatized. The Treasury’s attempts to limit bank ownership of non-financial firms are only the latest round in a long-running battle, and some seasoned observers remain unconvinced that this battle will ever be won.⁷² There are a number of indications that the status quo is highly resistant to reform. First, by offering the banks postponements, special exceptions, tax incentives, and compensatory approved rises in bank fees and rate spreads, the state has gone to considerable lengths to sweeten the bitter pill of divestiture.⁷³ Second, even though new local and foreign private investors have acquired controlling interests in segments of big business, the existing groups were also strengthened in the 1990s by opportunities for expansion furnished by some major privatizations and by boom conditions in construction and infrastructure.⁷⁴ Third, the top executives who formerly ran firms in the public and Histadrut sectors continue to be major players in big business.

While the personal wealth of members of the former managerial oligarchy and their potential role as capitalists in their own right have grown substantially, their struggles for control have not always been crowned with success.⁷⁵ But internationalization need not threaten the interests of the local business elite, whether owners or managers. They are equally likely to utilize it as a resource in struggles for personal and institutional wealth and power.⁷⁶ Koor, which came close to bankruptcy in the 1980s, illustrates the renewed vitality of big business in the era of globalization. Like other big manufacturing interests, Koor has evidently benefited from economic trends of the nineties – diversification away from arms production, penetration of new overseas markets, increased financial ties with overseas capital, and booming local and global stock markets.⁷⁷

*Privatization and Deregulation*⁷⁸

The changes that liberalizers seek to effect in the structure of the economy are, of course, directed not only at stimulating competition but also at reducing the scope of state ownership of firms and organizations producing marketable goods and services. Summing up developments in Israel prior to the mid-1980s, one survey concluded that in this period “no serious effort was made to privatize public corporations.”⁷⁹ The first major initiative occurred in 1988, when the cabinet embraced an

ambitious privatization program drawn up by an international consulting firm. Yet as in other countries, privatization has been hampered by the problem of finding a method of sale that would be at once feasible, politically acceptable, and make a worthwhile addition to the state treasury, as well as the need to overcome opposition from employees, executives, and responsible cabinet ministers in corporations targeted for privatization.

Beginning in 1990 the government budget has included sizable projected revenues from privatization, but until recently only 15–20 percent of the targeted revenues were actually raised.⁸⁰ The first few major sales, based on hastily-concluded deals with local and foreign investors, netted disappointingly low revenues. Several subsequent public offerings on the Tel Aviv Stock Exchange were more successful but this outlet was closed off when the market collapsed in 1994. The Likud-led government that assumed office following the May 1996 elections has carried the process much further, most notably by the sale in September 1997 of the government's controlling stake in the country's largest bank (Bank Hapoalim) to a consortium of foreign and local investors. A number of other major privatizations in banking, arms production, and transportation appear imminent, but could yet run into obstacles of various kinds.

Deregulation, a second catchword of neoliberal reform programs, has been carried out at least partially in several areas, notably by the dismantling of producer boards in agriculture.⁸¹ As part of their recent "trust-busting" frenzy, the authorities have launched specific measures designed to eliminate monopoly "rents" created by licensing and rationing mechanisms that were operated by or with the consent of the state. Current examples include the markets for insurance, pay TV, overseas and cellular telephony, and taxis. However, insofar as barriers to entry other than licenses are high (as in most of these examples), the result is typically an expanded market capable of supporting a few more large-scale players, rather than the substitution of many small players for one big one.

By far the most important locus of deregulation in Israel has been the attempt to roll back the state's domination of what in the past could only euphemistically be called the "capital market." It will be recalled that prior to 1985 the state was the dominant source of investment capital; both reinvestment of undistributed profits and unregulated bank credit played very limited roles. The disposal of long-term savings (in bonds, pension funds, and bank savings plans) was heavily regulated in ways that funneled the lion's share of these assets to the state, with the result that the stock market played virtually no role in the mobilization of investment capital for the business sector.

Two different factors account for the state's historic domination of capital flows. Its ability to acquire extensive foreign gifts, part of which took the form of donated capital goods or raw materials, naturally

encouraged the state and its political masters to prefer institutional and political modes of allocation. Both the state bureaucracy and the governing party benefited greatly from their resultant ability to directly steer the course of economic and indeed societal development right down to the micro level. However, once erected this interventionist bias proved highly durable even when the state's ability to cover the costs by foreign gifts and the political profits to be reaped from intervention both diminished. The 1967 and 1973 wars were turning points after which the state's commitments grew far beyond its extractive capacities, with the result that budget deficits and the cost of servicing accumulated public debt greatly increased.

This fiscal crisis reinforced the state's long-standing preference for meeting its commitments by pre-empting private savings through regulations requiring banks, pension funds, and other institutional investors to automatically convert the bulk of their accumulations into government securities.⁸² Under these circumstances the state's relationship with the big banks became characterized by competition to attract private savings, as well as by collaboration (the banks were charged with the profitable tasks of mobilizing funds for the state and distributing credit on its behalf). The authorities' seeming inattention to the banks' extensive manipulation of their own share prices in the early 1980s was one of the ways by which the state's economic managers attempted to handle this mix of competition and collaboration.⁸³

In addition, to protect the state's autonomy in fixing domestic credit and interest rates, international currency flows and the holding of foreign currency inside Israel were limited or banned outright. While most foreign currency controls were removed by the first Likud government in 1977, it was still necessary to finance a growing deficit and as a result controls were gradually reinstated.⁸⁴

As this example demonstrates, lowering fiscal indebtedness was a necessary condition for capital market deregulation. With the abrupt ending of hyper-inflation by the stabilization plan in 1985, public sector costs were reduced and state revenues enhanced. Along with other elements of the plan (such as large cuts in price subsidies and the partial de-indexation of wages), these developments virtually wiped out the domestic budget deficit. Since then, Treasury and Bank of Israel officials and the responsible cabinet ministers have been committed to ending the various forms of government regulation of savings and credit and to easing the local capital market into the international market. The measures already implemented or decided upon include eliminating "directed credit" and encouraging businesses to turn instead to banks and the stock market; and cutting the state's claims on (and obligations to) pension funds, provident funds, and insurance companies. In addition, foreign currency flows and holdings have been partially deregulated, so that while the Israeli shekel is still not fully convertible, foreign interest rates now exert a stronger influence over local ones.

That the state today makes a diminished claim on domestic savings, and that it has devolved the setting of important financial parameters onto the market, cannot be in doubt. Yet it remains uncertain whether the still ongoing process of capital market reform will be fully completed.⁸⁵ As I have emphasized, the competitiveness of the enlarged capital market is significantly bounded, especially given the obstacles facing attempts to limit the role and power of the big banks. On the other hand, both sides have reason to be satisfied by the partially liberalized status quo. The Treasury and the Bank of Israel have been at least partly freed of the necessity of propping up financial institutions and bidding up the cost of attracting private savings, and are themselves among the potential beneficiaries of the accessibility of foreign capital markets.

At the same time, the new avenues for raising capital (especially the stock market) which have been opened up by the state's withdrawal and deregulation measures have widened the scope for at least the very largest concerns to lessen their traditional dependency on both the government and the banks. Yet this enhanced flexibility need not promote a radical break with past patterns of ownership and control of business. Companies that "went public" during the stock market boom of 1992–3 by and large continued to be dominated by the same individual owners or holders of controlling blocks of shares. Similarly, the increased role of stock markets – domestic and overseas – in the 1990s has not eliminated either government subsidies or bank credit as mainstays of investment finance. Reliance on the New York exchanges is realistic only for big or "hot" enterprises, while the local market is operated largely by, and to an important extent for the benefit of, the large banks. It is a testimony to this continued domination that independent brokers, nonbank financial institutions, and foreign commercial banks have all made very limited inroads into the market for financial services, despite facilitating changes in the rules of the game.⁸⁶

The Labor Market

Liberalization of the labor market merits separate treatment because, as I emphasized in the historical introduction, the labor market was the stimulus and original site of many of the most distinctive features of Israel's political economy. The problem of creating jobs for propertyless Jewish settlers and insulating them from Arab competition led to the creation in 1920 of the Histadrut as a unitary, multifunctional, politicized national labor organization that for more than half a century played a dominant role in politics, the economy, and social protection. The problem of generating work for settlers also stimulated the public and Histadrut economies, where Israel's "bureaucratic sector" took root. The drive to provide immigrants with jobs and prevent emigration encouraged a political consensus on the desirability of full employment, as well as the readiness of successive governments to subsidize an inefficient business sector provided that jobs were created.

Given this background, the labor market sphere has generated what must be judged as perhaps the three most remarkable signs of contemporary change in Israel's political economy. First, revolutionary transformations of the structure and rationale of the Histadrut have led some observers to cast doubt on its continued viability. In the last few years the labor organization has experienced an internal political upheaval, massive membership losses, and the paring down of its mandate to trade union representation. Second, the government has violated an enduring nationalist taboo by admitting large numbers of foreign *gastarbeiter* who have replenished and enlarged Israel's stock of cheap non-citizen labor. Third, privatization of public and Histadrut-owned business enterprises accompanied by reduction or "casualization" of employment, together with diminished activity by the public sector (including the military) in creating new jobs, have retrenched the "bureaucratic sector."

It is hard to exaggerate the importance of the Histadrut, prior to the 1990s, in diverse spheres of Israel's political economy: power-brokering in the Labor Party; shaping the formation of economic and social policy; monopolizing the national-level representation of labor and centralized collective bargaining; nominally directing the country's main health fund and several of its largest financial and industrial enterprises; and leading an irresistible "distributional coalition" by coordinating the demands of private and Histadrut business and siding with privileged public sector workers.⁸⁷ The decomposition of the Histadrut's complex role-set had multiple sources, but the most salient (and mutually reinforcing) developments may be summarized as follows.

1. In 1979, after failing to gain the vital cooperation of the Histadrut for restrictive wage and economic policies, the Likud government's Minister of Finance revoked a long-standing arrangement whereby the Treasury authorized and subsidized the Histadrut's use of its pension fund accumulations to finance investment by its corporate affiliates. This act eliminated the principal source of Bank Hapoalim's leverage over its largest client, the Histadrut economy. Then in 1983 following the bank share collapse Bank Hapoalim suffered major losses and was effectively nationalized pending privatization. Along with contraction of military-related demand in Israel and worldwide, and the effects of deflation, the loss of favorable pension fund financing also precipitated an acute crisis in Koor, the Histadrut's flagship conglomerate.
2. In the labor relations sphere, determined employers – including Koor – embarked on the same road to decentralization and flexibilization of labor relations followed by their counterparts in other countries. Preoccupied with rearguard struggles to defend its affiliated pension funds, health service, and business enterprises, as well as its position inside the Labor Party, and sensitive primarily to pressures from

powerful groups of workers who could threaten its representational monopoly, the Histadrut leadership did little to counter layoffs and clawbacks in crisis-stricken firms, or the growth of individual employment contracts, subcontracting, and temporary employment. Then, partly for conjunctural political reasons and partly with an eye to obtaining aid for Koor's ailing enterprises, the Histadrut cooperated with a key element of the 1985 stabilization plan – the dismantling (albeit incomplete) of wage indexation. This removed the most significant aspect of its role in countrywide wage negotiations. In addition, the “framework agreements” hitherto negotiated for the whole of the business sector between the Histadrut and the Manufacturers Association were scrapped.⁸⁸ The combined result of the twin crises in the Histadrut's economic and labor-representation roles was that it lost not only economic assets and trade union legitimacy, but also the ability to pivot an alliance of big labor and big business against the state.

3. Finally, a long-brewing political crisis inside the labor complex came to a head in the runup to the 1994 Histadrut elections. Because of its unpopularity and the pressure on Labor cabinet ministers to prioritize aid to Histadrut enterprises and services over other policy goals, the labor organization had become a political liability. A group of younger liberals who had risen within the Labor Party independently of (and in conflict with) the old Histadrut-based “machine” openly articulated this tension. They succeeded in ousting the party-appointed Histadrut oligarchy, and given the labor organization's desperate fiscal crisis and the government's unwillingness to bail it out the result was not only a severing of the traditional political ties between the Histadrut and the party, but also the selling off of the Histadrut's business assets, the cessation of its responsibilities for health care, and consequently its loss of hundreds of thousands of captive members.⁸⁹

Current attempts to reformulate a role for the Histadrut as a trade union and to add roots from below to its corporate and centralized traditions are best understood as a belated adaptation, almost half a century after the event itself, to the challenge which statehood presented to the Histadrut's pre-state mode of operation. In contrast, the presence of some 200,000 foreign “guest workers” – perhaps one eighth of business sector employment – poses a stark contradiction to a core feature of Israel's state tradition, its hostility to the entry of non-Jews other than for tourist purposes. Following the occupation of the West Bank and Gaza, in an effort to prevent unrest in the territories and meet unmet demand for construction and agricultural labor, the government sanctioned the entry of Palestinian day laborers on a commuter basis. In the late 1980s and early 1990s, when this flow was disrupted by Palestinian strikes, Israeli retaliations, and security closures during the

Intifada, the number of Palestinians employed in Israel remained high (around 100,000, down by only 20%). But in 1993 security-related prohibitions were tightened considerably. Over the next two years the escalating scarcity of Palestinian labor was compensated almost precisely by increased quotas for “temporary” imported laborers, the largest contingents originating in Thailand and Romania.⁹⁰

The scope of the guest worker phenomenon has rapidly outgrown the problem of substituting for Palestinians, however, and observers agree that today there are probably as many illegal as legal immigrant laborers in Israel. Not only is this an indication of internationalization affecting yet another of Israel’s markets, but in consenting to labor importation and delegating responsibility for its operation to private manpower companies, the state has yielded capacities that include but go well beyond its role in regulating the economy. Yet in contrast to other reforms, Israel’s opening to the global market in cheap labor does not reflect a strategic embrace of liberalization by state elites. The decision to open the floodgates to foreign labor is the consequence of the state’s contradictory interests. The political economy of Palestinian pacification – whether under conditions of reconciliation and self-rule, or continuing Israeli occupation – requires that the Palestinian proletariat be able to earn a living inside Israel, but the real and perceived threat of terrorism leads policy in the direction of shutting the Palestinians out.

The third dimension of liberalization of Israel’s labor market is the diminished (although by no means exhausted) role of the state in furnishing employment. Privatization and deregulation, although incomplete, have putatively lowered both the scope and the sheltered quality of employment in public corporations, military industries, infrastructural monopolies, and the former Histadrut enterprises. Employment in the public services (health, education, government administration, etc.) has declined somewhat during the 1990s, and there has been a pronounced growth of new jobs in the business sector.⁹¹ In particular, industry has responded to the low cost of employing experienced skilled labor and highly specialized scientists and engineers from the former Soviet Union.⁹² The third component of the public sector is the military, which like public corporations and services has played a significant role in the past in absorbing excess (Jewish) labor. In 1983 the regular army (including conscripts) and reserve duty together accounted for over 12 percent of the total (civilian + military) labor force. By 1995 this proportion had fallen to 8 percent.⁹³

CONCLUSIONS

Israel’s political-economic regime is without question in the advanced throes of policy reforms, institutional shifts, and structural changes that are at odds with its long record of embedded illiberalism. Although much of the traditional exceptionalism of the political economy in Israel is

disappearing before our eyes, three important reservations must be noted. First, like any rapid major transformation liberalization has not occurred evenly, consistently, or completely. Second, despite dramatic reductions in the role of the state, "normalization" of the Histadrut and the cultural ascendancy of the market, the legacy of Zionist collectivism persists in many of the practices – and even more, the discourses – that surround the political economy. Third, the process of liberalization is indeterminate because of its inherently political nature: it is an occasion for struggle between winners and losers. The winners seek to exploit the rhetoric and the institutional tools of liberalization in order to protect and strengthen their favorable position in the status quo ante, thus changing both everything and nothing. Backlash from the losers may retard, limit, or even reverse changes.

These are the reasons why many of our findings have seemed contradictory. State expenditure is down, but some branches of public spending persist and even grow. The state has reduced or eliminated its control of the capital and foreign exchange markets, yet its role in wooing big multinational corporations, marketing Israeli-made weapons technology, and subsidizing hi-tech startups has if anything increased. Big business is still the core of the political economy, but it has been forced to accept huge cuts in state subsidies and budget-derived profit opportunities. However, the state has also greatly lowered corporate taxation and has opened up new opportunities for private mobilization of capital and entry into foreign markets. While Israel's business elite has become much more internationally oriented, at least part of this process seems to reflect its interest in preserving the hyper-concentrated structure bequeathed by the long era of state patronage.

The literature of political economy teaches us that transitions between policy regimes are propelled by a combination of endogenous and exogenous pressures for change: unintended and undesired consequences of existing policies and institutions accumulate, while changing external conditions add new opportunities and constraints. A long-term perspective on contemporary trends reveals that in both the mid-1960s and the mid-1980s the Israeli state found itself unable to revive a failing growth model that imposed heavy burdens on the state itself. In both cases it was no longer possible to resolve the contradictions by taking advantage of windfalls of imported financial and human capital. Given a political conjuncture that made it possible to ignore or even attack entrenched interests, the state responded with radical breaks from past habits. Its new policies were aimed at shedding economic obligations to powerful interests and defending its capacities to manage both the public economy and the wider national economy.

Theoretically, this dialectic fits well with a view of public policy as grounded in the state's interest in autonomy. When the pendulum swings and the state becomes burdened by commitments that no longer empower it *vis-à-vis* social groups and economic sectors, it may cast off

these fetters by devolving responsibilities to the market arena. The apparent paradox of willful liberalization – that *states willingly shed power in order to regain it* – makes sense analytically if we recognize the difference between *power as resources* and *power as autonomy*. Forfeiting resources may be the price which has to be paid for regaining lost autonomy.⁹⁴

This perspective sheds light on the *origins* of radically liberalizing policy initiatives like Israel's *mitun* and its current liberalization drive. It is less helpful in dealing with the question of how *durable* such policy realignments are likely to be. After little more than a year, even before the June 1967 War and its consequences propelled Israel toward a new political economic regime, the liberalizers of the time encountered serious difficulties in sustaining recessionary discipline and reaping the expected harvest of export-led growth.⁹⁵ However, in the dozen years that have elapsed since 1985 the structural reforms which were the subtext of the stabilization plan have been partially and sometimes haltingly implemented, but incontrovertibly so. Israel's political economy has changed, in ways that did not seem possible in the past.

To understand how a new regime becomes viable, we need to focus on the formation of mutually profitable coalitions that link (sectors of) the state with (sectors of) society.⁹⁶ Established patterns are unlikely to be broken for long unless the state's interest in initiating change connects with compatible interests (or at the very least, encounters a low probability of resistance) in important power centers outside of the state. This survey has identified trends during the 1980s and early 1990s that furnished precisely this condition.

1. The multifaceted political exchange between the Histadrut and the state – key to the persistence of the collectivist/interventionist bias in economic policy – was undermined by the Histadrut's decomposition, which also wore away the common political destiny which had bound the labor organization and the Labor Party.
2. Several key centers of the “big economy” – the major banks and the Koor conglomerate – were weakened by serious crises.
3. Globalization offered new opportunities to market, produce, and finance business activity – opportunities that were greatly enhanced by free trade agreements on the one hand and the “peace process” on the other.⁹⁷

The first two of these developments weakened the capacity of the most powerful beneficiaries of “excessive state intervention” to resist retrenchment; the third trend is indicative of a new global strategy for big business no less profitable than the previous regime. Indeed, the new turn in state/economy relations opened the way to transforming what had been vicious circles into virtuous circles. From the state's viewpoint, its new profile in the economy not only greatly eased fiscal strains,⁹⁸ but

also contributed to the new 1990s formula for rapid economic growth led by the export-oriented hi-tech sector. For big business a slimmer state meant fewer capital subsidies but also turned out to offer significant advantages. Privatization offered opportunities for private takeover of public enterprises and weakened the pressure from the bureaucratic sector on private sector wages. A smaller state budget led to lower taxes and a far more open capital market. But the budget has remained big enough to sustain vigorous state intervention helpful to business, including absorption of masses of cheap and productive immigrants, and educational and industrial policies that enhance Israel's edge in technology and expertise.

The role of the state thus remains crucial even though it is less obvious. In particular, it remains true that the state's management of the national conflict continues to impact on the political economy. The state plays a decisive trail-blazing role for Israel's arms industry, which remains the world's fifth largest exporter.⁹⁹ Perhaps most important of all, if the state were to turn its back on the peace process then internationally-oriented business strategies would be hampered and the military burden on the budget would rise again. Not only the conflict but another traditional extra-economic state function – its “demographic interest” – continues to be invested with major economic implications. I am referring of course to the immigration wave of the early 1990s, on which liberalization impacted not by ruling out state intervention but by transforming its instruments. Most of the privileges earmarked for immigrants have been dispensed as entitlements to financial aid rather than (as in the past) by bureaucratic allocation of state-provided goods, services, and exemptions. Similarly, the shift in industrial policy from blanket subsidies to “picking winners” in hi-tech fields is testimony to the renewed (albeit “market-conforming”) steering capacities of the state.

The virtuous circles metaphor for the current thrust of relations between the state and business should not be pushed too far. There is still ample room for tension between the two sides. In this connection it is important to recognize that the Treasury performs a dual role, both orchestrating diminution of the state and attempting to appropriate some of the benefits of liberalization for the state. In the specific cases of taxing capital gains on stock-market profits and diminishing the holdings of the big banks in industrial and service corporations, this “clawback” dynamic has resulted in sometimes acrimonious and still unsettled conflicts with big business.¹⁰⁰

It is not difficult to imagine other potential threats to the institutionalization of liberalization. The decline of hitherto protected industries, shrinkage of the bureaucratic labor market, and the mass importation of non-Jewish guest workers could all give rise to politically potent reactions.¹⁰¹ The 1996 elections have already demonstrated that the losers from liberalization can crystallize into a substantial political

force, although so far this force has been focused on issues relating to peace/borders and identity politics. The evident contradiction between the present government's activist impulses in relation to settlement and defense and its proclivity for shrinking the economic presence of the state could end up forcing it to backtrack on liberalization.

In any event, it is by no means obvious that the new growth model is sustainable, or even that it is entirely new. The developing economic downturn during 1997 raises the possibility that in the future Israel's strong economic performance in the 1990s may come to be seen as only a conjunctural success, a latter-day version of the old-fashioned growth machine powered by inflows of human and financial capital. Even if the market-driven and globally anchored growth model envisioned by the champions of economic liberalization really has taken root, it remains vulnerable should the collapse of the "peace process" and tension between the US and Israel cause foreign investors and financial institutions to revise their favorable view of Israel's economic potential. In sum, liberalization is real, entails far-reaching changes, and is supported by a genuine mutuality that bridges the state and business. But it is still too early to predict how complete and how durable the transformation of the Israeli political economy will turn out to be.

From the comparative standpoint espoused by this volume, the Israeli story is similar in essence to trends discernible elsewhere. The state has inaugurated a series of reforms very much in line with the "Washington consensus." Major barriers to national integration into international capital markets have been removed, stimulating cross-border capital flows and foreign trade. Some large government-owned banks and businesses have been sold to private owners. Public expenditure, taxes, and the state's indebtedness have all been markedly reduced. Deregulation has eliminated important forms of economic guidance and control by the state, and has eroded the preeminence of some significant public and private monopolies.

As in other countries, there are also contradictions. To a greater or lesser extent specific processes of liberalization have been incomplete or only skin-deep, a testament to the continuing ability of states to retain nationally distinctive institutions and policy paradigms (albeit within limits set by global pressures). Israel is also no exception to the rule that at the ideological level, liberalization has become the sole economic program favored by all major political parties, yet the employees and beneficiaries of the welfare state oppose its retrenchment and the mass public remains much more positive towards state expenditure than the politicians and their economic advisors. In short, the politics of liberalization, like the politics of economic policy generally, is rooted in the conflicting interests of winners and losers; furthermore, these interests are just as likely to be camouflaged as revealed by the contenders' ideological positions.

A comparative perspective on liberalization is handicapped by the

absence of reliable cross-national data against which the relative progress of state contraction in Israel could be assessed.¹⁰² An educated guess is that, relative to trends in other countries, Israel has gone particularly far in cutting (non-social) public expenditure and in deregulating the state's role in capital markets; is around the average with respect to trade and foreign-currency reforms and privatization; and ranks below the average in terms of welfare state retrenchment.

A comparative perspective on the dependent variable (how much liberalization?) is important for defining the puzzle: like other countries, over the last decade or so Israel has fundamentally altered long-standing patterns of state/economy relations; but as elsewhere, some elements of state contraction have been much more marked than others. Immigrant absorption, settlement over the pre-1967 borders, and aid to outlying areas within those borders continue to make significant claims on national resources, as do military commitments that continue to preempt close to one quarter of government budgets.¹⁰³ A comparative perspective on the independent variables (what are the forces that advance or retard liberalization?) requires that we pay attention to the continuing distinctiveness of Israel as a settler society with contested borders and legitimacy. The collectivist economy that was the historical legacy of Jewish settlement and Arab-Jewish conflict in the pre-state period is difficult to dismantle precisely because conflict and settlement continue to shape state commitments.

These issues are of course hotly contested in Israel's political discourse and practices. Ironically, while both the left and right wings of the political spectrum favor liberalization, they hold opposed positions on how to resolve long-standing boundary disputes. The "expansionist" position requires considerable state activism and funneling of economic resources to consolidate and defend territory, a requirement patently at odds with state contraction.¹⁰⁴ The right in Israel is also political home to Jewish social groups whose precarious economic standing would be deeply threatened by a rollback of Israel's settler-society welfare state and the triumph of meritocratic individualism.

The left, which in Israel means the "peace camp," holds out the prospect of further reducing military spending and altogether eliminating the costs of occupying and settling Palestine, as well as profitable exploitation of the regional and international economies formerly blocked by the Arab-Israeli conflict. Yet except for Arab-backed parties, the left remains committed to continued military strength and Jewish territorial, demographic, and cultural predominance. It is thus both unable and unwilling to contemplate an alternative to the active settler-society state.

The logical option for the left – a "post-Zionist" vision of Israel as a politically liberal state in the service of (all of) its citizens – is fundamentally at odds with almost the entire spectrum of Jewish opinion, both at the elite and the mass levels. It is especially at odds with

the religious-nationalist ethos of the right, on which the socio-political standing of the economic losers from liberalization is so dependent. But both right and left share a commitment to the Zionist consensus. The triumph of economic liberalization may eventually overpower this hegemony, unintentionally and perhaps even unconsciously.¹⁰⁵ Whatever the outcome, it is precisely the high and unique stakes involved – for Israel's identity as well as its political economy – which a comparative view of liberalization so effectively clarifies.

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2. M. Shalev, *Labour and the Political Economy in Israel*, Oxford: Oxford University Press, 1992.
3. On the notion of policy regimes, see G. Esping-Andersen, *The Three Worlds of Welfare Capitalism*, Cambridge: Polity Press, 1990. The concept of "political-economic regimes" is an alternative to the more grandiose "social structures of accumulation" used in my book. For discussion of these and related conceptualizations, see B. Jessop, "Regulation Theories in Retrospect and Prospect," *Economy and Society* 19/2 (May 1990) pp.153-216; L. Mjøset, "Nordic Economic Policies in the 1970s and 1980s," *International Organization* 41/3 (Summer 1987) p.403.
4. For a concise survey, see B. Cohen, "Phoenix Arisen: The Resurrection of Global Finance (Review Article)," *World Politics* 48/2 (Jan. 1996) pp.268-96. Economist Paul Krugman has argued vigorously that politicians and other interested parties exploit "pop internationalism" to their own end; P. Krugman, *Pop Internationalism*, Cambridge, MA: MIT Press, 1996. The political construction of "global imperatives" has been insightfully discussed in the Latin American context by B. Geddes, "How Politicians Decide Who Bears the Costs of Liberalization," in Ivan T. Berend (ed.), *Transition to a Market Economy at the End of the 20th Century*, Munich: Sudosteuroopa Gesellschaft, 1995, pp.203-28; K. Weyland, "Neo-Populism and Neo-Liberalism in Latin America: Unexpected Affinities," *Studies in Comparative International Development* 32/3 (Fall 1997) pp.3-31.
5. For evidence of cross-national divergence, see S. Berger and R. Dore (eds), *National Diversity and Global Capitalism*, Ithaca, NY: Cornell University Press, 1996; R.O. Keohane and H.V. Milner (eds), *Internationalization and Domestic Politics*, Cambridge: Cambridge University Press, 1996. On the limits and paradoxes of retrenchment, see P. Pierson, "The New Politics of the Welfare State," *World Politics* 48/2 (1996) p.143; S.K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*, Ithaca, NY: Cornell University Press, 1996. On the role of partisan differences and party dynamics, see T.R. Cusack, "Partisan Politics and Public Finance: Changes in Public Spending in the Industrialized Democracies,

- 1955–1989," *Public Choice* 91/3-4 (1997) pp.375–95.
6. L. Mjøset, "The Nordic Model Never Existed, But Does It Have a Future," *Scandinavian Studies* 64/4 (1992) pp.652–71; F.G. Castles, *Families of Nations: Patterns of Public Policy in Western Democracies*, Brookfield, VT: Dartmouth, 1993.
 7. J.G. Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36/2 (Spring 1982) pp.379–415.
 8. B. Kimmerling, *Zionism and Territory: The Socio-Territorial Dimensions of Zionist Politics*, Berkeley: Institute of International Studies, University of California, 1983; G. Shafir, *Land, Labor and the Origins of the Israeli–Palestinian Conflict 1882–1914*, Cambridge: Cambridge University Press, 1989; M. Shalev, *Labour and the Political Economy* (note 2).
 9. Z. Sternhell, *Nation-Building or Social Reform? Nationalism and Socialism in the Israeli Labor Movement 1904–1940*, Tel Aviv: Am Oved, 1995 (Hebrew); M. Shalev, "Time for Theory: Critical Notes on Lissak and Sternhell," *Israel Studies* 1/2 (1996) pp.170–88.
 10. On economic policy see H. Barkai, "The Public, Histadrut, and Private Sectors in the Israeli Economy," in *The Falk Project for Economic Research in Israel: Sixth Report, 1961–1963*, Jerusalem: The Falk Project for Economic Research in Israel, 1964, pp.15–77; Y. Plessner, *The Political Economy of Israel: From Ideology to Stagnation*, Albany, NY: State University of New York Press, 1994. The failure of early welfare state initiatives is discussed by A. Doron and R. Kramer, *The Welfare State in Israel – the Evolution of Social Security Policy and Practice*, Boulder, CO: Westview, 1991.
 11. U. Bialer, *Between East and West: Israel's Foreign Policy Orientation, 1948–1956*, Cambridge: Cambridge University Press, 1989; G. Yago, "Whatever Happened to the Promised Land? Capital Flows and the Israeli State," *Berkeley Journal of Sociology* 21 (1977) pp.117–46.
 12. N. Halevi, "Economic Growth and Economic Cycles in the Jewish Economy of Mandatory Palestine," *Iyumin Bekalkala* 1981, 1983, pp.313–21 (Hebrew); M. Beenstock, J. Metzger and S. Ziv, *Immigration and the Jewish Economy in Mandatory Palestine: An Econometric Explanation*, Falk Institute Discussion Paper No. 93.02, Jan. 1993.
 13. I. Sharkansky and A. Radian, "Changing Domestic Policy 1977–1981," in Robert O. Freedman (ed.), *Israel in the Begin Era*, New York: Praeger, 1982, pp.56–75; Y. Ben-Porath, "The Conservative Turnabout that Never Was," *Jerusalem Quarterly* 29 (Fall 1983) pp.3–10.
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 15. D. Bernstein and S. Swirski, "The Rapid Economic Development of Israel and the Emergence of the Ethnic Division of Labour," *British Journal of Sociology* 33/1 (March 1982) pp.64–85.
 16. Shalev, *Labour and the Political Economy* (note 2); P. Evans, D. Rueschemeyer and T. Skocpol (eds), *Bringing the State Back In*, Cambridge: Cambridge University Press, 1985.
 17. M. Shalev, "Labor, State and Crisis: An Israeli Case Study," *Industrial Relations* 23/3 (1984) pp.362–86.
 18. A. Mintz, "The Military-Industrial Complex: The Israeli Case," *Journal of Strategic Studies* 6/3 (Sept. 1983) pp.103–28; H. Barkai, *The Defense Industries at a Crossroads*, Research Paper No.197, Falk Institute for Economic Research in Israel, Jerusalem, 1987 (Hebrew).
 19. E. Farjoun, "Class Divisions in Israeli Society," *Khamsin (London)* 10 (1983) pp.29–39; Y. Aharoni, *Structure and Performance in the Israeli Economy*, Tel Aviv: Tcherikover, 1976 (Hebrew); M. Semyonov and N. Lewin-Epstein, *Hewers of Wood and Drawers of Water: Noncitizen Arabs in the Israeli Labor Market*, Ithaca, NY: ILR Press, 1987.
 20. L.L. Grinberg, *Split Corporatism in Israel*, Albany, NY: State University of New York Press, 1991; M. Shalev, "Israel's Domestic Policy Regime: Zionism, Dualism, and the Rise of Capital," in Francis G. Castles (ed.), *The Comparative History of Public*

- Policy, Cambridge: Polity Press, 1989, pp.100–48; S. Bichler, *The Political Economy of Military Spending in Israel*, unpublished PhD dissertation, Department of Political Science, Hebrew University of Jerusalem, 1991 (Hebrew).
21. M. Bruno, *Crisis, Stabilization, and Economic Reform: Therapy by Consensus*, Oxford: Clarendon Press, 1993.
 22. M. Shalev and L. Grinberg, *Histadrut-Government Relations and the Transition from a Likud to a National Unity Government: Continuity and Change in Israel's Economic Crisis*, Discussion Paper 19-89, Pinhas Sapir Center for Development, Tel Aviv University, Oct. 1989; H.J. Barkey, "When Politics Matter: Economic Stabilization in Argentina and Israel," *Studies in Comparative International Development* 29/4 (Winter 1994) pp.41–67.
 23. A. Razin and E. Sadka, *The Economy of Modern Israel: Malaise and Promise*, Chicago: University of Chicago Press, 1993.
 24. S. Bichler and J. Nitzan, "Military Spending and Differential Accumulation: A New Approach to the Political Economy of Armament – The Case of Israel," *Review of Radical Political Economics* 28/1 (March 1996) pp.51–95. The shift in opinion among key figures in the business elite has been retrospectively confirmed by a series of interviews carried out by Yehezkel Lein and myself during the summer of 1997.
 25. L.L. Grinberg, *Split Corporatism in Israel* (note 20).
 26. M. Keren, "Economists and Economic Policy Making in Israel: The Politics of Expertise in the Stabilization Program," *Policy Sciences* 26/4 (1993) pp.331–46.
 27. The *World Competitiveness Yearbook* is an expensive annual compendium published privately in Switzerland and targeted at governments and well-heeled investors. The cited ranking summarizes a battery of quantitative and qualitative indicators, including the results of a survey of executives in all the countries studied.
 28. For the sake of comparability I cite data from The Penn World Table (Mark 5.6), as made available at <http://datacentre.epas.utoronto.ca:5680/pwt/pwt.html>. Bank of Israel data covering the same period (1975–92) exhibit almost identical trends but have much higher absolute values. The idiosyncratic nature of the Israeli trend is emphasized by the fact that during the 25 year period ending in 1990, in the average OECD member-state the ratio of trade to GNP rose by 10 points. G. Garrett and D. Mitchell, "Globalization and the Welfare State: Income Transfers in the Industrialized Democracies, 1966–1990," paper presented at the Annual Meeting of the American Political Science Association, San Francisco, 1996. The Penn Tables cover 40 countries in Europe, the Americas and East Asia, excluding East Germany and Puerto Rico. Israel's rank on openness declined from 6 in 1975–84 to 7 in 1985–89 to 10 in 1990–92.
 29. BOI-96, Diagram Vav-1. Throughout this article, annual reports of the Bank of Israel in Hebrew are cited in the form "BOI-96" (for the 1996 edition).
 30. For detailed data on manufacturing exports, see the annual *HaTa'asiya Beyisrael* published by the Ministry of Industry and Commerce's Planning Administration.
 31. The comparison with 19 OECD members is drawn from the OECD's *Main Economic Indicators*, which indicates that Austria and Switzerland have the highest import surpluses – at only around three percent of GDP.
 32. H. Regev and S. Bar-Eliezer, *Control over the Domestic Market and Economic Performance in Israeli Industry*, Falk Institute Discussion Paper No. 94.05, 1994 (in Hebrew). Significantly, the overall rise between the low of 1980/81 and the peak reached in 1990 was quite widely diffused. Increases were posted in this period for 20 of the 22 disaggregated branches investigated by Regev and Bar-Eliezer, although in 3 cases the change was only negligible.
 33. N. Halevi (ed.) *Import Policy and Exposure of Israeli Industry*, Jerusalem: Falk Institute, 1994 (Hebrew). On import duties, see the annual reports of the State Revenues Administration.
 34. Both the figure cited here and the presentation in Figure 2 are based on data published in BOI-95, Appendix Table 12 which include both explicit supports and implicit credit subsidies. However, many other traditional elements in government aid to exporters, such as the provision of subsidized land, infrastructure, and labor, are not included in the figures.
 35. A high estimate of philanthropic aid, based on the category "foreign transfers to the national institutions and non-profits" in Appendix Table 11 of BOI-95, put it at under 2% of GNP throughout the last decade. In an article in *Yediot Acharonot* on

- 20 Aug. 1996, former Deputy Foreign Minister Yossi Beilin wrote that Israel's receipts from the United Jewish Appeal had declined to less than \$300 million a year, and that the Israel Bonds had become a more expensive way of raising money than free market loans.
36. BOI-95, p.238.
 37. For an optimistic survey of foreign investment, which dates the breakthrough to the Madrid peace conference of 1991, see H. Sher, "After the Revolution," *The Jerusalem Report*, 17 Oct. 1996, pp.37–41. I have also benefited from conversations on this topic with two Israeli bankers, Yair Saroussi and Nir Oliver.
 38. BOI-96, Appendix Table Vav-13.
 39. D. Levi-Faur, *Pinhas Sapir and the Industrial Development of Israel*, Tel Aviv: Sapir Center for Development, Tel Aviv University, 1993 (Hebrew).
 40. *Yediot Acharonot (Mamon)*, 1 Oct. 1997.
 41. Natan Lipson and Sami Peretz, *Ha'aretz*, 28 Oct. 1997.
 42. The dubious economic benefits to Israel of the gigantic Intel subsidy have been noted in many media commentaries (e.g. Oded Lipschitz in *Davar Hashavua*, 29 March 1994). Another noteworthy case is the 38% subsidy promised to Volkswagen (the government paid for \$133 of its nominal \$350 million investment) for a joint magnesium production venture with the Dead Sea Works (*Jerusalem Report*, 27 June 1996).
 43. In a communiqué dated 6 Nov. 1996, the Economics Desk of the Government Press Office reported that investment in Israeli shares by foreign citizens had reached \$5.5 billion, while other financial assets held by foreigners amounted to \$14 billion.
 44. Manufacturers' Association of Israel, *Globalization in Israeli Industry: Report of the Committee for Strategic Thinking*, Tel Aviv: Economic Division, MAI, 1997 (Hebrew); BOI-96, Appendix Table Vav-13.
 45. Comparison is between the five years preceding stabilization (1980–84) and the most recent five-year period for which data are available (1992–96). BOI-96, Appendix Table Hay-1a.
 46. This terminology is borrowed from R. Friedland and J. Sanders, "The Public Economy and Economic Growth in Western Market Economies," *American Sociological Review* 50 (Aug. 1985) pp.421–37.
 47. M. Shalev, *Labour and the Political Economy* (note 2) pp.266–7.
 48. In addition to subsidies granted under the Investment Incentive Law, the main formal means of capital subsidy – since abolished – was "directed credit" channeled through the commercial banks. Already by 1990 the cost to the government of directed credit was less than a quarter of its 1984 level in real terms.
 49. Data are based on budgetary allocations and are derived from Tables 1 and 2 of the statistical appendix to Y. Kop (ed.) *Allocation of Resources to Social Services 1996*, Jerusalem: The Center for Social Policy Studies in Israel, 1997 (Hebrew). According to the same source, in the 1990s the ratio of debt service to GDP fell by about 6 points. The Bank of Israel's estimates of the ratio of debt service to GNP (BOI-96, Appendix Table Hay-2b) are much more conservative, but they also indicate a major drop in the burden of both domestic and foreign interest payments.
 50. S. Hadar, *Blurring of the Boundaries between Public and Private in Relations between State and Industry*, Unpublished doctoral dissertation, Department of Political Science, Hebrew University of Jerusalem, 1990 (Hebrew); Bichler and Nitzan, "Military Spending and Differential Accumulation" (note 24).
 51. The data on domestic military expenditure in Figure 1 combine procurement expenses (including construction costs) with wage costs. The latter have hardly declined, while between 1985 and 1995 the share of the former in national product fell from 7.5% to 3.5% (calculated from BOI-95, Table Hay-7.)
 52. D. Swank, "Funding the Welfare State, Part I: Global Capital and the Taxation of Business in the Advanced Market Economies," Paper presented at Annual Meeting of the American Political Science Association, San Francisco, 1996.
 53. See the annual report of the State Revenues Administration for 1996, Table Kaf-12.
 54. Z. Schuldiner, *A Look at the 1996 Budget*, Tel Aviv: Adva Center, 1996 (Hebrew). Schuldiner estimated that relief of employer contributions to social security and health insurance, along with a wage subsidy paid to employers for the first two years of new hires, accounted for 12.5% of the government's "social expenditure" budget for 1996.
 55. O. Yosha and Y. Yafeh, "The Capital Market Reform 1985–95 and Modes of Finance

- in Israeli Manufacturing," *Rivon Lekalkala* 43 (1996) Table 3 (Hebrew).
56. For comparative discussions, see J.D. Stephens, E. Huber, and L. Ray, "The Welfare State in Hard Times," Paper presented at Conference on the Politics and Political Economy of Contemporary Capitalism, Humboldt University and the WZB, Berlin, 1995; P. Pierson, "New Politics of the Welfare State" (note 5). This section relies on data presented in the annual report of the Center for Social Policy Studies in Israel; Y. Kop, *Allocation of Resources* (note 49). The estimates from this source, which are based on substantive definitions of expenditure categories and refer to budget allocations, are more conservative (especially regarding income maintenance) than the national accounts data published by the Bank of Israel and referred to earlier.
 57. See also Schuldiner, *A Look at the 1996 Budget* (note 54).
 58. Retired women who did not work outside the home are now entitled to pensions, and an economically significant form of discrimination against Palestinian citizens has been ended with the decoupling of child allowances from military service.
 59. Schuldiner, *A Look at the 1996 Budget* (note 54).
 60. H.J. Karger and M. Monnickendam, "The Radical Right and Social Welfare in Israel," in James Midgley and Howard Glennerster (eds), *The Radical Right and the Welfare State: An International Assessment*, Savage, MD: Barnes & Noble, 1991, pp.124-40.
 61. While rules for the receipt of unemployment benefit were toughened with a view to making refusal of job offers more difficult, this failed to reduce the number of unfilled vacancies during the period of high unemployment in the early 1990s. S. Amir, *Unemployment in Israel 1964-1989: An Analysis based on the Beveridge-Curve Model*, Discussion paper No. 96.04, Falk Institute for Economic Research, Jerusalem, March 1996.
 62. For a general discussion, see A. Doron and H.J. Karger, "The Privatization of Social Services in Israel and its Effects on Israeli Society," *Scandinavian Journal of Social Welfare* 2 (1993) pp.88-95. It is hard to find reliable indicators of expenditure on "gray" health and education services. One analysis of the Household Expenditure Survey has shown little change in expenditure on private health services between 1986/7 and 1992/3, but this conclusion is probably already outdated. See A. Berg, B. Rosen, and G. Ofer, *Changes in Household Expenditure on Health*, Research Report No. RR-246-96, Brookdale Institute of Gerontology, Jerusalem 1996.
 63. A. Doron, *In Defense of Universalism: The Challenges Facing Social Policy in Israel*, Jerusalem: Magnes Press, 1995 (Hebrew); A. Doron, "The Contradicting Trends in the Israeli Welfare State: Poverty, Retrenchment and Marginalization," Paper presented at 19th Meeting of the ISA Research Committee on Poverty and Social Policy, Copenhagen, 1997; Z. Schuldiner, *A Look at the 1996 Budget* (note 54).
 64. E. Farjoun, "Class Divisions in Israeli Society" (note 19). A. Doron, "The Histadrut, Social Policy and Equality," *Jerusalem Quarterly* 47 (Summer 1988) pp.131-44.
 65. E. Kleiman, *The Structure of Israel Manufacturing Industries 1952-1962*, Unpublished paper for the Falk Project for Economic Research in Israel, Jerusalem, Dec. 1964; A. Bregman, "Government Intervention in Industry: The Case of Israel," *Journal of Development Economics* 25 (1987) pp.353-67; D. Levi-Faur, *Pinhas Sapir* (note 39); Y. Aharoni, *The Israeli Economy* (note 14).
 66. F.L. Pryor, *Property and Industrial Organization in Communist and Capitalist Nations*, Bloomington, IN: Indiana University Press, 1973.
 67. On the theory and the Israeli experience of business groups, see respectively M. Granovetter, "Business Groups," in N.J. Smelser and R. Swedberg (eds), *The Handbook of Economic Sociology*, Princeton: Princeton University Press, 1994, pp.453-75 and Daniel Maman's contribution to this volume. Until recently the striking role of big business in Israel and of banking within it was rarely mentioned by mainstream economists and never studied by them. Yair Aharoni and Shimshon Bichler were the first scholars to definitively establish the dualist character of Israeli capitalism. Y. Aharoni, *Structure and Performance* (note 19); R. Rowley, S. Bichler and J. Nitzan, *Some Aspects of Aggregate Concentration in the Israeli Economy 1964-1986*, Working paper No. 7/88, Department of Economics, McGill University (1988). More recently, hyper-concentration in banking and the big banks' multiple roles as owners, financiers and investors have been explored by A.L. Bebchuk, L. Kaplow and J.M. Fried, *Concentration in the Israeli Economy and Bank Investment in Commercial Companies*, Unpublished typescript, 1995; and by Yosha and Yafeh,

- "Capital Market Reform" (note 55). Indirect indications of the market domination of big business are furnished by Regev and Bar-Eliezer, *Control over the Domestic Market* (note 32).
68. S. Bichler, *The Political Economy of National Security in Israel: Some Aspects of the Activities of the Dominant Blocs of Capital*, Unpublished MA Thesis, The Hebrew University of Jerusalem, 1986 (Hebrew); M. Shalev, *Labour and the Political Economy* (note 2).
 69. The most up to date source of data on big business profits is S. Bichler and J. Nitzan, "The Great U-Turn: Restructuring in Israel and South Africa," *News from Within* 11/9 (Sept. 1995) pp.29-32, but these figures are not entirely consistent with earlier publications by Bichler cited in previous notes. According to Bichler and Nitzan, big business profits declined precipitously after 1984 and experienced only a very modest recovery through 1993 (the latest date of the series).
 70. The "Brodet Committee" on bank ownership of non-financial corporations was a milestone in this respect. D. Brodet, *Report of the Committee to Examine Structural Changes in the Capital Market*, Jerusalem: Israel Ministry of Finance, 1995 (Hebrew). The unprecedented activism of the current directors of two units of the Treasury – the Supervisor of the Capital Market and the Antitrust Commission – also constitute a sharp break with past practice. See for example *Ha'aretz* weekend supplement, 28 Nov. 1997.
 71. Between 1982/3 and 1990 the three-firm concentration ratio fell from 43% to 34% of total domestic sales. Regev and Bar-Eliezer, *Control over the Domestic Market* (note 32), Appendix Table 1.
 72. On the skepticism of well-placed observers, see the articles in *Globes* by Haim Barkai on 20 Dec. 1995 and by Orna Raviv on 4 Dec. 1995. As long ago as 1981 the Banking Law tried unsuccessfully to prohibit banks from holding more than 25% of the equity of any non-financial corporation. See O. Yosha, "Privatising Multi-Product Banks," *Economic Journal* 105/433 (1995) pp.1435-53. The recommendations of the Brodet Committee, endorsed by the government at the end of 1995, postponed the deadline for implementation of the Banking Law to the end of 1996, although the ownership ratio is supposed to be further reduced (to 20%) by the end of the century.
 73. See two articles by Sami Peretz in *Ha'aretz*, 29 March 1996.
 74. See the article by Daniel Maman in this volume.
 75. Privatization of the Histadrut-linked Koor conglomerate is a case in point. The June 1995 sale of the Hevrat Ovdim's 22.5% stake in the Koor group to Shamrock Partnerships, an American investment company, was immediately followed by the distribution of options to Koor's management with a theoretical value of close to \$30 million. Shamrock later sold out, for a considerable profit, to a consortium led by the Bronfman family. Benny Gaon, the aggressive CEO of Koor, initially kept his position under the new regime but was subsequently unseated by one of the new owners. See *Globes*, 5 and 27 Feb. 1996 and 24 July 1997. For a perceptive commentary on the changing position of the managerial elite, see Ephraim Reiner in *Ha'aretz*, 20 Nov. 1997.
 76. As Benny Gaon has candidly pointed out, one of the uses of internationalization has been the possibility of countering dependence on traditional bank partners (in Koor's case, Bank Hapoalim) by exploiting new opportunities to raise capital abroad. B. Gaon, *He Who Dares Wins*, Tel Aviv: Yediot Acharonot, 1997 (Hebrew).
 77. *Ha'aretz*, 26 July 1996.
 78. For a description of developments through 1992, see E. Murphy, "Structural Inhibitions to Economic Liberalization In Israel," *Middle East Journal* 48/1 (1994) pp.65-88.
 79. S. Eckstein, B.-T. Zilberfarb, and S. Rosowitz, "The Process of Privatizing Public Corporations in Israel: Survey and Evaluations for the Future," *Rivon Lekalkala* (May 1993) pp.31-47 (Hebrew). A recent study suggests that in the 1968-88 period, Labor and Likud governments were equally inactive in privatization. M. Harris, Y. Katz, and G. Doron, "Ideology and Privatization Policy in Israel," *Environment and Planning C: Government and Policy* 15/3 (August 1997) pp.363-72. Additional sources on privatization are Y. Katz, "Privatization in Israel: 1962-1987," *Medina, Memshal Veyachasim Benleumim* 35 (1991) pp.133-45 (Hebrew); M. Hasson, *The Privatization Policy of the Government of Israel: Declarations versus Action in Practice*, Unpublished MA thesis, Dept. of Political Science, Hebrew University,

- Jerusalem, 1995 (Hebrew).
80. M. Hasson, *Privatization Policy* (note 79).
 81. M. Schwartz, *Unlimited Guarantees: History, Political Economy, and the Crisis of Cooperative Agriculture in Israel*, Beersheba: Ben-Gurion University Press, 1995 (Hebrew).
 82. L. Leiderman and G. Bufman, *Financial Reform in Israel: A Case of Gradualism*, Tel Aviv: Pinhas Sapir Center for Development, 1994.
 83. Despite the judicial discourse of individual culpability in which it was framed, the report of the commission of inquiry into the bank shares collapse made this abundantly clear. See Commission of Inquiry into the Regulation of Bank Shares, *Final Report*, Jerusalem: Ministry of Justice, 1986 (Hebrew).
 84. Leiderman and Bufman, *Financial Reform in Israel* (note 82); I. Tov, "The Economic Upheaval of 1977 – Implementation of Operational Goals," *Rivon Lekalkala* 135-6 (April 1988) pp.33–47 (Hebrew).
 85. See the conclusions reached by O. Yosha and Y. Yafeh, *The Capital Market Reform and its Influence: An Analysis from the Angle of "Industrial Structure"*, Jerusalem: Bank of Israel Research Department, 1995 (Hebrew); and by Leiderman and Bufman, *Financial Reform in Israel* (note 82).
 86. These assertions are empirically supported by a recent wave of research sponsored by the Bank of Israel. See especially Yosha and Yafeh, "Capital Market Reform" (note 55); H. Ber, Y. Yafeh, and O. Yosha, *Conflicts of Interest in Universal Banking: Evidence from the Post-Issue Performance of IPO Firms*, Jerusalem: Bank of Israel Research Department, 1997, Discussion Paper 97.05.
 87. L.L. Grinberg, *Split Corporatism in Israel* (note 20); L.L. Grinberg, *The Histadrut Above All Else*, Jerusalem: Nevo, 1993 (Hebrew); Shalev, *Labour and the Political Economy* (note 2).
 88. Between 1980–84 and 1992–93 the role of cost of living adjustments in business sector wage increments was reduced by almost half (69% to 37%) and national-level wage increases (formerly 13.5% of the total increment) were eliminated altogether. D. Sharon, "Wage Policy and its Implementation," *Kalkala Veavoda* 9 (Oct. 1994) pp.97–115 (Hebrew); see also Z. Sussman and D. Zakai, *The Decentralization of Collective Bargaining and Changes in the Compensation Structure in Israel's Public Sector*, Jerusalem: Bank of Israel Research Department, 1996.
 89. The decline of the Histadrut has hardly been investigated systematically. See, however, the symposium in *Rivon Lekalkala*, April 1995. For earlier developments (through the late 1980s) see L.L. Grinberg, *Split Corporatism in Israel* (note 20). On the traditional political functions of the Histadrut health fund and its ultimate loss, see respectively A. Arian, "Health Care in Israel: Political and Administrative Aspects," *International Political Science Review* 2/1 (1981) pp.43–56; and D. Chinitz, "Israel's Health Policy Breakthrough: The Politics of Reform and the Reform of Politics," *Journal of Health Politics, Policy and Law* 20/4 (Winter 1995) pp.909–32.
 90. On the factors accounting for the entry of Palestinian labor to Israel and its implications, see Grinberg, *The Histadrut Above All Else* (note 87) Ch.6; Semyonov and Lewin-Epstein, *Hewers of Wood* (note 19). For an overview of the foreign worker phenomenon see D.V. Bartram, "Foreign Workers in Israel: History and Theory," *International Migration Review* 32/2 (1998) pp.303–25. Further documentation may be found in *Ha'aretz*, 22 March 1996; *Skira Kalkalit* (Bank Hapoalim Economic Department), 29 Aug. 1996; and the *Kav LaOved* website, a source of current information on the employment of Palestinian as well as foreign labor (<http://www.aic.org/org/kav-oved>).
 91. BOI-96, Appendix Table *Dalet*-8.
 92. Annual surveys of immigrant employment in industry conducted by the Manufacturers' Association have revealed the scope of immigrant employment in industry. Indirect evidence from the surveys, as well as media reports, point to the role of downgrading (such as the employment of qualified engineers as technicians, and technicians as skilled manual workers), low pay, and government wage subsidies in rendering immigrants attractive to employers.
 93. My calculations are based on estimates of the number of conscript and career soldiers published in *The Military Balance* (London: International Institute for Strategic Studies) and the extent of absence due to reserve duty as estimated by official labor force surveys.

94. I recognize, but have not investigated, a parallel (and complementary) dialectic located *inside* the state apparatus: the economic-policy bureaucracies favor a slimmer public economy with fewer commitments, because this enhances their autonomy by trimming the sails of other departments of state.
95. These difficulties derived from the resistance of the business sector to operating without state subsidies, and challenges posed to the legitimacy of the recession by popular unrest and individual out-migration. M. Shalev, "The Mid-Sixties Recession: A Political-Economic Analysis of Unemployment in Israel," *Machbarot Lemechkar Ulebikoret* 9 (Feb. 1984) pp.3-54 (Hebrew).
96. P. Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises*, Ithaca, NY: Cornell University Press, 1986; P. Swenson, "Bringing Capital Back in, or Social Democracy Reconsidered – Employer Power, Cross-Class Alliances, and Centralization of Industrial Relations in Denmark and Sweden," *World Politics* 43/4 (1991) pp.513-44.
97. The links between economic liberalization and globalization and the peace process have been emphasized by Y. Peled and G. Shafir, "The Roots of Peacemaking – the Dynamics of Citizenship in Israel, 1948-93," *International Journal of Middle East Studies* 28/3 (1996) pp.391-413. For other discussions of the "peace dividend," see J. Lederman, "Economics of the Arab-Israeli Peace Process," *Orbis – a Journal of World Affairs* 39/4 (1995) pp.549-66; A. Retzky, "Peace in the Middle East – What Does It Really Mean For Israeli Business," *Columbia Journal Of World Business* 30/3 (1995) pp.26-32; B.-Z. Zilberfarb, "The Effects of the Peace Process on the Israeli Economy," *Israel Affairs* 1/1 (1994) pp.84-95; E.C. Murphy, "The Arab-Israeli Peace Process: Responding to the Economics of Globalization," *Critique* (Fall 1996) pp.67-91.
98. Comparison of experience in the 1990s with a decade earlier shows that the state not only reduced its claims on the national product but also changed the profile of public finance: capacities of tax extraction were enhanced and reliance on debt and gifts reduced (BOI-96, Appendix Table Hay-1b).
99. Israel's rank in arms exports as reported by Israel Radio on 14 Oct. 1997, based on International Institute of Strategic Studies data. A good example of the state's role in facilitating military exports is an agreement reached between the Israeli and Polish governments for refurbishing helicopters in Israel (*Yediot Acharonot*, 15 Oct. 1997), a \$600 million deal that pressure from another trail-blazing state – the US – might ultimately force Israel to yield.
100. The Finance Minister of the 1992-96 Labor government was forced by business pressure to reverse the government's decision to tax stock market gains. The saga is documented and analyzed by Yehezkel Lein in a forthcoming MA thesis in the Department of Political Science at the Hebrew University.
101. As this article was being completed (Dec. 1997) a major confrontation developed between the Histadrut and the Ministry of Finance. While a dispute over pension reform was the central issue nominally at stake, the deeper source of tension was the attempt by the country's strongest groups of organized labor in the public sector to preempt state attacks on their privileged position by allying themselves firmly with the Histadrut.
102. One area in which data are readily available – openness to international trade – is the exception which proves the rule. I pointed out earlier that evaluation of trends in Israel's trade ratio is complicated by the role of arms and fuel imports and the diamond-processing industry. Truly comparable data which take account of these elements would be difficult to assemble.
103. According to the 1997 annual report of the Center for Social Policy Studies in Israel, defense accounted for 23.9% of 1997 budgets.
104. While "expansionism" requires an interventionist state, some of the means of this intervention can and have been effectively "liberalized", i.e. delegated to the market. In the heyday of Jewish settlement in the occupied territories, the state used massive subsidies to attract private contractors and home buyers on the basis of financial self-interest.
105. Compare the similar argument made by Lustick on the implications of competition between the main Zionist parties for their *de facto* orientation towards Israel's Palestinian-Arab minority. I. Lustick, "The Political Road to Binationalism: Arabs in Jewish Politics," in Ilan Peleg and Ofira Seliktar (eds), *The Emergence of a Binational Israel – The Second Republic in the Making*, Boulder, CO: Westview, 1989, pp.97-123.